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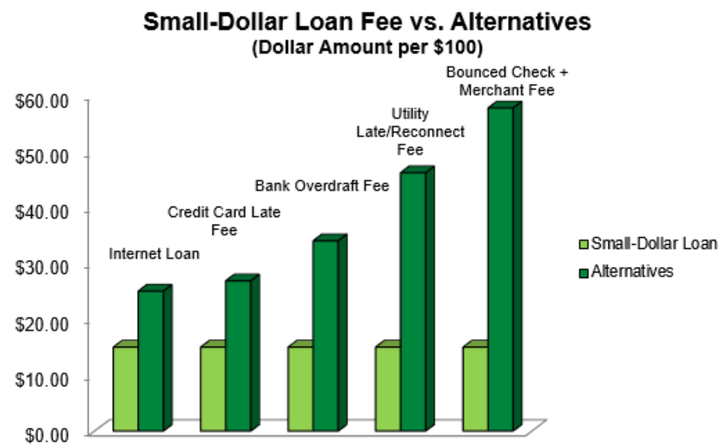
DISPELLING COMMON MYTHS: THE FACTS ABOUT SHORT-TERM, SMALL-DOLLAR LOANS

The realities of small-dollar loans are vastly different than the myths spread by industry critics. The following is a straightforward examination to help separate fact from fiction.

Myth: Short-term, small-dollar loans have unreasonably high interest rates.

FACT: Annual Percentage Rate (APR) is not an appropriate measure of the costs associated with short-term, small-dollar loans or the value they provide.

- The Federal Truth in Lending Act (TILA) requires all financial institutions to disclose loan fees as an APR. In order to comply with TILA, consumer financial services providers report the implied APR of their loans – the amount borrowers would pay in fees if they renewed their loan every two weeks for a full year.
- APR is not an appropriate measure of the costs associated with loans that last for less than a year, but rather is more accurate for long-term loans such as a mortgage or a car loan. The average short-term, small-dollar loan is only two to four weeks, while the typical small-dollar installment loan repayment will take anywhere from three to 36 months, depending on state regulations.
    - The APR on a small-dollar loan decreases as the term lengthens; a small-dollar installment loan has a smaller implied APR than a two-week, small-dollar loan.
- When borrowing a small-dollar loan, consumers pay a set price for a short-term, small-dollar transaction. Customers appreciate that a short-term, small-dollar loan with a single payment comes with a one-time fee, which can be less expensive than the costs or consequences of missed or late payments.
- Consumers choose these credit products because they are straightforward, transparent and often less costly than the alternatives. Whether comparing the direct cost or the APR of various options, consumers often find that short-term, small-dollar loans provided by non-bank consumer financial services providers are still the least costly option.



Sources: Consumer Federation of America Survey of Online Payday Loan Sites, 2011; CFPB CARD Act Report, 2013; CFPB Study of Overdraft Programs, 2013; Readex Research National Data on Short-Term Credit Alternatives, 2006; Bankrate.com Checking Account Survey, 2014; Moebs Services, 2012.

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Myth: Small-dollar lenders could still operate profitably if they charged a much smaller APR.

FACT: Capping interest rates for small-dollar lending services would effectively ban short-term, small-dollar loans.

- Lower fees would not generate enough income to pay for basic business expenses, such as rent, utilities, and wages.
- An APR of 36 percent on a two-week, small-dollar loan – an arbitrary rate some industry critics advocate – would mean customers pay a fee of $1.38 per $100 borrowed, or less than 10 cents per day.
- No market-based provider – not a credit union, not a bank, not a fintech lender – can sustainably lend a short-term, small-dollar loan at that rate without being subsidized. Such rate cap models overlook the significant cost of operating a regulated business and would be an effective ban on small-dollar loans.
- Customers recognize that the price of the one-time fee is appropriate for a short-term, small-dollar loan, relative to other options.
- While some lenders claim to be able to operate under a 36 percent APR, the reality is that these providers serve a very different customer than the lenders that would be forced out of the market by a rate cap, typically only serving subprime customers – those with credit scores between 610 and 640 – whereas the average credit score for a person in need of non-bank credit is 579.
    - Further, while these lenders may technically offer loans for 36 percent or less to a limited pool of subprime consumers, they often seek to evade this rate cap by offering expensive and unnecessary insurance products to their customers – services that are often implicitly positioned in loan agreements as required in order to qualify for the loan and are not included in the loan's APR calculation.

	With a fee of $15 per $100	With a 36 percent rate cap
Revenue, per $100 loan:	$15.00	$1.38
Costs, per $100 loan		
Operating expenses:	$9.41	$9.41
Bad debt expenses:	$3.74	$3.74
Costs of debt/equity capital:	$0.74	$0.74
Total costs:	$13.89	$13.89
Pretax profit:	$1.11	-$12.51
Rational decision:	provide loans	do not provide loans

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Myth: An APR cap does not eliminate consumers' ability to access credit.

FACT: Under an interest rate cap, many regulated providers are unable to continue to offer small-dollar loans. Many consumer financial services providers close their doors, leaving consumers to face the costs and consequences of unmet financial obligations and little choice but to turn to costlier, riskier options.

- APR caps harm eliminate critical choices 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 unregulated loans or bankruptcy.
- Several states have implemented APR caps and other restrictions on small-dollar credit, resulting in serious consequences for consumers and their ability to access credit.
- After South Dakotans passed a ballot initiative in 2016 implementing 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 most small-dollar lenders did not renew their licenses. Only a few dozen licensed lenders remained. Credit counselors in the state suspect borrowers simply migrated to online lenders, while pawn shops reported a rise in business.
- One year after Oregon implemented a 36 percent interest rate cap, 75 percent of Oregon's 360 small-dollar lending stores closed their centers. Consumer complaints against unregulated Internet lenders doubled, and nearly 70 percent of such complaints filed in 2010 were against unregulated online lenders.
- 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.

Myth: Small-dollar loans shouldn't just have lower fees/interest, they should have longer terms.

FACT: Mandating longer repayment terms doesn't address every consumer's credit needs and has consequences for their ability to access and choose the best credit option for their situation.

- Rather than strengthening financial inclusion and consumer choice in a free, competitive market, mandating small-dollar installment loans confines consumers' small-dollar credit options to a single product offering. It is often accompanied by an interest rate cap and the related consequences.
- This restrictive regulatory approach is not informed by consumer demand or the experiences and needs of consumers, nor is it the product of thoughtful study and data about consumer needs and behaviors. Rather, it is a model fabricated by those opposed to small-dollar loans.
- As with rate cap legislation, this form of restrictive regulation originated with national activist organizations looking to restrict and ultimately eliminate short-term, small-dollar loans.
- In the states that have adopted some form of mandatory small-dollar installment lending, without a short-term, two-week, single-payment option – including Colorado, Ohio, Virginia, and Hawaii – the licensed industry has either closed completely or significantly constricted, impacting consumers' access to credit.
- As we've seen after rate caps, anecdotal reports and regulator data indicate that in the absence of regulated and transparent borrowing options, many consumers in need of small-dollar credit have little choice but to turn to unlicensed, unregulated lenders online. These lenders evade state and federal laws, with higher costs and none of the consumer protections that regulated operators provide.

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Myth: Small-dollar loan customers should just go to a bank instead.

FACT: Consumers benefit from broad access to competitive credit options across principal amounts, terms, and providers, including regulated non-bank lenders.

- Most banks do not provide the kind of short-term, small-dollar loans that consumers need. The average amount of a small-dollar loan is about $370, significantly lower than what most banks will loan.
- Some banks and credit unions offer products they promote as "alternatives" but these options are not broadly available and involve a variety of restrictions, including credit qualification requirements and complex fee structures. Further, many consumers prefer non-bank lenders for reasons other than price, such as convenience.
- INFiN supports a competitive market across banks, credit unions, fintechs, and non-bank providers and encourages borrowers to weigh all of their options before choosing a small-dollar loan. Small-dollar loans are not for everyone, but customers make informed decisions, and choose these loans for their simplicity and reliability.
- The Federal Reserve Bank of New York reports that access to credit choices contributes to individual and community credit health, economic mobility, and resiliency. An array of credit options from different providers helps to eliminate the gaps that currently leave less-prime borrowers with few choices, resulting in greater parity in the credit marketplace so that all Americans can build credit.

Myth: Small-dollar lenders intentionally trap borrowers in a "cycle of debt."

FACT: Consumers experiencing periodic financial challenges use small-dollar lending services as long as they need to – and only as long as they need to.

- Consumer financial services providers make loans that match, but do not exceed, customers' needs. It hurts the company, and the customer, when a loan is not repaid.
- If a customer is unable to pay back a loan within the arranged timeframe, providers work with them to find the best way to deal with their individual situation.
- Regulated providers typically offer an Extended Payment Plan (where permitted under state law) that allows customers a longer time period to repay at no additional charge.
- According to research from credit reporting agency Clarity Services, "consumers who roll over small-dollar loans rather than paying them off are doing so because they choose to rather than being unable to," effectively creating a "cycle of preference." After considering credit score, monthly income (net and residual) and the availability of another credit line, Clarity's research found that many consumers still chose to roll over a loan rather than pay it off, even though they might be financially able to do so.

Myth: Small-dollar lenders prey on unsophisticated customers.

FACT: Small-dollar loan borrowers are hardworking, middle-income consumers who understand and appreciate the simplicity, transparency, and cost-effectiveness of this credit option.

- Small-dollar credit customers know precisely what they are getting and what it is costing them. They carefully weigh their options before borrowing a small-dollar loan, and choose the financial service that will help them overcome their challenges most effectively.
- According to a survey by Global Strategy Group (D) and Tarrance Group (R), 94 percent of borrowers agree that small-dollar loans can be a sensible decision when consumers face unexpected costs, and 96 percent say they fully understood how long it would take to pay off their loan. A majority of borrowers want to preserve their current ability to access small-dollar loans.

- Additionally, the vast majority of borrowers say their lender clearly explained the terms of the loan (93 percent) and what would happen if the loan was not paid back in time (85 percent).
- Small-dollar credit customers are hardworking individuals – including small-business owners, teachers, nurses, bus drivers and first responders – who make positive contributions to their communities.
- All customers must have a steady source of income in order to receive a loan and must have a checking account.

Myth: Small-dollar lenders offer loans without confirming a borrower's ability to repay the loan.

FACT: Consumer financial services providers evaluate each and every customer's ability to repay their loan using an underwriting process.

- Regulated non-bank providers do not authorize loans that are more than a customer can afford to repay; doing so would make little business sense.
- Consumer financial services providers typically assess potential borrowers based on dozens of different factors including income, past credit performance, and eligibility under all applicable state and federal laws.
- Providers are committed to ensuring their customers are successful borrowers. If a customer is unable to pay back their loan within the arranged timeframe, lenders work with them to find the best way to deal with their individual situation and repay the loan.

Myth: Small-dollar lenders target racial and ethnic minority groups at a disproportionate rate, including based on where they're located.

FACT: Consumers who choose and value small-dollar lending services reflect the diverse communities regulated consumer financial services providers are proud to be part of and serve. They are from every walk of life, across income brackets, race, and ethnicity.

- The mission of the regulated consumer financial services industry is to ensure all consumers – regardless of gender, race, ethnicity, marital status, or disability – have access to cost-effective, transparent financial services and credit options when they need and choose them, and to enable and empower financial inclusion and stability.
- Community-based providers play an especially vital role in the lives and livelihoods of the millions of consumers and communities they serve, which are often underserved, overlooked, or left behind by other financial institutions.
- Consumers who turn to, appreciate, and value regulated consumer financial services, including small-dollar credit, embody America. Small-dollar lending customers are typically from middle-income, educated, working families; they are neighbors, friends, and family members.
- Community-based providers are located where consumers live, work, and shop, providing the help and convenience consumers need. Operating within reputable shopping centers, often near large, nationally known anchors, these locations are professional and inviting; companies must also abide by complex zoning regulations in communities, which dictate that locations must be in designated business districts.

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Myth: If an all-in 36 percent rate cap works for military servicemembers, it should work for all consumers.

FACT: The Military Lending Act (MLA) effectively ended small-dollar lending to U.S. servicemembers and their families.

- In compliance with the MLA and its all-in 36 percent APR cap, regulated consumer financial services providers do not offer short-term, small-dollar loans to active-duty servicemembers.
- According to the Department of Defense (DoD) in its "Report on the Military Lending Act and the Effects of High Interest Rates on Readiness," released June 30, 2021, "[F]inancial products such as payday loans and vehicle title loans…are effectively prohibited based on other provisions of the MLA."
- Further, the Government Accountability Office (GAO) determined that the DoD report used to justify the MLA was flawed and urged caution in interpreting its findings and recommendations. Other studies, including from faculty at the U.S. Military Academy, have also concluded that the MLA's measures to restrict servicemembers' access to short-term, small-dollar loans may be unnecessary and excessive.
- After the adoption of the MLA's APR cap, a number of reports – including from military aid societies – suggested that some servicemembers and military families have resorted to expensive programs offered by financial institutions, including "predatory or punitive overdraft practices."
- Another likely scenario is that many servicemembers are turning to unlicensed, unregulated lenders, as has been the case in every state with comparable restrictions.
- Still, consumer financial services providers operate under strict compliance with this and all applicable state and federal laws.