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Written Testimony

Of

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"Protecting Americans from Debt Traps by Extending the Military's 36% Interest Rate Cap to Everyone"

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Chairman Brown, Ranking Member Toomey and members of the committee, I am David Pommerehn, General Counsel at the Consumer Bankers Association ("CBA") and I appreciate the opportunity to testify at today's hearing. CBA is the voice of the retail banking industry whose products and services provide access to credit to millions of consumers and small businesses. Our members operate in all 50 states, serve more than 150 million Americans, and collectively hold two-thirds of the country's total depository assets.

Banks work diligently to provide access to safe and affordable loan products to consumers. A fundamental aspect of lending and a cornerstone to prudent banking practices is a bank's ability to accurately price risk. Expanding rate caps to all consumers and many important loan products will ultimately disrupt banks' ability to appropriately price risk, increase the cost of credit, and limit its availability. Borrowers with troubled credit histories will be most affected by any limitation on banks' ability to price risk, reducing the amount of available loan offerings that are tailored to meet their financial needs.

Access to Credit

While well-intentioned, capping interest rate is not an effective policy for protecting against debt traps or other negative outcomes for consumers. Banks are highly regulated entities that are obligated to carefully and appropriately price lending risk before extending credit to borrowers. Placing a cap on that price in the form of an all-in maximum annualized percentage rate (APR) does not mean consumers will get lower rates on their loan; it means in many cases consumers will not have access to loans at all. Research has shown interest rate caps reduce credit availability and create negative outcomes for the populations their proponents intend to benefit,

often having the worst impact on credit access for low- and moderate-income communities, and those seeking small-dollar, emergency funds. Like any financial product, loans have fixed costs that a financial institution must justify or risk insolvency. A loan for even a small amount requires significant upfront investment by the lender in risk management, legal review, servicing, and technology. Lenders must have a reasonable opportunity to recoup these fixed costs before justifying the extension of a loan. Inflexible APR caps that incorporate fees as well as the risk-based interest rate available to the borrower make it exceedingly difficult for responsible lenders to extend short-term credit.

A federal APR restriction may lead to less availability for certain popular credit cards and other products with annual rates. As in any normal market economy, reduced access is felt by those at the margins and is often not evenly distributed among consumers. Interest rate caps have little practical economic impact on higher-income individuals and those with ample access to sources of credit. However, borrowers with higher risk profiles or other financial challenges will not be able to find affordable credit options due to an APR cap, but instead will find fewer (or no) options among well-regulated lenders. Limited credit options in turn lead to more negative outcomes for individuals left with no recourse for their financial needs.

Small-Dollar, Emergency Liquidity

Today, the need for accessible small-dollar, emergency credit for consumers has never been greater. According to the Federal Reserve, nearly half of all American adults say they cannot cover an unexpected expense of $400.   Similarly, Bankrate states “63% of American adults say they are unable to pay an unexpected expense with their savings […]" A Financial Health Network

(formerly the Center for Financial Services Innovation) study found more than a third of all households say they frequently or occasionally run out of money before the end of the month. Further, more than four in ten households struggle to keep up with their bills and credit payments.

Our recovering economy has left consumers with less cushion for emergencies and reduced credit options, making access to reasonably priced small-dollar liquidity products even more important. While various entry-level credit products exist to meet a wide range of these needs, including traditional credit cards, personal loans, and other forms of credit, some consumers unfortunately cannot qualify for them.

Accordingly, policymakers have long been encouraging depository institutions to enter or remain in the small-dollar lending market. Banks worked with regulators to developed products carefully designed to ensure strong safeguards at reasonable prices. Consumer demand still exists for a short-term loan product, and if allowed, highly regulated banks can make safe, affordable, and easy to access small-dollar loans to consumer in need.

A 36% rate cap will eliminate these products. For a loan product to be sustainable, depository institutions must be able to recover costs. Costs include not only the cost of funds for a loan, but also fixed costs related to compliance, customer service, IT, underwriting, administration, and defaults (including losses). For example, for a three-month $500 loan costs would generally amount to $55, a seemingly reasonable amount which if charged to the consumer at cost—without any additional risk-based interest charge—would equate to a 44% rate and would be prohibited under this legislation. APR calculations for emergency loan products such as short-

term, low-dollar loans are often high and are essentially misleading because they do not represent the value of these forms of credit to those who ultimately need them for emergencies.

Accordingly, under a 36% interest rate cap, depository institutions could choose to comply by not offering small dollar loans or by increasing minimum loan amounts to make the APR calculation meet the 36% threshold. Because of the construct of a short-term loan, the interest rate must go up to recoup the lender's costs in a shorter amount of time. Conversely, banks can usually afford to attach smaller rates to larger loans because risk and cost is spread out though a longer term. The simple math required under and APR cap results in shutting out marginal borrowers or borrowers seeking less credit amounts for shorter terms.

Mandating a maximum annualized rate of 36% would effectively eliminate small-dollar loans as a credit option for millions of financially vulnerable Americans pushing them out of the well-regulated, well-supervised depository industry and into inferior alternatives. This has been evidenced by rules promulgated by regulators which would require overly restrictive ability to pay requirements for small-dollar loans that exceed a 36% APR. In 2017, the Consumer Financial Protection Bureau (CFPB) finalized a strict and prescriptive rule that greatly restrained lenders from entering the small-dollar market. The rule created conditions for loans exceeding 36% by requiring compliance costs so great they negate depository lenders' ability to make small-dollar loans at reasonable cost to consumers. The hurdles reduced efficiencies, restricted flexibility, and reduced consumer options for small-dollar liquidity. While some of these burdensome provisions were later rescinded, current leadership at the CFPB has indicated they will once again revisit the rule to reinstate barriers for loans exceeding 36%, leaving banks without a clear path and little choice but to not participate in this market.

A reality many Americans and their families will face upon losing access to short-term credit will be the inability to meet an emergency financial need and incur more financial harm through unpaid bills, negative hits to credit histories, lost opportunities and more.

Credit Cards

The consumer credit card market today offers a wide variety of products designed to meet the needs of different consumers at a variety of price points. Many customers choose cards with annual membership fees because such products offer non-credit related features such as reward programs, travel and dining benefits, and insurance. Extending an all-in cap to all consumer loans will reduce the availability of these popular credit card rewards and benefits. The MAPR contemplated under this legislation is not simply a 36% cap on interest alone. Unlike the standard APR calculation under the Truth in Lending Act, the MAPR incorporates various fees that may be charged on the account, including the annual membership fee. Because the MAPR is calculated on an annualized basis, membership fees that are charged once a year are treated as though they were imposed every month. This means if a customer has a balance in the month in which the annual fee is assessed, even a small fee can cause the MAPR to exceed 36%.

The Department of Defense's implementing regulations do allow for the exclusion of annual membership fees (and certain other fees) from the MAPR calculation if they are "bona fide" and "reasonable for that type of fee." However, this standard is inherently subjective and difficult to prove: an issuer can show that its fee is "bona fide" and "reasonable" only by demonstrating other issuers charge a similar fee for a similar product. In practice, this precludes issuers from relying on the bona fide fee safe harbor if they offer new or unique products or services that their

competitors do not. The bona fide fee exception therefore inhibits innovation and reduces the diversity of product offerings that customers prefer and priced for the value delivered. If the MAPR were expanded to all consumer credit cards, the result will be reduced rewards and benefits and fewer consumer choices as issuers would be forced to adjust their product offering to reduce the risk that annual fees would trigger the 36% MAPR threshold.

Credit-related Ancillary Products

For all credit transactions (open-end and closed-end) the MAPR must include any fee/premium for credit insurance, including single premium credit insurance, and for debt cancellation or debt suspension agreements. These amounts must be included regardless of whether such fees/premiums are voluntary and could be excluded from the finance charge under Regulation Z. In addition, for open-end credit, these fees/premiums must be included in the MAPR even if the products are obtained after the account is opened. Second, the MAPR must include any fee for a “credit-related ancillary product sold in connection with” the credit (whether for closed-end or open-end credit), and even if sold after the account is opened, for open-end credit.

To date, there is virtually no guidance on what products are deemed “credit-related ancillary products sold in connection with” a transaction. This overapplication included in an all-in APR such as the MAPR is indicative of the compliance difficulties that will ultimately deprive consumers of the products and services that they have come to expect and enjoy.

Expansion of MLA

It is important to acknowledge that the Military Lending Act (MLA) applies to only active-duty military personnel and their dependents who together amount to less than 1% of the total

financial services marketplace. The small number of consumers covered under the MLA present minimal risk to banks' loss reserves when defaults occur. If the MLA is expanded to all consumers, the current expected credit loss methodology (CECL) which requires lenders to ensure any future loss is accounted for with a necessary capital offset, will further sideline needed capital and cause additional reductions in consumer lending.

There is very little data on the impact that MLA is having on credit accessibility for military personnel. Even with this protected class, who have a consistent annual income, there is evidence of constricted credit availability for military service men and women. The National Foundation for Credit Counseling (NFCC) reported in their 2020 Military Financial Readiness Survey that over a third (36%) of servicemembers say the pandemic has caused them to take out a payday loan/cash advance in the past year, something the MLA was intended to protect against. We strongly encourage a deeper study into the affects the MLA has had on credit availability to service men and women. It is imperative that before Congress considers any extension of MLA rate caps to all consumers extensive research is conducted to understand the real impact on consumers and financial institutions.

Conclusion

Banks provide access to safe, well regulated, high-quality consumer credit products and have invested significant resources toward innovating small-dollar, short-term lending options to encourage more consumers to enter into the banking system. An APR cap would prevent those most in need the ability to access small-dollar credit options. We encourage the committee to further understand the full effects of a federal 36% APR cap before considering any legislation.

CBA remains eager to work with you on our shared commitment to improve financial opportunities for all Americans.