AMERICAN FINANCIAL SERVICES ASSOCIATION

May 11, 2021

The Honorable Lee Hein
Chair, House Ways and Means Committee
1007 East Grand Avenue
Des Moines, Iowa 50319

Re: HF 893 – Consumer Loans

Dear Chairman Hein:

I write on behalf of the American Financial Services Association ("AFSA")[1] to express our grave concerns with HF 893, which would change the maximum rate for consumer loans in Iowa to a rate cap based on the federal military annual percentage rate. Although this change is a small part of a larger bill, the proposed rate change would harm credit markets for those Iowa consumers seeking much-needed loans and leave Iowa law out of step with nearly every other state. While we believe Iowa's rate structure for small loans is in need of modernization, the Military Lending Act's rate cap is not the solution.

The Problems with 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 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 HF 893 would require.

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

[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.

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.

Importantly, numerous states have recognized the importance of keeping state law consistent with TILA and rejected MAPR rate caps, and only two states have enacted such proposals into law.

The Need for a Modernized Rate Structure for Small Loans

While MAPR is not the solution, Iowa's rate structure for small loans is in need of modernization. For small-dollar loans, the quality, affordability, and soundness of the loan is best judged by its structure. This is because interest rates on small amounts and shorter loans can be misleading as to cost. APR is a function of time and the loan term, rather than a measure of the dollar cost of a loan. The actual finance charge on any specific loan is largely a combination of the individual borrower's risk profile (*i.e.* the likelihood the loan will be repaid in full at the end of the term), and, importantly, the fixed costs (*e.g.* overhead) for the lender. Because smaller loans generate a lower return with the same fixed costs, the finance charge must necessarily be higher in order to even recoup the cost of making the loan and break even. If rates remain capped at 21 percent, small loans will continue to be stuck below the break-even point and lenders cannot provide small dollar credit to consumers who need it most. Because our members report to credit bureaus, they help thousands of Iowa adults graduate out of subprime credit scores each year, and modernizing Iowa's rate structure would make these opportunities available to more consumers.

Traditional Installment Loans are Safe and Affordable Credit

For decades, 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 (TILs) 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 TILs as tools of financial capability and even mobility, hinges on the fact that TILs are repaid in regularly scheduled, equal payments of principal and interest. Furthermore, unlike payday loans, TILs 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 Iowa borrowers looking to build a credit history and increase their financial mobility.

In fact, TILs 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) have passed several resolutions in support of TILs, including one 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.[2]

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

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 Iowa and accordingly reject the proposed change to the consumer loan law. Thank you in advance for your consideration of our comments. If you have any questions or would like to discuss this further, please do not hesitate to contact me at 202-469-3181 or mkownacki@afsamail.org.

Sincerely,

Matthew Kownacki
Director, State Research and Policy
American Financial Services Association
919 Eighteenth Street, NW, Suite 300
Washington, DC 20006-5517

cc: Members of the Ways and Means Committee