THE INDEPENDENT FINANCE ASSOCIATION OF ILLINOIS

January 22, 2021

The Honorable J.B. Pritzker
Governor of the State of Illinois
Office of the Governor
207 State House
Springfield, IL 62706

Re: Senate Bill 1792 – the Predatory Loan Prevention Act

Dear Governor Pritzker:

We write on behalf of the American Financial Services Association ("AFSA")[1], the Illinois Financial Services Association, the Independent Finance Association of Illinois, and the Illinois Automobile Dealers Association[2] to express our grave concerns with Senate Bill 1792 and urge you to the veto the bill, which would create the Predatory Loan Prevention Act and institute a 36 percent rate cap based on the federal military annual percentage rate for all loans not exceeding forty thousand dollars, including vehicle loans. While SB 1792 contains many admirable provisions aimed at creating a more equitable Illinois, the proposed rate cap would leave Illinois consumers worse off and immediately cut off access to credit for those most in need.

The Limitations of Military Annual Percentage Rate

For over 50 years, the federal Truth in Lending Act (TILA) has provided a standard of how to calculate the annual percentage rate (APR) of loans, ensuring that all references to APR are consistent and require little interpretation. This allowed consumers to have a clear understanding of the terms and cost of credit and to compare costs of similar loan products. TILA expressly excluded the costs of voluntary products from the APR calculation. The federal Military Lending Act introduced a military APR (MAPR) that, unlike TILA, includes the cost of voluntary goods, services, or insurance that are unrelated to the cost of credit and are <u>not comparable</u> across credit products.

Whereas traditional TILA APR applies to all consumers and all credit products, MAPR is only applicable for certain small loans to active duty servicemembers and their dependents. Importantly, this distinction exists, in part, because certain types of insurance and protection products are already available to members of the military as a benefit of their service. For this reason alone, MAPR is not

[1] Founded in 1916, the American Financial Services Association (AFSA), based in Washington, D.C., is the primary trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including direct and indirect vehicle financing, traditional installment loans, mortgages, payment cards, and retail sales finance. AFSA members do not provide payday or vehicle title loans.

[2] The Illinois Automobile Dealers Association associate themselves with the all-in / vehicle finance elements of the letter and make no comment as to the traditional installment lending arguments, which do not affect IADA's members.

appropriate for broader application beyond servicemembers. Additionally, because MAPR is federally applicable only to certain small loans, it is not clear how the rate would even be calculated for other loan products, like a vehicle loan, as SB 1792 would require. Further, to the extent that SB 1792 extends to vehicle finance and would require including ancillary products, it is wholly improper and, more significantly, an unworkable calculation. There is fundamentally no consistent or reasonable way to include these products into an APR calculation.

Setting a rate cap based on MAPR is certain to cause confusion among the consumers it purports to help. This rate cap would mean creditors must either disclose to the consumer both the MAPR under state law AND the TILA APR, or only the TILA APR, which, if ancillary products or other fees are involved, is lower than and inconsistent with the rate calculated for the purposes of the state's rate cap. Neither option presents the consumer with a clear understanding of the loan contract and cost of credit, undermining the central purpose of TILA. Further, by including other costs into the calculation, MAPR distorts the true cost of credit, making it difficult for consumers to rate shop and compare similar loans.

No other state uses MAPR for all loans. Only one state has passed a non-TILA APR on a statewide basis: South Dakota, and it was by initiative, not legislation. That law was immediately amended by the legislature to exclude the vast majority of vehicle financing, because calculating the APR under that law was impossible for vehicle finance. We note that Connecticut passed a non-TILA loan cap for small-dollar loans only.

As the population of Illinois is nearly three times the combined population of these two states, the disastrous effects of SB 1792 would be far more wide-reaching. Importantly, not a single state legislature has enacted such a broad expansion to include vehicle finance as that included in SB 1792.

The "Banks Will Step In" Myth

The idea that banks and credit unions can pick up the slack from established licensed non-bank lenders is a pipedream. Regular attempts by private entities and government at all levels aimed at catalyzing the provision of small-dollar loans by banks and credit unions simply retread a well-worn path to the unmistakable conclusion: banks and credit unions cannot successfully balance their business models with the provision of safe and affordable credit for non-prime borrowers, and loans for small-dollar amounts cannot be made profitably at 36%.

Banks are closing branches all over the country at an increasing pace. They are not going to open new ones in historically underserved communities in order to make unprofitable, risky, subprime consumer loans. Where they have dabbled in small loans, they make payday, or "deposit advance" loans, relying on their control over the customer's bank account in lieu of underwriting, or they make "overdraft" loans, where the cost, along with the cost of bank NSF fees, can often be significantly higher in APR terms than mainstream traditional installment lending credit.

One Third of Illinois Adults Will be Ineligible for Safe and Affordable Installment Credit if You Sign This Bill into Law

Our traditional installment members test ability to repay, verify application elements, have robust compliance processes, and check and report to credit bureaus. The fixed costs associated with extending a traditional installment loan before a loan is made—EXCLUDING the cost of personnel and commercial space—includes receipt of application / portal fees, credit bureau pull, ID & background data, work # / job verification costs, cost of funds, red flag check portal fee, income verification costs.

These costs—for one small-dollar lender for example—add up to $85 for each loan before the loan is even made.

This is a sample of costs associated with making small-dollar loans. Here, a sample lender extends small-dollar loans ranging from $450 to $1750, depending on the amount requested and the credit profile of the borrower. Note that loans in red can no longer be made if this law is enacted, unless someone is willing to make these loans at a loss. This means that 3.5 million Illinois consumers—28-36% of Illinois adults (compared to 8% today) would be excluded from credit. If you sign SB 1792 into law, this sample lender would have to stop lending to Illinois borrowers with credit scores under 650 in order to stay in business.

	No Score	**300-500**	**501-550**	**551-600**	**601-650**	**651-700**	**701-750**	**751-800**	**801+**
Avg Loan (Proceeds)	$450	$450	$500	$650	$750	$1000	$1,250	$1,500	$1750
FICO Default Rates	44%	79%	63%	45%	27%	13%	5%	2%	1%
Avg Charge-off (Loss) Rate	29%	52%	42%	30%	18%	9%	3%	1%	1%
Expected Loss	$131	$235	$208	$193	$134	$86	$41	$20	$12
Cost of Capital	$24	$28	$29	$35	$38	$47	$56	$66	$77
Cost to Service (excl Exp Loss)	$48	$55	$52	$48	$45	$42	$41	$40	$40
Cost to Service %	11%	12%	10%	7%	6%	4%	3%	3%	2%
Total Cost	$203	$317	$289	$277	$216	$175	$138	$126	$129
Total Cost %	45%	71%	58%	43%	29%	18%	11%	8%	7%

	No Score	300-500	501-550	551-600	601-650	651-700	701-750	751-800	801+
APR needed w/ no add'l cost	41%	109%	71%	42%	22%	9%	3%	1%	1%
APR needed w/ cost capital	47%	118%	79%	48%	27%	14%	8%	6%	5%
APR needed w/ Serv Cost	82%	239%	137%	74%	41%	21%	12%	9%	8%
APR needed w/ 8% Return	114%	366%	192%	102%	58%	34%	24%	20%	18%

	No Score	300-500	501-550	551-600	601-650	651-700	701-750	751-800	801+
IL Adults by FICO Score	1,092,982	416,977	542,902	661,266	793,371	1,016,131	1,520,285	1,930,513	1,690,103
IL Adults by FICO Score	11%	4%	6%	7%	8%	11%	16%	20%	17%
Cumulative Population	1,092,982	1,509,959	2,052,861	2,714,127	3,507,498				
Percent of Population Excluded	11%	16%	21%	28%	36%	*** 28-36% of adults will be excluded from credit compared to roughly 8% today.			

Traditional Installment Loans are Safe and Affordable Credit

For small-dollar loans, the quality, affordability, and soundness of the loan is best judged by its structure, and not its interest rate. This is because interest rates on small amounts can be misleading as to cost.

For example, say you lend me $100 today and charge me $1 in interest:

- If I pay you back in one year, the APR is 1%
- If I pay you back in one month, the APR is 12%
- If I pay you back tomorrow, the APR is 365%
- If I pay you back in an hour, the APR is 8760%

Same dollar in interest, vastly different APRs.

For over 100 years, traditional installment lenders have consistently provided consumers with reliable, community-based small-dollar credit that is accessible and affordable, giving borrowers a tried-and-tested mechanism to safely manage their household credit. Traditional installment loans are widely acknowledged by consumer groups and others as a safe and affordable form of credit, carrying with them significant socio-economic benefits for individuals, families, and communities. This appreciation for traditional installment loans as tools of financial capability and even mobility, hinges on the fact that they are repaid in regularly scheduled, equal payments of principal and interest. Furthermore, unlike payday loans, these loans require an underwriting process that includes a calculation of the borrower's ability to repay a loan out of their monthly budget and also report loan performance directly to credit bureaus, which is vital for Illinois borrowers looking to build a credit history and increase their financial mobility.

In fact, traditional installment loans have repeatedly been recognized as safe payday alternatives by government officials at both the federal and state levels. For instance, the National Black Caucus of State Legislators (NBCSL) passed a resolution in 2016 that stated:

> NBCSL supports the expansion of Traditional Installment Loans as an affordable means for borrowers to establish and secure small dollar closed end credit while preventing cycle of debt issues inherent with non-amortizing balloon payment loans.[3]

This was also demonstrated recently by decision of the federal Consumer Financial Protection Bureau (CFPB) to exclude traditional installment loans from the provisions of its Payday Lending Rule.

Elite-Only Credit

While elite borrowers in Illinois may be able to find other sources of credit or afford larger loan sizes, lower income individuals will likely be left in credit deserts and forced to turn to more dangerous, or illegal, options like pawnbrokers and loan sharks.

Because our members report to credit bureaus, they help hundreds of thousands of Illinois adults graduate out of subprime credit scores each year—so we deeply understand the effects of this bill. This

[3] NBCSL Resolution BED-16-21, *A Resolution Promoting Safe and Affordable Lending Practices*, available at https://nbcsl.org/public-policy/docs/file/56-resolution-bed-16-21.html

will have ripple effect in those communities where unregulated lenders will operate and proliferate, credit mobility will decline, debt costs will increase as will overall debt loads, and long term wealth will decline when people lose access to both affordable credit and means to improve their credit scores. Elite borrowers will remain unaffected. Only those in the lowest third of tiered credit scores will find themselves unable to access credit or build their credit history using traditional installment loans.

As outlined above, efforts by banks and credit unions to replicate small-dollar lending universally fail, even when propped up by government incentives. While banks and credit unions can be more selective about the borrowers they serve by limiting loans to existing members or customers, there is still no way that depository institutions can source, underwrite, and service small-dollar loans for all consumers at rates lower than installment lenders. Small loans are a critical source of credit, allowing a consumer to access sums of money that help them to deal with unforeseen circumstances. With additional credit options, individuals and families may build or repair their credit, consolidate debts, free up funds to deal with emergencies and take advantage of opportunities that would otherwise be missed.

We urge you to consider the reasons above and conclude that MAPR is not a solution for Illinois and accordingly veto SB 1792. If you have any questions or would like to discuss this further, please do not hesitate to contact us at your convenience.

Sincerely,

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