July 28, 2021

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate

Dear Chairman Brown, Ranking Member Toomey, and Members of the Committee

On behalf of the undersigned organizations, representing a diverse coalition of taxpayer and free market organizations, we write to express our comments ahead of a July 29th hearing entitled, "Protecting Americans from Debt Traps by Extending the Military's 36% Interest Rate Cap to Everyone" that will be before your committee. We are concerned that this hearing will be used to push a big government agenda that could have far reaching consequences for everyday consumers and lower-income Americans who want or need credit. As will be mentioned in our commentary below, there are many reasons to resist the opportunity to impose additional regulations on businesses. As such, we urge you to stand with taxpayers and consumers by supporting free market lending and oppose more government overreach into individuals' financial decisions.

General Issues with Government-Imposed Price Controls

Government-imposed price controls do not work. History has shown that price controls on any commodity produce unintended but consistently detrimental effects and often worsen the very problems they are supposed to solve. Whether placed on gasoline, rental housing, interchange fees, or prescription drugs, setting prices at below-market rates leads to shortages, squeezes the cost bubble toward some other portion of the economy, and imposes a deadweight cost on society. Certainly, these laws of economics are applicable to consumer loans that are the subject of the upcoming hearing: short-term, small dollar loans and credit card interest rates.

The appeal of price controls is understandable, as interest can often be another added cost that makes credit expensive, particularly for lower-income Americans. Yet, interest rates are an incredibly important pricing tool for lenders as they allow them to price in all their fixed and unforeseen costs. Factors such as the lender's costs and risks, consumer demand for credit, and an individual's credit history all affect how expensive or inexpensive credit will be - or if credit is offered at all. Price controls, however, take pricing power out of the hands of lenders and consumers (the free market), and places credit decisions under the domain of the federal government.

For this conversation, the federal government would place a price control on consumer interest rates through a cap on the Annual Percentage Rate (APR) of a loan. APR is the calculation that adds together the amount financed, interest, fees, and payment schedule into the cost of credit expressed as a yearly rate. However, using the Annual Percentage Rate (APR) as the rationale to cap interest rates is entirely arbitrary and economically flawed. The APR is simply the rate of interest a borrower will pay over the course of a year due to compounding, but it is extremely rare for a loan to be outstanding for an entire year. So, while some loans may appear to have extremely high APR, the vast majority of loans are paid back in a matter of weeks or months, not extended for an entire year.

Veterans and Consumers Fair Credit Act

The centerpiece of the hearing is likely to be the announcement of the reintroduction of the Veterans and Consumers Fair Credit Act (VCFCA), which would amend the Military Lending Act by extending certain provisions of the law that applies solely to service members to all consumers. This legislation would prohibit short-term lenders from charging an interest rate above 36 percent APR, which as stated earlier, would be detrimental to consumer credit access. While the actual legislative text has yet to be announced, it is expected to be similar to the VCFCA of 2019, which was approved on a straight party line vote in the House Financial Services Committee in February 2020. At the time, one of the signatories of this letter, the National Taxpayers Union submitted a letter to that Committee highlighting their opposition to the bill, noting that "Congress has a long history of imposing regulations intended to help low-income Americans that end up causing economic pain – and they are poised to do so once again with short-term lending."

If enacted, the VCFCA would put the federal government between consenting borrowers and lenders, hurt small businesses and consumers, and have disastrous unintended consequences across the economy.

More than 12 million Americans rely on short-term loans each year, with 7 out of 10 borrowers using the loans for basic expenses such as rent and utilities. In many circumstances, short-term loans or using a credit card can act as a cash advance that is paid back in full at the borrower's next pay period. It is highly likely that if enacted, VCFCA could make it substantially harder for Americans to access short-term, small dollar loans. Financial institutions and other lenders would likely only lend or provide services to those with near perfect credit scores or require additional collateral to back the loan - leaving those with modest means out in the cold. Without this access, potential borrowers may either miss a payment; default on the loan; or seek an illicit, unregulated market for a loan.

Moreover, Pew Charitable Trusts notes, "69% used short-term loans to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food; and 16% dealt with an unexpected expense, such as a car repair or emergency medical expense." Small-dollar credit products help many people deal with everyday household expenses and unforeseen emergencies that can happen to anyone from any income level.

Short-term loans are important financial tools that help people cover their obligations - both expected and unexpected. As the U.S. economy continues to recover and personal finances remain shaky, it makes little sense to strip consumers of this financial option. Additionally, short-term loans are already highly regulated at the state level, and federal law requires lenders to disclose the cost of a loan before a borrower enters into a loan agreement to ensure consumers have enough knowledge ahead of time to make an informed decision. The interest rate cap empowers government to second-guess consumers—imposing their judgment on how prospective borrowers should value goods and services.

Credit Card Interest Rates

Equally as damaging as capping interest rates on short-term, small dollar loans is the proposal to extend a price ceiling on interest rates of credit cards. As stated previously, price controls on consumer loans are likely to hurt - not help - people no matter how many times proponents of price controls call it beneficial to consumers. The result will be all too predictable: more people will lose access to credit, people will have credit limits slashed, and consumers will lose popular benefits associated with credit cards.

If enacted, credit card users will likely have their cash back rewards altered, credit limits reduced, and other negative effects. Nearly half of all open credit accounts are considered prime or subprime (177 million accounts), and the vast majority of these users have at least one credit card. To that end, a study found 74 percent of cardholders with an income between $20,000 and $30,000 own a rewards credit card. For these individuals, extra cash-back or “points” at the grocery store or the gas station can go a long way. Most importantly, 94 percent of cardholders earning less than $30,000 believe their credit card rewards program is valuable to them.

Such a cap will impose a chilling effect across the payments industry, as businesses will be less inclined to invest in faster or safer technology, since these innovations are capital intensive. While these businesses will likely remain profitable despite a price cap, this policy will reduce the incentive to develop pro-consumer innovations.

A close example pertinent to this discussion of payment industry price controls is the 2010 Durbin amendment, which was slipped into the landmark Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L 11-203) at the 11th hour. The Durbin amendment required the Federal Reserve to limit the fees banks can charge retailers for processing debit card transactions.

As a result of the Durbin amendment price control, many financial institutions suffered a significant drop in revenue. To offset the revenue decline from interchange fees, banks increased other fees and reduced services, including higher overdraft and ATM fees, fewer accounts with free checking, and increased minimum balances. In addition, proponents of the Durbin amendment said capping these interchange fees would be a boon for limited-income Americans because businesses would lower prices on goods. Unfortunately, evidence seems to disagree. In fact, a Federal Reserve Bank of Richmond report noted 98.8 percent of retailers either raised prices or kept them the same after the legislation passed.

It is likely we would see similar consumer outcomes of a nationwide cap on interest rates as we saw following implementation of the Durbin Amendment.

Big government schemes intended to “help” people are likely only to harm low-income and low-credit consumers. Congress has a long history of imposing regulations intended to help low-income Americans that end up causing economic pain – and they are poised to do so once again with these additional price controls. Americans should have the freedom to make the financial choices they deem necessary for their own situation, and lawmakers should not restrict this choice. We urge you to stand with taxpayers, businesses, and consumers by supporting free market lending and reject government-imposed price controls.

Sincerely,

National Taxpayers Union
Heritage Action For America
American Commitment

Americans for Tax Reform
Center for a Free Economy
Council for Citizens Against Government Waste
Less Government
Market Institute
Rio Grande Foundation
Taxpayers Protection Alliance