APR CAPS LEAD TO EFFECTIVE BANS ON SHORT-TERM, SMALL-DOLLAR CONSUMER LOANS

Instituting an annual percentage rate (APR) cap on the fees for short-term, small-dollar loans is an effective ban of the service and fails to address consumers' need for credit, instead leaving them with one less credit option. In fact, the Center for Responsible Lending, which has led the campaign to prohibit small-dollar lending in various states, said that one state's policymakers "fully understood that [an APR cap] would ban the product," when the legislature passed an APR cap in 2008.[1]

Effective Bans

In recent years, several states and the District of Columbia have implemented APR caps:

- Arizona
- Arkansas
- Colorado
- District of Columbia
- Illinois
- Montana
- Nebraska
- New Hampshire
- New Mexico
- North Carolina
- Ohio
- Oregon
- South Dakota
- Virginia

Not Economically Viable

APR caps create an environment that is not economically viable for many lenders, as they are unable to cover basic operating costs, such as wages, rent and utilities. For example, **under a 36 percent APR cap, a $100 loan would yield a $1.38 fee, or less than 10 cents a day**. No business – not a credit union, not a bank – can lend money at that rate without being subsidized. Lenders in states with APR caps were forced to close hundreds of centers, costing thousands of employees their jobs and leaving consumers with fewer credit options.

Unintended Consequences

Interest rate caps harm consumers by eliminating a critical choice for thousands of people who need short-term, small-dollar credit. Consumers' need for credit does not disappear once these regulations are in place. Instead, they either cannot meet their financial obligations or they are forced to choose costlier or less regulated options, such as unregulated loans. Consumers choose small-dollar loans because they are cost- competitive, highly regulated and transparent.

Case Study:
The *Portland Business Journal* reported that after passing a 36 percent APR cap on short-term, small-dollar loans, and brick-and-mortar lenders closed their centers, Oregon became "a hotbed for illegal Internet payday loans." The number of complaints against lenders filed with state regulators doubled after lawmakers passed the rate cap. Nearly 70 percent of such complaints filed in 2010 were against online lenders. By contrast, "We get few or no complaints about (licensed) payday lenders," said David Tatman, administrator of Oregon's Division of Finance & Corporate Securities.[2]

---

[1] Business TN, September 2008.
[2] "Borrowers Flock to Online Payday Lenders," Matthew Kish, Portland Business Journal, February 11, 2011.

Supporting Research

Independent research confirms that consumers fare worse under bans on short-term small-dollar credit products:

- **Mississippi State University:** A study examining the effects of **Illinois**' 36 percent interest-rate cap on small-dollar loans enacted in 2021 on the availability of credit concluded the law significantly decreased credit options and worsened the financial well-being of many consumers. Researchers found a 44 percent decrease in the number of loans to subprime borrowers in Illinois following the state's interest-rate cap, and a 40 percent increase in average loan size to subprime borrowers. In addition, 79 percent of borrowers who had used small-dollar credit in Illinois in the two years prior to the rate cap's enactment indicated that they would like the option to return to their previous lender if they had a funding need. Only 11 percent of borrowers said their financial well-being increased following the interest rate cap.[3]

- **World Bank Group:** The World Bank published a Policy Research Working Paper in 2018 analyzing the impact of recent developments in interest rate caps globally. Researchers found that interest rate caps enacted in other countries over the past few years – either through new regulations or tightened restrictions on existing statutes – "often have substantial unintended side-effects," including "lower credit supply and loan approval rates for small and risky borrowers," as well as limiting services in rural areas.[4]

- **Dartmouth College:** One year after a new law capped the interest rate at 36 percent in July 2007, 75 percent of **Oregon**'s 360 small-dollar lending stores had closed, resulting in a loss of more than 800 jobs. As a result of the effective ban, Professor Jonathan Zinman of Dartmouth College found that many former small-dollar credit borrowers resorted to lesser substitutes, primarily checking account overdraft programs and/or late bill payments.[5]

- **Federal Reserve Bank of New York:** A Federal Reserve Bank of New York staff study compared households in states where small-dollar loans are available to households in **Georgia** and **North Carolina**, states that effectively banned small-dollar lending through interest rate caps in 2004 and 2005, respectively. The study found that consumers in Georgia and North Carolina "bounced more checks, complained more about lenders and debt collectors and have filed for Chapter 7 ("no asset") bankruptcy at a higher rate."[6]

- **George Mason University:** A study by Professor Todd Zywicki of George Mason University's Mercatus Center found that eliminating small-dollar loans does not eliminate the need for small-dollar credit, and the unintended negative consequences of over-regulation outweigh any positive effect. Zywicki said, "[E]fforts by legislators to regulate the terms of small consumer loans (such as by imposing price caps on fees or limitations on repeated use 'rollovers') almost invariably produce negative unintended consequences that vastly exceed any social benefits gained from the legislation."[7]

- **The U.S. Department of the Treasury**, in contract with **The Urban Institute**, released reports investigating small-dollar loan usage, availability, policy and research. These reports revealed that stringent price caps and prohibitions lead to a lesser supply of alternative financial options, which in turn leads to consumers resorting to costlier, unregulated options for small-dollar credit. The studies found that prohibiting small-dollar loans is associated with just a 35 percent decline in their use, as consumers use the Internet or travel across state lines to obtain loans. The studies also indicated that traditional financial institutions do not provide the same access to credit as small-dollar lenders, and small-dollar loans are "economically rational" for a large percentage of small-dollar borrowers. The reports concluded by suggesting further research to inform policymaking on meeting the small-dollar credit needs of underserved populations.[8]

---

[3] "Effects of Illinois' 36% Interest Rate Cap on Small-Dollar Credit Availability and Financial Well-Being," J. Brandon Bolen, Gregory Elliehausen, Thomas W. Miller Jr., December 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4315919

[4] "Interest Rate Caps: The Theory and the Practice," Aurora Ferrari, Oliver Masetti, Jiemin Ren, World Bank Group, April 2018, https://openknowledge.worldbank.org/handle/10986/29668

[5] "Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap," Jonathan Zinman, Dartmouth College, October 2008, https://www.sciencedirect.com/science/article/abs/pii/S0378426609002283?via%3Dihub

[6] "Payday Holiday: How Households Fare after Payday Credit Bans," Donald P. Morgan and Michael R. Strain, Federal Reserve Bank of New York, November 2007, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr309.pdf

[7] "The Case Against New Restrictions on Payday Lending," Todd J. Zywicki, George Mason University, July 2009, https://www.mercatus.org/research/working-papers/case-against-new-restrictions-payday-lending

[8] "Prohibitions, Price Caps, and Disclosures: A Look at State Policies and Alternative Financial Product Use," July 2013, https://www.urban.org/sites/default/files/publication/23931/412889-prohibitions-price-caps-and-disclosures-a-look-at-state-policies-and-alternative-financial-product-use.pdf