

Expert Opposes Caps and Encourages Modernizing NC Consumer Finance Act

Caps Imposed on Consumer Finance Often Discourage Lenders and Hurt Consumers

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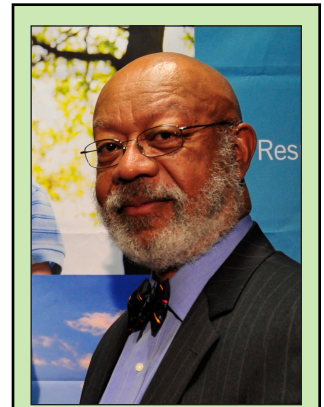
Dr. Harold Black, Professor of Financial Institutions at the University of Tennessee, discussed the consumer loan industry on Carolina Journal Radio in his June 10th interview. Dr. Black, whose financial credentials take him all the way from professor at several prestigious universities to Who's Who Worldwide, is in favor of lifting caps on lending imposed in the North Carolina Consumer Finance Act and the main debate of NC House Bill 810. While some activists insist this would not be in the best interest of the people of North Carolina, Dr. Black explains this is simply not true. "All of the research shows that these sorts of caps actually decrease the wealth and well-being of the people who you are intending to protect—the research shows that there are higher bankruptcies. It shows that people become worse off financially. It shows strife within families, increases in divorce, increase in debt burdens. And the ironic thing is that the research also shows that when those caps are lifted, people become better off and actually reduce their debt. These are things that need to seriously be considered by the public—that legislation with the intent of helping people actually turns out to hurt them and make them worse off." Mitch Kokai of Carolina Journal Radio, suggested, "[It's] another case of the law of unintended consequences," in his interview with Dr. Black.

Much of the debate over HB 810, which already passed in the NC House vote on June 2nd, stems from the difficulty in understanding APR and how it actually works. Dr. Black further explains, "APR is a terrible metric to use to measure lending cost. APR assumes that you write a loan for one year, and you pay on that loan for one year, and the interest charges reflect that. However, if you have a shorter-term loan, for instance a two-month loan, and calculate an APR—which is an *annual* percent rate—this assumes that you take that loan and refinance it every other month for an entire year in order to get that rate." This is simply not accurate. Dr. Black goes on to say, "These charges in the total cost are not unreasonable. Quite the contrary. They are actually so reasonable that your traditional lenders won't make these loans. They can't afford to. Here's the way the math works. I can charge a small fee, like an application fee of perhaps \$10. That will translate into an APR, almost automatically, of triple digits for a short-term loan. So a \$10 fee turns out to generate an APR of, let's say, 150 percent. It's still just \$10, but you tell people it's 150 percent; they'll say that's outrageous. Well, it certainly would be outrageous on a loan of that amount for a one-year period, and those are not the type of loans that this small consumer loan industry makes."

In his clarification, Dr. Black discusses how a small fee affects APR, and although most lenders charge late fees, over the limit fees and other fees according to their contracts, the Consumer Installment Loan Industry does not charge any of these types of fees in North Carolina. In addition, they have a cap on the rates they charge for these smaller, shorter term loans. This actually makes them less expensive than many common loans.

This debate has been going on for a very long time. According to Dr. Black, "For those people who are interested in history, caps on consumer lending constitute the most common work of legislatures since recorded history. We have quotes from Aristotle on this. We have quotes from great American thinkers on this issue. We have actually a very famous foundation called the Russell Sage Foundation that studied this at the turn of the century, and as a result, got two-thirds of the states' statutes changed with regard to lending ceilings on consumer loans. Now here's the thing that I find ironic. If you read that history and read the report of the Russell Sage Foundation, you will see that they find, at the turn of the century, that a loan for consumers should reasonably be priced at 3 to 3½ percent per month. That translates into an APR of 36 percent. Now, given all of the changes in costs over all of these years, isn't it ironic that last year, introduced into the U.S. Congress, was a national usury ceiling of 36 percent, and the cap in North Carolina is very close to that, today, after all of these years? Isn't that ironic?"

For more information contact: Christine Robinson, crproduction@charter.net



Dr. Harold Black
is the James F. Smith,
Jr. Professor of
Financial Institutions
at the University of
Tennessee, Knoxville