The Effects on Subprime Borrowers after Illinois Imposed an All-in Rate Cap of 36 Percent

Before South Carolina lawmakers enact a 36 percent cap, I urge that they study the impact on access to credit for subprime borrowers resulting from the all-In 36% Rate cap in Illinois. Credit bureau data used in our research on Illinois' Predatory Lending and Prevention Act (PLPA) show that this cap did not make loans less expensive for all borrowers, but it did make loans less available for borrowers with subprime credit.

Research that I conducted with my co-authors, J. Brandon Bolen of Mississippi College, and Gregory Elliehausen of the Board of Governors of the Federal Reserve system (ret.), on Illinois' all-in rate cap offers results for South Carolina policymakers.

The PLPA went into effect in March of 2021. The law capped interest rates for any consumer lending product under $40,000 at an all-in rate of 36%. The cap applied to any person or entity offering loans to Illinois residents—with the exception of banks and credit unions.

Our research compared data from Illinois after the PLPA went into effect with Missouri, a neighboring state with no interest rate cap. Using four quarters of credit bureau data from Illinois and Missouri, we found that these rate caps do not work as intended and harm consumers.

First, we found that the average loan size in dollars increased across all borrower risk categories after the imposition of the rate cap, thereby making them more expensive for borrowers.

Second, the number of loans to subprime borrowers decreased by 44% meaning that PLPA restricted access to credit for these borrowers.

The third finding is that big banks and credit unions did not step in to fill the void and make small dollar loans to higher risk borrowers – those most vulnerable to an unexpected expense. In the six months after the PLPA went into effect, the supply of loans made by banks and credit unions to subprime borrowers did not increase significantly.

To explore the results of our research further, we analyzed a survey of Illinois that asked about their finances in the new rate cap environment. In the survey of former users of small-dollar credit, 39% of respondents said that their financial well-being declined after the PLPA passed, and 60% stated that they could not borrow necessary funds.

Rate cap advocates in South Carolina are relying on the Military Lending Act's (MLA) 36% interest rate cap and seeking to apply that to all consumers in the state. Yet a 2022 study from the Urban Institute found that a 2015 expansion of the MLA did not decrease delinquency or impact borrowers' credit scores. In other words, the MLA's rate cap had little to no effect on the credit health of those covered by the law.

Financial policy designed to enhance consumer welfare is a laudable goal. The pathway to this goal, however, should restrict access to credit for borrowers with subprime credit. Rate caps on small-dollar installment loans severely limit the availability of this product.

The lessons from Illinois are clear, and ones that South Carolina should take to heart.

Small dollar installment loans have a long history of providing an emergency safety net for consumers. In the early 20th century, capitalists and progressive activists cooperated to create model legislation. The

result of this collaboration was the Uniform Small Loan Law of 1916. Both sides worked diligently to find a way to provide consumers with a safe, affordable loan product and to help borrowers avoid predatory lenders.

The market for small-dollar installment loans thrived in the decades that followed. The competitive loan industry provided consumers with access to needed credit. In recent years, however, states have found themselves where South Carolina is today – debating whether to allow the competitive market to set rates or whether to introduce an arbitrary rate cap for this product.