REGULATED LENDERS ASSOCIATION OF MICHIGAN

THE UNINTENDED CONSEQUENCES OF THE OVER-REGULATION OF SMALL-DOLLAR LOANS

Some state and federal regulators have called for an annual percentage rate (APR) cap on the fees for small-dollar loans.

Attempts to over-regulate small-dollar lending harm consumers by eliminating a critical choice for thousands of people who need 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 overdraft programs, unregulated loans or bankruptcy. For these reasons, **more than two-thirds (69 percent) of short-term, small-dollar loan users oppose government restrictions on the loans, according to a national poll**.

Consumers face real risks when they are forced to resort to unregulated loans, which are widely available online even in states that have banned small-dollar loans. Unlicensed lenders offer loans that involve higher costs, and none of the consumer protections that regulated companies provide.

Lenders that operate outside of the jurisdiction of federal and state regulators are not subject to state examinations, lender compliance standards, or formal complaint processes. As a spokesperson for a state chapter of the Better Business Bureau warned, "If we do away with payday loan companies in this state, we are literally pushing the poor to these websites [for unregulated or offshore loans] where they will be, in my opinion, completely taken advantage of."

In recent years, several states and the District of Columbia have implemented APR caps and other restrictions on small-dollar credit. Below are some of the unintended consequences states have experienced after limiting or effectively banning small-dollar lending.

- **Illinois:** Nine months after Illinois passed a 36 percent interest rate cap in March 2021, 45 percent of consumers who took out short-term, small-dollar loans between January 2019 and March 2021 said their financial well-being had declined, with nearly three-quarters of these individuals unable to pay their bills more than once or borrow money when they needed to.[i] Nearly all lenders left the state as a result of the legislation, and 79 percent of respondents indicated they would like to go back to their previous lenders if given the opportunity. Research from the Urban Institute concluded that the Illinois rate cap had little to no impact on credit scores or the amount of debt in collections, suggesting the rate cap did not improve consumer welfare.

- **New Mexico**: Less than a year after New Mexico implemented a 36 percent interest rate cap in January 2023, 32 percent of former borrowers of short-term, small-dollar installment loans reported their financial well-being had declined. Fifty-seven percent said they have been unable to borrow money from a lender when they needed it, requiring them to pay bills late and incur fees, alongside other costs and consequences. Nearly three-quarters (73 percent) would like the option to be able to borrow from their previous lender. After the rate cap forced most consumer lenders to close their doors, the Southwest Public Policy Institute conducted "secret shopper" research to assess the remaining short-term, small-dollar lending market in New Mexico and found many widely touted bank and credit union alternatives to be inaccessible, even to well-qualified borrowers.

- **Nebraska:** Since Nebraska passed a ballot initiative in 2020 limiting businesses to charging a 36 percent annual interest rate, all of the state's regulated lenders have shuttered their doors.[ii] In the first full year following the rate cap, the number of licensed "delayed deposit services businesses" dropped from 65 just prior to the ballot initiative to 19, and now none remain.[iii,iv]

- **Virginia:** In 2020, the commonwealth passed a mandatory longer term for small-dollar loans on top of existing state regulations, including a 36 percent interest rate cap. As a result, Virginia's largest regulated consumer lenders closed their doors ahead of the law's January 2021 effective date, leaving residents with fewer regulated options and eliminating over 200 jobs statewide.[v]

- **Ohio:** In 2018 – the year Ohio passed a restrictive law eliminating two-week loans in favor of mandatory installment loans with a 28 percent interest rate cap — state-regulated lenders issued almost 3.4 million small-dollar loans, representing nearly $5 billion in credit. In 2020, only 427,573 loans were made, representing $100 million in credit – a staggering 98 percent decrease.[vi]

- **South Dakota:** After South Dakotans passed a ballot initiative in 2016 that used a 36 percent rate cap to effectively eliminate the state's regulated small-dollar lending industry, a little over a year later, reports found that 162 small-dollar lenders did not renew their licenses.[vii] Regulators estimated only a few dozen licensed lenders remain. Credit counselors in the state suspect borrowers simply migrated to online lenders, while pawn shops reported a rise in business.[viii]

- **Colorado:** In 2010, Colorado eliminated two-week loans and mandated only longer-term installment loans, resulting in the closure of roughly half of the state's lenders.[ix] As a result, a leading lender in the state reported that more than a quarter of customers were paying their six-month loans off within the first 59 days, in order to re-borrow and avoid incurring monthly maintenance fees. The state's adoption of a 36 percent rate cap in 2018 further consolidated the number of regulated lenders in the state.[x]

- **Oregon:** One year after implementing a 36 percent interest rate cap, 75 percent of Oregon's 360 small-dollar lending stores closed their centers. Complaints against unregulated internet lenders greatly increased.[xi] There are just 12 licensed small-dollar lenders operating in the state with storefronts and online.[xii]

- **Montana:** Following a 2010 ballot initiative implementing a 36 percent rate cap on all lending, all but 18 of Montana's 150 small-dollar lending stores closed. One year later, the Commissioner of Banking reported that complaints against Internet lenders were up substantially over the previous year, with illegal lenders making loans up to 1,000 percent APR.[xiii]

- **Georgia and North Carolina:** A Federal Reserve Bank of New York study reported that people "bounced more checks, complained more about lenders and debt collectors and have filed for Chapter 7 ('no asset') bankruptcy at a higher rate" after small-dollar lending was banned through interest rate caps in Georgia and North Carolina.[xiv]

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[i] "Virginia's biggest payday loan firm is leaving as state crackdown looms," Daily Press, June 1, 2020, https://www.dailypress.com/business/consumer/dp-nw-loan-licenses-surrendered-20200601-w24ssimypnbkvdi3fzagobkf2e-story.html

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[iii] 2020 Annual Report, Nebraska Department of Banking and Finance, pg. 39. https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/reports/NDBF%202020%20Annual%20Report.pdf

[iv] 2021 Annual Report, Nebraska Department of Banking and Finance, pg. 41. https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/reports/2021%20Annual%20Report_1.pdf

[v] "Virginia's biggest payday loan firm is leaving as state crackdown looms," Daily Press, June 1, 2020, https://www.dailypress.com/business/consumer/dp-nw-loan-licenses-surrendered-20200601-w24ssimypnbkvdi3fzagobkf2e-story.html

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[viii] Ibid

[ix] "Fact check: Does Colorado law allow payday lenders to charge over 200% interest on small loans?," Ballotpedia, October 30, 2018, https://ballotpedia.org/Fact_check/Does_Colorado_law_allow_payday_lenders_to_charge_over_200_interest_on_small_loans

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[xi] "Borrowers flock to online payday lenders," Portland Business Journal, February 11, 2011, https://www.bizjournals.com/portland/print-edition/2011/02/11/borrowers-flock-to-shady-payday-lenders.html

[xii] Oregon Division of Financial Regulation, Licensed payday and title lenders, accessed December 1, 2023, https://dfr.oregon.gov/financial/loans/personal/payday/pages/licensed-payday-and-title-lenders.aspx

[xiii] "Payday lenders find new home online; interest rates hit 1,000 percent," The Missoulian, December 18, 2011, https://missoulian.com/mobile/article_a428eea2-2922-11e1-b2eb-001871e3ce6c.html

[xiv] "Payday Holiday: How Households Fare after Payday Credit Bans," Federal Reserve Bank of New York, February 2008, https://www.newyorkfed.org/research/staff_reports/sr309.html