Testimony of the American Financial Services Association in opposition to HB 24-1148

Before the Colorado House Finance Committee

February 26, 2024

Thank you for the opportunity to testify today on HB 1148. The American Financial Services Association, known as AFSA, 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 does not represent payday lenders or title lenders.

Our members have significant concerns about HB 1148, which has the potential to further disrupt access to safe and affordable credit in Colorado. If passed as written, it will drive far-reaching negative socio-economic consequences, as more than a million Coloradans with credit scores that make it more difficult to secure loans from banks and credit unions, find that they have nowhere to turn for the credit they need to smooth their finances, meet emergencies, and build the credit scores they need to become financially mobile.

Three out of four Coloradans seeking installment loans in the state are already turned down, according to a report the state itself commissioned.[i] Those turn down rates reach over 85% for deep subprime Colorado consumers.[ii]

A similar law—albeit with a higher rate—passed in Illinois in 2021. This has demonstrably failed, with three particularly notable consequences:

1. <u>368,916 Borrowers Lost Access to Credit:</u> The total number of borrowers who got some kind of state-reported loan went from 431,018 people in 2019 down to 62,102 people in 2021.[iii] The difference is 368,916 people no longer getting state-regulated and reported loan products.
2. <u>The number of licensed lenders in the state halved:</u> The number of state licensed lenders went from 1,813 entities at the end of 2020 to 900 entities at the end of 2021.[iv]
3. <u>The lucky few who could qualify for credit were forced into larger loans for longer terms:</u> For the lucky subprime consumers who still have access to credit in Illinois, the average loan size increased by 40 percent.[v] According to the Illinois Trends Report issued by the state, loans for larger amounts with longer repayment terms have increased by 226%.[vi] Imposing an arbitrary limit on APR means that people who need small loans are forced to borrow more money for longer terms—if they still qualify for loans at all.

There is now a preponderance of evidence that points to the fact that these Military-style APR (“MAPR”) limits eliminate small dollar credit in the states where they exist. This

disproportionately affects those with developing credit scores, who have yet to reach the stage at which they qualify for bank credit.

This is because, as the United States Federal Reserve noted, creditors do not break even at 36 percent unless a loan is for more than approximately $2,500. [vii] This is the case for loans at 36% (not Colorado's 21%) AND as defined in the Truth in Lending Act (TILA). This break-even rate would be higher under HB 24-1148, because it uses MAPR, which includes non-APR items in the APR calculation.

Several organizations understand the value of traditional installment lending and the potential damage caused by MAPR-based rate cap laws:

- The National Black Caucus of State Legislators resolution BED-16-21[viii] states "Traditional Installment Lenders should be reasonably protected" and "that the 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."
- The 2022 Congressional Black Caucus Institute Annual Report[ix] highlights the harm of 36% rate caps, saying "proposals to protect consumers from predatory practices through a 36% rate cap . . . cause more harm than help by limiting consumer access to credit."
- The Urban Institute study[x] on the effects of the Military Lending Act (*i.e.* the same MAPR rate cap contemplated in HB 1148) uses credit bureau data from 2013-2021 and finds no evidence of decreased collection rates among subprime borrowers, no improvement in credit scores, suggestive evidence that subprime consumers had less access to credit, noting that expanding the MLA "might have detrimental effects on the most vulnerable consumers by limiting their access to credit in times of need."

Furthermore, when the novel definition of "All-In APR" or MAPR is used for rate cap purposes, it acts as a ban on optional protection products, such as credit insurance, for consumers who want to build financial resilience. If Colorado has concerns about products like credit insurance, debt cancellation contracts, debt suspension agreements, credit-related ancillary products, and/or "other benefits conferred on the consumer" contemplated in HB 1148, we respectfully request that proponents of this legislation please open a dialogue about those concerns instead of effectively banning them by including them in the calculation of "rate."

Fundamental to the discussion of APR caps is an understanding of what APR is and what it measures. APR is a measure of time, not cost. As an example, A $100 loan with $1 in interest is one percent APR if paid back in a year, and 365 percent if paid in a day—but the cost is still $1. Though the MAPR definition is particularly troublesome, APR limits such as those contemplated in HB 1148 are an inappropriate way to regulate loans in general. They have little bearing on the true cost of credit and only serve to eliminate good sources of small dollar credit along with bad. This also explains why loans in Illinois have increased in size and term since the passage of their 36% MAPR rate cap: because in order to get the "rate" down, a loan has to be larger and/or longer to fit the cap. Ironically, this results in consumers taking out larger loans than they may need. And although these loans are lower "rate" they are not lower cost.

In conclusion, the small dollar loans that will be eradicated should HB 1148 pass as written, are a critical source of credit for working individuals and families in Colorado. They are a safe and affordable alternative to other forms of credit and critically, by reporting loan performance to credit bureaus, they allow borrowers to build or repair their credit, consolidate debt, free up funds to deal with emergencies, and take advantage of opportunities that would otherwise be missed. This is an essential financial capability and the key to financial mobility.

For these reasons, we oppose HB 1148 as written. Thank you for the opportunity to submit our testimony.

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[i] The Availability of Safe and Affordable Credit from Non-Depositories in Colorado: A Report to the Colorado Attorney General, January 2023, p. 6.
[ii] *ibid*
[iii] Source: Illinois Trends Report 12/20/2022
[iv] *ibid*
[v] Source: Credit for me but not for thee: The effects of the Illinois rate cap 7/3/23
[vi] Source: Illinois Trends Report 12/20/2022
[vii] "A loan amount of $2,530 is necessary to break even at 36 percent." *The Cost Structure of Consumer Finance Companies and Its Implications for Interest Rates: Evidence from the Federal Reserve Board's 2015 Survey of Finance Companies*, FEDS Notes, The Board of Governors of the Federal Reserve System, August 12, 2020, We note that the break-even figure is for a 36% TILA APR. The amount of a loan would presumedly need to be larger in a state with an APR definition that includes items beyond TILA rate as "rate."
[viii] A Resolution Promoting Safe and Affordable Lending Practices (NBCSL)
[ix] https://www.cbcinstitute.org/21stcenturycouncil
[x] The Effects of APR Caps and Consumer Protections on Revolving Loans (Urban Institute)