September 26, 2023

The Honorable Jack Reed
United States Senate
728 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Jeff Merkley
United States Senate
531 Hart Senate Office Building
Washington, D.C. 20510

Re: SA 1285, *Veterans and Consumers Fair Credit Act*

Dear Senators Reed and Merkley:

The undersigned trade associations, representing financial institutions that serve hundreds of millions of American consumers, are united in opposition to proposals that would limit the fees and interest charged on consumer loans through a national fee and interest rate cap of 36 percent.

Small dollar loans, credit cards, and other forms of short term credit are critical for helping consumers meet emergency expenses, disruptions in pay, and misalignments in the timing of their expenses and income. The proposed 36 percent fee and interest cap would make it more difficult for many consumers to obtain credit, thereby harming the very consumers the legislation seeks to protect. Congress should reject these legislative measures.

Proponents believe a cap on fees and interest would help consumers, especially subprime borrowers who have less than perfect credit histories, by limiting what they pay on payday loans and other less regulated short term credit. In reality, its impact would extend far beyond payday lenders to the broader consumer credit market to cover affordable small dollar loans that financial institutions are being encouraged to offer, along with credit cards, personal loans, and overdraft lines of credit. As a result, many consumers who currently rely on credit cards or personal loans would be forced to turn elsewhere for short term financing needs, including pawn shops, or worse– loan sharks, unregulated online lenders, and the black market.

A 36 percent annual percentage rate (APR) cap, however calculated, will mean financial institutions will be unable to profitably offer affordable small dollar loans to consumers. For a loan product to be sustainable, lenders must be able to recover costs. Costs include not only the cost of funds availability, but also costs related to compliance, customer service, IT, underwriting, administration, defaults, and, most notably– losses. Furthermore, the terms of consumer loans are often much less than a year, and the APR is an inappropriate and misleading way to measure the cost of a short term loan. For example, for a three month $500 loan, costs would generally amount to $55, which if charged to the consumer would equate to a 44 percent APR. Such a rate would be prohibited under the legislation.

The available evidence confirms that fee and interest rate caps reduce access to credit, especially for those with no or troubled credit history, and force some consumers to take out a larger loan than they need to get a lower APR. When the state of Illinois imposed a 36 percent all-in rate cap in 2021, the number of loans in Illinois to subprime borrowers decreased by 38 percent, and the average loan size to subprime borrowers increased by 35 percent.[1] When the state of Oregon established an interest rate cap in 2007, access to credit decreased significantly, borrowers were forced to switch to inferior alternatives, and on average, consumers were financially harmed more than they were helped. A

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4315919

similar population in the state of Washington that was not subject to these restrictions did not lose access to credit.[2] Additionally, a Federal Reserve report on small dollar loans confirms the downsides of an across the board 36 percent APR cap. The report found that 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.[3]

A recent analysis from Pew found that more banks now offer small dollar loans as an additional emergency safety net option available to consumers within the well-regulated banking system. However, while some larger banks have introduced small dollar products, the application of artificially low APR limits to small dollar products would preclude many from being able to establish available small dollar products to meet consumer needs.

Credit card customers would also be impacted by an all-in rate cap. Including annual and other fees in the calculation will cause credit cards to exceed the cap, resulting in the elimination or reduction of popular and valued credit card features like cash back and other rewards. Such a cap will also inhibit innovative credit cards with non-credit features designed to attract underserved groups because even a nominal annual fee will result in an all-in rate that exceeds 36 percent.

Moreover, the proposal specifies use of the "military annual percentage rate" (MAPR) as defined in the Military Lending Act rule to calculate the cost of credit. In addition to incorporating fees not included in the familiar federal rate calculation used today to measure and explain the cost of credit, like the traditional APR, the MAPR of that rule is flawed, mathematically incorrect, and overstates the cost of credit, as it assumes a fee imposed once a year is imposed 12 times a year. For example, a credit card with a $10 annual fee and 18 percent interest rate will have a MAPR of 138 percent if the balance is $100 in the month the annual fee is charged.

We urge opposition to this fee and interest rate cap proposal because it will reduce access to credit for millions of consumers, particularly subprime borrowers who rely on affordable small dollar loans, credit cards, and other products for short term financing needs. This fee and interest rate cap would also discourage development of innovative products, especially those designed for the underserved market.

Sincerely,

Consumer Bankers Association
American Financial Services Association
Bank Policy Institute
Independent Community Bankers of America
Association of Military Banks of America
American Bankers Association
Mid-Sized Bank Coalition of America

Cc: Members of the U.S. Senate

---

[2] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335438
[3] https://www.federalreserve.gov/econres/notes/feds-notes/the-cost-structure-of-consumer-finance-companies-and-its-implications-for-interest-rates-20200812.html