Protecting Credit Since 1916
American Financial Services Association

December 22, 2014

Federal Docket Management System office
4800 Mark Center Drive
2nd Floor
East Tower
Suite 02G09
Alexandria, VA 22350-3100

Re: Limitations on Terms of Consumer Credit Extended to Service Members and Dependents
DOD-2013-OS-0133, RIN 0790-AJ10

> From a private stationed in Kansas: "Thank you so much. Without [AFSA Member Company] we would not have had our house right now. Keep up the good work."
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> From a Service member stationed in North Carolina: "[The loan from an AFSA Member Company] helped out so much, that not only could I put a down payment on my car, but I also surprised my family by being home for Christmas."
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> From a retired Service member: "Thanks, our car was stolen and my wife's wheelchair was in the trunk. This loan replaced the wheelchair and some of my tools that were also in the trunk. Thank you so much."

To Whom It May Concern:

The American Financial Services Association ("AFSA")[1] does not believe that the Department of Defense ("Department") should finalize its proposed rule ("Proposed Rule")[2] amending the regulation that implements the Military Lending Act ("MLA").

For almost 100 years, AFSA members have been offering safe and affordable financial products and services to Americans. As you can see from the quotes above, Service members need, and are very grateful for, the products and services offered by AFSA member companies. AFSA members are often the only ones meeting the credit needs of Service members and their families.

[1] AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its more than 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers. AFSA members are not payday lenders, auto title lenders, or pawn shops. Please see the definition below of "traditional installment loan" to understand the distinction between these types of lenders and AFSA members.
[2] Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 79 Federal Register 58602 (Sept. 29, 2014)

If the Proposed Rule is finalized, AFSA members will be unable to meet many of these needs. A military family may be forced out of a home. A Service member may not make it home for Christmas. And a retired Service member may not be able to help a disabled spouse.

The MLA limits the amount of interest a creditor may charge a Service member or dependent for "consumer credit" to a maximum "military" annual percentage rate of 36%. The Department is proposing broad-based amendments to its existing regulation primarily for the purpose of extending the protections of the MLA to a broader range of credit products, rather than the limited credit products currently defined as consumer credit. In addition, the Department is proposing to amend its existing regulation to alter the provisions governing a tool a creditor may use in assessing whether a consumer is a "covered borrower," modify the disclosures that a creditor must provide to a covered borrower, implement the enforcement provisions of the MLA, as amended, and for other purposes.

The Department justifies the sweeping changes in the Proposed Rule by saying that some creditors are evading the protections put in place by the 2007 MLA regulation.[3] However, instead of helping Service members and their families, we are certain that the Proposed Rule will cut off access to fair and affordable small-dollar loans to many Service members and their families. Moreover, the safe harbor in the Proposed Rule has the potential to seriously disrupt consumer credit throughout the county. There is very little to justify a rule with these consequences and no reason to expand the policy so drastically. If change is needed, it should be small and targeted. Policymakers should ensure that access to safe and responsible credit is maintained and not swept away by grouping it with less-desirable loans.

I. The Proposed Rule will cut off access to fair and affordable credit to Service members and their families.

AFSA shares the concerns expressed by the conferees on the Fiscal Year 2013 National Defense Authorization Act that military personnel and their families have access to affordable credit and are protected from abusive lending practices. We are sensitive to the hardship that is placed on Service members and their families with repeated deployments, especially for dual-career spouses, and the financial difficulties created by frequent moves.

At the same time, it is imperative that the implementing regulations do not result in the unintended consequences of restricting the availability of legitimate and appropriate credit products to deserving Service members and their families (e.g., those with an ability to repay, and particularly those who otherwise are not and will not be served by creditors such as conventional commercial banks, credit unions, or by the Military Relief Societies[4]).

The Proposed Rule would have the serious consequence of severely restricting access to fair and affordable small-dollar loans for countless Service members and their families. Creditors simply

[3] Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 72 Federal Register 50580 (Aug. 31, 2007)

[4] The "Military Relief Societies" refer to the four relief societies for the Military Services – Army Emergency Relief, Navy-Marine Corps Relief Society, Air Force Aid Society, and Coast Guard Mutual Assistance.

cannot make small-dollar loans at 36% Military Annual Percentage Rate ("MAPR"). According to a study done by three academics using industry data, in order to make a break-even loan at 36% Annual Percentage Rate ("APR"), the loan would have to be made for at least $2,600.[5] For a loan to be made profitably at 36% MAPR, the loan would have to be for around $3,600 - $4,000.

Thus, by expanding the definition of "consumer credit" in the Proposed Rule, the Department is cutting off access to loans below $3,600 - $4,000 for Service members and their families. However, the Department is not eliminating the need for these small-dollar loans. This leaves the Service member with limited options. The Service member could borrow an extra few thousand dollars to get a loan, paying an unnecessary finance charge. Or, more likely, the Service member could go to disreputable "lenders" (or loan sharks) to get the money needed.

This was the case in North Carolina. Because of the restrictions in North Carolina's Consumer Finance Act, the 2009 Consumer Banking and Finance Survey found that 11% of residents surveyed had received a payday or auto title loan through the internet or by driving to another state. This was an almost three-fold increase since 2007.[6]

A number of other studies demonstrate the fact that rate caps cut off access to credit. The Federal Reserve Bank of St. Louis studied the result of North Carolina's 1999 predatory lending law. The study cited evidence that "the introduction of the North Carolina law substantially reduced the flow of subprime credit. The impact seems to be larger for low-income borrowers and minority borrowers."[7]

An extensive study done for the European Commission concluded, "High-risk borrowers requesting small-amount credit can only be served when a certain threshold interest rate is exceeded. Hence, they may not be served credit in the presence of interest rate restrictions.[8]

A paper by Todd J. Zywicki and Robert C. Sarvis issued by the Mercatus Center at George Mason University explains the unintended consequences that regulation can have on consumer credit:

> "Government regulators proposing restrictions on specific forms of consumer credit all too often ignore the reality of how and why consumers use credit. They also ignore lenders' legitimate reasons for pricing their services as they do; consumers' legitimate reasons for choosing the financing options they do; the risks consumers face when credit offerings are made unavailable to them; and the

[5] See Appendix II: Durkin, Thomas A., Gregory Elliehausen, and Min Hwang, "Rate Ceilings and the Distribution of Small Dollar Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders." December 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2533143); forthcoming 2015 Journal of Law, Economics, and Policy.

[6] MarketSearch Corporation, "Consumer Banking and Finance Survey." North Carolina Office of the Commissioner of Banks, April/May 2009. pp. 22-23.

[7] Ho, Giang and Anthony Pennington-Cross, "States Fight Predatory Lending in Different Ways." St. Louis Federal Reserve. January 2006. http://www.stlouisfed.org/publications/pub_assets/pdf/re/2006/a/predatory_lending.pdf

[8] Reifner, Prof. Dr. Udo, Sebastien Clerc-Renaud, RA Michael Knobloch. "Study on interest rate restrictions in the EU." 2010. http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf. p. 325

> many consumers who use the particular forms of consumer credit responsibly and effectively.
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> As a result, new laws and regulations on consumer credit have unintended consequences that frequently harm the very people they are meant to help by making credit more expensive and harder to obtain; by inducing lenders to reprice non-interest-rate terms and reduce transparency; and by forcing consumers to substitute less-preferred types of credit. The restrictions also harm individuals and families that don't use any form of consumer credit by inducing banks to increase fees on bank accounts, ATM transactions, and other services. Low-income individuals and families are particularly harmed by these fees and may even be forced out of the traditional banking system altogether as simple checking accounts become less affordable. Additionally, regulations on some forms of consumer credit may drive consumers into other, perhaps even more problematic, forms of credit.
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> Regulators must be mindful not to restrict consumers' access to credit nor to increase the cost of credit by well-intentioned but misguided laws and regulations."[9]

The paper goes on to explain, "Unavailability of credit can result in non-payment of bills or bounced checks, which can put consumers at risk of potentially disastrous financial penalties, termination of bank accounts, eviction, discontinuation of utilities or medical treatment, or other problems."[10]

The 36% MAPR cap is not the only factor that may restrict credit to Service members and their families. The cost to create a new loan type in creditors' operating systems and the cost to create new loan documents, coupled with the other loan restrictions in the Proposed Rule and the risk of significant penalties for honest mistakes or inadvertent errors, are likely to result in many creditors deciding not to offer loans that are compliant with 10 U.S.C. § 987. This is especially true for creditors who make only make a small percentage of their loans to covered borrowers. One AFSA member said that the expense of setting up a new loan type for 1% of its customers would likely be greater than the benefit of making these loans, even though its normal rates for loans over a certain amount would be under the 36% MAPR.

In addition to cutting off access to fair and affordable credit to Service members and their families, the Proposed Rule could have a broader economic impact. For example, some creditors may decide not to offer certain products for Service members and other products for civilians. Consequently, in order to comply with MLA, these creditors would not make any loans under 36% MAPR – which means that they would stop making small-dollar loans.

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[9] Zywicki, Todd J. and Robert C. Sarvis. "The Pitfalls of Regulating Consumer Credit." The Mercatus Center at George Mason University. October 2012. http://mercatus.org/sites/default/files/Pitfalls_Regulating_Consumer_Credit_MOP_v1-0.pdf . p. 1.

[10] *Ibid.* p. 2.

In another example, the Proposed Rule could have an effect on communities surrounding military bases. A number of creditors that offer consumer credit as defined by the Proposed Rule also purchase retail installment sales contracts from businesses such as auto dealers and furniture stores. Auto dealers, furniture stores, and others sell these contracts in order to maintain their cash flow. Since creditors may decide that they cannot offer credit to Service members under the Proposed Rule, they may decide to close their branches near military bases. Without nearby branches, auto dealers and furniture stores may have trouble selling their retail installment sales contracts. Without that cash flow, these businesses may not be able to extend these products and services to Service members, their families, and others living near the bases.

We note that the Military Relief Societies will not be able to fill the void left by creditors leaving the marketplace. If they were able to meet the needs of Service members, they would already be doing so. For example, one AFSA member made a loan to a sergeant in Texas that enabled the sergeant to travel to his uncle's funeral. His uncle was instrumental in parenting him, but because his uncle never had legal custody nor was an immediate blood relation, the Army Emergency Relief Society ("AER") denied the sergeant's loan application.

In another example, a specialist at a base in Colorado applied to an AFSA member for funds to repair his vehicle. The branch manager told the specialist that he could receive an interest free loan through AER. The specialist said that would not work because there was a three-week waiting time. He also said that he did not want his command involved in his finances because he had heard horror stories of other Service members who had done so. He added that he needed the funds quickly because the vehicle in need of repair was the only vehicle his family had. The loan turn-around time with the bank, even if he was approved, was anywhere from three to ten days, and he could not wait that long.

We have other examples we believe are important for the Department to consider. A sergeant at a base in North Carolina got a small-dollar loan from an AFSA member company to pay for his wife's emergency dental surgery. The surgery was not covered by the military's dental insurance plan. The sergeant did not qualify for a loan at other banking institutions because of his credit history. A specialist at the same North Carolina base got a loan from an AFSA member company to purchase a crib, baby carrier, and other essentials to support a newborn baby. The specialist contacted her command about applying for an AER loan, but was told that her situation was not classified as an emergency. Another sergeant, also stationed at the same North Carolina base, got a loan to pay her mother's medical bills, since her mother did not have medical insurance. She could not go to AER because this type of situation is not classified as an emergency.

AFSA member companies can provide expedited services to qualified Service members and their families facing financial emergencies. When Service members and their dependents identify and establish that the need for a loan arises from a bona fide emergency, some AFSA members expedite loan processing and can provide the needed funds within 24 hours.

Military Relief Societies have neither broad lending policies nor the financial capacity to meet the need. The existing financial (capital) restrictions and regulatory requirements that limit Military Relief Society lending to very narrow and limited purposes (e.g., emergency loans for urgent required travel, rent, food, utilities and essential automobile repairs). Military Relief

Societies will only provide travel or funeral expenses for immediate family members, which does not include grandparents, aunts, or uncles. Military Relief Societies will also not provide financial assistance for repair costs for a second vehicle, even if that second vehicle is necessary for a family. Nor do the Military relief Societies provide financial assistance for orthodontia care for family members. Non-emergency orthodontia is outside the scope of the relief societies and is only partially covered by dental benefits. Military Relief Societies also do not provide legal fees for divorces. Except in the simplest cases (which are few), military legal assistance offices do not provide legal services to divorcing Service members. Military Relief Societies also do not provide financial assistance to Service members for the purpose of paying income or property taxes. Neither will the relief societies pay for home furnishings, including cribs and other furniture, for newborns.

The Department states that in 2012, the Military Relief Societies provided only $142.2 million in no-interest loans and grants. That total is just a small fraction of the total lending to Service members and their families by AFSA member companies. Moreover, as you can see from the example above, our member companies report that many of their customers have come to them specifically because they were denied funding by a Military Relief Society.

II. The safe harbor in the Proposed Rule will seriously disrupt consumer credit in this country.

To take advantage of the safe harbor in the Proposed Rule, the creditor must verify the status of a consumer by accessing the information relating to that consumer, if any, in the database maintained by the Department available at http://www.dmdc.osd.mil/mla/owa/home ("MLA Database"). This means that creditors will have to check the MLA Database before making any loans. According to the data cited in the Proposed Rule, creditors would have to check over the database over 300 million times a year.[11] Thus, the Proposed Rule will affect every American applying for credit. There are many problems with the MLA database, not the least of which is how expensive it will be for members to check it with each and every loan application. These problems will only be compounded by the volume of credit inquiries.

The MLA Database in its present form is inadequate to serve the needs of the U.S. credit industry. As designed, the MLA Database does not support scripted queries and instead requires manual entries from a website. Further, creditors are limited to 1,000 queries per hour, an absurdly low number. If the U.S. credit industry were obligated to operate under these conditions, <u>the MLA Database would become the pinhole that completely jams the flow of credit in the U.S.</u> The proposed regulations cannot be implemented unless and until a commercial solution is in place that permits automated queries of the MLA Database.

The Department will need to resolve another deficiency in the MLA database as well. The MLA protects covered borrowers as defined by 10 U.S.C. § 987, which includes: (1) a regular or reserve member of the armed forces serving on active duty; (2) the member's spouse; (3) the member's child; and (4) an individual for whom the member provided more than one-half of the individual's support for 180 days immediately preceding an extension of consumer credit covered by 32 C.F.R. Part 232. According to Defense Manpower Data Center ("DMDC"), the

[11] 79 Federal Register 58627, Footnote 179.

MLA Database may not accurately include members included in the fourth definition above (receiving more than half of the member's support for 180 days prior to the loan), rendering information obtained from the MLA Database suspect and the safe harbor provision potentially illusory.

Another problem is the frequency with which the site is down. When the site is down, unless the Proposed Rule is modified, creditors would not be able to take advantage of the safe harbor. In order to avoid liability, creditors would frequently not be able to make any loans to anyone until the site is restored. Information in the database may not be-up-to-date. Another concern is that a slight discrepancy between the creditor's records and the MLA Database records will render a check of the website ineffective. For example, a simple one letter typographical difference in a name, the addition of a suffix, or a hyphen in a surname, will render the result useless.

The Proposed Rule does not address what creditors should do in response to differences between MLA Database-provided data and military orders obtained from Service members. Reservists and National Guardsmen are to be afforded benefits as of the date the orders are received, but the MLA Database shows only when they report for duty. Different versions or formats of orders make it difficult to discern the dates to apply the benefits.

The Department provides no data demonstrating that there are a significant number of instances of Service members or covered dependents falsely declaring that they are not covered borrowers. Members of the military serve the United States honorably and AFSA questions allegations that these Service members may be misrepresenting their status as covered borrowers. The Department also provides no data to support its assertion that some spouses of active duty Service members may not understand that they are covered by the current regulations. Thus, AFSA does not believe that current safe harbor needs to be changed.

Even if the MLA Database was fully automated and easy to use, it would still be expensive for creditors to check each time a consumer applied for credit. AFSA would like to be able to provide a general estimate of the cost, but since the system is nowhere near ready to be used on such a massive scale, most AFSA members could not come up with an accurate cost estimate. Programming systems and training employees always carries a significant cost. The cost to comply with the new rules also limits the money available to lend to military members, their families, and all other consumers.

One small business estimated just the time it would take and the cost to check the MLA Database manually. This small business estimated that it would take about five to ten minutes per loan application to access the MLA Database, receive a response, print the confirmation, and file the confirmation per loan application, assuming no delay in accessing and obtaining the information from the database. Considering that this small business processes about three applications to make one loan, the proposed safe harbor procedure may add $10 or more to the cost of *every* loan made, not just loans to Service members.

Thus, without providing any evidence that such a change is necessary, the Department is making policy that will affect millions of consumers and impose burdensome costs on creditors. The

MLA Database is not designed to support the level of traffic that it would be subject to under the Proposed Rule.

These problems will increase exponentially and will affect more people than just Service members and their families. If the MLA Database is down, and no other safe harbor is provided, borrowers in need of credit (possibly for a medical emergency or an immediate car repair to get to work) will be frozen out of the system. Consumer credit, a multi-billion dollar industry affecting hundreds of millions of non-military consumers, effectively will be shut down until the technical issues with the MLA database can be fixed. This is not fair to creditors or the millions of non-military applicants for credit.

If the Department is willing to take that risk, we ask that the Department at least include some data showing how many Service members and their dependents are providing false information to creditors. We believe it would be far more beneficial for Service members, their families, and all other American consumers for the Department to retain the safe harbor for a creditor's use of the covered borrower identification statement, if not for all purposes, then at least for use when the MLA Database is not working or is unavailable to the creditor.

III. There is no reason to expand the existing policy so drastically.

AFSA shares the concerns expressed by Department that Service members and their families have access to affordable credit and are protected from abusive lending practices. Notwithstanding, AFSA strongly urges the Department not to finalize the Proposed Rules.

The Department states, "After observing the effects of its existing regulation, the Department believes that a wider range of credit products offered or extended to Service members reasonably could – and should – be subject to the protections of the MLA, and that the extremely narrow definition of 'consumer credit' permits creditors to structure credit products in order to reduce or avoid altogether the obligations of the MLA."[12]

The reasons that the Department believes a wider range of credit products should be subject to the protections of the MLA are described in the Department's April 2014 H ouse Report ("Report").[13] The Report presents data from consumer groups pushing an agenda and a survey – the DMDC QuickCompass of Financial Issues ("Survey").

Unfortunately, this Report suffers from reliance on anecdotal information. Neither the Survey nor the Report contain empirical data studying the economic impact on the subgroup needing access to small-dollar credit. Perhaps the most glaring example of this flaw can be seen in the fact that the Survey asked Service members questions concerning their perspective and experiences using credit, but when asked about specific credit products – including bank direct deposit advanced loans, payday loans, and vehicle title loans – installment loans are not even listed as an option.[14] This oversight is compounded by the fact that follow-up questions[15] are

[12] *Ibid.* p. 58603.
[13] Department of Defense. "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents," April 2014.
[14] *Ibid.* p. 49 (Question 30).

based on the respondents' use of one of the listed credit products. We question the advisability of finalizing a rule limiting Service members' access to safe and affordable credit options based on Survey results that ignore this important segment of the market.

IV. Policymakers should ensure that access to safe and responsible credit is maintained and not swept away by grouping it with less-desirable loans.

According to the Survey, 41% of enlisted Service members said that they had used one or more sources of small-dollar lending in the past 12 months.[16] The Proposed Rule also states, "The Department continues to believe that certain payday loans, vehicle title loans, and refund anticipation loans present the most severe risks to Service members and their families, and remains mindful that more broadly defining the 'consumer credit' that would be subject to 10 U.S.C. 987 may present unintended consequences, including a reduction in 'credit availability.'"

Thus, the Department recognizes that there is a need for small-dollar credit, while at the same time being concerned that the current regulation implementing the MLA does not protect covered borrowers from high-cost credit products. AFSA agrees with the Department that Service members and their families should have access to safe and responsible credit. We understand the Department's concern that high-cost loans can pose risks to Service members and their families.

The Department's proposed approach, though, does not meet these two goals. It seems that the Department is willing to prevent covered borrowers from accessing much needed, good, small-dollar credit options by rewriting the rules with a broad brush stroke that assumes that all products are undesirable. Pardon the analogy, but the current Proposed Rule is analogous to using a shotgun rather than a rifle to take out the "offensive" creditor. Let's use the rifle instead to prevent the inevitable collateral damage.

A. Traditional Installment Loans

Since the Department believes that a change needs to be made, the Department should seek to limit certain high-cost credit products, while still allowing covered borrowers access to Traditional Installment Loans. This is consistent with the recommendation to the European Commission, "Rules should carefully observe the impact on the distribution of certain regulated products. Differentiation by marketing practice, product, life-time and amount is more promising than unified approaches."[17] Traditional Installment Loans are a type of consumer credit transaction. Traditional Installment Loans are fixed rate, fully-amortized closed-end extensions of direct consumer credit. Fully-amortized means that the Amount Financed under the Truth in Lending Act ("TILA") and the Finance Charge under TILA are repaid in substantially equal multiple installments at fixed intervals to fulfill the consumer's obligation.

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[15] *Ibid.* pp. 49 – 52.
[16] 79 Federal Register 58604.
[17] Reifner, Prof. Dr. Udo, Sebastien Clerc-Renaud, RA Michael Knobloch. "Study on interest rate restrictions in the EU." 2010. http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf. p. 329

If any of the following is true, a transaction is not a Traditional Installment Loan: (1) the transaction has a repayment term of 181 days or fewer AND is secured by the title to the borrower's motor vehicle or automobile [commonly referred to as "title loans," "title secured loans," "title pawn" or "vehicle title loans"]; (2) the transaction requires that the amount of the credit extended together with all fees and charges for the credit be repaid in full in 91 days or fewer [commonly referred to as a "payday loan"]; (3) the transaction's scheduled repayment plan contains one or more interest-only payments and/or a balloon payment due at maturity; (4) the transaction, at origination, requires the borrower (a) to agree to a pre-authorized automatic withdrawal in the form of a bank draft, a preapproved Automated Clearing House or its equivalent; (b) to agree to an allotment or an agreement to defer presentment of one or more contemporaneously-dated or postdated checks; or (c) to repay the loan in full at the borrower's payday or other recurring deposit cycle, where the repayment is connected with a bank account [commonly referred to as a "bank payday loan"]; (5) the lender did not make a reasonable attempt under the circumstances to determine the borrower's ability to repay the loan; or (6) the transaction is a credit sale, retail installment sale, or lease, or the forbearance of debt arising from a credit sale, retail installment sale, or lease. This definition of a Traditional Installment Loan was adopted by Missouri this past April.[18]

Traditional installment lending provides access to affordable, repayable consumer credit because creditors work with borrowers to determine that they have the ability to make the payments required to repay the loan. It is the safest form of small-dollar lending. Installment loans utilize amortization as a means of protecting borrowers from an endless cycle of debt. The traditional installment consumer credit products offered by AFSA member companies are not the problem – in fact they are often the best solution to the financial needs of Service members and their families. For example, a gunnery sergeant needed money to move her children to base housing during a divorce. She also needed money for a divorce attorney. Her bank denied her loan application because her spouse damaged their credit while she was deployed and because of the loan's intended purpose. However, she was able to get a loan from an AFSA member.

AFSA members also help Service members and their families get out of debt. A senior airman at an Air Force base in Florida applied for funds to help consolidate his debt. During the workup, the AFSA member company determined that the airman was paying over $720 a month in credit card and other personal debts. The AFSA member was able to pay off most of his debt and lower his payment to just $290 per month, saving him over $430 a month. Another senior airman at the same base also applied for a loan to consolidate her bills. The airman was a single mother who was using credit cards to pay for child daycare. An AFSA member company was able to reduce her total monthly payments by $600 a month by consolidating her credit card debt with other household bills.

Traditional Installment Loans are clearly, and have long been, a beneficial and useful service for Service members and their families. Thus, the Department should use the definition above to exempt Traditional Installment Loans from the Proposed Rule.

Both the National Black Caucus of State Legislators and the National Hispanic Caucus of State Legislators have passed resolutions promoting access to safe and affordable small-dollar credit.

[18] Mo. Rev. Stat. § 408.512 effective October 10, 2014.

The resolutions stress the importance of protecting vulnerable elements in society, which includes some Service members, from harmful products, but at the same time preserving their access to beneficial forms of credit. The resolutions are included in Appendix I.

Academics have also weighed in on the subject. Included as Appendix II to this letter is a paper written by three academic authors (one whom retired from the Federal Reserve as a senior economist and another who is currently a senior economist at the Federal Reserve) with the preliminary findings from AFSA's member survey of traditional installment lending.[19] The survey collected information on the characteristics of six million installment loans outstanding as of the end of December, 2013. The authors realized that relatively little is known about traditional installment lending and that it often gets erroneously lumped in with payday lending. The purpose of the paper is to provide background, some discussion of relevant economic theory, and a look at some newly available statistical information on traditional installment lending. The Department asked for data in the Proposed Rule and we hope that the paper will provide the Department with the information it is seeking.

Many of the loans in the survey are small and "likely made to borrowers who have little availability of credit at primary lending sources or who have loans from primary lenders but have exhausted any further credit availability from them and are only eligible for relatively small loans at secondary (subprime) lenders."[20] The paper concluded that the loans are likely to exhibit relatively high APR's both because they are small and because they are made to risky borrowers. The paper also stated that "the loans likely are of appropriate size to keep the payments low and within budgets of subprime consumers."[21]

The authors offer a detailed explanation of why small loans exhibit high interest rates:

> "This phenomenon arises from the economic fact of 'production cost economies of size.' In other words, lending costs rise as loans become larger (because of the need for more careful screening, the need to take and record more payments over time, etc.), *but well less than proportionately*, due to production cost economies of size. A multi-million dollar loan to a top-rated international corporation may cost more to investigate, book, and collect than a small loan to a risky consumer, *but not per loan dollar*."[22] [Emphasis in original.]

B. <u>Credit Cards</u>

In addition to exempting Traditional Installment Loans from the Proposed Rule, the Department should also exclude credit cards from the Proposed Rule. An exemption for credit cards would not create regulatory gaps, but would allow Service members and their families' access to an extremely useful and very sought after form of credit. As the Department notes, the Credit Card Accountability Responsibility and Disclosure Act ("CARD Act") provides sufficient protection

[19] Durkin, *et al.*
[20] *Ibid.*
[21] *Ibid.*
[22] *Ibid.*

for all borrowers. The Consumer Financial Protection Bureau ("CFPB") wrote in its report on the CARD Act:

> "The CARD Act was enacted to 'establish fair and transparent practices related to the extension of credit' in this market, regulating both the underwriting and pricing of credit card accounts." Among other things, the Act prohibits credit card issuers from extending credit without assessing the consumer's ability to pay, with special rules regarding the extension of credit to persons under the age of 21. The Act restricts the amount of 'upfront' fees that an issuer can charge during the first year after an account is opened, and limits the instances in which issuers can charge 'back-end' penalty fees when a consumer makes a late payment or exceeds his or her credit limit. The Act also restricts the circumstances under which issuers can increase interest rates on credit cards and establishes procedures for doing so."[23]

The CFPB concludes in the report that the CARD Act has enhanced transparency for consumers, largely eliminated overlimit fees and repricing actions, as well as decreased the dollar amount of late fees. The CFPB also concludes that the total cost of credit in the credit card market has declined.[24]

V. Effective Date

AFSA respectfully requests that the Department give creditors at least a year to comply with the final regulation. Creditors will need time to change their systems, develop new disclosures, and train employees.

The Department should allow creditors to use the current safe harbor – a covered borrower identification statement which allows the consumer to state whether or not the consumer is a covered borrower – until a commercially provided information product is developed. Because the MLA Database is not automated, it would be impossible for creditors to check every applicant. It would not be possible to use the proposed safe harbor until a commercially provided information product is developed.

VI. Answers to Questions

QUESTION 1: The Department solicits comment on whether an approach should be taken that would define "consumer credit" consistently with certain credit regulated under TILA, and invites suggestions on alternative approaches.

The Department should not change its definition of consumer credit. If the department does define "consumer credit" consistently with certain credit regulated under TILA, Traditional Installment Loans and credit cards should be exempted from the Proposed Rules.

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[23] Consumer Financial Protection Bureau, "CARD Act Report." October 2013. p. 4.
[24] *Ibid*. p. 4.

QUESTION 2: If the Department were to adopt a regulation as proposed, to what extent, and in what manner, would the Department's regulation affect the availability of consumer credit to Service members and their dependents or have other consequences?

As discussed above, imposing a 36% MAPR will mean that Service members and their families who need small loans will be forced to borrow more money for longer terms than they need, and to pay higher real charges, or be denied access to credit altogether. This is because the larger and longer the loan, the less the impact of the creditor's fixed costs on the MAPR, as there are more and higher payments over which the fixed costs are spread. In other words, MAPRs (or Annual Percentage Rates in general) are chiefly a function of term and loan size and an inherently poor indicator of underlying cost or of the creditor's profit on a relatively short-term, small dollar loan. (See Appendix II for a more detailed explanation.)

Artificially imposed APR caps have historically wiped out much of the formal consumer lending industry. The paper in Appendix II examines the differences between loans made in Texas, which permits higher rates on smaller loans, and Pennsylvania, which does not. The authors note, "It also again suggests the possibility that some Pennsylvania borrowers may be taking larger loans than they otherwise would prefer if smaller loans were available under the state's lower rate ceilings."[25] Borrowers are forced to look elsewhere for credit – to loan sharks and other illegal options.

Another major problem with the Proposed Regulation is the safe harbor, as explained in Section II above.

QUESTION 3: If the Department were to adopt a regulation as proposed, to what extent would a creditor, as a practical matter, need to develop separate classes of credit products, namely, one class of products for covered borrowers and other classes for other consumers?

Creditors will either stop making small-dollar loans (since they cannot make them at a MAPR of under 36%) or they will develop separate classes of credit products for covered borrowers and other consumers. Creditors will make this decision by looking at the cost of compliance with the Proposed Rule and the cost of not making small-dollar loans.

At least two states, California and Ohio, have non-discrimination provisions to protect Service members. If the Proposed Rule is adopted, then every creditor that makes a type of loan subject to the provisions in the Proposed Rule would have to offer that loan to Service members and their families in California.

The creditor would not be able to make loans to non-covered borrowers, but refuse to make the same type of loan to Service members or their dependents. Of course, the loans to covered borrowers would be subject to the 36% MAPR limit. The creditor could not say that a particular type of loan is not sustainable to offer to Service members and their families at this low rate. If the loans are offered to others in California and Ohio, the loans would also have to be offered to Service members and their dependents. As a result, creditors may choose not to operate in California or Ohio.

[25] Durkin, *et al.*

QUESTION 4: If the Department continues to pursue an approach that defines "consumer credit" to be generally consistent with certain credit regulated under TILA, should the Department consider a limited or complete exemption for an insured depository institution or insured credit union? What legitimate basis could there be for any exemption for an insured depository institution or insured credit union from the requirements of the MLA, particularly if under this approach other financial institutions would be subject to the Department's regulation? What other protections relating to credit products already are afforded to—or could be improved for—Service members and their dependents?

Instead of an exemption for the type of institution, the Department should make an exemption for the type of loan. As explained above, we believe that Traditional Installment Loans and credit cards should not be covered by the Proposed Rule. Traditional Installment Loans are fixed rate, fully-amortized, closed-end extensions of direct consumer credit. Fully-amortized means that the Amount Financed under TILA and the Finance Charge under TILA are repaid in substantially equal multiple installments at fixed intervals to fulfill the consumer's obligation.

If any of the following is true, a transaction is not a Traditional Installment Loan: (1) the transaction has a repayment term of 181 days or fewer AND is secured by the title to the borrower's motor vehicle or automobile [commonly referred to as "title loans," "title secured loans," "title pawn" or "vehicle title loans"]; (2) the transaction requires that the amount of the credit extended together with all fees and charges for the credit be repaid in full in 91 days or fewer [commonly referred to as a "payday loan"]; (3) the transaction's scheduled repayment plan contains one or more interest-only payments and/or a balloon payment due at maturity; (4) the transaction, at origination, requires the borrower (a) to agree to a pre-authorized automatic withdrawal in the form of a bank draft, a preapproved Automated Clearing House or its equivalent; (b) to agree to an allotment or an agreement to defer presentment of one or more contemporaneously-dated or postdated checks; or (c) to repay the loan in full at the borrower's payday or other recurring deposit cycle, where the repayment is connected with a bank account [commonly referred to as a "bank payday loan"]; (5) the lender did not make a reasonable attempt under the circumstances to determine the borrower's ability to repay the loan; or (6) the transaction is a credit sale, retail installment sale, or lease, or the forbearance of debt arising from a credit sale, retail installment sale, or lease.

QUESTION 5: If the Department continues to pursue an approach that defines "consumer credit" to be generally consistent with certain credit regulated under TILA, should the Department consider including one or more exemptions for certain types of credit products, such as student loans? What legitimate basis could there be for any particular exemptions for certain credit products?

An exemption for student loans would be appropriate. Student lending is already highly regulated by the CFPB. The CFPB has direct supervisory authority over private student lenders. The CFPB also has supervisory authority over larger participants in the student loan servicing market. Including student loans in the definition of "consumer credit" could restrict the availability of student loans to Service members and their families.

QUESTION 6: Apart from the conditional exclusion proposed for a credit card account that charges bona fide fees, as discussed below, should the Department consider providing one or more exceptions from the charges that must be included in the MAPR for de minimis bona fide fees associated with an open-end credit line? If so, should that type of exception be limited to an open-end line of credit connected to a deposit account? If so, please specifically describe which fees on these accounts would be bona fide fees eligible for such an exception. What would be the appropriate cost limit of a de minimis fee? If the Department does provide for such an exception to open-end credit (other than for credit card accounts), what parameters should the Department use to limit the exception to prevent evasion of the protections under the MLA?

The Department should use its authority under the MLA to define MAPR so that it is consistent with the definition under TILA.

QUESTION 7: If the Department continues to pursue an approach that defines "consumer credit" to be generally consistent with certain credit regulated under TILA, should the Department consider including an exemption specifically for a credit card account under an open-end (not home-secured) consumer credit plan? Would the consumer protection under TILA be sufficient to be consistent with the requirements of MLA? How would an exemption for consumer credit offered through a credit card account be articulated?

As explained above, the Department should include an exemption for a credit card account under an open-end consumer credit plan. The consumer protection under TILA is sufficient to be consistent with the requirements of the MLA.

If the Department does not include an exemption for credit card accounts, the Department should at least clarify the effect of deferred interest payments plans on the MAPR calculation. Specifically, the Department should clarify that the assessment of accrued interest upon the expiration of a deferred interest payment plan should not be deemed an interest assessment in excess of the 36% MAPR cap. Rather, a credit card issuer should be permitted to factor into the MAPR calculation the fact that the interest had accrued over a number of months at a rate that was less than a 36% APR.

QUESTION 8: The Department solicits comment on potential operational issues with applying the regulation under the MLA to credit card products offered in retail sales locations, particularly at the point of sale. How should the Department address any such potential issues in a final rule that may cover some or all credit card products extended to covered borrowers?

There will be operation issues and compliance costs with providing oral disclosures. The Department should use its authority to prescribe disclosure regulations under the MLA to remove the requirement to provide oral disclosures. Or, at the very least, the Department should allow a toll-free number to be provided in all transactions, not just mail transactions, internet transactions, and transactions conducted at the point-of-sale in connection with the sale of a nonfinancial product or service. The Department should also specify that a person does not need to answer the toll-free number. A recording is sufficient.

There is a lot of training – both at first and on an on-going basis – associated with providing oral disclosures. This training is a financial burden and a burden on employees' time. We do not believe that verbally repeating disclosures that are provided in written form justifies this time or money.

QUESTION 9: Do the proposed standards appropriately describe whether a bona fide fee may be excluded from the calculation of the MAPR as "reasonable and customary?" If not, please specifically describe the language the Department should use to clarify when a bona fide fee is not required to be included in the MAPR.

The proposed standards for whether a bona fide fee may be excluded from the calculation of the MAPR as "reasonable and customary" are convoluted and difficult. We believe that the CARD Act affords sufficient protections to Service members and other borrowers.

Also, AFSA believes that if the Department can exclude bona fide fees, such as cash advance fees, balance transfer fees, and annual fees, on credit cards, the Department should be open to excluding fees on other products. If the Department exempts bona fide credit card fees, the Department can and should also use the authority granted by the MLA to prescribe regulations to exclude optional credit insurance, debt protection, and other ancillary products. Optional products that a Service member chooses to purchase are specifically exempt under Regulation Z and are not a "cost of credit."

QUESTION 10: Does the threshold of $3 billion in outstanding credit card loans on U.S. credit card accounts appropriately allow an assessment of whether a bona fide fee is "reasonable," in light of the fees charged by credit card issuers whose credit card products are typical in the marketplace? If not, what measure(s) should be used to facilitate a creditor's own assessment of its bona fide fees, for the purposes of complying with conditions proposed in § 232.4(d)(1), while also preventing other creditors who offer credit card products that carry unreasonable fees from benefitting from the safe harbor? Is a pool of 5 or more creditors reasonably large for computing an average fee for the purposes of § 232.4(d)(1)? Does a period of 3 years provide sufficient stability for measuring whether a credit card issuer meets the asset-size standard? If not, what period should be used?

As stated in the answer to Question 9, the proposed standards for whether a bona fide fee may be excluded from the calculation of the MAPR as "reasonable and customary" are convoluted and difficult. Instead of creating these burdensome calculations, the Department should exempt credit cards from the regulation.

QUESTION 11: If the Department makes appropriate adjustments to the MLA Database, should the Department modify the language of § 232.5 to clarify that a creditor may take advantage of the safe harbor by conducting a covered borrower check using a commercially provided information product whose underlying data is derived from the MLA Database? If so, please specifically describe the language the Department should use to clarify this aspect of § 232.5.

If the Department proceeds with the proposed safe harbor, the Department should clarify that a creditor may take advantage of the safe harbor by conducting a covered borrower check using a commercially provided information product whose underlying data is derived from the MLA Database.

As stated above, the MLA Database in its present form is inadequate to serve the needs of the U.S. credit industry. As designed, the MLA Database does not support scripted queries and instead requires manual entries from a website. Further, creditors are limited to 1000 queries per hour, an absurdly low number. If the U.S. credit industry were obligated to operate under these conditions, the MLA Database would become the pinhole that completely clogs the flow of credit in the U.S. The proposed regulations cannot be implemented unless and until a commercial solution is in place that permits automated queries of the MLA Database.

The Department will need to resolve another deficiency in the MLA database as well. The MLA protects covered borrowers as defined by 10 U.S.C. § 987, which includes: (1) a regular or reserve member of the armed forces serving on active duty; (2) the member's spouse; (3) the member's child; and (4) an individual for whom the member provided more than one-half of the individual's support for 180 days immediately preceding an extension of consumer credit covered by 32 C.F.R. Part 232. According to DMDC, the MLA Database may not accurately include members included in the fourth definition above (receiving more than half of the member's support for 180 days prior to the loan), rendering information obtained from the MLA Database suspect and the safe harbor provision potentially illusory.

QUESTION 12: If the Department were to adopt a framework for a creditor to conduct a covered-borrower check as proposed in § 232.5, should the Department also adopt an exception from the safe harbor that addresses the situation when the creditor has actual knowledge that a consumer is a covered borrower? What are the likely costs associated with conducting covered borrower checks as proposed in § 232.5? What alternatives should the Department consider for creditors to conduct covered-borrower checks? Should the Department consider alternative safe harbor provisions for certain types of creditors or certain types of consumer credit, such as credit extended at retail sales locations? Please provide specific language for provisions that would implement these alternatives.

The Department should not adopt a framework for a creditor to conduct a covered-borrower check as proposed. However, if the Department does so, creditors should be permitted to rely on the MLA Database to attain protections from the safe harbor. The proposed "actual knowledge" carve-out to safe harbor is not workable.

As proposed, § 232.5(c)(2) would state that "actual knowledge" of the status of a consumer as a covered borrower may be established "only on the basis of a record (including any electronic record) collected by the creditor prior to entering into a transaction or establishing an account for consumer credit and maintained in any system used by the creditor that relates to the consumer credit involving that consumer." As a practical matter, this provision places the creditor in the unworkable position of trying to determine which information is correct: its own records, or the information in the MLA Database. In most every case, the records collected by the creditor will be older, dated information and prove only that the applicant was a "covered borrower" at some prior point in time. Presumably, the MLA Database will provide a more current, more accurate snapshot of the applicant's actual status. Accordingly, a creditor should be provided the protections of safe harbor so long as it performs a check of the MLA Database, and the proposed "actual knowledge" carve-out to safe harbor should not be adopted.

QUESTION 13: Should the Department retain a safe harbor for use of the covered borrower identification statement? The Department solicits comment on whether the use of the statement would be unduly cumbersome if the Department expands coverage of the regulation to additional types of credit products?

The Department should retain a safe harbor for use of the covered borrower identification statement. However, if the Department decides to use the safe harbor in the Proposed Rule, the Department should retain a safe harbor for use of the covered borrower identification statement when the MLA Database is not operational.

QUESTION 14: Should the Department provide a fallback provision to protect a creditor from liability in the case that the creditor is temporarily or permanently unable to access the internet at the time of conducting a transaction or establishing an account for consumer credit? Should the Department provide protection from liability from the MLA in the case that a creditor can demonstrate that the MLA Database was not operational at the time the creditor attempted to search the database? If so, should the Department address how the creditor may establish that the MLA Database was not operational at the time the creditor attempted the search?

The Department should provide a fallback provision to protect a creditor for liability in the case that the creditor is temporarily or permanently unable to access the internet or if the MLA Database was not operational. The fallback provision should protect the creditor not only if the MLA Database is not operational, but also if the service provided by a commercial carrier is disrupted.

QUESTION 15: Does the revised definition of covered borrower appropriately cover active duty Service members and their dependents?

AFSA does not have a comment on the revised definition of covered borrower.

QUESTION 16: Should the Department consider eliminating the timing condition of § 232.4(c)(1)(ii) to require the inclusion in the MAPR of any fees for credit-related ancillary products sold either upon account opening or at any time during the existence of an account for open-end consumer credit? If so, please specifically describe the scope of an amended § 232.4(c)(1)(ii). For example, how should the Department define a "credit-related ancillary product?" How should the Department define the seller whose charge for a credit-related ancillary product would be subject to inclusion in the MAPR (i.e., "sold by the creditor" or "sold by the creditor or any affiliate of the creditor")?

The Department should use the authority granted by the MLA to prescribe regulations to eliminate not only the inclusion in the MAPR of fees for credit-related ancillary products, but also any application fee or participation fee.

Including all third-party fees in the MAPR would have a detrimental impact on Service members and their families in that it would greatly reduce the ability of the consumer to compare interest rates and fees while shopping for credit. This would defeat one of the primary purposes of TILA – to allow consumers to do an "apples-to-apples" comparison of rates and fees related to credit among various creditors. The APR could be identical in two credit products, but the third-party services and products could be quite different. Because different creditors offer different voluntary or optional products in connection with their loans, the proposed MAPR definition will result in potentially misleading comparisons of products. It is important that Service members and their families understand what costs the creditor is imposing in connection with the loan. If third-party costs are included, it would cloud Service members and their families' ability to understand what the creditor is charging and therefore would make it difficult to compare one creditor's costs with another.

Thomas A. Durkin, a former senior economist at the Federal Reserve, wrote:

> "First, if ancillary products are not required as part of the credit, then the fees for them are not payment for the credit granted and the fees economically are not finance charges. … Second, in 1968, Congress understood that debt protection that is not required is economically not part of the underlying credit and the fee for debt protection is not part of the finance charge. … Third, since debt protection fees are not finance charges economically, arbitrarily declaring them to be finance charges confounds the ability of consumers to shop effectively for credit costs, frustrating the basic purpose and intent of TILA in the first place. This is bad public policy."[26]

QUESTION 17: Would this approach to include any application fee or participation fee in the calculation of the MAPR be reasonable to implement the statutory provision of "interest," which covers "any other charge or premium with respect to the extension of consumer credit?"

As explained above, including any application fee or participation fee in the calculation of the MAPR is not reasonable to implement the statutory provision of "interest." The Department should use the definitions in TILA and its implementing regulation, Regulation Z. There is no reason why this definition should be different for Service members and their families. It is not a military issue and should be the same for everyone.

QUESTION 18: Are there operational issues with the use of the effective APR methodology for open-end credit products that the Department should consider? If so, are there alternative methods for calculating the MAPR for these products that would be consistent with 10 U.S.C. 987 and that would address the operational issues?

Credit card issuers are not generally using the "effective APR" methodology.

[26] Durkin, Thomas A., "Conceptual Difficulties with the 'All In' Finance Charge and APR Proposal from the Consumer Financial Protection Bureau." Consumer Finance Law Quarterly Report. Vol. 67, Nos. 1-2. p. 53

QUESTION 19: What alternatives should the Department consider for the evidentiary standard articulated in proposed § 232.5 (c)(2)? Please provide specific language for provisions that would implement these alternatives.

As stated in the answer to Question 12, the Department should not adopt a framework for a creditor to conduct a covered-borrower check as proposed. However, if the Department does so, creditors should be permitted to rely on the MLA Database to attain protections from the safe harbor. The proposed "actual knowledge" carve-out to safe harbor is not workable.

As proposed, § 232.5(c)(2) would state that "actual knowledge" of the status of a consumer as a covered borrower may be established "only on the basis of a record (including any electronic record) collected by the creditor prior to entering into a transaction or establishing an account for consumer credit and maintained in any system used by the creditor that relates to the consumer credit involving that consumer." As a practical matter, this provision places the creditor in the unworkable position of trying to determine which information is correct: its own records, or the information in the MLA Database. In most every case, the records collected by the creditor will be older, dated information and prove only that the applicant was a "covered borrower" at some prior point in time. Presumably, the MLA Database will provide a more current, more accurate snapshot of the applicant's actual status. Accordingly, a creditor should be provided the protections of safe harbor so long as it performs a check of the MLA Database, and the proposed "actual knowledge" carve-out to safe harbor should not be adopted.

QUESTION 20: If the Department were to adopt a regulation as proposed, to what extent, and in what manner, would the elimination of the clear-and-conspicuous requirement affect the presentation of the categories of information required under 10 U .S.C. 987(c)(1)(A) and 987(c)(1)(C)?

AFSA does not have a comment on the clear-and-conspicuous requirement.

QUESTION 21: If the Department were to adopt a regulation as proposed, to what extent, and in what manner, would the requirement to provide a description of "the charges the creditor may impose, in accordance with this part and subject to the terms and conditions of the agreement relating to the consumer credit to calculate the MAPR," instead of a definitive figure for the "annual percentage rate" of interest applicable to the consumer credit, affect the offering or provision of that credit to a covered borrower?

AFSA members believe a description of charges would be more informative for Service members and their families than a definitive figure for the MAPR, especially if the MAPR is convoluted by the inclusion of other charges such as an application fee. Also, since the MAPR may include products purchased after origination, it would be impossible to give an accurate MAPR at application.

QUESTION 22: Please specifically describe the benefits currently provided to a covered borrower by requiring a creditor to provide a specific statement describing the protections afforded to Service members and their dependents under the MLA, as set forth in § 232.6(a)(4).

What would be the likely costs or benefits of eliminating the requirement in § 232.6 (a)(4) to provide this specific statement?

There would be a significant cost savings to eliminating the requirement in § 232.6(a)(4). Because the statement required in § 232.6(a)(4) must be delivered in written form and orally, there is a significant cost to delivering the statement. As discussed above, the cost to train employees to deliver oral disclosures is substantial. And of course, there are the printing costs for written disclosures.

Because the Department does an excellent job of informing Service members and their families of their benefits, we do not believe that Service members and their families will benefit in any real way by receiving the statement when they apply for a loan. The cost of providing the statement does not outweigh the small benefit that Service members might receive.

However, if the Department does believe that it would be beneficial for Service members and their families to receive additional notification of benefits, we suggest that the Department could allow the statement to be posted in branch offices.

QUESTION 23: The Department solicits comment on whether the proposal adequately addresses compliance challenges involving the provision of oral disclosures required by the MLA. The Department invites comment on al ternatives that would balance the informational needs of covered borrowers with the compliance burden of creditors.

The Proposed Rule does not adequately address compliance challenges involving the provision of oral disclosures required by the MLA. As stated in the answer to Question 8, t here are significant cost and compliance issues with providing disclosures orally. We strongly believe that written disclosures are sufficient.

QUESTION 24: What would be the likely costs or benefits of revising the refinancing prohibition in 10 U .S.C. 987(e)(1) to apply only to a s pecific type of creditor who is "engaged in the business of extending consumer credit subject to applicable law to engage in deferred presentment transactions or similar payday loan transactions (as described in the relevant law)," and to not include a creditor that is "chartered or licensed under Federal or State law as a bank, savings association, or credit union?"

The Department should regulate financial products or services, not which institutions offer the products. The Proposed Rules should apply universally because the liability structure of the creditor is not relevant to the safety of the product itself. If a financial product or service is deemed "safe" it does not matter who offers the product or service. Thus, instead of excluding institutions, the final rule should exclude products, including Traditional Installment Loans and credit cards.

It is unclear from the Proposed Rule what the "relevant law" is. We agree that that limitation should only apply to payday loan transactions, but in order to do so, either "payday loan" needs to be more fully described or the exemption needs to be re-written to exclude Traditional Installment Loans and credit cards.

QUESTION 25: What would be the likely costs or benefits of amending the prohibition in 10 U.S.C. 987(e)(5) to apply to creditors other than a creditor who is "chartered or licensed under Federal or State law as a bank, savings association, or credit union?"

Again, instead of excluding institutions, any exemption should be applied uniformly by product. Traditional Installment Loans and credit cards should be included in any exemption.

QUESTION 26: Should the Department consider a broader exemption from the term "creditor for the military welfare societies and the service Relief Societies specified in 10 U.S.C. 1033(b)(2) and 37 U.S.C. 1007(h)(4)?

The Department should not consider a broader exemption for military welfare societies and the service relief societies. If they are excluded, then it will not be possible for Service members and their families to compare the cost of credit.

<u>The following requests for comment were included in the Regulatory Analyses section of the Proposed Rule.</u>

In this regard, the Department has considered whether to retain a safe harbor for a creditor's use of the covered borrower identification statement, and explicitly seeks comment on that alternative. Likewise, the Department has considered alternative provisions relating to a creditor's use of the MLA Database via commercial information-services providers, such as consumer reporting agencies, and seeks comment on that approach. In light of the data and other information available to the Department at this time, the Department has considered alternative approaches to the provisions of the proposal and, as appropriate, explicitly solicits comments on the alternatives the Department should consider.

See discussion on the MLA database in section II above.

As the Department assesses whether to amend its regulation, as proposed, the Department will further consider the potential benefits and costs of extending the protections of the MLA to a broader range of closed-end and open-end credit products. There are several areas where additional information could assist the Department in better estimating the potential benefits, costs, and effects of amending its regulation. The Department requests interested parties to provide specific data relating to the benefits and costs of amending the regulation, as proposed, including costs to implement measures to adjust computer systems and to train personnel. The Department seeks comments on whether all anticipated costs have been adequately captured in the analysis. Please provide information on the type of costs and the magnitude of costs by providing relevant data and studies.

The Department estimates that its Proposed Rule would impose costs of approximately $96 million during the first year and $20 million on an on-going basis.[27] The Department provides no documentation for how it estimated this number, which we believe to be low.

[27] 79 Federal Register 58624.

Even if the Department's estimation of the cost of the Proposed Rule were correct, the analysis is still flawed. There is no discussion in the Regulatory Analyses about how whether the expected cost is justified by the benefit. All creditors, except those that meet the exceptions in § 232.3(2) will have to change their systems and processes to check the MLA Database for every application. There is no justification in the Proposed Rule for why such a massive change is necessary. One AFSA member estimated that the Proposed Rule would only affect 0.3% of that member's borrowers, but the member still expects substantial costs to meet the safe harbor.

The substantial cost to comply with the Proposed Rule is even more ridiculous since base commanders have said that the problems they had seen have been solved by the current regulation.

The Department seeks comments on whether the estimate of 40,000 creditors is reasonable. Please provide data and studies that support the comment.

Yes, we believe that the estimate of 40,000 creditors is reasonable.

Additionally, creditors may experience some increase in call volume and costs associated with providing oral disclosures if borrowers engage in consumer credit transactions by mail, internet, or at the point of sale in association with the sale of a nonfinancial product or service. The Department seeks comment, as well as data (as may be appropriate), on its supposition regarding the costs associated with these sales channels.

The cost to train employees to provide oral disclosures would be substantial.

Proposed § 232.6(d)(2) reflects the Department's effort to minimize the burden on creditors while retaining the structure and intent of the current regulation. The Department seeks comment on the assumptions invoked in this section. Please provide comment on the reasonableness of the assumptions and likelihood of the associated costs. Please provide data and studies that support the comment.

As discussed above, the cost estimates that the Department provides are too low.

The Department seeks comment on the potential costs to creditors, across a variety of contracts implicated by the prohibition in proposed § 232.8(c), who offer forms of consumer credit that could be affected by the prohibition against requiring arbitration.

We ask that the Department clarify whether the Proposed Rule prohibits a creditor from having a covered borrower enter into an arbitration agreement or whether it only prohibits a creditor from requiring a borrower to submit to arbitration. If the former, there will be significant operational and systemic costs involved in removing arbitration language from contracts. We suggest that it would be more cost-effective for the creditor, and offer the covered borrower the same protections, if creditors could be permitted to add a line to the arbitration provision in a contract stating, "This provision does not apply if you are a Service member or dependent."

The Department estimates that the proposal, if adopted, would reduce the separations associated with financial distress. To assess the anticipated savings reasonably attributable to a reduction in involuntary separations, the Department has used three estimates of the possible reduction in involuntary separations: 5 percent, 17.5 percent, and 30 percent. The Department believes that estimating between 5 percent and 30 percent reduction in the total number of these separations is reasonable in light of the conservative assumptions relating to the separations due to financial distress. The Department seeks comment on the reasonableness of these estimates. Please provide data and studies that support the comment.

AFSA does not believe that Traditional Installment Loans are causing financial distress that leads to involuntary separations. We ask that the Department thoroughly analyze what causes the financial distress that leads to involuntary separation.

Department seeks comment, particularly from potentially affected small businesses themselves, on the possible impact of the proposed rule on small businesses. Please provide data and studies that support the comment.

The collection of data from the MLA Database would be a substantial cost burden on small businesses.

VII. Conclusion

We strongly oppose the Proposed Rule. There is no evidence that Traditional Installment Loans or credit cards are providing a problem for Service members or their families. In fact, the reverse is true, loans from AFSA members benefit Service members and their families. A sergeant stationed in North Carolina said, "When we had nowhere else to turn, [AFSA Member Company] stood by our side and we are very thankful that [AFSA Member Company] helped us in our time of need." If there is a problem with some creditors trying to evade the previous regulations, those problems should be addressed directly. The Proposed Rule is basically cutting off a leg in order to remove a splinter in the knee. The Proposed Rule will cut off access to fair and affordable credit to Service Members and their families. The safe harbor in the Proposed Rule has the potential to seriously disrupt consumer credit in the county. The Department should ensure that access to safe and responsible credit is maintained and not swept away by grouping it with less-desirable loans.

We look forward to working with the Department on this Proposed Rule. Please contact me by phone, 202-466-8616, or e-mail, bhimpler@afsamail.org, with any questions.

Sincerely,

Bill Himpler
Executive Vice President
American Financial Services Association

APPENDIX I

NHCSL RESOLUTIONS 2013

2

SENATOR LETICIA VAN DE PUTTE (TX) LAW & CRIMINAL JUSTICE TASK

PROMOTING SAFE AND AFFORDABLE LENDING PRACTICES

WHEREAS, the National Hispanic Caucus of State Legislators (NHCSL) has always been committed to financial empowerment through improved access to capital as marketplace that offers safe and affordable lending products and services;

WHEREAS, in 1998, the United Nations defined poverty as the lack of access to certain essential goods and services, including access to credit;

WHEREAS, the need for small-dollar credit exists in every community throughout the country;

WHEREAS, not all loan types are equally safe and affordable, and the structure of certain loans significantly increases the likelihood of borrowers falling into a cycle of d
WHEREAS, responsibly structured credit is essential to support a household's ability to save, build a sound credit history, and facilitate crucial investments that can foundation for other wealth-building activities;
WHEREAS, the key structural qualities of loans that are safe and affordable are that the lender makes a good faith efforts to assess the borrower's ability to repay the that the loan is repayable in substantially equal installments of principal and interest, with no balloon payments;

WHEREAS, it is the intention of this body to ensure access to loans that are low cost rather than low rate, since consumers buy goods with dollars and cents and not wit percentage rates;

WHEREAS, government subsidized loans do not exist in meaningful numbers and whenever they do exist, their availability is only temporary, and so loan products available at commercially sustainable rates;

WHEREAS, it is important that safe and affordable small-dollar loans be made from offices located within communities and licensed and audited by state authorities from predatory lenders and lending practices.

THEREFORE BE IT RESOLVED, that the National Hispanic Caucus of State Legislators (NHCSL) supports the development of lending products that encourage res underwriting, and attempts to assess a borrower's stability, ability, and willingness to repay the loan;

BE IT FURTHER RESOLVED, that NHCSL encourages policymakers to take the following into account:
That lenders should support and observe all applicable state laws regarding collection practices and that they should make good faith attempts with borrowers to delinquent account;
That any loan should be structured in such a way as to minimize the danger of that a borrower might fall into the cycle of debt;
That lenders take care to explain to borrowers, the terms of a possible loan transaction in as clear and transparent a manner as possible;
That lenders should be a vital part of the communities in which they operate and actively participate in community activities and charitable endeavors;
That lenders should support and participate in financial literacy programs by contributing financially to organizations that offer these services to borrowers; and
That lenders, non-profit organizations, and government entities should work together to improve financial literacy;

BE IT FURTHER RESOLVED, that the NHCSL supports efforts to protect consumers who need short-term loans; and

BE IT FINALLY RESOLVED, that a copy of this resolution be transmitted to the President of the United States, Vice President of the United States, members of the Unit House of Representatives and the United States Senate, and other federal and state government officials as appropriate.

THIS RESOLUTION WAS ADOPTED ON JULY 13, 2013, AT THE NHCSL EXECUTIVE COMMITTEE MEETING HELD IN MASHANTUCKET, CONNECTICUT AND RATI NOVEMBER 16, 2013 AT THE NHCSL ANNUAL MEETING HELD IN ORLANDO, FLORIDA.
SPONSORED BY: Senator Leticia Van De Putte (TX)
CO-SPONSOR: Senator Juan Pichardo (RI)
CO-SPONSOR: Iris Y. Martinez (IL)

PROMOTING SAFE AND AFFORDABLE LENDING PRACTICES

WHEREAS, the National Black Caucus of State Legislators (NBCSL) has always been committed to financial empowerment through improved access to capital as well as a marketplace that offers safe and affordable lending products and services;

WHEREAS, in 1998, the United Nations defined poverty as the lack of access to certain essential goods and services, including access to credit;

WHEREAS, the need for small-dollar credit exists in every community throughout the country;

WHEREAS, not all loan types are equally safe and affordable, and the structure of certain loans significantly increases the likelihood of borrowers falling into a cycle of debt;

WHEREAS, responsibly structured credit is essential to support a household's ability to save, build a sound credit history, and facilitate crucial investments that can provide a foundation for other wealth-building activities;

WHEREAS, the key structural qualities of loans that are safe and affordable are that the lender makes a good faith efforts to assess the borrower's ability to repay the loan and that the loan is repayable in substantially equal installments of principal and interest, with no balloon payments;

WHEREAS, it is the intention of this body to ensure access to loans that are low cost rather than low rate, since consumers buy goods with dollars and cents and not with annual percentage rates;

WHEREAS, government subsidized loans do not exist in meaningful numbers, and whenever they do exist, their availability is only temporary, and so loan products must be available at commercially sustainable rates;

WHEREAS, it is important that safe and affordable small-dollar loans be made from offices located within communities and licensed and audited by state authorities to protect from predatory lenders and lending practices.

THEREFORE BE IT RESOLVED, that the National Black Caucus of State Legislators (NBCSL) supports the development of lending products that encourage responsible underwriting, and attempts to assess a borrower's stability, ability, and willingness to repay the loan;

BE IT FURTHER RESOLVED, that NBCSL encourages policymakers to take the following into account:

- that lenders should examine factors like a borrower's credit bureau reports, the availability of monthly income for debt service, the length of time the consumer has been gainfully employed, and the amount of the borrowers' debt compared to assets and income as a condition for making a loan;
- that lenders should support and observe all applicable state laws regarding collection practices and that they should make good faith attempts with borrowers to remedy a delinquent account;
- that any loan should be structured in such a way as to minimize the danger of that a borrower might fall into the cycle of debt;
- that lenders take care to explain to borrowers, the terms of a possible loan transaction in as clear and transparent a manner as possible;

- that lenders should be a vital part of the communities in which they operate and actively participate in community activities and charitable endeavors;
- that lenders should support and participate in financial literacy programs by contributing financially to organizations that offer these services to borrowers; and
- that lenders, non-profit organizations, and government entities should work together to improve financial literacy;

BE IT FURTHER RESOLVED, that the NBCSL supports efforts to protect consumers who need short-term loans; and

BE IT FINALLY RESOLVED, that a copy of this resolution be transmitted to the President of the United States, Vice President of the United States, members of the United States House of Representatives and the United States Senate, and other federal and state government officials as appropriate.

SPONSOR: Representative Larry Miller (TN)
Committee of Jurisdiction: Business, Financial Services, and Insurance Policy Committee
Certified by Committee Chair: Senator Catherine Pugh (MD)
Ratified in Plenary Session: Ratification Date is December 7, 2012
Ratification is certified by: Representative Barbara W. Ballard (KS), President

APPENDIX II

Rate Ceilings and the Distribution of Small Dollar Installment Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders

Thomas A. Durkin
Federal Reserve Board (Retired)

Gregory Elliehausen
Federal Reserve Board

Min Hwang
George Washington University

December 2, 2014

December 2, 2014

Rate Ceilings and the Distribution of Small Dollar Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders

Thomas A. Durkin, Gregory Elliehausen, and Min Hwang[1]

Summary

1. Government ceilings on interest rates extend to the farthest reaches of recorded history.

2. In contemporary US, most controversial are current ceilings on smaller loan sizes in some states where advocate individuals and groups would like to see ceiling rates much lower.

3. As long as four decades ago a federal study commission showed that production and risk costs of making small installment loans *compared to the amount of the loan* meant that lending rates would need to be higher on these loans than on other consumer credit before legal lenders would be interested in lending. The commission showed statistically what the Russell Sage Foundation had argued beginning almost a century ago, leading to development of the Uniform Small Loan Law in 1916.

4. Findings from the American Financial Services Association survey of installment lenders are consistent with hypotheses developed many years ago from the economic theory of credit rationing. These hypotheses suggest that users of small dollar amounts of installment credit from secondary credit sources are "rationed" borrowers in an economic sense, those borrowers unable to obtain as much credit as they need or want from primary lenders at low rates. Specific findings include:

   - Most loans (more than 85 percent) clearly are subprime on the basis of credit scores. (Table 1)
   - These installment loans are both small and short term. Almost 80 percent of the loans are made for $2000 or less and almost 85 percent for two years or less. (Table 2) These are precisely the loans the federal study commission determined would require high rates.
   - High APRs are due to both small size and high risk. (Table 1 and Table 3)
   - Loans are made with low payments to satisfy both demand among rationed borrowers for small payments and supply by lenders who also are interested in easy repayment. More than 40 percent of the loans have payments of $100 or less monthly and almost 80 percent $150 or less. (Table 4)

[1] Respectively, Federal Reserve Board (Retired), Federal Reserve Board, and George Washington University. The views expressed here are of the authors and do not represent those of the Federal Reserve Board or its staff. The authors thank the American Financial Services Association (AFSA) for making the data available for analysis. The views expressed here also do not reflect those of AFSA. Any errors are the responsibility of the authors.

5. Survey results demonstrate clear evidence of lending risk. Delinquency among loans made is correlated with:

    - Loan size (inversely, Table 6).
    - Credit Score (inversely, Table 7).
    - APR (directly, Table 8).

6. Loans vary substantially by state, due to regulatory differences that limit the locations acceptable to lenders.

    - Frequency of lending varies sharply among states. States with low rate ceilings have few loans (Table 9).
    - There are loans made to residents of low rate Arkansas, but almost all of them (99 percent) are to residents of counties that border other states, especially Oklahoma, Missouri, Louisiana, and Texas. This suggests the loans actually are made elsewhere.
    - Similarly, evidence suggests that many small loans made to residents of border counties in North Carolina actually originate in South Carolina (Table 10).
    - Compared to loans to Texas residents, loans to residents of low-rate Pennsylvania:

        - Are much less common.
        - Are considerably larger. (In Pennsylvania. fewer than 1 percent of loans are made in size under $1000 compared to almost 70 percent in Texas, Table 11.)
        - Have considerably lower APRs. (In Pennsylvania, more than 99 percent of loans carry APR 19 to 36; in Texas 92 percent carry APR 49 to 99, Table 12.)
        - Have larger payment amounts due to larger sizes. (In Pennsylvania about 55 percent of loans have payment amount greater than $150, compared to about 21 percent in Texas, Table 13.)
        - Have about the same borrower credit scores, for loans where scores are recorded (Table 14). Larger loans at the same score suggest many Pennsylvania borrowers are borrowing more than they need or want in order to obtain loans at all.
        - Are more expensive in total finance charges. This can happen when the rate ceiling in Pennsylvania prevents borrowers from obtaining Texas-type small loans there and they must borrow more than they need and for an extended period (Table 15).

    - Low rate ceiling on small loans in California together with no rate ceiling on loans larger than $2500 means that these lenders make few small loans but many loans larger than $2500.

Introduction

Interest rate ceilings on loans of money or goods are possibly the oldest continuously running controversy. Found in recorded history as early as the ancient Babylonian Code of Hammurabi (c. 1770 BC), imposed rate ceilings probably extend even farther back into unrecorded tribal antiquity. Historical evidence shows that through much of history ceilings have been evaded or ignored, which suggests, at a minimum, that ceilings have been continuously controversial and not popular with large segments of the population (for extended historical discussion, see Homer and Sylla 1996 and Gelpi and Julien-Labruyere 2000, included in the references at the end of this paper).

Today in the twenty-first century United States, a good deal of the modern argument over interest rate ceilings concerns a variety of consumer lending products and processes sometimes collectively referred to as "small dollar" loans. High interest rates on smaller loans have attracted the attention of various individuals and organizations who would like to see these rates much lower. Much of the discussion has centered on single-payment so called "payday loans" found in many states and which exhibit very high Annual Percentage Rates (APRs), but sometimes other kinds of loans like small dollar installment loans become lumped into such discussions. These small dollar installment loans are authorized by state small loan laws, which require lenders to obtain licenses and regulate interest rates and other credit terms. Typically APRs on these small dollar installment loans are much lower than on payday loans though higher than on some other familiar kinds of consumer credit. Heretofore, it seems that relatively little is recently known about this other small dollar form of consumer lending, despite discussions that sometimes lump such lending with payday lending. The purpose of this paper is to provide background, some discussion of relevant economic theory, and a look at some newly available statistical information on small dollar installment lending, especially on the influence of rate ceilings on the size distribution of small loans in the market.

Background

At the outset, it seems worthwhile to review the reasons why small loans exhibit high interest rates in the first place. This phenomenon arises from the economic fact of "production cost economies of size." In other words, lending costs rise as loans become larger (because of the need for more careful screening, the need to take and record more payments over time, etc.), *but well less than proportionately*, due to production cost economies of size. A multi-million dollar loan to a top-rated international corporation may cost more to investigate, book, and collect than a small loan to a risky consumer, *but not per loan dollar*.

As a result, the loan charge to cover production costs is going to have to be higher per loan dollar for small loans than for large loans. For small loans, the dollar production cost of the loan looms large not in total but rather relative to the dollars of the loan. Much of the production cost arises from the necessity of maintaining lending locations entailing rent charges, employing personnel who must be paid salaries, acquiring office supplies and equipment with prices and amortizations. There also is the cost of the lending capital itself and the cost of risk, which can also be substantial relative to loan amount for small loans. Almost by definition, a borrower in need of a small loan is going to be a risky borrower.[2]

To cover the average cost of extending a small size loan, a lender will need to charge a number of dollars for the loan that is large *relative to the amount of the loan*, even though the dollar amount of the cost is not in itself very large. Despite the loan size, the lender still needs enough revenue to justify obtaining and maintaining the lending location, hiring and paying the personnel, acquiring the supplies and equipment, raising the capital, and allocating the risk cost. Translating these necessities for small loans into an Annual Percentage Rate as required by Truth in Lending makes the disclosed rate very high, even though the dollars involved are much less startling. This anomaly occurs simply because the production cost looms large relative to the loan dollars involved and the short term of the loan on which the lending cost must be recovered.

The relationship of production cost to loan amount and term to maturity on small loans is hardly a new issue. It is worth recalling that the National Commission on Consumer Finance (NCCF) extensively discussed the matter in its *Report* to the Congress in late 1972. The NCCF was a federal study commission established by Title IV of the federal Consumer Credit Protection Act of 1968, the same law that established Truth in Lending as Title I. Section 404 states: "The Commission shall study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit transactions generally. The Commission in its report and recommendations to the Congress, shall include treatment of "… [t]he adequacy of existing arrangements to provide consumer credit at reasonable rates...." The Commission consisted of three members of the Senate, three members of the House of Representatives, and three public members appointed by the President. The Commission had a staff of economists and lawyers and retained the services of a number of outside economists and lawyers as consultants. In addition to its extensive *Report*, the Commission also issued six volumes of supporting technical studies.

In Chapter 7 of its *Report*, the Commission explored relationships among lending production costs, rate ceilings, and credit availability for consumer finance companies making small installment loans. As part of its investigations, the Commission undertook extensive data gathering and empirical work. To study costs of consumer finance companies, the Commission reanalyzed data from a major study of costs at consumer finance companies by Paul F. Smith (1967). The Commission also obtained cost data from AFSA and engaged the late Professor George J. Benston of the University of Rochester, the leading expert in the country at the time on the use of statistical cost studies of production processes of financial institutions (see Benston 1975 and Benston 1977). While the Commission undertook its work many years ago, the underlying principles have not changed and the Commission's work remains illustrative. The process of originating, servicing, and collecting loans is labor intensive. Activities such as

[2] The credit card industry has spent huge sums of money to automate the lending process for small amounts of credit and reduce overall lending costs, but this impersonal kind of lending is not available to all consumers, especially the riskiest ones. Evidence from the Federal Reserve's most recent Survey of Consumer Finances in 2010 shows that only 68 percent of families (economic units) have credit cards. And, riskier borrowers who have credit cards may also quickly reach their smaller credit limits but occasionally still need additional credit to meet some emergency or for some other need or desire. The basic theory of why credit-constrained consumers can obtain more credit only at higher rates is in Juster and Shay (1964), especially Appendix I, discussed here later. See also, Durkin, Elliehausen, Staten, and Zywicki (2014), Chapters 3 and 5.

discussing loan options, taking applications, assessing ability to pay, processing payments, and collecting delinquent accounts all involve substantial labor costs.[3] Salaries and benefits of employees likely have not decreased as a share of operating costs, even with information systems and office automation, because the more sophisticated nature of the technologies employees now use for evaluating and managing risk and today's more stringent regulatory obligations require better educated and trained employees.[4] They also spend more time on regulatory compliance, which is costly. As a first look at small loan lending more recently, it is useful to examine the Commission's findings.

One of the Commission's important findings based upon its cost studies was that the annual percentage rates would have to be quite high, approaching triple digits at the smaller loan sizes, due to the necessity of covering production and risk costs with only small amounts of loan dollars. Examining Smith's (1967) data, the Commission estimated a $370 fixed cost per loan (2013 dollars) plus a variable cost of 11 percent of the loan amount for a one-year loan (the average loan term). This cost estimate enabled the Commission to calculate break-even APRs for different loan sizes. Figure 1 shows the calculated inverse relationship between break-even APR and loan amount:

- A $739 loan has a break-even APR of 91.36 percent.
- A $1000 loan has a break-even APR of 77.86 percent. $1000 is the largest allowed payday loan in some states.[5]
- A $2100 loan has a 42 percent break-even APR. Reformers in the early twentieth century recommended a 42 percent rate ceiling for small loans (Robinson and Nugent 1935).
- A $2600 loan has a 36 percent break-even APR. In recent years, a 36 percent APR has sometimes been sometimes mentioned as a desirable maximum APR for small loans.[6]

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[3] In a recent conference presentation, Phillips (2013) discussed costs at a large small-loan company. He noted that while credit bureau scores are important, an employee's judgmental analysis is a critical input in underwriting low credit score applications. Employees must assess the applicant's ability to pay and determine a set of loan terms (loan amount and monthly payment) that an applicant can easily afford to repay. He noted further that the collections process was especially labor intensive. Despite efforts to make monthly payments easily affordable, a significant share of borrowers makes late payments. Employees spend considerable time attempting to contact delinquent borrowers, making arrangements for payment, and resolving problems. Phillips also provided break-even APRs for different loan sizes based on the company's costs. His data showed an inverse relationship between APR and loan size, and the levels of APR at each loan size were broadly consistent with the NCCF estimates. Available at http://www.philadelphiafed.org/consumer-credit-and-payments/payment-cards-enter/events/conferences/2013/small-dollar-credit/papers/Phillips.pdf

[4] For discussion, see Durkin et al. (2014), pp. 85-8.

[5] The typical payday loan ($300 to $400) is much smaller than $1000 (Elliehausen 2009).

[6] See, for example, the discussion of the FDIC's Small-Dollar Loan Pilot Program in Miller et al. (2010). The paper concluded "… given the small size [of the loans] …, the interest and fees generated were not always sufficient to achieve robust short-term profitability (p. 32)." The maximum loan size for the program was $2,500. The maximum loan size was increased from $1000 after the first year to enhance profitability: "Data collection was expanded to … [$1,001-$2,500] after the first year of the pilot, when some bankers relayed … the importance of these loans to their business plans. In particular, they indicated that some of their customers could qualify for larger loans and that these loans cost the same to originate and service as … [smaller loans], but resulted in higher revenues" (p. 30).

- And a $7550 loan has a break-even APR of 19.21 percent. $7750 is about the median of credit card balances financed, as reported in the 2010 Survey of Consumer Finances (Bricker et al. 2012).

The Commission also estimated costs for a 15 percent variable cost markup, which it suggested would "… allow for enlargement of the market through a higher degree of risk acceptance" (National Commission on Consumer Finance 1972, p. 144). The 15 percent markup produced a similar inverse relationship between loan amount and the break-even APR. The Commission's conclusion was that the Annual Percentage Rate on $739 (2013 dollars) loans for one year would have to exceed 94 percent before lenders would be willing to make such loans at the risk level the Commission suggested was necessary to expand the market. Further, rates would have to exceed 36 percent for any loan size less than $2300 (see discussion and table in National Commission on Consumer Finance 1972, p. 144).

Even then, these conclusions about necessary rates assumed that loans would be made for a one year period. The Commission specifically noted that shorter term loans would need even higher APRs because the loans would be outstanding and earning revenue even less time but the operating costs would still need to be recovered. According to the Commission, "Recognizing that loans of [typical small sizes found then], the required APR will be higher than in Exhibit 7-16 [of the Commission's *Report*] because the costs of putting the loan on the books and servicing it must be recaptured over the shorter time" (National Commission on Consumer Finance 1972, p. 145). The Commission's cost estimates also assumed monthly payments. Operating costs would be higher for loans with more frequent payments because they would require more personnel costs for servicing the more frequent payments, other things being equal.

The historical record demonstrates the seriousness of the Commission's concerns over credit availability. Well known to the Commission, beginning in 1910 the Russell Sage Foundation had undertaken a philanthropic program to fight illegal loan sharks then prevalent in many places. The program helped inform the foundation on lending costs. Through its experience the foundation concluded that the only way to attract sufficient funds to satisfy consumer demand for small loans was to allow interest rates that enable lenders to obtain a market rate of return on invested capital. The foundation proposed for passage in the various states model legislation known as the Uniform Small Loan Law and advocated its acceptance. This model act provided for exceptions to low state rate-ceiling laws to permit state-licensed lending entities to provide small dollar cash loans to consumers legally. By the 1960s, almost all states had passed a version of this law. Even so, well known inadequacies of legal rates on the smallest loan sizes had come to the National Commission's attention and were the motivating factor in its study of this area and its recommendations at the end of 1972.[7]

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[7] The Uniform Small Loan Law's early choice of 3½ percent rate per month was based on the Russell Sage Foundation's studies of cost and experience of remedial loan companies and other small loan lenders at the time (see Clark 1931, pp. 46-7, Robinson and Nugent 1935, pp. 115-7), and Carruthers, Guinnane, and Lee 2012, p. 402-3). Even then, the Foundation recognized that most lending costs are fixed, so that a 3½ percent ceiling made a $100 loan less profitable than a $300 loan, discouraging production of the smaller loans. The Foundation's position on transparency and simplicity of the transaction prevented it at first from supporting any particular remedy for this problem, however, such as allowing the lender to charge a higher percentage finance charge for smaller loans or a

Hypotheses from the Economic Theory of Credit Rationing

In their economic analysis of consumers' credit decisions, Juster and Shay (1964) explained why consumers may sometimes be willing to borrow at the relatively high rates of interest charged by the small dollar installment lenders (see also Durkin, Elliehausen, Staten, and Zywicki 2014, Chapter 3, for further discussion). To summarize, Juster and Shay argued that many products purchased using credit provide benefits over a period of time. Examples include car purchase for transportation to place of employment, acquisition of labor saving appliances, home or car repair, and emergency health care expenditures. Such benefits imply a rate of return that can be compared with the cost of acquiring the product or service, and acquisitions that produce returns greater than costs are wealth and utility increasing. Limited empirical evidence at that time suggests that the return on durable assets can be quite large for many households, especially growing households with young children (see Poapst and Waters 1964 and Dunkelberg and Stephenson 1975).

Juster and Shay's Analysis

Juster and Shay's analysis extended the economic model of the inter-temporal investment and consumption decision to situations in which a lender limits the amount of credit it is willing to extend to a borrower but a smaller amount of additional credit may be available at a higher interest rate from a different lender. These situations are common in consumer lending. Primary lenders financing the purchase of autos and other durables commonly require that borrowers provide equity and collateral. These requirements may constrain some consumers' debt-financed household investment. However, secondary lenders offer, at higher rates, additional, smaller amounts of credit, often on an unsecured basis. Historically these secondary lenders were consumer finance companies. Juster and Shay showed that credit constrained consumers might achieve greater household investment and more highly valued inter-temporal consumption using higher rate credit from secondary lenders than would be possible borrowing only from primary lenders.

Credit Constraints and High Rate Credit in the 21st Century

Consumer credit markets have changed considerably since Juster and Shay's study. Advances in information availability and in the technology to manage and analyze large amounts of information have improved lenders' ability to assess risk.[8] Lenders' requirements for borrowers' equity in the purchases have also relaxed, as terms to maturity have lengthened for

fixed fee per loan (see Carruthers, Guinnane, and Lee 2012). Either of these changes would complicate the transaction. Graduated rate ceilings, which allow higher rates on smaller loans, later became a common feature in state small loan laws.

[8] Credit reporting through automated credit reporting agencies (credit bureaus) is now close to comprehensive. Credit reports thus generally reflect a consumer's complete credit history, making information in credit reports more useful for predicting future payment performance. In addition, the development of credit bureau scores has made statistical credit evaluation available to all lenders.

most closed end installment credit, and down payment requirements have also been reduced. Furthermore, home equity lines of credit and cash out refinancing of mortgage loans have developed to allow consumers to finance acquisition of durable goods using savings from equity in their homes. Thus, today many consumers are more able to finance a greater proportion of their household investment through primary lenders at the lower rates they offer.

Nonetheless, higher rate credit products from secondary lenders have also proliferated. Unsecured credit has become more widely available through bank credit cards, and many borrowers today use bank credit cards in much the same way as Juster and Shay described borrowers using unsecured personal loans (see Bizer and DeMarzo 1992, Brito and Hartley 1995). Competition has extended availability of bank credit cards to many consumers who previously would have had difficulty qualifying for them. As a result, unsecured credit is now available to more consumers at lower cost than in the past.

Various "subprime" versions of credit cards, automobile financing, mortgage loans, and other credit exist. As this term suggests, such products are mostly used by those who exhibit greater amounts of credit risk than mainstream consumers and likely are more credit constrained at low rates. These subprime products allow consumers to finance a larger share of the value of household durable goods and services, borrow more heavily against future income, and obtain credit despite previous problems repaying debts. The financial crisis of 2008-2009 disrupted aspects of subprime credit markets, but after necessary reevaluation and restructuring, these credit sources are unlikely to go away.

There also are new short term subprime cash-lending products to go with the small loan industry that has existed for decades and pawn lenders prevalent for centuries. The payday lending industry allows consumers to obtain an advance on their next paycheck and automobile title lenders offer small loans secured by consumers' automobiles. Consumer finance companies still make small installment loans, and small installment loans are different from these other products because their multipayment nature suggests they can be better adapted to the budgets of rationed borrowers.

Characteristics of Credit Constrained Consumers

As mentioned, household investment is wealth or utility increasing when its return is greater than the cost of financing it. Some consumers can finance all of their household investment solely using funds from primary market lenders or themselves. Other consumers may still have wealth increasing investment opportunities after exhausting their ability to borrow from primary lenders and themselves. This latter group of credit constrained consumers, called rationed borrowers by Juster and Shay, might well consider secondary lenders such as consumer finance companies. The rate of return on the expenditures could be as high as the higher rate charged by secondary lenders (or even greater than the higher borrowing rate in which case the preferred amount of borrowing exceeds the secondary lenders' limit).

Based on this theory, users of high APR credit products would be expected to have characteristics of rationed borrowers. Unrationed borrowers generally would not find high APR credit products attractive.[9] Within this theoretical context, Juster and Shay identified characteristics that likely distinguish rationed and unrationed borrowers. Their distinction is useful in assessing consumers' use of high APR credit products.

Specifically, rationed borrowers are likely to be in early family life cycle stages. For them, rates of return on household investment tend to be high. They tend to have relatively low or moderate current incomes and little discretionary income, making the sacrifices in current consumption to pay for large expenses personally costly. And because of their moderate incomes and relatively young age, rationed borrowers generally would not have accumulated large amounts of liquid assets. At this stage in the life cycle, their liquid asset holdings have a high subjective yield due to precautionary savings motives.

In these cases, subjective yields on any liquid asset holdings are higher than nominal yields for many consumers because of strong precautionary motives. Many consumers use liquid assets grudgingly even when events occur that impair their earning potential or require large expenditures. Their reluctance to use liquid assets stems from a belief that the worse the current situation, the greater is the need to maintain reserves for future emergencies (Katona 1975). As a consequence, subjective yields on liquid assets are often substantially greater than nominal yields.

Unrationed borrowers, in contrast, typically are in later family life cycle stages or have relatively higher incomes or assets. Unrationed borrowers in later life cycle stages or with more income may have relatively few high return household investment opportunities. For them, high income may provide discretionary amounts that allow for relatively large expenditures without costly reductions in current consumption. Moreover, their age or income may allow them to accumulate some discretionary savings. Consequently, subjective yields on liquid assets can be substantially lower for unrationed borrowers than for rationed borrowers. Availability of low cost discretionary income and liquid assets for acquisition of durable goods and important services would make unrationed borrowers generally unwilling to pay high interest rates for additional credit.

Empirical Tests of Juster and Shay's Theory

Juster and Shay suggested several empirically testable hypotheses about rationed and unrationed borrowers' demand for credit. Looking at the hypotheses relevant for small installment lending, they predicted that:

1. unrationed borrowers' demand for credit would be more sensitive to interest rates than rationed borrowers' demand;

[9] A large, disproportionate percentage of unrationed borrowers using high APR credit products would raise a question whether the credit use is irrational, as marginal borrowing rates for unrationed borrowers are normally relatively low. But surveys of users of high rate consumer credit products have found that they are not representative of the population as a whole or even of credit users generally, but rather are more limited in their credit options. For discussion, see Durkin, Elliehausen, Staten, and Zywicki (2014), Chapter 8.

2. a simultaneous increase in the interest rate and term to maturity that reduces the amount of monthly payments would increase borrowing by rationed borrowers and decrease borrowing by unrationed borrowers;
3. and,more generally, that rationed borrowers would respond more strongly than unrationed borrowers to differences in monthly payments.

Juster and Shay tested these hypotheses in an experimental study in which a panel of consumers was asked to express preferences for different hypothetical sets of credit terms. Consumers were classified into rationed and unrationed groups based on their income and family life cycle stage, and responses were used to compute elasticities of credit demand for rationed and unrationed groups.

Evidence from the experimental data was consistent with the predictions of Juster and Shay's theoretical model. The evidence strongly supported hypotheses that unrationed borrowers' demand was more sensitive to interest rates than rationed borrowers' demand (hypothesis 1) and that a simultaneous increase in the interest rate and term to maturity that reduces the amount of monthly payments increased rationed borrowers' demand and decreased unrationed borrowers' demand (hypothesis 2). They also found that rationed borrowers responded more strongly than unrationed borrowers to changes in monthly payments (hypothesis 3).

Significantly, Juster and Shay's analysis reconciled the apparent inconsistency noted at that time between consumers' lack of sensitivity to interest rates and the predictions of neoclassical economic theory as handed down from Fisher (1907, 1930) and Seligman (1927): Rationed consumers, whose demand for debt exceeded the amount available at going interest rates and who, therefore, were not sensitive to these interest rates, likely comprised a large majority of the population at that time. Thus, aggregate data from then and earlier largely reflected the behavior of these rationed borrowers. The aggregate data obscured the behavior of the smaller group of unrationed borrowers, who were sensitive to interest rates.

The hypothesized large proportion of rationed consumers at the time also provides insight into consumers' lack of knowledge of interest rates also noted then: Rationed consumers do not need to know the interest rate to minimize credit costs. Rationed consumers find the longest available maturity and shop for the lowest monthly payment (payment size is perfectly correlated with interest rate for a given loan size and maturity). Juster and Shay found that knowledge of interest rates actually paid on recent credit transactions was concentrated mainly among the unrationed consumers, who need to know the interest rate to make rational credit decisions. Nevertheless, at that time, before Truth in Lending, many of the unrationed borrowers also underestimated or did not recall the rate paid. Later studies have shown that lack of knowledge has changed in the years since Truth in Lending went into effect in 1969 (see Durkin and Elliehausen 2011, Chapter 7).

Juster and Shay believed that the proportion of unrationed consumers (and, therefore, consumers' overall sensitivity to interest rates) would increase gradually over time. They pointed to secular growth in consumer income and a trend toward longer terms to maturity as factors that would shift consumers from rationed to unrationed groups. In addition to the factors identified by them, advances in creditors' ability to assess and price risk have likely reduced the proportion of rationed consumers in the population in recent years. It seems that all these factors likely have reduced the proportion of rationed borrowers in the marketplace, but certainly not to zero.

There also were limited subsequent empirical tests of Juster and Shay's theory. In an experimental study, Walker and Sauter (1974) presented to a random sample of consumers pairwise comparisons of five alternative sets of financing terms for a household appliance. The sets of financing terms varied in terms of interest rate, product price, monthly payment size, and amount of downpayment. For each of ten possible pairs of alternatives, consumers chose the alternative that they preferred. Comparing the responses of lower income and higher income consumers, Walker and Sauter found that greater proportions of lower income consumers than higher income consumers preferred alternatives with lower monthly payments regardless of interest rate over sets with higher monthly payments or positive downpayment. They interpreted these results as consistent with Juster and Shay's hypotheses.[10]

More recently, Attanasio, Goldberg, and Kyriazidou (2000) used automobile purchase data from the 1987-1995 Consumer Expenditure Surveys to estimate interest rate and maturity elasticities for households hypothesized to be more or less likely to be rationed. Both their modeling and their statistical work are somewhat technical, but they provided evidence based on actual consumer behavior that credit choices of households likely to be rationed are sensitive to loan term (hence, other factors being equal, to the size of monthly payments). In contrast, they found that credit choices of households likely to be unrationed were sensitive to the interest rate but not loan term. Classifying consumers as rationed or unrationed on the basis of age or income alone is not precise, since rationing involves both high demand for debt and limited resources for servicing the debt.[11] Nonetheless, these findings provide additional support for Juster and Shay's theoretical model of consumer credit use.

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[10] Walker and Sauter's analysis has several technical flaws that diminish its contribution to understanding consumers' credit preferences, however (see Burstein 1978). For instance, they did not take into account that the size of monthly payment is not independent of price, downpayment, interest rate, and term to maturity. Some of the alternatives were clearly preferable to others, and choice between a higher product price or a higher interest rate is a matter of indifference for all consumers when the monthly payment and the downpayment are the same. Several pairs of alternatives did involve tradeoffs that theory predicts would cause rationed or unrationed borrowers to choose one or the other of the alternatives, but Walker and Sauter's classification of consumers as rationed or unrationed consumers solely on the basis of income is inadequate. (For example, a household in retirement may have low income but would not normally be rationed because demand for credit would often be low.) Walker and Sauter reported statistically significant differences by education, occupation, marital status, and sex. However, they did not discuss how such differences might be related to Juster and Shay's or any other hypotheses about consumers' behavior.

[11] Attanasio, Goldberg, and Kyriazidou also estimated their model for age groups (less than 35 years and 35 or older) interacted with education (high school diploma or less and some college or college degree). Partial derivatives were not statistically significant except for the group of households headed by persons less than 35 years of age with a high school diploma or less education. For that group, the partial derivative with respect to maturity is statistically significant and positive. As lower levels of education are associated with lower income, this group is likely to have booth high demand and limited resources.

Available information specifically about the characteristics of borrowers of small installment loans suggests the likelihood of their being rationed by primary lenders, although the only study specifically of these borrowers (undertaken for the National Commission on Consumer Finance) is also quite old (Durkin 1975). This study shows that at that time small loan borrowers were concentrated among the lower income segments of society. The results of a survey of borrowers showed that most of them belong to the parts of the population that often had trouble at the time obtaining credit elsewhere. Many of them reported being turned down elsewhere.

Recent Experience

With this as background, what does this mean for small dollar installment cash lending today? Little statistical information about small installment loans or borrowers has been available, but recently the American Financial Services Association has surveyed its members about small dollar installment loans. The survey collected information on the characteristics of 6.0 million installment loans outstanding as of the end of December, 2013. To focus on the most current lending, the discussion here reflects loans outstanding on December 31, 2013 and that were made in the previous six months. There were 3.1 million of these loans made by surveyed companies during this six month period.

Evidence from this survey suggests that the overwhelming majority of these loans were subprime in nature (discussed in more detail below). More than half of the loans reported a credit score, and about 88 percent of these loans can be classified as subprime (Table 1). Among the loans with scores, about 24 percent were deep subprime, with scores below 551. Only about 2 ½ percent of the loans with scores went to borrowers with good credit standing (fifth column from left in the table). In other words, most of the customers for this kind of installment loans probably were ineligible for much additional credit from mainstream lenders.

The subprime character of these loans immediately suggests some specific hypotheses about small installment loans based ultimately upon the work of Juster and Shay. (Among the hypotheses about these loans, the fourth concerns the geographic distribution of the loans, suggesting they may not be available everywhere. Consequently, the other hypotheses apply only to the areas where the loans are available.)

First, the loans likely are quite small. Since they are mostly subprime in character, many of them likely are made to borrowers who have little availability of credit at primary lending sources or who have loans from primary lenders but have exhausted any further credit availability from them and are only eligible for relatively small loans at secondary (subprime) lenders. This suggests that large loans are unlikely.

Second, the loans likely exhibit relatively high APR's both because they are small and because they are made to risky borrowers.

Third, consistent with the findings of Juster and Shay, the loans likely are of appropriate size to keep the payments low and within budgets of subprime consumers. This result would come about because credit constrained consumers will demand longer maturities and smaller payments whenever possible. And to assure an acceptable likelihood of receiving their money back, lenders will offer a term to maturity and limit the amount of credit granted to an amount that allows affordable monthly payments.

Fourth, because rate ceilings vary substantially among the states, prevalence and characteristics of these loans probably vary substantially among the states as well. Smaller loans will be more prevalent when rates ceilings are high. Mostly large loans will be available when rates ceilings are low.

Examination of the survey data produces findings consistent with each of these hypotheses. First, survey results show that these cash loans are mostly quite small. Almost 80 percent of the loans were made in amounts of $2000 or less (sum of the first three lines of Table 2). The small size of loans suggests they may have been substitutes for amounts of credit otherwise available on credit cards, likely indicating many of these customers were unable to obtain credit using cards, or at least as much credit as they preferred. Consistent with their generally small size, these loans also exhibited short maturities: Almost 85 percent were made for a term of 24 months or less (sum of first three columns of Table 2). Almost 60 percent had terms of one year or less.

Not surprisingly, loan size and maturity are correlated. The smallest loans have the shortest maturities and larger loans longer maturities (demonstrated by the slant of the numbers in Table 2 downward to the right). The relationship between size and maturity so that the largest loans have the longest maturities, likely is an attempt to fit the loan payments effectively into monthly budgets. This is unlike payday lending where the single-payment payday loans are due in one lump, possibly causing budget difficulties.

Second, the survey results also show that the APRs on these loans are higher than on the most familiar mainstream kinds of credit for consumers like mortgage credit, auto, and credit card credit. APRs range upward to and over 100 percent on an annual basis for the smallest loans (Table 3). The loans also show an inverse relationship between loan size and APR: the highest APRs are associated with the smallest loans, which are also the loans with the shortest maturities. This is exactly what the National Commission on Consumer Finance predicted in 1972 that a competitive market would produce. Further, the range of rates is right where the National Commission predicted in 1972 they would have to be, based on its cost studies, before lenders would be willing to make loans of this kind (see National Commission on Consumer Finance 1972, Chapter 7, and Figure 1 below).

Third, consistent with suggestions from Juster and Shay, the survey results also demonstrate directly what appears to be an attempt to fit repayments into households' budgets. Virtually all the smallest loans have monthly payments of $100 or less (less than two tanks of gas in recent months), and up to $1000 loans $150 or less (intersection of the first two lines of Table 4 with the first three columns).

The survey also shows that, on balance, installment borrowers are slightly younger than the population average (Table 5). Further, smaller loans more often go to younger borrowers and larger loans to older ones. However, neither relationship is especially strong. Rather, borrowers of all ages borrow in amounts across the board, but with some limited tendency toward a direct relationship between age and loan size.

In sum, the survey of installment lending shows that the industry makes mostly small subprime loans with short maturities, the kind of loans that might be expected of secondary lenders as predicted by Juster and Shay. The Annual Percentage Rates of charge on these loans are relatively high by the standards of many common (and larger) kinds of loans made to middle class consumers, but the rates are right where the National Commission on Consumer Finance predicted a generation ago they would have to be before lenders would make this sort of loan. There is evidence of attempt to make repayment plans fit into budgets, which is much different from the single-payment nature of other subprime cash loans like payday, auto title, and pawn loans. Although younger consumers tend to borrow in smaller amounts, the tendency is not strong. Loans of all sizes range across all age groups.

Further Evidence of Lending Risk

The survey results also demonstrate further evidence of the relationship between various loan features and after-the-fact measurement of lending risk in this lending segment. For instance, the survey showed that nearly one quarter of the loans were in some state of delinquency on the survey date (December 31, 2013), a high proportion. A portion of these loans (though not all) are destined for eventual repayment but probably with some (costly) difficulties, like employee reminders, loan modifications, and even potential legal action for some of them.

Delinquency on the survey date is clearly correlated with loan features. For example, small loans are much more likely to be delinquent than larger loans (Table 6). More than 38 percent of the smallest loans were delinquent on the survey date (even though likely most of this money is headed eventually toward repayment, even if with some difficulty), but only about 12 percent of the largest loans. This tendency undoubtedly reflects the greater willingness of lenders to take chances with smaller amounts of money than large amounts.

Likelihood of delinquency is definitely correlated with credit score (Table 7). More than a third of the loans in the lowest score group were in delinquent state on the survey date, but only about 7 percent of those in the highest score grouping. This relationship is very strong and not surprising. Based on this evidence, it is easy to conclude that both loan size and credit score are predictors of risk. (The totals in this table differ slightly from Table 6, because not all loans report a credit score.)

The fact of greater risk on loans with different sizes and credit scores clearly shows itself in the relationship between delinquency and APRs charged (Table 8). Simply stated, riskier loans, as demonstrated by their actual delinquency state on the survey date, are also the ones that receive the highest APRs. This demonstrates the common-sense notion that lenders are willing to make loans to the riskiest borrowers only if they receive compensation for the risk.

While loan size clearly is also a factor explaining APR, with the smallest loans exhibiting the highest APRs, the smallest loans also are the riskiest and for that additional reason are going to be associated with high APRs. Again, this is consistent with the contentions of the National Commission on Consumer Finance in 1972 and noted above that only sufficient rates would "allow for enlargement of the market through a higher degree of risk acceptance" (National Commission on Consumer Finance 1972, p. 144). It is possible to contend that causality is the other way and the high APRs cause the delinquency, but this possibility seems unlikely in most cases, since calculations show that higher APRs have a much greater impact on lenders' revenues (and compensation for the costs of risk) than they do on monthly payments, since repayment of the principal sum and not interest on the loan represents the dominant share of the payment amount, as it also does on other kinds of small dollar credit.

Differences among States

To examine the fourth hypothesis that prevalence and characteristics of installment lending vary substantially among the states according to regulatory features, it is possible to array the loans according to residence area of the borrowers. By concentrating on totals, the discussion so far masks any differences that may exist among the states. Differences among state may arise either because of differences in local demand or because of variations in supply factors, notably including variations in regulation. As the National Commission on Consumer Finance pointed out in its report in 1972, demand for small cash loans is widespread but legal rate ceilings will alter supply.

States With and Without Small Loans

Distribution of the loans in the database according to the residence of the borrower (zip code) shows large differences in concentration of these loans among the states. One large state (Texas) accounts for more than one fifth of the surveyed loans, and ten states combined account for more than three quarters of the loans (Table 9). In contrast, there were fewer than 1000 loans each made to residents in zip codes of 17 states (plus the District of Columbia), including the populous states of Maryland New York, New Jersey, and Massachusetts. Fifteen states, including Massachusetts and New York (plus the District of Columbia), had fewer than 100 loans.

Median loan size made also varies sharply among the states. The six states with the largest number of loans outstanding show median loan size made of $1000 or less. In contrast, ten other states show median loan size made of more than $3000, including California, Colorado and Washington at more than $4000 (not in table).

Geographic distribution of these closed end cash loans naturally reflects the distribution of the lending locations or offices where lenders make these closed end loans, and the location of the offices reflects rate ceilings. All of the ten states that account for the bulk of the small loan lending are states permitting relatively high rates of charge on these small loans. In contrast, all of the states with very few loans are low rate states.

Loans across State Borders

It is, of course, possible for borrowers to approach a lender in another state if regulatory differences suggest greater availability of lending offices and credit there. For this purpose, Arkansas offers a good test. It is a known low rate state; consumer loan rates are capped at 17 percent. The survey shows more than 20,000 loans made to Arkansas residents despite having a rate ceiling that makes loans less than about $10,500 unprofitable. Arkansas is especially noteworthy because it borders five of the states identified in Table 9 as states with many small closed end cash loans (Texas, Tennessee, Oklahoma, Louisiana, and Missouri).

Examination of the zip codes of Arkansas loans shows that almost all of the borrowers reside in the 31 counties that border other states, in particular Oklahoma, western and eastern Missouri, Louisiana, and Texas (Figure 2). Consequently, it seems probable that most of these small loans were made by lenders across the state border. In sharp contrast, only 411 of the 21,078 Arkansas loans were made in the 44 interior counties, despite inclusion within them of the Little Rock area, the largest population center in the state. Likely at least some, if not all, of the loans in the interior counties also involved borrowing across the state line. The relatively small number of loans in Arkansas counties bordering central Missouri may at least in part be explained by sparse population in areas adjacent to the Mark Twain National Forest. And the absence of a bridge crossing the Mississippi River for about 100 miles between Helena/West Helena, Arkansas and Greenville, Mississippi likely explains a lack of loans in Arkansas counties along much of the eastern border of the state.

North Carolina offers another test. It is a state that allows relatively low rates on the smaller loan sizes but rates on larger loans that are within the range the NCCF predicted would be necessary to encourage installment lending. This state offers an interesting test because it has a border with South Carolina that permits higher rates on small loan sizes and because some major North Carolina population areas are near this border.

Arraying loans in the database that were made to residents of the counties in North Carolina bordering South Carolina shows that loans made to these individuals are typically smaller than the loans made in the rest of North Carolina (Table 10). This suggests that many North Carolina residents in border counties are travelling across the state line and into South Carolina in order to obtain small loans. The table indicates that small loans are much more available in South Carolina from the surveyed companies than in North Carolina.

Distribution of Loans in High and Low-Rate States

Loans to borrowers in other low rate states also may be made across state lines, but it is more difficult for borrowers if a state with greater availability (higher ceiling rate) does not border the state in question. In both cases, borrowing across state lines will be more difficult for residents of interior counties. It appears that unless rates on the smallest loan sizes are sufficiently high to cover operating and risk expenses on the loans, small dollar lenders are not going to populate these states and loans actually made by lenders who do locate there are going to be considerably different, especially larger. California and Pennsylvania provide examples. Neither has an especially high rate ceiling on the smallest sizes and neither borders another state with this characteristic. In fact, the surveyed loans to the residents of these two states are much different from those in the states permitting higher rates on the smaller sizes, for example Texas which has the largest loan total (Table 9).

Cash lending was much more common by surveyed companies in Texas during the period of the lending survey than in either Pennsylvania or California. Twenty-five loans per 1000 population were outstanding at surveyed companies in Texas on the survey date according to 2013 population estimate but only 1.57 per 1000 population in Pennsylvania and 0.76 surveyed loans per 1000 population in California. Some other states had even larger numbers of loans per 1000 population (Table 9). Furthermore, loans in California and Pennsylvania had very different characteristics than Texas loans.

For instance, loans in Pennsylvania and California were much larger than in Texas. In the former states, the survey found almost no loans of $500 or less and only about one half of one percent of the loans at $1000 or less (Table 11).[12] This distribution of Pennsylvania loans illustrated in the table compares to about 31 percent of Texas loans in the smallest size and almost 70 percent in amount of $1000 or less. This difference suggests that small loans sizes are mostly unavailable in Pennsylvania (or in California, not illustrated in the table), but also the potential that borrowers in the low rate states might sometimes need to borrow more than they really prefer in order to find lenders willing to make any loan.[13]

Comparisons for other loan terms follow from the loan size difference. For instance, APRs on Texas loans are higher (Table 12). This finding is consistent with the contention of the National Commission on Consumer Finance that high rates are necessary on small loans in order for the lenders to be able to recover lending costs on the small dollars of credit involved. In Pennsylvania, almost all loans were made at APRs from 19 to 36 percent, but the mostly smaller loans in Texas showed rates 49 to 99 percent, in line with what the NCCF suggested would happen. (Looking more closely at the Pennsylvania distribution, more than 80 percent of the loans carried APRs of 25 to 27 percent, reflecting the rate ceiling in this range. Almost all of the rest of the loans carried APRs of 22 to 24 percent.) Payment size also reflected loan size difference. In Pennsylvania, 55 percent of the loans were made with monthly payment size greater than $150; the corresponding proportion in Texas was 21 percent (Table 13).

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[12] It appears that the bulk of the Texas loans at surveyed companies were made under Chapter 342, Subchapter F of the Texas Finance Code, a provision that allows higher rates on loans of $1300 or less. There is no comparable provision of Pennsylvania law. For recent discussion of Section 342 of the Texas Code see Hutchings and Nance (2012).

[13] In Texas, there also is a group of “large loan lenders” that were not part of the survey. Including them would change the proportions among Texas loans toward greater proportion of larger loans, but it would not alter the fact of far greater availability of small loan sizes in this state.

It is interesting to note that the difference in credit scores is not as pronounced between the states as the other loan characteristics (Table 14). Clearly, most borrowers in both states can be considered subprime (scores below 661). It is possible that lenders in Pennsylvania are willing to take the risks of making larger loans with some borrowers, albeit a smaller number than in Texas. Individual lenders' favorable experiences with certain borrowers may make them willing to grant the loans despite subprime credit scores or no credit scores. (Almost all Pennsylvania loans had scores.) It also again suggests the possibility that some Pennsylvania borrowers may be taking larger loans than they otherwise would prefer if smaller loans were available under the state's lower rate ceilings.

Difficulties may arise when rate ceilings prevent subprime borrowers from obtaining loans in the sizes they desire, forcing them to obtain larger loans than necessary in order to obtain any credit at all. A first difficulty arises from the potential risk that these consumers may not have the requisite self-discipline or show enough care to retain in their reserves the excess funds they must borrow beyond what they want to borrow. If they also spend the additional funds, their repayment burden increases beyond what it would be with a smaller loan. Simply put, they have to repay more principal over a longer time, which can pose financial risks for them.

A second difficulty is that the additional borrowing for a longer time also means higher finance charges, despite the lower APR. It is easy enough to see this effect from some examples using typical APRs and loan sizes in Texas and Pennsylvania.

Suppose a credit constrained borrower in Pennsylvania needs or wants a $500 loan, a typical small loan in Texas, but it is unavailable from either primary or secondary lenders in Pennsylvania. In Texas, suppose this small loan would entail 6 monthly payments of $107.88 at APR of 95 percent. Total finance charge over the six months would be $147.31 (top panel of Table 15).

Suppose also that a secondary lender in Pennsylvania is unwilling to make Texas-type small loans but is willing to lend typical Pennsylvania-type small loans. This entails a loan of $2000 at 27 percent. To keep the payments roughly equivalent, the loan is made for 24 payments of $108.76 (lower panel of Table 15). The problem is that the finance charge more than quadruples despite the lower APR, due to the larger loan and longer maturity.

The calculus is similar if the borrower wants a $1000 loan, a typical large loan for these Texas small dollar lenders. In this case, the Texas lender would make this loan at 72 percent APR for 12 months of payments of $119.28. Such a loan is illegal in Pennsylvania.[14] A borrower there in need of a $1000 loan but unable to obtain one because of the ceiling might instead obtain a $2000 loan at 27 percent, assuming the borrower qualifies for the larger loan. Using the same example for the Pennsylvania loan, it would involve almost the same payment size as the Texas

[14] The small number of such loans visible in Table 12 probably are loans made by telephone, mail, Internet, or to individuals who subsequently moved to Pennsylvania from some other state.

loan ($108.76 in Pennsylvania at 27 percent APR versus $119.28 in Texas at 72 percent APR). But because the loan would be both larger and longer in Pennsylvania, the finance charge would accrue for a longer time and in total would be considerably more than on the shorter Texas loan at higher APR, assuming the Pennsylvania borrower even qualifies for the larger loan at the lower rate. It is not at all clear that these Pennsylvania borrowers are better off when looking for small loans under the Pennsylvania rate ceiling than they are in Texas where the rate ceilings are much higher but small loans are available.

Finally, the survey results show that Texas borrowers are somewhat younger than their counterparts in Pennsylvania (Table 16). In Texas, the survey found that about 27 percent of loans were to borrowers under age 35, compared to about 17 percent in Pennsylvania. This also is consistent with the Juster-Shay conception of rationed borrowers.

In contrast to comparison with Texas, comparison of Pennsylvania with California shows similar absence of small loan lending in these two states. Both states specify relatively low rate ceilings on smaller loan sizes and both show few loans in these size groups (California not in table). Unlike Pennsylvania, however, California has no rate ceiling on loans greater than $2500, and the surveyed installment lenders make larger loans there. Overall, more than 91 percent of surveyed loans in California were larger than $2500. The bulk of them were in a size group of $2500 to $14,999.99. In this group, the median loan size was $4311 with median maturity 35 months. Median payment size was $190 and median APR 34 percent. Again, presence or absence and height of the rate ceiling are reflected in differential availability of loans of different sizes in the jurisdiction.

Comparison of Rates and Loan Availability with Recommendations of the NCCF

It is possible to construct a series of APRs recommended by the National Commission on Consumer Finance (NCCF) as necessary for small loans lenders to produce loans of various sizes (see discussion above) and then to compare them with some existing state ceilings and the availability of loans of various sizes in those states. Table 17 provides such a comparison using the NCCF's estimates of APRs that would "… allow for enlargement of the market through a higher degree of risk acceptance" (National Commission on Consumer Finance 1972, p. 144) and adjusting loan amounts and production costs for inflation. The table compares these NCCF rates to actual rates on surveyed loans in the $100 size groupings ranging upward from the selected loan amounts. All of the calculations of the NCCF rate used in the table assume a 12 month maturity except the $500 loan which assumes a 6 month maturity.

APRs on the surveyed loans demonstrate exactly the pattern recommended by the NCCF in 1972 based upon its cost analyses and its contention that market competition would keep rates in this range if rate ceilings were to allow them. Actual rates on loans are highest on the smallest loan sizes and fall off in the pattern predicted by the NCCF. In the intermediate size groups ($1000, $1500, and $2000) it appears that rates in the table in are moderately above predicted rates for some states in large part because a portion of the loans in these states within the indicated size groups are actually for terms less than the assumed maturity of 12 months. This moves the overall mean for the grouping upward, but the mean rates are still relatively close to the NCCF recommendation based on costs, and they show the predicted downward trend relative to loan size.

By loan size $2500, actual rates on surveyed loans in all states in the table are right around the NCCF projected level. As discussed earlier, loans of this size are available from the surveyed companies in all the states in the table, but the smaller sizes are not available in California or Pennsylvania, the low rate states in the right hand columns. This is consistent with the writings of the National Commission but also with the earlier theoretical work of Juster and Shay who predicted exactly this outcome.

Conclusion

Research conducted many years ago that indicated substantial cost economies of loan size in consumer lending. That is, smaller loans are more costly per loan dollar to produce than larger loans. Consequently, break-even interest rates for smaller loans are much greater than break-even interest rates for larger loans. This consequence implies that low interest rate ceilings make small loan sizes unprofitable. Hence small loan sizes will not be available in the marketplace. Furthermore, research indicates that demanders of small cash loans tend to be relatively risky and to face binding limits on the amount they can borrow at relatively low rates. These rationed consumers may benefit from additional credit, even credit at relatively high rates.

New data on small installment cash lending are consistent with the hypotheses of this previous research. Nearly all of the loans are extended to risky borrowers, who clearly are subprime on the basis of their credit scores. By far most loans are quite small. The annual percentage rates of interest for these loans are high because of their small size and the riskiness of the borrowers. The loans are made with low payments to satisfy both demand among rationed borrowers for small payments and supply by lenders who also are interested in easy repayment.

Differences in the availability of smaller loan sizes vary directly with the height of state interest rate ceilings. States with high ceilings for smaller loan sizes have many small loans. States with low ceilings have few such loans. In some cases, consumers in states with low ceilings may obtain smaller loan sizes in neighboring states with high ceilings. Such actions appear to occur mostly in border areas, where crossing state lines is convenient. Smaller loan sizes are rarely evident in interior areas of low-rate states. Smaller loan sizes also are not found in border areas of low-rate states not proximate to states with high ceilings for smaller loans.

Finally, average APRs on surveyed loans reflect the pattern of rates recommended by the National Commission on Consumer Finance (1972) based on its cost analyses and conclusion that completion would cause rates to reflect costs of production rather than rise to the maximum allowed by law. Average rates are highest on the smallest loan sizes and fall off in the pattern predicted by the commission's cost analyses.

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Table 1. Installment Loans Outstanding End of September 2012 and Made During Previous Six Months: Credit Scores of Borrowers

	Borrower Credit Score					
	<551	551-619	620-659	660-699	>700	All
All	24.3	43.6	20.5	8.9	2.6	100.0

Notes for Tables 1 through 5:

Values are percentages of total.

Columns and rows may not add exactly to totals because of rounding.

Source for Tables 1-5: Installment Loan Survey.

Table 2. Installment Loan Maturity, by Loan Amount (Months)

Loan Amount (TIL Amount Financed)	Term to maturity (Months)						
	1-6	7-12	13-24	25-36	37-120	>120	All
< $501	11.1	11.4					22.5
$501-1000	0.3	26.1	1.7				28.2
$1001-2000	0.2	9.9	15.9	1.7			27.7
$2001-5000		0.1	7.8	8.5	0.7		17.1
$5001-10,000			0.2	2.8	0.9		4.0
>$10,000				0.2	0.2		0.4
All	11.6	47.5	25.7	13.3	1.9		100.0

Table 3. Annual Percentage Rate, by Loan Amount

Loan Amount (TIL Amount Financed)	Annual Percentage Rate (Percent)					
	≤18	19-36	37-48	49-99	100-199	All
< $501			0.4	12.8	9.3	22.5
$501-1000		1.8	2.5	22.3	1.6	28.2
$1001-2000	0.6	7.8	5.3	14.1		27.7
$2001-5000		14.1	2.4	0.5		17.1
$5001-10,000		4.0	0.1			4.0
>$10,000		0.4				0.5
All	0.6	28.1	10.6	49.7	10.9	100.0

Table 4. Monthly Payment Amount, by Loan Amount

	Payment Amount (Dollars)					
Loan Amount (TIL Amount Financed)	<50	50-100	101-150	151-200	>200	All
< $501	1.0	21.3	0.1			22.5
$501-1000	0.2	13.9	13.9	0.1		28.2
$1001-2000		4.5	16.9	6.2	0.2	27.7
$2001-5000		0.3	6.5	7.7	2.6	17.1
$5001-10,000				0.2	2.8	4.0
>$10,000					0.4	0.4
All	1.2	40.0	37.5	14.2	7.0	100.0

Table 5. Age of Borrower, by Loan Amount

	Age of Borrower, (Years)						
Loan Amount (TIL Amount Financed)	18-24	25-34	35-44	45-54	55-64	>65	All
<$501	4.2	5.3	4.1	4.0	3.1	2.0	22.8
$501-1000	1.9	5.3	5.8	6.2	5.2	3.7	28.2
$1001-2000	1.0	4.4	5.9	6.7	5.6	3.6	27.3
$2001-5000	0.4	2.5	3.9	4.4	3.6	2.3	17.1
$5001-10,000	0.1	0.5	1.0	1.2	0.9	0.5	4.1
>$10,000			0.1	0.2	0.1		0.4
All	7.6	18.1	20.9	22.7	18.6	12.2	100.0
Memo: Adult Population[15]	13.1	17.5	17.5	19.2	15.6	17.2	100.0

[15] Source: 2010 Census (US Census Bureau 2011, Table 7, p. 11).

Table 6. Delinquency and Loan Amount

	Loan Amount						
Delinquent	<$500	$501-1000	$1001-2000	$2001-5000	$5001-10000	>$10,000	All
Yes	38.6	26.1	19.7	14.7	11.7	11.5	22.8
No	61.4	73.9	80.3	85.3	88.3	88.5	77.2
All	100	100	100	100	100	100	100

Table 7. Delinquency and Credit Score

Delinquent	<550	559-659	660-699	650-699	>700	All
Yes	34.6	21.6	14.4	10.4	6.6	21.9
No	65.4	78.4	85.6	89.6	93.4	78.1
All	100	100	100	100	100	100

Table 8. Delinquency and Annual Percentage Rate

	Annual Percentage Rate (Percent)					
Delinquent	<18	19-36	37-48	69-99	100-199	All
Yes	11.2	14.4	18.8	29.0	36.3	22.7
No	88.8	85.6	81.2	71.0	63.7	77.3
All	100	100	100	100	100	100

Note for Tables 6 through 8:

Values are percentages of each column.

Columns and rows may not add exactly to totals because of rounding.

Source for Tables 6-8: Installment Loan Survey.

Table 9. States with Many and Few Loans

States with Many Loans	Percent of Total	Median Size (Dollars)	Surveyed Loans per 1000 Population
Texas	21.6	701	25.2
Georgia	9.2	929	28.4
South Carolina	8.6	865	55.3
Tennessee	7.7	900	36.8
Alabama	6.0	818	38.8
Oklahoma	5.4	872	42.5
Illinois	5.3	1102	12.8
Louisiana	4.9	1086	33.2
North Carolina	4.4	2031	14.0
Missouri	4.2	1000	21.6
Total Ten States	77.3		

Populous States with Few Loans[1]	Number of Loans	Median Size (Dollars)	Surveyed Loans 1000 Population
California	28,860	4146	0.8
Pennsylvania	20,421	3861	1.6
Maryland	665	2545	0.0
New Jersey	535	2500	0.0
New York	98	*	0.0
Massachusetts	24	*	0.0

Notes for Table 9:

[1] After rounding, each of the example states after California accounts for 0.0 percent of the total loans and has 0.0 surveyed loans per 1000 population. In addition, there also were 13 additional states not listed in the table (plus the District of Columbia) with fewer than 1000 loans.

* Not enough loans to construct a meaningful median size.

Source: Installment Loan Survey.

Table 10. Loan Sizes Made to North Carolina and South Carolina Borrowers

Loan Size:	South Carolina (Cumulative Pct.)	NC Counties Bordering SC (Cumulative Pct.)	Other NC Counties (Cumulative Pct.)
Less than $500	22.7	7.9	0.4
Less than $1000	55.0	25.4	7.8
Less than $1500	74.4	46.9	31.2
Less than $2000	82.4	59.5	44.2
Less than $2500	89.0	70.5	57.9
All	100.0	100.0	100.0

Source: Installment Loan Survey.

Table 11. Loan Maturities in Pennsylvania and Texas, by Loan Amount

Pennsylvania Loans

Loan Amount (TIL Amount Financed)	Term to Maturity (Months) 1-6	7-12	13-24	25-36	37-120	>120	All
< $501	0.1						0.1
$501-1000	0.1	0.3					0.5
$1001-2000	0.2	1.9	7.3	1.2			10.7
$2001-5000		0.4	15.3	41.5	0.9		58.2
$5001-10,000			0.7	22.1	5.2		28.0
>$10,000				0.9	1.6		2.5
All	0.4	2.7	23.4	65.7	7.7		100.0

Texas Loans

Loan Amount (TIL Amount Financed)	Term to Maturity (Months) 1-6	7-12	13-24	25-36	37-120	>120	All
< $501	21.0	10.4					31.4
$501-1000		36.0	0.4				36.4
$1001-2000		19.4	8.8				28.2
$2001-5000			2.4	0.8			3.2
$5001-10,000			0.1	0.5	0.1		0.6
>$10,000							
All	21.1	65.8	11.7	1.3	0.1		100.0

Notes for Tables 10 through 14:

Values are percentages of total.

Columns and rows may not add exactly to totals because of rounding.

Source for Tables 10-14: Installment Loan Survey.

Table 12. Annual Percentage Rates in Pennsylvania and Texas, by Loan Amount

Pennsylvania Loans

	Annual Percentage Rate (Percent)						
Loan Amount (TIL Amount Financed)	<18	19-36	37-48	49—99	100-199	>200	All
< $501				0.1			0.1
$501-1000		0.3		0.1			0.5
$1001-2000		10.6		0.1			10.7
$2001-5000		58.2					58.2
$5001-10,000		28.0					28.0
>$10,000		2.5					2.5
All		99.7	0.1	0.2			100.0

Texas Loans

	Annual Percentage Rate (Percent)						
Loan Amount (TIL Amount Financed)	<18	19-36	37-48	49—99	100-199	>200	All
< $501				27.9	3.5		31.4
$501-1000		0.1	0.1	35.2	1.1		36.4
$1001-2000		0.7	0.4	27.1			28.2
$2001-5000		3.2					3.3
$5001-10,000		0.1	0.6				0.6
>$10,000							
All		4.1	1.1	90.2	4.6		100.0

Table 13. Monthly Payment Amount in Pennsylvania and Texas, by Loan Amount

Pennsylvania Loans

Loan Amount (TIL Amount Financed)	Monthly Payment Amount (Dollars) <50	50-100	101-150	151-200	>200	All
< $501		0.1				0.1
$501-1000	0.1	0.4	0.1			0.5
$1001-2000	0.1	7.7	2.6	0.2		10.7
$2001-5000		3.5	30.2	22.5	2.1	58.2
$5001-10,000				3.3	24.8	28.0
>$10,000					2.5	2.5
All	0.2	11.6	32.8	25.9	29.5	100.0

Texas Loans

Loan Amount (TIL Amount Financed)	Monthly Payment Amount (Dollars) <50	50-100	101-150	151-200	>200	All
< $501	3.0	28.4				31.4
$501-1000		10.2	26.1			36.4
$1001-2000		0.3	9.6	18.4		28.2
$2001-5000			0.9	1.7	0.6	3.2
$5001-10,000					0.6	0.6
>$10,000						0.1
All	3.0	39.0	36.7	20.1	1.3	100.0

Table 14. Borrower Credit Score in Pennsylvania and Texas, by Loan Amount

Pennsylvania Loans

Loan Amount (TIL Amount Financed)	Borrower Credit Score <551	551-620	621-660	661-700	>700	All
< $501						
$501-1000	0.1	0.2	0.1	0.1		0.4
$1001-2000	1.8	4.2	2.4	1.2	0.8	10.5
$2001-5000	11.6	23.9	13.7	6.3	2.7	58.3
$5001-10,000	5.3	11.5	6.9	3.2	1.3	28.3
>$10,000	0.7	0.9	0.6	0.2	0.1	2.5
All	19.5	40.8	23.7	11.0	5.0	100.0

Texas Loans

Loan Amount (TIL Amount Financed)	Borrower Credit Score <551	551-620	621-660	661-700	>700	All
< $501	7.2	10.1	3.7	1.3	0.3	22.5
$501-1000	8.0	15.9	6.2	2.6	0.6	33.4
$1001-2000	6.7	14.9	10.0	4.6	1.0	37.1
$2001-5000	0.8	2.2	1.7	0.8	0.2	5.7
$5001-10,000	0.2	0.4	0.3	0.1	0.1	1.1
>$10,000		0.1				0.1
All	22.9	43.6	21.9	9.4	2.2	100.0

Table 15. Loan Terms and Charges for Typical Small and Large Loans in Pennsylvania and Texas[1]

Pennsylvania Loans

Small Loan	
Amount	$2000
APR	27 percent
Maturity	24 months
Payment size	$108.76
Interest (Finance charge)	$610.25
Large Loan	
Amount	$4000
APR	27 percent
Maturity	36 months
Payment size	$163.30
Interest (Finance charge)	$1878.83

Texas Loans

Small Loan	
Amount	$500
APR	95 percent
Maturity	6 months
Payment size	$107.88
Interest (Finance charge)	$147.31
Large Loan	
Amount	$1000
APR	72 percent
Maturity	12 months
Payment size	$119.28
Interest (Finance charge)	$431.32

Notes for Table 15:

[1] "Typical" loans are approximately modal loan amounts and associated APRs and terms to maturity in the largest small and large loan amount intervals for each state. Monthly payment size and interest charge are calculated.

Source: Installment Loan Survey.

Table 16. Age of Borrower, by Loan Amount

Pennsylvania Loans

Loan Amount (TIL Amount Financed)	Age Borrower (Years) 18-24	25-34	35-44	45-54	55-64	>65	All
<$501							0.1
$501-1000		0.1	0.1	0.1	0.1	0.1	0.5
$1001-2000	0.5	1.9	2.1	2.6	1.9	1.8	10.7
$2001-5000	1.7	8.9	13.8	14.6	11.1	8.1	58.2
$5001-10,000	0.4	3.2	6.7	8.2	6.4	3.1	28.0
>$10,000		0.3	0.7	0.7	0.6	0.2	2.5
All	2.7	14.4	23.3	26.2	20.1	13.3	100.0

Texas Loans

Loan Amount (TIL Amount Financed)	Age Borrower (Years) 18-24	25-34	35-44	45-54	55-64	>65	All
<$501	5.6	7.3	5.9	5.6	4.3	3.0	31.7
$501-1000	2.3	6.8	7.7	8.0	6.8	4.9	36.4
$1001-2000	0.5	4.0	6.2	7.3	6.2	3.8	27.9
$2001-5000		0.5	0.8	0.9	0.7	0.4	3.3
$5001-10,000		0.1	0.2	0.2	0.1	0.1	0.6
>$10,000							
All	8.5	18.6	20.6	22.1	18.2	12.1	100.0

Notes for Tables 10 through 13 and Table 16:

Values are percentages of the total.

Columns and rows may not add exactly to totals because of rounding.

Source: Instalment Loan Survey.

Table 17. APRs Recommended by the National Commission on Consumer Finance and Actual APRs on Surveyed Loans for Selected Loan Sizes and States

Loan	NCCF	Average Rates in Selected States[2]					
Amount	APRs[1]	TX	SC	IL	MO	PA	CA
$500	187	91	68	90	118	26	*
1000	62	78	58	69	78	25	*
1500	47	33	44	54	62	25	27
2000	39	31	43	34	44	25	24
2500	34	30	36	34	38	25	33

Notes for Table 17:

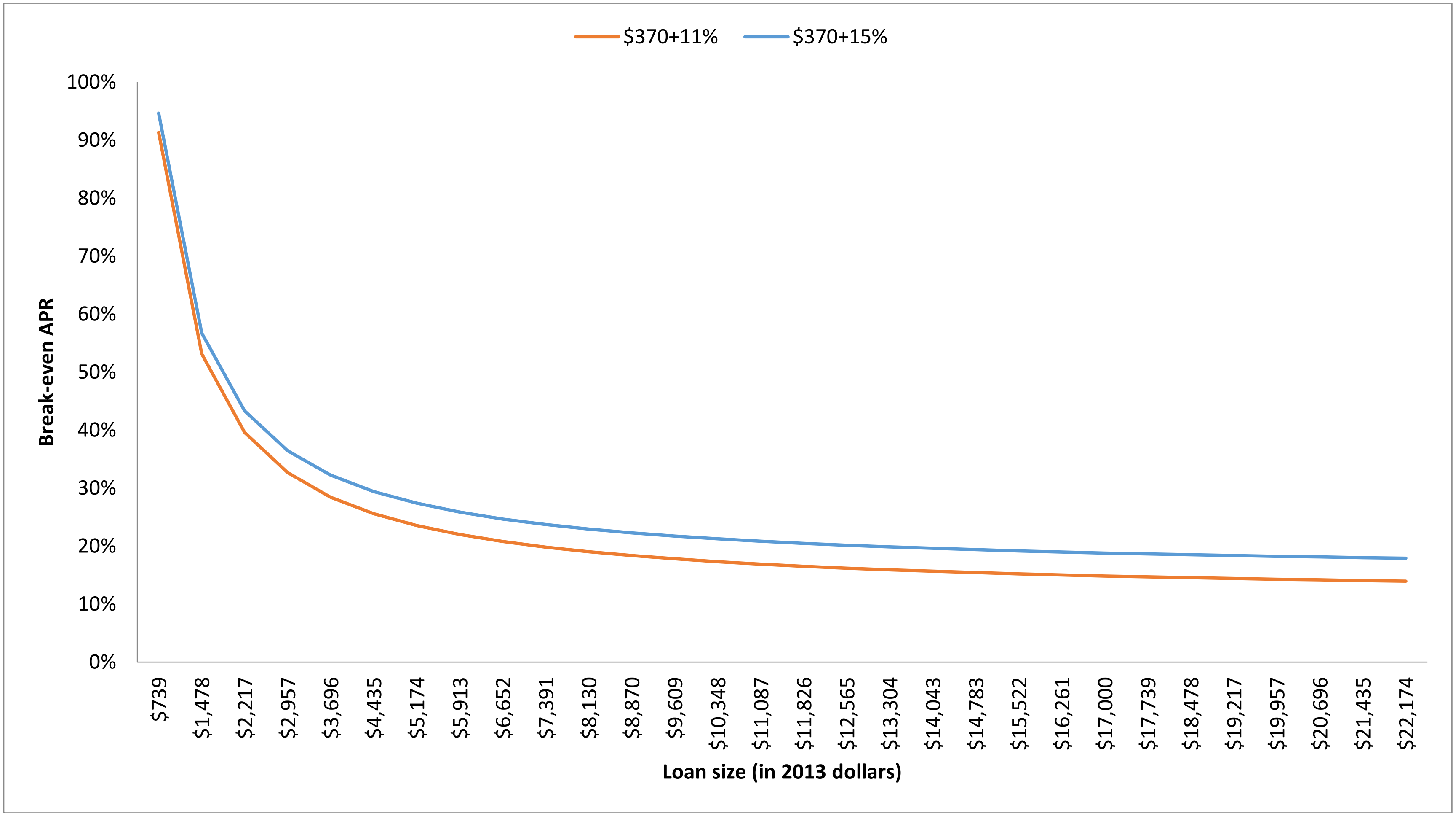
[1] Rates that would "… allow for enlargement of the market through a higher degree of risk acceptance" (National Commission on Consumer Finance 1972, p. 144). Calculated rates are for 12 month maturities except for $500 category which is for 6 month maturity.

[2] Mean rates on surveyed loans for loan amounts (Truth in Lending "Amount Financed") in the $100 increment upward from the loan amount indicated (e.g. mean rates for the $500 loan amount line are for surveyed loans of $500-599). The $2500 category is for loan amounts of $2500 or more.

* Insufficient number of surveyed loans to provide a meaningful mean rate.

Source: Instalment Loan Survey.

Figure 1. NCCF estimates of APR necessary to recover costs of a 12-month consumer finance company loan, by loan size



Source: National Commission on Consumer Finance (1972), Exhibit 7-16. Based on data in Smith (1967). Average loan size was $3,581 (in 2013 dollars).

Figure 2. Small consumer finance company loans to Arkansas borrowers, by borrowers' ZIP-code