



January 30, 2015

The Honorable Yvette Herrell  
Chair  
Regulatory and Public Affairs Committee  
New Mexico House of Representatives  
325 Don Gaspar  
Santa Fe, New Mexico 87501

**Re: HB 24 and HB 36 Relating to Lending**

Dear Representative Herrell:

I write on behalf of the American Financial Services Association (AFSA),<sup>1</sup> to register our serious concerns with House Bills 24 and 36, which seek to impose artificial Annual Percentage Rate (APR) rate caps on small-dollar loans in New Mexico. While we believe that the intent of the bills is to crack down on providers of loans with certain problematic characteristics, their effect will be to eliminate all forms of small dollar credit in New Mexico, creating a “credit desert” which, given the likelihood the demand for credit remains consistent, will consign needy borrowers to significant hardship, or drive them into the arms of black market lenders.

AFSA represents traditional installment lenders, generally considered to be providers of safer, less expensive and more convenient alternatives to payday or title-type loans. Responsible underwriting allows installment lenders to offer terms and levels of safety over and above those offered by payday or title lenders. This was acknowledged by a July 2003 Consumers Union report, *Payday Lenders Burden Working Families and the U.S. Armed Forces*,<sup>2</sup> which stated that installment lending:

*“...provides a clearly safer and more affordable alternative to high-risk, high-cost payday loans.”*

The reason for this lies in the structure of an installment loan, which is designed to be repaid in regularly scheduled, same-sized payments that can be mapped out between the borrower and the lender. This allows borrowers to avoid the so-called “cycle-of-debt” associated with loans that demand repayment in full on a certain date, such as payday or title loans.

This cycle-of-debt challenge is generally acknowledged as the impetus for rate cap laws. It is therefore crucial that, when working on laws to remove the threat of harmful loan products, policymakers acknowledge that more often than not, the damage done by small dollar loans stems from their structure, not their rate, and ensure that legislative action does not shut down beneficial loan-types alongside troublesome ones. As written, House Bills 24 and 36 fall short of this ideal.

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<sup>1</sup> The American Financial Services Association is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA member financial institutions offer vehicle financing, cards, personal installment loans and mortgage loans. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages.

<sup>2</sup> Consumers Union, *Payday Lenders Burden Working Families and the U.S. Armed Forces*, available at <http://consumersunion.org/pdf/payday-703.pdf> (July 2003).

## **APR Caps are Unsuitable for the Regulation of Small-Sum, Short-Term Loans**

APR limits are an inefficient and inappropriate tool for regulating short-term loans, being just one of several disclosures required by the Federal Truth in Lending Law, Regulation Z.<sup>3</sup> Their value lies in helping to compare loans with identical maturities and of identical amounts. Other mandated disclosures include the total finance charges expressed in dollars.

APRs are not helpful as an indicator of the relative cost of loans of widely different amounts and maturities. This is because finance charges include both fixed and variable costs. Fixed costs are not significant when spread over larger amounts and longer terms, but become very significant in smaller, shorter-term loans. In fact, APRs can actually be “contra-indicators” of cost in small loans. Typically a smaller loan borrowed over a shorter period will cost less in terms of total dollars and in finance charges as a percentage of principal, but have a higher APR. There is typically an inverse relationship between cost expressed in dollars or charges as a percentage of principal and APRs.

Certain indicators of affordability or the ability to repay are much more useful than APRs when it comes to small loans. They include:

- Total dollar cost of the loan;
- Total charges as a percentage of principal;
- Manageability of repayment schedule, for example, equal monthly installments of principal and interest.

Imposing an arbitrary limit on APRs will mean that people who need small loans will be forced to borrow more money for longer terms than they need, and pay higher real charges or be denied access to credit altogether.

In Japan artificially imposed APR caps have, in effect, wiped out much of the formal consumer-lending industry. Borrowers are forced to look elsewhere for credit – to loan sharks and other illegal options. This must be guarded against very carefully here in the United States.

### **U.S. Department of Defense and Installment Loans**

In 2007, the U.S. Department of Defense (DoD) exempted installment loans from legislation designed to prevent predatory lending to service personnel and their families, acknowledging in its report (*Limitations on Consumer Credit Extended to Service Members and Dependents* August 27, 2007) the need to protect installment credit while identifying and attacking payday and title loan products.

In exempting installment loans from the law, the DOD illustrated that:

- It is easy for borrowers to get trapped in a cycle-of-debt, unless their loan has two key features: the lender must have practiced responsible underwriting during the loan-making process, and the loan must be payable in equal installments of principal and interest, rather than in one lump sum;
- APR were unhelpful as a measure of cost or the lender’s profitability, except when comparing loans of equal amount or duration;

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<sup>3</sup> 12 C.F.R. § 1026.

- The use of APRs to regulate the loan industry merely denies credit to those who need small amounts or shorter terms.

In its final rule on the Warner Act, the DoD stated:

*“Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation. Consequently, installment loans that do not fit the definition of “consumer credit” in Section 232.3(b), including the definition of “payday loans,” “vehicle title loans,” or “tax refund anticipation loans” are not covered by the regulation.”*

This ruling was in recognition of the fact that:

*“The intent of the statute is clearly to restrict or limit credit practices that have a negative impact on Service members without impeding the availability of credit that is benign or beneficial to Service members and their families.”*

This recognition of the essential differences between installment lenders and payday or title lenders must be considered by policymakers as they look for ways to best regulate the credit industry.

### **Consumer Financial Protection Bureau**

Nevertheless, despite the potentially disastrous nature of HB 24 and HB 36, there is no doubt that New Mexico can and should take steps to curtail real instances of abuse in the state.

The Federal Consumer Financial Protection Bureau (CFPB) is expected to publish its findings on small dollar credit in the early part of this year. It is expected to produce some strong rules about structure, which ought to go a long way to eradicating the problems which have excited critics not just in New Mexico, but around the country. Perhaps the wisest thing to do in New Mexico, is to learn from the CFPB’s findings and respond accordingly. To rush ahead with a rate cap law could be disastrous for the very people it is intended to help.

We respectfully request that you give our concerns due consideration. If you have further questions, I can be contacted by phone 952-922-6500 or email [dfagre@afsamail.org](mailto:dfagre@afsamail.org).

Respectfully,



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