



Consumers' Research
established 1929

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April 28, 2024

The Honorable Stanley Wright
Chair, House Committee on Military & Veterans Affairs
Alaska House of Representatives
Juneau, AK 99801

The Honorable Bryce Edgmon
Co-Chair, House Committee on Finance
Alaska House of Representatives
Juneau, AK 99801

The Honorable Neal Foster
Co-Chair, House Committee on Finance
Alaska House of Representatives
Juneau, AK 99801

The Honorable DeLena Johnson
Co-Chair, House Committee on Finance
Alaska House of Representatives
Juneau, AK 99801

The Honorable Forrest Dunbar
Chair, Senate Committee on Community & Regional Affairs
Alaska State Senate
Juneau, AK 99801

The Honorable Donald Olson
Vice Chair, Senate Committee on Community & Regional Affairs
Alaska State Senate
Juneau, AK 99801

Dear Chair Wright, Co-Chair Edgmon, Co-Chair Foster, Co-Chair Johnson, Chair Dunbar, and Vice Chair Olson:

Alaska legislators are considering HB 145 and its companion, SB 264, a bill that adds new restrictions to consumer lending, including the imposition of an all-in 36 percent interest rate cap. The measure would mean that lenders would be prohibited from offering loans, regardless of their length or the risk posed by the borrower, with a rate above 36 percent, including fees, which the law interprets as adding to the financing cost.

DEFENDING CONSUMERS



Lawmakers have proposed similar bills that simply run afoul of the research. About three years ago, Illinois lawmakers presumably thought they were helping borrowers by limiting the all-in rates lenders could charge as well. But did they? Did this rate cap improve consumer welfare and protect the underprivileged from so-called predatory lenders? And, importantly, did this rate cap make small-dollar loans more affordable?

Working with a fellow academic (Brandon Bolen) and an economist from the Federal Reserve (Greg Elliehausen), we addressed these questions and other findings in a recent study. In that study, we documented the measurable effects on Illinois borrowers after the 36 percent all-in rate cap went into effect.

We examined the number and size of unsecured installment loans over a twelve-month period—six months before the imposition of the all-in cap and six months after. We sorted credit bureau data into credit score buckets by county or county groups for Illinois and Missouri, which we chose as a comparison state because it had no legislated rate cap. In Missouri, the competitive market sets borrowing rates.

Basic economic theory predicts that interest rate caps have effects that differ across groups of borrowers. A rate cap will affect borrowers with poor credit differently than those with a strong credit history. In our study, we found that the all-in 36 percent rate cap impacted subprime borrowers, those with credit scores below 600, most significantly.

Using statistical techniques, we estimated how the number of loans made after the cap was imposed and compared it to an estimated number of loans that would have been made without the cap. According to our model, in the period following the imposition of the 36 percent cap, the number of loans to subprime borrowers fell by 38 percent. Meanwhile, the average loan size increased by 35 percent from where it would have been without the cap.

Additionally, we estimated that the total dollars loaned to subprime borrowers fell about 14 percent, or about \$26 million. The deepest subprime borrowers, those with the fewest credit alternatives, were the most affected: the dollars lent to them fell by about 26 percent. This amount may sound trivial to some; however, this amount of money is significant to the Illinois families denied access to credit. We estimated that roughly 34,000 Illinois families now have even fewer credit options because they lost access to unsecured installment loans.

We also examined the results of a survey of actual installment loan borrowers in Illinois who lost access to credit after the 36 percent rate cap imposition. Ninety-three percent of the respondents said their pre-cap loans helped them manage their financial situation. Seventy-nine percent of borrowers surveyed responded that they would like the option to return to their previous lender operating under pre-cap conditions.



The proponents of an all-in 36 percent rate cap may all think they are doing a great thing for working families, but their good intentions stand in stark contrast to the cold facts observed when rate caps like the one they propose, have been imposed. Legislators claim they care about consumers who are struggling financially, but if their struggles lead them to miss payments and pay bills late, the result is a lower credit score, further limiting their access to credit. Such was the case when Illinois instituted its version of Alaska's proposed rate cap, which harmed Illinois borrowers with low credit scores while providing additional credit access to borrowers with higher credit scores.

I urge you to study the actual impacts of imposing this rate cap and I urge you to look for other ways to measure the cost of short-term loans before you move forward. Imposing an interest rate cap has actual effects that differ from the intentions of lawmakers. A 36% all-in interest rate cap is especially harmful to the very consumers the law is intended to protect.

Sincerely,

Tom Miller Jr., PhD
Professor of Finance
Mississippi State University College of Business
Senior Research Fellow
Consumers' Research

Cc:

The Honorable Cathy Tilton, Speaker, Alaska House of Representatives
The Honorable Dan Saddler, Majority Leader, Alaska House of Representatives
The Honorable Calvin Schrage, Minority Leader, Alaska House of Representatives
The Honorable Julie Coulombe
The Honorable Mike Cronk
The Honorable Will Stapp
The Honorable Frank Tomaszewski
The Honorable Alyse Galvin
The Honorable Sara Hannon
The Honorable Any Josephson
The Honorable Dan Ortiz