American Financial Services Association

THE FOLLY OF ARBITRARY APR LIMITS

Across the country so-called "consumer" groups are stepping up their efforts to convince policymakers that Annual Percentage Rates (APRs) should be used as caps for small-dollar, relatively short term installment loans – despite the fact that these figures bear no relation to the *actual* cost of a loan.

In simplified terms, the APR must be calculated by making the absolutely false assumption that the fee for a small-dollar personal loan will be charged not simply once, as most state laws require, but regularly, throughout the year. This voodoo mathematics gives rise to high APR calculations which serve the dramatic interests of the interest groups.

Imagine what would happen if the same technique was used to measure the cost of other financial transactions and everyday consumer items.* The results would be alarming for sure, but like the small loan example, misleading as to true cost.

EXAMPLE 1:

Converting coins using a supermarket change machine

Amount in coins: $100
Fee: 8.9%
Total received: $91.10
Fee Calculated as APR: **3565.86%**

EXAMPLE 2:

Cost of a bounced check

Amount of check: $100
NSF Fee: $30
Total payment: $130
NSF charge calculated as APR: **10950.00%**

EXAMPLE 3:

Paying college tuition for two students

Cost of tuition: $45,000
Fee for charging to a credit card: $900 (2%)
Total payment: $45,900
Fee calculated as APR: **730.00%**

EXAMPLE 4:

Using an out-of-network ATM

Typical withdrawal: $40
Fee for out-of-network ATM use: $2.50
Total Payment: $42.50
Fee calculated as APR: **2281.00%**

For everyday consumer items, the APR technique becomes even more misleading:

EXAMPLE 5:

Egg and cheese sandwich

Retail Price: $ 2.10
Cost to restaurant: $0.65
Gross profit calculated as APR: **81,423.08%**

EXAMPLE 6:

Hazelnut Latte

Retail Price: $2.75
Cost to coffee shop: $0.63
Gross profit calculated as APR: **122,825.40%**

** Note: All prices/fees provided are estimated. Calculations are based on an assumption of a 'one day loan".*

Even government levied fees are high when cast as APR:

EXAMPLE 7:

Parking Ticket (Meter Violation)

Amount of Ticket: $25

Fee for late payment: $10

Fee calculated as APR: **14,600.00%**

EXAMPLE 8:

Parking Ticket (Fire Lane Violation)

Amount of Ticket: $50

Fee for late payment: $10

Fee calculated as APR: **7,300.00%**

EXAMPLE 9:

IRS Late Fee (1%)

Taxes Owed: $800

Fee for late payment: $8.00

Fee calculated as APR: **365.00%**

** **Assumes:** $40,000 income, $800 in taxes

Of course, compared to these extreme examples, the cost of an installment loan is slight—even when misleadingly measured by APR.

It is also important to bear in mind the cost of making small loans. Often the underwriting that must take place to measure the borrower's ability to repay and protect lenders against default is similar to that required for much larger loans. It follows then that there is a minimum cost to lenders which must be exceeded in order to make a profit. Installment lenders across the country are committed to keeping their loans affordable, safe and manageable loans. It is vital that misleading, nonsensical efforts to impose APR caps in this context must not be allowed to destroy the business model.

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