RATE CAPS Harm Consumers

AFSA AMERICAN FINANCIAL SERVICES ASSOCIATION

Rate caps will remove credit options for consumers

In 2020, the Federal Reserve issued a report on small-dollar lending. The report found:

- With a 36% Truth-in-Lending Act APR cap, consumers would not be able to get loans for less than $2,530.
- Because installment lenders have substantial fixed costs, high interest rates are necessary to provide sufficient revenue to cover the costs of providing such loans. Despite the many changes in consumer credit markets, a large share of costs of small personal loans at consumer finance companies remains fixed. Technology does not eliminate the need to have employees available to originate loans, process payments, and collect delinquent accounts.
- 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.

The Financial Health Network believes:

- "The demand for small-dollar credit is itself a symptom of the financial struggles too many families face, highlighting the need for public and private action that will enable these families to improve their financial health and minimize the demand for small-dollar credit. The current economic and health crisis has made that need even more urgent."
- "Among households that are financially struggling, there clearly are those that can benefit from well-structured small-dollar credit products as an occasional way to help with illiquidity. For households without other resources, these products have the potential to help them weather a misaligned cash flow by bridging to the next paycheck or help them weather emergencies or other financial shocks.

If Congress enacts a rate cap, consumers will be left in a precarious and unfair position.

- Those seeking to borrow less than $2,500 (or more if an "all-in" rate cap is enacted) will be forced to borrower a higher amount than they need or want, along with higher finance charges, longer repayment periods, and higher overall costs.
- Many traditional installment lenders will not be able to offer these loans at all, which will create credit deserts.
- Four in 10 adults, if faced with an unexpected expense of $400, would not have access to the credit they need, or would be forced to turn to gray- or black-market lenders.

RATE CAPS
Understanding APR Caps

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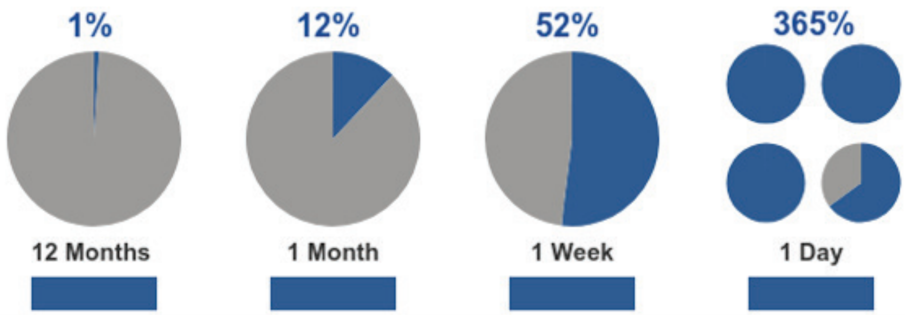
Why APR Can Be Misleading When Evaluating Loans

APR is a great tool to compare products of like terms and amounts, such as two credit card offers, or two 30-year mortgages, but it is a mathematical tool that has value only as a comparator.

What does APR really measure, cost or time?

Let's say you borrow $100 and agree to pay $1 interest. Seems fair, right?

What is the APR of the agreed upon $1 interest charge?



While the cost of credit remains exactly the same ($1.00), the APR varies dramatically based on the duration (or term) of the loan. Thus, APR cannot be relied upon as an indicator of loan affordability.

An All-in APR undermines the Truth in Lending Act, is Misleading and Confuses Consumers

For nearly 50 years, consumer credit transactions have been subject to the Truth in Lending Act (TILA), which requires disclosures about terms and costs of loans, including APR.

TILA APR is the standard for calculating APR, which is the cost of credit expressed as a yearly rate in a percentage. TILA mandates that APRs are consistent and require little interpretation. Because APR is a defined and well-understood term, consumers can use it to compare similar loan products.

All-in APR includes the cost of optional products (e.g., goods, services, or credit insurance) that are unrelated to the cost of credit. This removes the ability for consumers to quickly and reasonably compare credit products.

Under Director Richard Cordray in 2017, the CFPB decided in favor of using a TILA APR, rather than an "all-in" APR in its Payday Rule. The CFPB explained that the TILA APR is widely accepted and built into many state laws.

Imagine what would happen if consumers used APR to evaluate common transactions and their costs

Converting coins using a supermarket change machine

Amount in coins: $100
Fee: 8.9%
Fee Calculated as APR: 3,248.5%

Cost of a bounced check

Amount of check: $100
NSF Fee: $30
NSF charge calculated as APR: 10,950%

IRS Late Fee (1%)

Taxes owed: $800
Fee for late payment: $8.00
Fee Calculated as APR: 365%

Parking Ticket (Meter Violation)*

Amount of ticket $25
Fee for late payment: $10
Fee Calculated as APR: 14,600%

Using an out-of-network ATM

Typical withdrawal: $40
Fee for out-of-network ATM use: $2.50
Fee Calculated as APR: 2,281%