March 31, 2025

The Honorable Lyman Hoffman
Co-Chair
Senate Finance Committee
Alaska State Legislature

The Honorable Donald Olson
Co-Chair
Senate Finance Committee
Alaska State Legislature

The Honorable Bert Stedman
Co-Chair
Senate Finance Committee
Alaska State Legislature

Re: March 20 Committee Hearing on SB 39 – Loans under $25,000

Dear Finance Committee Chairs,

The Online Lenders Alliance (OLA) represents the growing industry of innovative companies focused on credit inclusion and financial solutions for all Americans through a common goal: to serve hardworking Americans who deserve access to trustworthy credit. Consumer protection is OLA's top priority and members abide by a rigorous set of Best Practices to ensure consumers are fully informed and fairly treated.

As detailed in our March 19 letter to the Committee, OLA opposes SB 39 which would repeal the state's deferred deposit lending statute and impose a new predominant economic interest (PEI) standard on certain bank loans.

On March 20, the Committee held an initial hearing and heard public testimony on SB 39. During that hearing, bill supporters misrepresented several aspects of this issue and made assertions that do not tell the full story. This letter seeks to clear up these misstatements and any confusion that misinformation may have caused.

Banks/Credit Unions Adhere to Rate Cap

<u>One SB 39 supporter stated that banks and credit unions already adhere to a 36% rate cap</u>.

There is no federal interest rate cap covering all Americans. This legislation specifically exempts federally chartered banks and credit unions from adhering to the provisions of SB 39, allowing these entities to charge rates that are higher than the 36% rate cap Alaska applies to other lenders. Furthermore, the bill exempts credit insurance from the bill's all-in Annual Percentage Rate

(APR) calculation which is originally meant to capture all fees in the APR price. This carve out was sought by Alaskan credit unions. Credit insurance is a product that ensures the lender is paid in the event there is a problem. Consumer groups complain that credit insurance is a benefit to the lender with the cost borne by the borrower. The fact that it is being exempted is an admission from credit unions that their products can carry all-in APRs above 36%.

Banks and Credit Unions Serving Nonprime Consumers

Several supporters of SB 39 implied that banks and credit unions provide small dollar credit for nonprime consumers.

While technically true, it is incorrect from a practical standpoint as these loans are difficult to obtain from banks and credit unions because of their high eligibility requirements. Banks and credit unions have historically focused on prime consumers, with high credit scores and large incomes. These individuals are the largest consumers of mortgages, credit cards, auto loans, and other products in which banks and credit unions specialize. In contrast, nonprime consumers are more likely to need short-term, small-dollar credit, in order to bridge emergency expenses or sudden drops in income. Serving these nonprime consumers, however, can be challenging. These consumers may have incomplete or nonexistent credit scores, making the underwriting process very challenging and expensive.

To obtain a small dollar loan from a Wells Fargo branch, someone would need to open an account (which typically requires the consumer to have money to do so), have an account in good standing for at least a year, and pass a credit check. Credit unions have similar standards, except they require potential borrowers to be an existing credit union member.

Small Dollar Loans Carry Higher APRs

Several supporters of SB 39 referenced higher APR figures and declared these loans as "predatory".

These proponents are willfully ignoring the math behind an APR calculation. The reality is that small dollar loans to nonprime consumers carry higher APRs due to the shorter duration and smaller amount of the loan. As an illustration, let us assume a lender charges $1.00 for a $100.00 loan:

- If the loan is paid in one year, the loan's APR is 1%.
- If the loan is paid in one month, the loan's APR is 12%.
- If the loan is paid in one week, the loan's APR is 52%.
- If the loan is paid in one day, the loan's APR is 365%.

These fundamentals are corroborated by the Federal Reserve as well as bank and credit union trade associations. Economists from the Federal Reserve[1] explain, "With substantial fixed costs,

[1] https://www.federalreserve.gov/econres/notes/feds-notes/the-cost-structure-of-consumer-finance-companies-and-its-implications-for-interest-rates-20200812.html

high interest rates are necessary to provide sufficient revenue to cover the costs of providing such loans. If small loan revenue is constrained by rate ceilings, only large loans will be provided. Consumers who need a small loan or only qualify for a small loan would not be served."

In addition, trade associations[2] for banks and credit unions state the following: "A 36% rate cap, however calculated, will mean depository institutions will be unable to profitably offer affordable small dollar loans. For a loan product to be sustainable, depository institutions must be able to recover costs. Costs include not only cost of funds, but also costs related to compliance, customer service, IT, underwriting, administration, and defaults (including losses)."

Small Dollar Loans Under 36% APR?

A supporter of SB 39 said that banks and credit unions have begun introducing alternatives to payday loans with reasonable interest rates.

The fact is that many banks and credit unions offer overdraft protection, which have APRs well above 1,000%, according to the Consumer Financial Protection Bureau. Credit unions can be the worst offenders, as a Brookings Institute researcher recently noted "[M]y research has uncovered credit unions, including several of the largest, that have developed an addiction to overdraft products that mirrors the worst predatory banks."[3].

Another supporter testified that Alaskans had many options to obtain credit under 36% APR, including from the Spirit of Alaska Credit Union and Wells Fargo. Last year, the Spirit of Alaska FCU offered "payday" loans on their website which had APRs greater than 36% and sometimes exceeding 100%.[4]

Wells Fargo, and other large national banks, purport to provide small dollar loans with APRs under 36%, but recent data[5] shows that many of the borrowers of high APR loans are actually Wells Fargo customers. If it were true that Wells Fargo had made small dollar loans widely available to their consumers, it begs the question, "Why are so many of their customers choosing to shop for their small dollar loans elsewhere?" One reason is because these loans are not widely available and as highlighted above, the eligibility requirements are extensive. In summary, obtaining a small dollar loan from Wells Fargo requires a potential borrower to open an account, have the account in good standing, and pass a final credit check.

[2] https://www.nafcu.org/system/files/files/H.R.%203549%20Predatory%20Lending%20Elimination%20Act-%20Joint%20Trades%20Letter.pdf

[3] https://www.americanbanker.com/creditunions/opinion/do-credit-unions-have-an-overdraft-problem

[4] The Spirit of Alaska FCU offered "payday loans" to Alaskans with APRs exceeding triple digits just last year. They offered PAL loans with a 28% interest with a separate $20 application fee. For a $200 loan paid back in one month, the "all-in APR" would exceed 100%.

[5] https://onlinelendersalliance.org/new-online-lenders-alliance-research-finds-that-consumers-continue-to-rely-on-alternative-providers-for-small-dollar-credit-even-when-they-may-have-options-at-their-bank-or-credit-union/

Small Dollar Loans and Bankruptcies

One committee member referenced a study that seemed to conclude that access to small dollar loans may have increased bankruptcies.

The study in question only looked at one lending company, instead of a larger group of small dollar lenders. A more robust and recent study in the Journal of Banking and Finance found that rate caps have no "short-run or long-run effects… on bankruptcy." An older study by economists from the New York Federal Reserve studies the impacts of rate caps that were implemented in Georgia and North Carolina. They found that "Compared with households in states where payday lending is permitted, households in Georgia have bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at a higher rate. North Carolina households have fared about the same."

SB 39 Differs from Other Types of State Legislation

Several supporters of SB39 suggested that the Alaska bill was similar to many other states that have passed rate caps, including Illinois.

The Alaska bill is **not** like the legislation passed in other states. In fact, it is unique in that no other existing legislation in the United States impacts commercial lending - specifically small business lending. SB 39 contains an anti-evasion section (Sec. 10) that negatively impacts the small business lending market in addition to the consumer lending market.

Illinois' Experiences

Supporters also stated that Illinois' borrowers were able to access credit after Illinois imposed a rate cap. The supporters pointed to a poll of 274 people (conducted by a political polling firm) that found that 8 in 10 "former high-interest loan recipients" were able to borrow some money when they attempted to take out a loan while 4 in 10 respondents were able to borrow the full amount.

The supporters did not divulge that the same survey also showed that only 51% of respondents answered in the affirmative when asked if they were able to obtain a loan when they needed one. In other words, nearly 50% of those "former high interest loan recipients" have been left without credit access following the law, despite these individuals from being able to access credit prior to the Illinois rate cap law. In addition, a separate consumer survey of actual former high APR borrowers in Illinois showed that only a quarter of respondents were able to obtain a loan when they had a funding need, leaving many without any credit options.

In addition to surveys, the number of lender licenses dropped by more than 50% in Illinois, and a studyhttps://papers.ssrn.com/sol3/papers.cfm?abstract_id=4315919 by two academics and an economist from the Federal Reserve found that, "The interest-rate cap decreased the number of loans to subprime borrowers by 38 percent and increased the average loan size to subprime borrowers by 35 percent."

In the end, both surveys showed that many of those who were able to obtain a loan before the Illinois rate cap law could no longer do so after the cap went into effect, leaving many with little or no access to credit.

Loan Rollovers

Several supporters of SB 39 stated that borrowers were taking out more than 5 loans per year, insinuating they were trapped in their loan.

Under Alaska law, a payday loan can only be renewed twice.

Complaints Against Small Dollar Loans

Supporters of rate cap legislation claim there are a large number of complaints against small dollar loan providers and the products they provide to Alaska consumers.

According to the Consumer Financial Protection Bureau's complaint database, there were a total of 1,354 complaints against all financial service products in Alaska in 2024. Of this, there were only six complaints specifically about personal loans, which include payday, installment, title, and advance loans (representing 0.44% of the complaints submitted by Alaskans).

Thank you for your consideration.

Sincerely,

Andrew M. Duke

Andrew Duke,
CEO
Online Lenders Alliance