February 1, 2021

The Honorable Susan Herrera
State Capitol
490 Old Santa Fe Trail
Room 206-A
Santa Fe, NM 87501

The Honorable Patricia Roybal Caballero
State Capitol
490 Old Santa Fe Trail
Room 206-B
Santa Fe, NM 87501

The Honorable Joy Garratt
State Capitol
490 Old Santa Fe Trail
Room 206-A
Santa Fe, NM 87501

Re: HB 149

Dear Representatives Herrera, Roybal Caballero, and Garratt:

I write on behalf of the American Financial Services Association ("AFSA")[1] to express our grave concerns with HB 149. The proposed rate cap would cut off an enormous number of New Mexico consumers from access to licensed, safe, affordable credit, particularly those who need credit most.

A 36% Cap Means Four in 10 New Mexico Adults Will be Ineligible for Safe and Affordable Installment Credit

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, and income verification costs. These costs—for one of our small dollar members for example—add up to $85 for each loan before the loan is even made.

The following chart is a sample of costs associated with making small dollar loans. Here, a sample lender extends small dollar loans ranging from $300 to $1,300, depending on the amount requested and the credit profile of the borrower. Note that loans in red can no longer be made in New Mexico if this bill is enacted, unless someone is willing to make these loans at a loss. If this bill is enacted, between 428,000-548,000 consumers—half a million people: 36-46% of New Mexico adults (compared to 9% today) would be excluded from credit. If this bill passes, this sample lender would have to stop lending to New Mexico borrowers with credit scores under 650 in order to stay in business.

[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 traditional installment loans, direct and indirect vehicle financing, mortgages, payment cards, and retail sales finance. AFSA members do not provide payday or vehicle title loans.

Predicted Credit Exclusions

	No Score	300-500	501-550	551-600	601-650	651-700	701-750	751-800	801+
Avg Loan (Proceeds)	$329	$441	$473	$543	$648	$822	$963	$1,134	$1,267
FICO Default Rates by score	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	$96	$230	$197	$161	$115	$71	$32	$15	$8
Cost of Capital	$13	$21	$21	$22	$24	$29	$32	$38	$42
Cost to Service (excl Exp Loss)	$48	$55	$52	$48	$45	$42	$41	$40	$40
Cost to Service %	15%	12%	11%	9%	7%	5%	4%	4%	3%
Total Cost	$157	$305	$269	$232	$185	$142	$105	$93	$90
Total Cost %	48%	69%	57%	43%	29%	17%	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	46%	116%	77%	47%	26%	13%	7%	5%	4%
APR needed w Serv Cost	67%	145%	97%	61%	35%	19%	11%	8%	7%
APR need w 8% Return	79%	161%	111%	72%	44%	28%	20%	16%	15%

	No Score	300-500	501-550	551-600	601-650	651-700	701-750	751-800	801+
NM Adults by FICO Score	144,500	70,408	98,896	114,212	120,736	128,517	166,675	188,738	151,916
NM Adults by FICO Score	12%	6%	8%	10%	10%	11%	14%	16%	13%
Potentially Excluded from Credit	144,500	214,908	313,804	428,016	548,752				
Potentially Excluded from Credit	12%	18%	26%	36%	46%				

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 not in the business of making loans under $5,000 to subprime consumers, and half of New Mexico consumers are subprime. Banks are closing branches all over the country at an increasing pace. They are not going to open new ones in order to make unprofitable, risky, subprime consumer loans. Where they have dabbled in small loans, they make loans relying on their existing customer relationship and usually their access to the customer's bank account in lieu of underwriting. And their rates are typically above 36%.

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 and short-term loans can be misleading as to cost. Annual percentage rate (APR) is a function of time and the loan term, rather than a measure of the dollar cost of a loan.

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 New Mexico 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 Hispanic Caucus of State Legislators in 2013 passed a resolution in 2013 that stated:

> [I]t is the intention of this body to ensure access to loans that are low cost rather than low rate, since consumers buy goods with dollars and cents and not with annual percentage

> rates;[2]
>
> and
>
> it is important that safe and affordable small-dollar loans be made from offices located within communities and licensed and audited by state authorities to protect from predatory lenders and lending practices.[3]

And the National Black Caucus of State Legislators 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.[4]

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 borrowers among New Mexico's elite may be able to find other sources of credit or afford larger loans, lower income individuals will likely be left in credit deserts and forced to turn to unregulated or illegal options like loan sharks.

Because our members report to credit bureaus, they help thousands of New Mexico adults graduate out of subprime credit scores each year—so we deeply understand the effects of this bill. This will have a ripple effect in those communities where unregulated lenders will operate and proliferate, 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 36-46% of tiered credit scores will find themselves unable to access credit or build their credit history using traditional installment loans.

The Limitations of a Non-TILA Annual Percentage Rate

For over 50 years, the federal Truth in Lending Act (TILA) has provided a standard of how to calculate the APR of loans, ensuring that all references to APR are consistent and require little interpretation. This allows consumers to have a clear understanding of the terms of credit and to compare similar loan products. TILA expressly excludes the costs of voluntary products from the APR calculation.

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[2] NHCSL Resolution 2013-10, *Promoting Safe and Affordable Lending Practices* available at https://nhcsl.org/resources/resolutions/2013/2013-10/

[3] Ibid.

[4] 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

Setting a rate cap based on anything other than TILA 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 New Mexico APR 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, a non-TILA APR distorts the true cost of credit, making it difficult for consumers to rate shop and compare similar loans.

Only one state has enacted a non-TILA APR on a statewide basis: South Dakota, and it was by ballot initiative, not legislation. We note that Connecticut passed a non-TILA loan cap for small dollar loans only. Those two states have no meaningful presence of very small dollar loans (*i.e.* loans under $4,000) at all—each has maybe one or two traditional installment lenders in the state and none making many loans under $3,000 or so. Both Connecticut and South Dakota have higher median income than New Mexico: Connecticut's median income for 2019 was the sixth highest in the country, while New Mexico's was 49th.[5] People with larger incomes can more likely afford to pay back the type of larger dollar loans that are required for a business to break even at a 36% interest rate.

Conclusion

In sum, 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 individuals and families to build or repair their credit, consolidate debts, free up funds to deal with emergencies, and take advantage of opportunities that would otherwise be missed.

Introducing a New Mexico-specific formula for calculating interest—different than the universal standard of TILA—would be unnecessarily confusing to consumers, since TILA also will be disclosed and since banks governed by the National Bank Act will not be required to use the New Mexico APR. If you have a problem with the type of products or other charges you seek to include in a New Mexico-specific APR, we urge you to consider and address those issues directly. We would welcome the opportunity to be part of that dialog.

A 36% cap means that 428,000 to 548,000 people—36%-46% of the adult population in New Mexico—will be completely cut off from safe, regulated, and affordable installment credit, and will thereby lose the opportunity to build their credit profiles with information reported to credit bureaus from small dollar installment loans.[6] The elite of New Mexico will be fine, as they

[5] Connecticut median income 2019 = $37,865; South Dakota median income 2019 = $31,033; New Mexico median income 2019 = $25,881. Source: United States Census Bureau

[6] See yellow blocks in the chart on page two. That is the population potentially excluded from credit, compared with approximately 9% of the population today.

always have been, because they can qualify for the type of larger loans necessary to break even at 36%.

We urge you to consider the reasons above and conclude that a 36% rate cap is not good policy for small dollar loans. If you have any questions or would like to discuss this further, please do not hesitate to contact me at your convenience.

Sincerely,

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cc: Members of the House Judiciary Committee
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