Experts Agree: The Negative Consequences of a Small-Dollar Loan Interest Rate Cap

A number of states have implemented, or have sought to implement, arbitrary interest rate caps on consumer loan products, including short-term, small-dollar loans. These misguided restrictions have proven ineffective and counter-productive, reducing access to regulated credit for hardworking Americans, and subsequently pushing them towards costlier, less regulated alternatives. Many policymakers, think tank experts, independent researchers and academics have confirmed the negative consequences of arbitrary rate caps on consumers in need of credit and greater financial inclusion, as well as the value of providing consumers with access to small-dollar credit options.

"When states set interest-rate ceilings, the effect is to eliminate the smaller loan sizes. It is the Taskforce's view that any ceiling will inevitably eliminate some potential borrowers from the market. For this reason, it urges states to exercise caution when setting interest rate caps and to consider the impact on credit availability."

"The Taskforce urges that any legislative or regulatory steps taken to deprive marginal consumers of access to small-dollar loan products be grounded in sound economic theory and empirical evidence and not in unfounded and condescending stereotypes of the consumers who use these products."

"States should exercise caution when setting interest rate caps when implementing regulations on small-dollar credit loans. States should carefully consider the negative impact on credit availability when considering further regulations. Preferably, interest rate caps should be eliminated entirely."

– CFPB's Taskforce on Federal Consumer Financial Law Report Volume II, January 2021

"Setting such arbitrary limits on interest rates would undoubtedly put lenders out of business and prevent millions of both middle class and struggling Americans from getting accessible and affordable credit."

– Matthew Adams, policy analyst at the Competitive Enterprise Institute, "Interest Rate Caps Harm Financial Inclusion; Bank Partnerships Spread Inclusion Around," February 12, 2020

"…imposing interest rate caps hurt the very people they are intended to help. Some also claim that interest rate caps do not reduce the supply of credit. These claims are not supported by any predictions from economic theory or demonstrations of how loans made under an interest rate cap are still profitable.

"Despite the predictable howls of derision to the contrary, a free market provides the best quality products at the lowest prices. Government interference in a market lowers quality or raises prices, or does both."

– Tom Miller, professor of finance at Mississippi State University and adjunct scholar at the Cato Institute, "Interest rate caps harm consumers," The Hill, February 6, 2020

"For some Americans who may require the convenience of unsecured credit, a policy decision that effectively revokes their access to credit (without any compensating replacement) can cause a significant disruption to life. A family that does not qualify for the lowest interest rates or know someone willing to lend to them on short notice and good terms is left to make hard choices when the unexpected happens. A car that breaks down may go unfixed and a job unworked, or a home unheated when a boiler fails. When people in need cannot meet their credit needs through financial institutions, the need does not go away; instead, people are driven to 'informal' sources."

– Statement from the American Bankers Association, February 5, 2020

"Mandating an annualized rate of 36 percent would effectively eliminate small-dollar loans as a credit option for millions of financially vulnerable Americans. To where will these consumers turn should the proposed bill pass? Interest rates are objective tools used to ensure Americans retain access to demanded credit."

– Beau Brunson, director of policy and regulatory affairs at Consumers' Research, and Joe Conway, a research fellow at Consumers' Research, "A national interest rate cap would harm consumers in the name of consumers," The Hill, September 19, 2019

"Regulations that curb choice and stifle access to credit have no place in our economy. Restricting the availability of short-term credit will not solve the financial problems facing so many American families, but it will push them toward riskier and unregulated products."

– Representative Blaine Luetkemeyer (R-Mo.), "California passes new rules that cap personal loan interest at 36%, CNBC, September 17, 2019

"Eighteen states either expressly disallow payday loans or establish annual percentage rate caps on loans that, given the risks and costs of serving these types of loans, make it impossible for businesses to cover the expense of offering these products."

– Gary Wolfram, Ph.D, Mackinac Center for Public Policy, "Small-Dollar Lending Innovation and the True Cost of Credit," July 2019

"[A California bill to establish a 36 percent interest rate cap] would do more harm than good, eliminating many accessible, regulated small-dollar loans that thousands of Californians, including many Latinos, rely on to deal with an unexpected crisis… The evidence shows that states that have enacted rate caps haven't achieved the desired outcome of protecting and supporting consumers."

– Julian Canete, president of the California Hispanic Chamber of Commerce, "Limiting interest rates on loans for poor will only create more problems," The Sacramento Bee, June 14, 2019

Rate caps are price controls, which reduce access to credit for millions of financially underserved Americans… These types of rate caps will harm millions of consumers by denying them access to the credit they need, and in exchange push them toward higher-cost products they don't. This isn't consumer protection, its crony capitalism."

– Gerard Scimeca, attorney and vice president of Consumer Action for a Strong Economy (CASE), "Interest Rate Caps Don't Protect Borrowers, They Just Make Borrowing Difficult," RealClearMarkets, June 12, 2019

"…if real market forces were at work, it would be natural for a 36% loan product to beat a 100% loan product in a free market, so why is a regulation necessary?...As important, if a business could make a profit with a 36% loan, why wouldn't all the businesses in that market reduce their interest to compete?"

– State Senator Ray Haynes [R – CA], "Politicians and Pay to Play; How Bad Actors in the Small Loan Market Are Attempting to Manipulate the Law to Eliminate Competition," FlashReport, June 9, 2019

"…working-class households still needed access to credit so strict usury laws didn't diminish the demand for these loans. Rate caps simply discouraged legitimate enterprises from entering the marketplace."

"This is because a rate cap that works for large, long-term loans will not work for smaller, shorter-term ones. Only a charity or government-subsidized lender, such as a postal bank, could offer short-term, small-dollar loans at a rate of 15% per year and make ends meet."

"Millions of consumers nationwide depend on access to small loans. Limiting the rate of charge to 15% per year will not make these loans cheaper. It will simply make the law-abiding industry disappear."

– Anne Fleming, associate professor of law at Georgetown University, "Sanders and AOC want to cap interest rates on consumer loans at 15% – here's why that's a bad idea," The Conversation, May 28, 2019

"…interest rate caps have rarely ever worked. In a competitive system, interest rates reflect a variety of financial factors, including credit history, customer defaults, transaction size, credit limits, rewards programs, collection proceedings and fraud… The critical problem is economics 101. When caps are imposed and market rates are rising, lenders simply adjust their customer eligibility profile to correlate to the interest rates that can be charged."

– Thomas P. Vartanian, executive director and professor of law at George Mason University, "The unintended consequences of interest rate caps," The Hill, May 19, 2019

"…the consequences of a cap would be disastrous, removing access to credit for millions of low- and moderate-income households and forcing them to rely on family members, tighten their belts or seek higher-cost forms of credit."

"…payday loans are better than illegal alternatives that can result in higher rates or even criminal behavior. Yet, a 15% cap would make it impossible for most of these credit-constrained Americans to get credit through payday loans or other means."

– Diego Zualaga, policy analyst at the Cato Institute, "AOC and Sanders' credit card interest rate cap would be disastrous," CNN, May 17, 2019

"CFSI recognizes that there is often a trade-off between cost and availability. We encourage policymakers to allow institutions to experiment along the cost and availability spectrum, including for products with pricing above 36% APR. Policymakers should focus their efforts around understanding whether a product improves consumer outcomes in a measurable and demonstrable way rather than just filling immediate demand or meeting compliance requirements."

– Garry Reeder, Vice President, Center for Financial Services Innovation (now Financial Health Network), Testimony before the House Committee on Financial Services, Sub-Committee on Consumer Protection and Financial Institutions, April 30, 2019

"What will be the effect of a 36 percent rate cap on the market, on lenders, and on consumers? Economic theory predicts that a binding rate cap will create a shortage in the number of loans being made: the quantity demanded will exceed the quantity supplied."

"Economic theory predicts that a 36 percent interest rate cap will result in zero supply of payday loans."

"Currently, 16 states prohibit payday lending. If APRs are capped at 36 percent, this cap will act as a de facto ban. The federal Military Lending Act of 2006 likewise effectively prohibits payday lending to military personnel by placing a maximum APR of 36 percent on loans offered to them."

"Imposing a 36 percent interest rate cap on this market eliminates the supply of payday loans. Eliminating payday loans pushes borrowers with poor, or nonexistent, credit histories toward other options. These options include using bank overdraft protection, deferring the payment of bills (and facing the resulting unpleasant consequences), and turning to unlicensed lenders known as loan sharks."

– Thomas Miller, Mercatus Center, "How Do Small-Dollar, Nonbank Loans Work?" April 24, 2019

"…payday lenders provide many Americans, who often don't have access to traditional bank services, with the opportunity to smooth consumption or get cash quickly when emergencies arise. The apparently 'high' fees are a natural outcome of lending small amounts to riskier borrowers. Any restrictions that limit these fees or impose increased costs on lenders may eliminate access to any loans, leaving former borrowers with less-desirable, higher-cost options."

– Peter Van Doren, former professor at Princeton and Yale and senior fellow at the Cato Institute, "The CFPB and Payday Lending Regulations," February 19, 2019

"At APRs of just 36 percent, typical loans of $300-$600 that last several months will not be profitable."

"Small loans that reach the scale needed to compete with payday lenders, meaning they are available to a large share people who would otherwise turn to high-cost credit, will necessarily have all-in APRs over 36 percent."

"If rates are limited to 36 percent APR, credit unions also are likely to need revenue from loans larger than $2,000 to subsidize unprofitable smaller loans."

"Our research indicates a 36 percent interest rate and $20 application fee will be inadequate to support a robust small-loan program in a safe and sound manner."

– Nick Bourke, Pew Charitable Trusts, Comment to CFPB's Notice of Proposed Rulemaking on the Payday Alternative Loan Program, RIN 3133-AE84, August 3, 2018

"…a 36 percent cap eliminates payday loans altogether. If payday lenders earn normal profits when they charge $15 per $100 per two weeks, as the evidence suggests, they must surely lose money at $1.38 per $100 (equivalent to a 36 percent APR)... In view of this, '36 percenters' may want to reconsider their position, unless of course their goal is to eliminate payday loans altogether."

– Robert Deyoung, Ronald J. Mann, Donald P. Morgan, and Michael Strain, "Should Payday Lenders Be Banned?" Federal Reserve Bank of New York, October 25, 2015

"…so-called 'consumer groups' have proposed an arbitrary usury cap of 36%. At this rate, as previous experience demonstrates, lenders could not cover the cost of administering the loan."

– Thomas W. Miller Jr. and Chad Reese of the Mercatus Institute, "Why a 36% Cap Is Too Low for Small-Dollar Loans," American Banker, August 4, 2015

"The typical interest rate caps implemented by policymakers are, in practice, no different than outright bans."

– Paige Skiba, professor of law at Vanderbilt University, "Regulation of Payday Loans: Misguided?" Spring 2012

"Restrictive states either do not permit payday lending or have price caps low enough to eliminate payday lending in the state. This rate cap often is 36 percent APR."

– Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why," July 2012