March 3, 2022

The Honorable Janet L. Yellen
Secretary
United States Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Secretary Yellen:

On behalf of the American Financial Services Association (AFSA),[1] I write in response to President Biden's executive order promoting competition in the American economy (Executive Order 14036). AFSA supports efforts highlighting how competition in the consumer credit market helps consumers.

Robust competitive markets, not government-imposed controls, are the best way to ensure that access to consumer credit remains safe and affordable for millions of hard-working families, including lower- and middle-income households. All consumers, regardless of zip code, deserve access to credit products that fit their financial needs. As the Competition Council examines the effects on competition in the consumer finance marketplace, we express our strong opposition to endorsing any measures that would place a harmful interest rate cap on consumer lending. Our letter explains that rate caps reduce competition, using recent state rate caps as an example. We also explain how traditional installment loans, financial service products that have served consumers for more than a hundred years, are safe and affordable options for consumers.

I. Rate Caps Reduce Competition

When I testified before the Senate Banking Committee in 2021 on promoting access to reliable and transparent financial services,[2] I said that instituting a 36 percent "all-in" rate cap would have a disastrous effect for millions of Americans seeking reliable options for their credit needs.

There is a great deal of evidence, including a recent Federal Reserve report published on small-dollar loans, that confirms the downsides of an across-the-board 36-percent APR rate cap.[3] Among its findings: consumers would be forced to borrow a higher amount than they need or want (if they even qualified for a larger loan), resulting in higher finance charges, longer repayment periods, and higher overall costs, despite the appearance of a lower APR on their billing statement.

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[1] Founded in 1916, AFSA is the national 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, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.
[2] Bill Himpler, AFSA President and CEO, testimony before the Senate Banking Committee (July 2021)
[3] Federal Reserve, *The Cost Structure of Consumer Finance Companies and Its Implications for Interest Rates* (August 2020)

II. Case Studies of Rate Caps – Illinois & New Mexico

In the second quarter of 2021, Illinois imposed a 36 percent "all-in" rate cap, demonstrating how rate caps are anti-competitive and reduce access to credit. Immediately following the institution of the cap, several lenders left that state. This is the same pattern that we've seen in other states. When lenders leave a state, competition in a state decreases.

When competition decreases, borrowers are left with fewer credit options. Preliminary findings of academics Brandon Bolen,[4] Gregory Elliehausen,[5] and Tom Miller[6] (using data from a major credit bureau), show that after implementation in the first quarter of 2021 the 36 percent rate cap decreased the number of loans in Illinois to subprime borrowers by 29,000 loans (or 36 percent). Furthermore, it decreased the number of loans to deep subprime borrowers by 4,700 loans (or 57 percent).

The same preliminary findings also show that those subprime borrowers who were still able to get loans had to take out larger and therefore more expensive loans. Loan size grew by 75 percent for deep subprime borrowers ($700 larger loans) and for subprime and no-score borrowers, loan size increased by roughly 30 percent.

The demand by subprime borrowers for loans is not diminishing. However, in many cases, the only reliable, state and federally regulated option that these customers had access to (a traditional installment loan) was eliminated because they could not qualify for loans under the rate cap law. Given the significant fixed operating costs of business activities, the Federal Reserve found, "break-even interest rates for credit from consumer finance companies were quite high at small loan amounts because of the great relative weight of fixed operating costs."[7]

With an "all-in" 36 percent rate cap, the Federal Reserve report concluded consumers would not be able to receive a loan for less than approximately $3,000. Additionally, the Federal Reserve noted, "if small loan revenue is constrained by rate ceilings, only large loans will be provided. Consumers who need a small loan or only qualify for a small loan would not be served." As a result, Illinois consumers are being forced to turn to less scrupulous options, such as payday or unregulated online lenders, who place these consumers in the type of financial straits the law was intended to prevent.

As another example, New Mexico recently approved a similar rate cap proposal. In that state, due to prior policy decisions, there is virtually no payday loan industry. When the rate cap law is implemented, as many as 550,000 New Mexicans will not qualify for a small-dollar loan under $1000 from a reputable lender. They will be forced to turn to unsavory options online or out of state. One popular argument among rate cap proponents is that even if a rate cap puts finance companies out of business in a state, banks and credit unions will fill the void. This is flatly false: Preliminary findings from Bolen, Elliehausen, and Miller reflected in the chart below show that banks and credit unions made very few installment loans to non-prime and subprime borrowers before the rate cap, and they are not making such loans after the rate cap.

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[4] Assistant Professor of Economics at Mississippi College in Clinton, Mississippi.
[5] Principal Economist at the Federal Reserve.
[6] Professor of Finance and Jack R. Lee Chair of Financial Institutions and Consumer Finance at Mississippi State University.
[7] Federal Reserve, *The Cost Structure of Consumer Finance Companies and Its Implications for Interest Rates* (August 2020)

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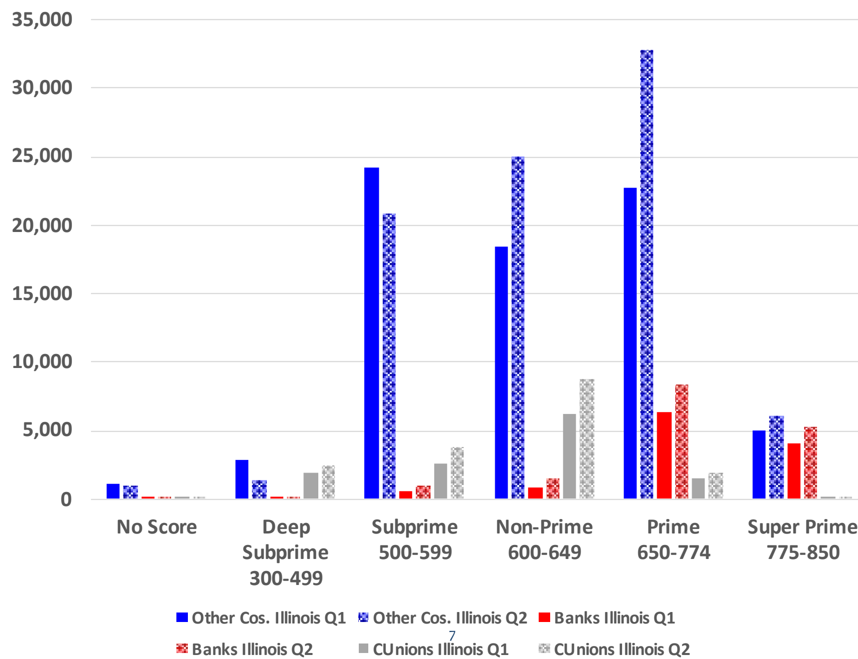
III. Traditional Installment Loans Benefit Consumers

Our members strongly believe all Americans, not limited to those with elite credit history, deserve an opportunity to achieve their long-term financial goals and find financial stability.

Number of Unsecured Installment Loans, by Credit Score Buckets, Q1 and Q2 in Illinois, by Lender



Each year, millions of Americans visit community-based, traditional installment lenders to help meet unexpected needs, such as the purchase of a new refrigerator, emergency auto repairs, or recovery from weather-related events. This access to credit is especially important as costs continue to rise.[8] These hard-working individuals are nurses, teachers, farmers, firefighters, electricians, postal workers, lawyers, doctors, judges, and other middle-income Americans who rely on cost-effective credit products. With an average traditional installment loan duration of fifteen months, consumers have a reasonable opportunity to repay their loan in a suitable period of time that they can afford without being trapped in an endless cycle of debt.

[8] For example, in the 50 largest U.S. metro areas, the median rent increased 19% from December 2020 to December 2021. (Time, *Rents Reach 'Insane' Levels Across U.S. With No End in Sight* (February 2022))

High-quality, small-dollar installment loans are curated to each customer's ability to repay and provide an opportunity for consumers to improve their credit standing. They are fully amortizing and repaid in equal installments. This is distinctly different from gray- and black-market loans, and payday loans that offer short-term cash with triple-digit interest rates. Unlike those loan types, traditional installment loans are heavily regulated and report to credit agencies so that consumers can better their credit standing.

IV. Conclusion

For over a hundred years, AFSA member companies have filled an important role in providing credit for Americans of all economic backgrounds. What the states learned a hundred years ago remains true today: There is no place in our economy for unregulated predatory lenders that trap consumers in a cycle of debt. However, well-intentioned proposals to apply interest rate cap restrictions are not a solution that helps consumers.

We share the Competition Council's objectives to ensure Americans have choices among financial institutions. Promoting consumer choice and protection is a central part of AFSA's mission. We appreciate your efforts in helping borrowers meet their financial goals and look forward to serving as a resource for the Competition Council if there is an opportunity to collaborate. Please do not hesitate to contact me at 202-296-5544 or bhimpler@afsamail.org with any questions.

Sincerely,

Bill Himpler
President & CEO
American Financial Services Association