Ranking Member Pat Toomey (R-Pa.)
Opening Statement
Full Committee Hearing: Protecting Americans from Debt Traps by Extending the Military's 36% Interest Rate Cap to Everyone
July 29, 2021 at 10:00 AM

Thank you Mr. Chairman. I'd like to thank all of our witnesses, especially Congressman Loudermilk, for speaking today to explain the significant damage this proposal would do.

It is a fundamental principle of economics that markets discover prices. Sellers compete until they reach the lowest prices that will let them stay in business. The only exceptions are under monopoly conditions, which generally only exist when the government creates or facilitates them.

Nevertheless, history is littered with examples of government planners' failed attempts to set prices. They fail because they generate huge unintended consequences, which inevitably harm the very people they are supposed to protect.

Proponents of a 36% interest rate cap seem to think it would result in borrowers getting cheaper credit, but that's just not the case. In fact, those most in need would simply lose access to credit. If a lender can't recoup its costs, it won't make the loan.

Studies have found a loan under $2,600 is a money loser for the lender at 36% interest. That is because there are fixed costs to issuing a loan, regardless of its size.

The Bank Policy Institute has estimated that a issuing a 3-month, $100 loan would cost a typical bank $35 to issue. Expressed as an annual percentage rate, or APR, this is roughly 140%, meaning a 36% rate cap would make it impossible to offer.

Many would suffer if they lost access to small loans. A 2020 Federal Reserve study revealed that 35% of adults could not cover an unexpected $400 expense using cash, savings, or the equivalent.

Who would be most at risk of losing access to credit? The 30% of U.S. consumers who have a subprime credit score, and the more than 1 in 10 Americans who are “credit invisible.”

This particularly harms minorities. For example, in 2020 only 21% of black households had a credit score above 700.

Moreover, while I am skeptical of the evidentiary value of unverified complaints, the fact that Personal loans, Payday loans, and Title loans each account for fewer than 1% of consumer complaints in the CFPB’s database certainly suggests consumers are not dissatisfied with them.

Here’s another example that highlights the inflexibility of an APR cap. Consider a renter who is $100 short on rent on the first of the month, but will not be paid until the second. To avoid a $50 late fee, she might opt to borrow $100 at a cost of $15 paid back any time over the next three months. That would be a 60% APR. This is a real product that a major American bank offers. But it appears that would be illegal under the proposed 36% APR rate cap. Therefore, instead of paying $15 to the bank, the renter would be forced to pay $50 to her landlord.

The effects would be far more severe using the “all-in” rate cap the Military Lending Act, known as the MLA, imposes. Even though it is called an APR, an “all-in” APR like this encompasses far more than interest. It includes fees, finance charges, and the cost of ancillary products like credit insurance.

As a result, a supposed 36% rate cap functions like a much lower limit. This is particularly evident for credit cards, including even a modest annual fee in the “all-in” APR calculations can cause a credit card to exceed 36%.

What’s more, virtually all other Federal and State laws use a standard APR calculation. As a result, an “all-in” rate cap of 36% would preempt even those states that have interest caps that are seemingly set at a similar rate, with the sole exception of Illinois.

While some argue that the MLA should apply universally, service members are not reflective of the general population. By definition they have a reliable income. And, different factors affect their readiness to deploy on a moment’s notice than most people consider when ordering their finances.

What’s more, research on the MLA’s effects suggests that the MLA has had adverse effects on service members. A survey of service members showed that the percentage of service members suffering financial distress more than doubled, from 16% before the MLA’s passage to 34% five years later. Approximately 51% of all military families had been denied credit specifically because of the MLA. And, research by West Point professors found that payday lending had not adversely affected service members.

Although proponents claim extending the MLA to all consumers would help veterans, veterans groups have disagreed. In 2019, a number of veterans’ groups opposed legislation to extend the MLA, with several noting that veterans have more difficulty accessing capital than others.

Congress should not remove, but expand, access to credit. Regulators have made it very difficult for banks to offer small-dollar credit.

Although Federally-chartered credit unions can offer Payday Alternative Loans, an NCUA-approved small-dollar product, fewer than 600 credit unions nationwide offer them, and in the first half of 2020 the “all-in” APR for these loans, including fees, actually exceeded 36%.

At the end of the day, taking choices away from consumers just doesn’t work. Instead, it hurts the very people it’s supposed to help.