Whitehouse Amendment #3746 – Interest Rate Caps

State rate cap. The Whitehouse amendment would allow states to set maximum interest rates – including any fees or points – applicable to any non-mortgage consumer credit transaction.

Coverage: The state would be able to cap rates on all non-mortgage consumer loans, including:

- Car loans.
- Unsecured lines of credit, including overdraft lines of credit.
- Overdrafts (which have been deemed to be “credit” and thus would be covered).
- Non-mortgage installment loans.
- Student loans.
- Small dollar affordable loans (e.g. those under FDIC’s small dollar affordable loan pilot).

Car dealers and other retailers offering credit would have a competitive advantage over banks.

In offering loans, a car dealer selling and financing a car can stay under a state interest rate cap by increasing the price of the car, in effect subsidizing the cost of the loan with car sales. History has shown this is what retailers do when faced with rate caps, whether selling cars or another product. The only way a bank can subsidize loans is by lowering deposit rates or charging additional or higher fees on other products, which is more difficult to do because, unlike car sales and loans, these services aren’t connected and must compete as stand-alone products.

State interest rate caps will limit fees, complicate compliance, and increase risk of liability.

Banks operating in multiple states potentially will have multiple rules, complicating compliance, increasing the risk of violations and liability, and making it more difficult to offer consumer loans.

A state rate cap may mean requiring two separate calculations for every car loan, overdraft line of credit, installment loan, and other non-mortgage loan: one to determine the state interest rate cap and one to determine the APR for Regulation Z disclosure, complicating compliance and increasing the likelihood of a violation.

An “all-in” rate cap that includes fees would mean banks reach the cap more quickly and limit their ability to offer some products, especially open-end loans, overdrafts, and low dollar loans.

The state rate cap may be based on an all-inclusive APR that is different from the Truth in Lending Act (Regulation Z) definition of APR. For example, the interest rate calculation under the bill could include application fees, late payment fees, and annual or periodic fees. This means the rate calculated under a state rate cap could be higher than the Regulation Z APR, making it more likely a lender will reach the state rate cap, particularly for small dollar loans with short terms.

Determining the state rate cap for open-end credit and overdrafts would be particularly problematic, as it would have to be determined retroactively (the “historic” APR) in order to take into account fees such as periodic fees and late payment fees. Banks would have to either significantly limit or eliminate all such fees so that the APR would be under the state rate cap, or simply not offer those products.

Overdrafts are “credit” according to bank regulators, but currently the fees are not considered “finance charges,” and therefore exempt from Regulation Z. State laws would be permitted to limit the “interest” on overdrafts by treating them as open-end loans subject to a retroactive “effective” or “historic” APR calculation and limiting the amount that may be charged.

Affordable small dollar loans such as those intended as alternatives to payday loans, (such as the 36 percent loans suggested under FDIC’s affordable loan pilot) may not be permitted under state laws. By definition, loans that are small dollar amounts, have fixed costs that are part of the finance charges and reflected in the APR, and have short terms will have higher APRs likely to exceed any state interest rate cap.

States would determine potential liability. Liability would depend on the state law. For example, it could provide that any contract with a rate higher than the cap is unenforceable. The state law could require that any interest paid in excess of the rate cap be refunded and impose a statutory damage amount, as the Truth in Lending Act does. Suits could be brought by the borrower (including class action) or by a regulator.