March 27, 2023

The Honorable Mark Snyder
Chair, House Finance Committee
200 E Colfax
RM 307
Denver, CO 80203

Re: HB 1229 – Consumer Lending

Dear Chairman Snyder:

I write on behalf of the American Financial Services Association (AFSA)[1] to express our serious concerns with House Bill 1229, which would make drastic changes to Colorado's consumer lending laws and institute all-in rate caps for nearly all forms of credit in the state, including personal installment loans and vehicle loans. HB 1229's proposed changes would leave Colorado consumers worse off and immediately cut off access to credit for those most in need.

Existing Rate Caps Already Limit Small Dollar Credit Access

Colorado already has some of the lowest allowed rates in the nation for small dollar loans, and these existing low rates have created credit access issues for borrowers in lower credit tiers. In 2021, the General Assembly authorized the state Attorney General's Office to study the availability of safe and affordable credit by non-bank creditors in Colorado. In January 2023, the AG's office released the troubling findings.[2] The study looked at credit availability in Colorado versus several states without usury limits and found that "for subprime and deep subprime consumers and those with insufficient credit history to generate a credit score, reported small-dollar loans appear to be less available for such consumers in Colorado" than the other states.

The study also identified this effect in larger loans and noted: "for consumers in higher-risk credit tiers seeking larger installment loans—credit may be less available in Colorado than it is in states without usury limits." While the loan size may differ, the similar effect is clear: lower rates mean less credit availability for consumers in lower credit tiers. By including other products and fees in the rate calculation, HB 1229 would effectively lower the state's already-low rate caps, making the credit access problems identified by the study even worse.

[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] Financial Health Network, *The Availability of Safe and Affordable Credit From NonDepositories in Colorado,* available at https://coag.gov/app/uploads/2023/01/Consumer-lending-study-Jan.-2023.pdf.

The Limitations of All-in Rate Caps

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. HB 1229 would impose an all-in rate cap 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.

Setting a rate cap based on all-in APR 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 all-in 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, <u>undermining the central purpose of TILA</u>. Further, by including other costs into the calculation, all-in APR distorts the true cost of credit, making it difficult for consumers to rate shop and compare similar loans.

Importantly, the products in question have been approved for sale by Colorado's regulators, are fully underwritten based on the borrower's credit profile and financial background, and are voluntary; consumers choose to purchase and finance these products because they find value in the protection the products provide. Including the cost of these products in an artificially low rate cap will only limit the availability of those protections and deprive borrowers of the opportunity to select credit products that work for them.

Just four other states have imposed all-in rate caps for small loans, but Colorado's existing rate bands, to which the all-in calculation would apply, are lower overall than the rates allowed in those other states. Importantly <u>only one state</u>—Illinois—has a non-TILA APR cap on a statewide basis that includes vehicle finance. In fact, other states have recognized the harm of an all-in rate for vehicle finance and declined to enact it and, in one case, even roll it back. After a South Dakota initiative broadly imposed a rate cap that included vehicle financing, 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.

Similarly, if HB 1229 were enacted, it is not clear how the rate would even be calculated for a vehicle loan. For instance, the bill requires that "any fee for a credit-related ancillary product sold in connection with the credit transaction" be included in the finance charge calculation, but it is not clear what qualifies as a credit-related ancillary product when the purchase of a vehicle is financed. Many non-insurance ancillary products sold in connection with the credit transaction protect the borrower and vehicle collateral, but these products are entirely voluntary and may also be available in all-cash transaction. Without clarification or amendments, there is fundamentally no consistent or reasonable way to include ancillary products into an APR calculation for a vehicle loan.

All-in Rate Caps Harm Consumers

The federal Military Lending Act in 2006 introduced an all-in military APR (MAPR) that, unlike TILA, includes the cost of voluntary goods, services, or insurance that are unrelated to the cost of credit. 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. The MLA was expanded to include additional loan products in 2015.

A January 2023 study from the Urban Institute[3] examined the effects of the expansion and found that the expanded all-in APR "did not lead to better credit and debt outcomes for service members most likely to be affected by this policy." The study noted that the expanded all-in APR did not decrease delinquency or collection rates among covered borrowers with subprime credit scores and did not have an impact on their credit scores. More importantly, the study found that those consumers most in need of access to credit were actually harmed by the all-in rate cap, because "the policy had a negative effect on consumers with deep subprime credit scores (Vantage scores lower than 500) through reduced access to credit." Expanding Colorado's existing rate caps into all-in rate caps will similarly have reduce access to credit and have a negative effect for borrowers most in need of it.

Traditional Installment Loans are Safe and Affordable Credit

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. For small-dollar loans, the quality, affordability, and soundness of the loan is best judged by its structure, and not its interest rate. 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 Colorado 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.[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. As outlined above, Colorado consumers may already difficulty obtaining small dollar credit, and as

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[3] Urban Institute, *The Effects of APR Caps and Consumer Protections on Revolving Loans*, available at: https://www.urban.org/sites/default/files/2023-01/The%20Effects%20of%20APR%20Caps%20and%20Consumer%20Protections%20on%20Revolving%20Loans.pdf.
[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.

drafted, HB 1229 would likely eliminate the remaining crucial sources of non-bank small dollar credit for Colorado borrowers.

We urge you to consider the effects these restrictions will have on Colorado's credit markets and not move forward with the legislation as drafted. Thank you 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

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