FISCAL IMPACT REPORT

SPONSORS Herrera/Egolf/Garratt/Anderson/Ely
ORIGINAL DATE 1/28/22
LAST UPDATED
HB 132

SHORT TITLE Interest Rates for Certain Loans
SB

ANALYST Rees/Graeser

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY22	FY23		
	$180.0	Nonrecurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	$0	$4.0	$27.0	$62.0	Recurring	General Fund
	$0	($22.0)	($38.0)	($52.0)	Recurring	Financial Literacy Fund

Parenthesis ( ) indicate revenue decreases

This table should be regarded as order of magnitude and could be considered minimal. See FISCAL IMPLICATIONS for assumptions and calculations.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		See Fiscal Implications				

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to: HB78; SB107 and SB129 (Duplicates)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Regulation and Licensing Department/Financial Institutions Division (RLD)

No Response Received From
Public Education Department (PED)
Public Regulation Commission (PRC)

SUMMARY

Synopsis of Bill

House Bill 132 amends the New Mexico Bank Installment Loan Act of 1959 (BILA), Sections 58-7-1, et seq, NMSA 1978, and the New Mexico Small Loan Act of 1955 (SLA), Sections 58-15-1, et seq., NMSA 1978, by raising the maximum dollar amount for loans that may be made pursuant to the BILA and SLA from the current cap of up to $5,000 to a new cap of up to $10 thousand. The bill also adds a new requirement for lenders making loans under the BILA (other than a federally insured depository institution) to be licensed under the SLA. These changes to the applicability of the BILA and SLA may impact the number of companies that will seek to be licensed under the SLA, as well as the total dollar amount of loans made under the BILA and SLA.

HB132 reduces the annual percentage rate (APR) for loans made under the BILA and SLA from the current 175 percent, (calculated in terms of 12 CFR Part 1026, known as "Regulation Z" implementing the federal Truth in Lending Act, 15 U.S.C. 1601, et seq.) to a redefined 36 percent, calculated in terms of both Regulation Z plus "any" other charge, fee, or premium for ancillary product or service "in connection with or concurrent with the extension of credit".

HB132 allows for the interest rate on contracts to exceed 36 percent when the prime loan rate (as published by the Federal Reserve) exceeds 10 percent for three consecutive months. The rate on loans is allowed to match the increases in the prime loan rate "during the month following" the third consecutive month period of prime increases, and to revert to 36 percent if the prime rate falls below 10 percent for the same amount of time.

HB132 requires the Financial Institutions Division (FID), within 10 days, to publish when lenders may contractually increase or must decrease interest rates based on the history of the prime lending rate.

HB132 amends the definition of "consumer" in the BILA to match the definition currently in the SLA to include a person who "resides in New Mexico or who enters into a loan agreement in New Mexico." Additionally, HB132 expands the definition of "Installment Loan" to include loans repayable "in any number of payments and with any initial stated days to maturity that bears no finance charge as disclosed pursuant to 12 CFR Part 1026, known as "Regulation Z", and with respect to which no other fees or charges of any kind are imposed at any time".

HB132 modifies reporting requirements for licensees to segment the number of loans and the dollar amount of interest and fees charged for loans with an APR from zero to more than 36 percent (when allowed due to qualifying increases in the prime rate as described above) from the current range of zero to 175 percent. Additionally, HB132 creates an additional reporting category for loans larger than $5,000 but less than or equal to $10 thousand.

HB132 retains the obligation to report installment and refund anticipation loans as previously defined from existing legislation but makes it optional to report installment loans that fall under Section 58-15-2(F.)(2) NMSA 1978 of the SLA. If reported, installment loans made under Subsections F.(1) and F.(2), must report both "positive and negative performance by the borrower."

Unlike HB78, SB107, and SB129, the language of HB132:
(1) limits maximum loan terms for loans of $10 thousand or less to a maximum of 24 months;
(2) prohibits "accrual" of fees, penalties and charges for ancillary products;
(3) "after 90 days of nonpayment" prohibits accrual of interest;
(4) prohibits the legal remedies of garnishment and of loan assignment;
(5) makes a loan ineligible for refinancing unless "the debtor is not in default … and has made at least 30 percent of the payments and paid at least 30 percent of the principal";
(6) adds a requirement for all loans, not only renewals (per Section 58-7-7 F. and Section 58-15-17 L. NMSA 1978, to be "subject to underwriting"; and
(7) requires licensees under the SLA to "provide a clear disclosure that complies with the federal Truth in Lending Act, including an amortization schedule."

HB132 appropriates $180,000 from the general fund to the Public Education Department for expenditure in FY23 for the purpose of developing and providing financial literacy curriculum and training. Any unexpended or unencumbered balance remaining at the end of FY23 shall revert to the general fund.

The effective date for HB132 is July 1, 2022.

FISCAL IMPLICATIONS

According to the Financial Institutions Division (FID) of the Regulation and Licensing Department (RLD), changes in revenue resulting from HB132 are indeterminate due to the uncertain impact that a combination of the proposed changes to licensing requirements and maximum allowable APRs. The FID does not have data on non-depository lending that exceeds $5,000.

FID also comments that, "…new licensees under the SLA are assessed fees totaling $1,900. This total is comprised of a $1,000 investigation fee, a license fee of $500, a $200 examination fee, and $200 financial literacy fee. License renewal fees are a minimum of $900. This is comprised of the fixed licensing fee of $500 plus a variable component of 75 cents per $1,000 of loans made under the Small Loan Act that are outstanding as of December 31st of the preceding year. Renewal licensees are also assessed a $200 exam fee and $200 financial literacy fee."

With the increase in permissible loan amounts to $10 thousand, there may be more entrants into the business. With the decrease in APR to 36 percent, there may be more borrowers. However, two elements indicate that the predominate behavior might be to shutter some businesses. A number of banks and credit unions in the state have indicated a willingness to issue small loans with interest rates equal or less than the 36 percent allowed in the provisions of this bill. A reduction from 175 percent APR to 36 percent APR will certainly lead to lower profits for participants in this business. Lower profits at similar risk of loss from non-performing loans might lead to fewer participants in the industry. As FID indicates, this leads to a largely indeterminate revenue forecast. Nor is it possible to anticipate whether the balance of these proposed changes will lead to more participants or fewer or whether the revenue impacts on FID will be positive or negative. As FID notes, the variable portion of annual license fees are based on the total of loans outstanding at the rate of 75 cents per $1,000 of loans.

FID publishes an annual Small Loan Report[1]. Useful information from the 2020 report includes the following:

Total number of borrowers	223,915
Total number of loans	367,291
Total amount of loans	$420,907,165
Average loan	$1,146
NUMBER LOANS BY DOLLAR AMOUNT OF LOANS	
<$500	27%
$501-$1,000	34%
$1,001 - $3,000	33%
>$3,000	6%
Estimated borrowers with loan principal and interest written off.	20,152
Average Default Rate ($ written off/$ borrowed)	4.3%

FID has provided the information that there are 529 licensees pursuant to the Small Loan Act. In order to get an order of magnitude for the financial implications of this bill, LFC staff assumes the following:

1. Because of the substantial decrease in allowed interest rate from 175 percent to 36 percent, the number of licensees will shrink from 529 to between 100 and 150, but this shrinkage will take five years to be realized. Outstanding loans at 175 percent will be held until paid or refinanced at 36 percent.
2. Reducing the maximum interest rate to 36 percent will result in more borrowers and more loans, despite the fact that a number of Credit Unions and Savings and Loan institutions will offer competitively priced loans. A number of current SLB and BILA borrowers either have no credit rating or abnormally low credit rating. For the purpose of an range estimate, a 50 percent increase in the number of loans is assumed, phasing in over a three-year period.
3. Staff assumes that the average loan amount will be relatively constant at $1,200, despite the increase in the maximum loan amount to $10 thousand. Because of currently high inflation rates, we increase the average loan amount by 5 percent per year.

With these assumptions, the fiscal impacts on FID are minimal.

FY22	FY23	FY24	FY25	FY26	R/NR	
$0	$4.0	$27.0	$62.0	$119.0	R	General Fund
$0	($22.0)	($38.0)	($52.0)	($62.0)	R	Financial Literacy Fund

Section 6 (G) of the bill establishes a penalty pursuant to the Unfair Practices Act, Section 57-12-2 NMSA 1978. Whether the changes in HB132 will lead to more civil penalties pursuant to the Unfair Practices Act is also indeterminate.

It should be noted that the $180 thousand appropriation from the general fund is directed to the Public Education Department (PED) for use in the course of FY23 to develop and provide financial literacy curriculum and training. It is uncertain if the $200 fee imposed by FID to initial license

[1] https://www.rld.nm.gov/financial-institutions/annual-reports/small-loans-annual-reports/

applicants and annual renewal applicants are transferred to PED or are retained by FID and spent on programs developed by FID.

Data on fees imposed by FID are:

Initial License				
investigation fee	$1,000			
license fee	$500			
examination fee	$200			
financial literacy fee	$200			
Renewal				
license fee fixed	$500			
license fee variable	$0.75	per	$1,000	of loans outstanding
exam fee	$200			
financial literacy fee	$200			

SIGNIFICANT ISSUES

Background: Under current provisions of the New Mexico Bank Installment Loan Act of 1959 (BILA) and New Mexico Small Loan Act of 1955 (SLA), Small Loan Act Installment loans are loans of $5,000 or less that are repaid in four or more payments of principal and interest with at least 120 days to maturity. According to the Pew Charitable Trusts, approximately 10 million Americans use installment loans annually in 44 states. Pew notes that the pricing, affordability, and structure of installment loans are more consumer-friendly than those of other subprime credit products, such as payday and auto title loans. Installment lenders can provide access to credit for borrowers with subprime credit scores who may not be able to access conventional bank loans or credit cards. However, Pew also notes that many installment lenders use practices detrimental to consumers, such as front-loaded fees, stated APRs that do not reflect the total costs of the loans, and selling of credit insurance and other low-value products with upfront premiums. According to Pew, existing research is mixed on the overall impact of small credit on consumer well-being.

According to the National Consumer Law Center, as of early 2020, 45 states and the District of Columbia have rate caps for at least some installment loans, with a median rate cap of 38.5 percent. Twenty states cap the APR for a $500, six-month loan at 36 percent or less, while 12 states cap the rate at between 36 percent and 60 percent, and 13 states cap the rate at over 60 percent. New Mexico implemented its current APR cap of 175 percent in 2017. Previously, the state did not have any APR cap. Nationally, the Military Lending Act caps the APR on most consumer loans to service members and their dependents at 36 percent.

A 2018 Pew report on installment lending found that New Mexico had one of the highest rates of installment lending stores per capita, with over seven stores per 100 thousand people. By comparison, most states had less than two stores per 100 thousand people. In 2010, the Federal Deposit Insurance Corporation (FDIC) released a report on a pilot project of banks that made small dollar loans of up to $2,500 with APRs of 36 percent of less. The report found that interest and fees generated for lenders from small loans with APRs of 36 percent or less were not always sufficient to achieve robust short-term profitability, and that most participating banks sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products. However, the report concluded that banks can feasibly offer affordable small dollar loan products as an alternative to high-cost credit products, like payday loans and fee-based overdraft protection.

HB132 seeks to address some of the issues involved in the 2018 PEW report. This bill includes the following provisions:

1. **Reduces the maximum allowable interest rate from 175 percent APR to 36 percent APR.**
2. **Indexes the maximum allowable interest rate to the prime rate of interest.** HB132 provides an override to the 36 percent APR cap when the prime rate of interest exceeds 10 percent for three consecutive months. The maximum permitted APR will increase by one percentage point for each percentage point that the prime rate of interest exceeds 10 percent.
3. **Increases the dollar amount of loans covered by the SLA and the BILA from loans of $5,000 or less to loans of $10,000 or less.**
4. **Enacts additional anti-evasion protections to prevent businesses from circumventing the 36 percent APR cap.** This anti-evasion language mirrors similar installment loan legislation in Georgia and more recently in the Illinois Predatory Loan Prevention Act, and addresses practices that have been seen in other states.
5. **Enacts additional consumer protections to prevent predatory lending practices.** The bill creates additional loan requirements – providing that loans shall not be made for a term greater than 24 months, shall not accrue certain charges or interest, be recoverable through wage garnishment, be eligible for refinancing unless the borrower is not in default and has paid a certain percentage of the loan contract. HB132 requires that lenders making loans be subject to underwriting and be reported to consumer credit agencies and complies with the federal Truth in Lending Act.
6. **Proposes an Appropriation of $180 thousand to the Public Education Department.** The bill contains a $180 thousand appropriation for the Public Education Department to develop and provide financial literacy training and curriculum.

The FID notes the following issues:

> "Totality of the circumstances" determination for lenders: HB132 expands persons or businesses subject to licensing to include a person who, by a "totality of circumstances," is a lender. This change appears to be intended to prevent the ability to evade the requirements of the BILA and SLA by lenders who structure transactions to avoid specified provisions of those acts. This wording may create confusion concerning who may initiate an investigation or bring a legal action against a "totality of the circumstances" lender. As drafted, the language of HB132 does not clarify which entity is authorized to investigate or bring legal action against such lenders.
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> A potential solution to this uncertainty would be to specify that the director of the FID is authorized to determine whether the "totality of the circumstances" indicate a person is a lender, and that a transaction is structured to evade requirements of the SLA. The Director would then issue a final order on the matter, subject to review through the standard judicial review process.

"Buy-now, pay-later" loans: HB132's broadened definition of installment loans and removal of the credit reporting requirement effectively legalizes loans being offered by providers of so-called "buy-now, pay-later" loan products. Under current law, for transactions up to $5,000, this form of commerce constitutes the making of a loan, and, as such, is in violation of the SLA due to: (1) the product's repayment time being shorter than the current 120-day minimum repayment period; and (2) the loan's repayment not being in at least four substantially equal repayments. Numerous regulators across the country and internationally, including the FID, have expressed concerns about the potential for consumers to overextend their finances by taking out multiple buy-now pay-later loans for items that they might not have otherwise purchased. Additionally, regulators are concerned that the "optionality" of credit reporting of small loans overall will lead to a significantly diminished usefulness of consumer credit reports, particularly when it comes to all lenders being able to effectively determine a consumer's ability to repay any given debt (which is required in certain lending laws, such as under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Ability-to-Repay/Qualified Mortgage Rule in Regulation Z).

The federal Military Lending Act (MLA), 10 USC Section 987, enacted in 2006 and implemented by the Department of Defense (DoD), protects active duty members of the military, their spouses, and their dependents from certain lending practices. DoD promulgated regulations pursuant to the MLA which caps interest rates for these individuals at 36 percent annual percentage rate [See 32 CFR Part 232.4 (b)].

PERFORMANCE IMPLICATIONS

The FID is uncertain about the effect of enactment of HB142 on its performance measurements due to uncertainty about licensure turnaround time and the percentage of examinations completed.

ADMINISTRATIVE IMPLICATIONS

According to the FID, if a substantial increase in the number of small loan licensees results from the increase in the maximum loan amount designated as a "small loan," the FID may require additional funding to increase the number of licensing staff and examiners to effectively regulate and supervise the small loan industry.

OTHER SUBSTANTIVE ISSUES

Other States Have Passed 36 percent APR Caps in recent years:

- In 2016, South Dakota enacted a 36 percent APR cap on payday loans through ballot referendum. Studies and focus groups of former borrowers conducted after the rate cap found that other financial options were available to South Dakotans, including small dollar loans from other financial institutions and other financial strategies.[2]
- In 2021, Illinois enacted a statutory 36 percent APR cap through the Predatory Loan Prevention Act (PLPA). Comparing a 5-month period in 2019, before the PLPA passed to the same period in 2021 — including months after the PLPA passed — Illinois consumers saved over $200

[2]Center for Responsible Lending "The Sky Doesn't Fall: Life After Payday Lending in South Dakota" Desnhttps://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-the-sky-doesnt-fall-jan2020_1.pdf (January 2020).

million in fees for high-cost loans.[3]

- In Illinois, affordable lenders moved in to fill the void left after the departure of high-cost lenders. Community Development Financial Institutions saw an increase in affordable loan volume after the 36 percent rate cap went into effect. Some installment lenders, including One Main Financial, which also does business in New Mexico continued to operate under the 36 percent APR cap. Sixty-seven new installment lenders applied for licensure after the 36 percent APR cap went into effect and Fintech lenders continued to operate in Illinois.[4]

- In a survey of eight states that enacted interest rate caps on installment and payday loans between 2001 and the present, eliminating high-cost loans led to an increase in the availability of affordable loans, such as those from credit unions and borrowers did not turn to illegal online loans in large numbers.[5]

Affordable Lending Options in New Mexico**:**

- Credit Union Association of New Mexico: CUANM supports a 36 percent APR cap. There are over 140 credit union branches across New Mexico, many of which offer small dollar loans or even refinance high-cost storefront loans at rates much lower than 36 percent APR. Many credit unions do not require a credit score to offer loans.
- CU SAFE Coalition: Credit Union Survivor Alliance for Financial Empowerment (CU SAFE) is based in and founded in New Mexico. CU SAFE provides survivors with low-interest loans, financial navigators, and other resources not currently available in other agencies or banks.[6]
- Bank on Burque: this is an initiative of the City of Albuquerque in partnerships with credit unions, banks, and community organizations to connect families to certified safe and affordable checking accounts in the Albuquerque Community.[7]
- Fintech lenders: members of the American Fintech Council operate online and offer credit at well under 36 percent APR in communities across the country, including New Mexico.[8]
- TrueConnect is a product available for employees of counties and municipalities across the state. These are employer-based loans well below 36 percent APR.[9]

TECHNICAL ISSUES

HB132 has an effective date of July 1, 2022. Currently, licensees under the SLA are required to report their small loan activity for the prior calendar year by April 15. This discrepancy would create two data sets for year 2022, which could be difficult for licensees in terms of reporting and would likely result in error-prone data reported to the FID.

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[3] Woodstock Institute, "The PLPA's 36% rate cap is working - and the data proves it," https://woodstockinst.org/news/blog/36-rate-cap-is-working/ (January 11, 2022).
[4] Woodstock Institute, "The Importance of at 36% Rate Cap: A Briefing for Illinois Latino Legislative Caucuses" https://woodstockinst.org/wp-content/uploads/2022/01/Latino-Caucus-briefing-Presentation.pdf (January 25, 2022).
[5] National Consumer Law Center, "After Payday Loans: Consumers Find Better Ways to Cope with Financial Challenges," https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/IB_After_Payday_Loans.pdf (August 2021).
[6] American Bar Association "Domestic Violence & Economic Paths to Safety: The Credit Union Model of Support" https://www.americanbar.org/groups/crsj/events_cle/recent/credit-union-model-of-support/ (October 26, 2021).
[7] City of Albuquerque, "Bank on Burque," https://www.cabq.gov/legal/bank-on-burque (last visited January 26, 2022).
[8] American Fintech Council, https://fintechcouncil.org/ (last visited January 26, 2022).
[9] Prosperity Works, "Fair Lending Options" https://bit.ly/3u3xseI (last visited January 26, 2022).

FID recommends using January 1, 2023, as the start date for alterations in licensees' annual reporting requirements. This change will allow for a homogenous data set for each year. Because the calculation of APR in HB 132 conflicts with Regulation Z, FID recommends either: (1) simplifying the calculation to exactly reflect the Regulation Z requirements or (2) requiring both the current Regulation Z APR disclosure and a second calculation titled other than "APR" to demonstrate the total annual percentage cost of financing, including other products and/or fees not covered under Regulation Z.

The FID notes that HB132 does not define the term "default" (as used in Section 58-7-7(K)(1)(e) NMSA 1978 at pg. 9, lines 3-6; Section 58-15-10.1(12) NMSA 1978, pg. 30, lines 2-5; Section 58-15-10.1(14) NMSA 1978, pg. 30 lines 10-11; Section 58-15-17(Q)(1)(e) NMSA 1978, pg. 40, lines 10-13).

HB132 also does not define the term "underwriting" (Section 58-7-7(K)(2) NMSA 1978, pg. 9, lines 7-9; as used in Section 58-7-7(Q)(2) NMSA 1978, page 40, lines 14-15, for example). Both "default" and "underwriting" have different meanings depending on the context, industry, and topic of law. Therefore, the FID recommends defining both terms.

HB132 redefines "consumer" as someone who resides in, or enters into a loan contract in New Mexico. A number of current licensees under the SLA lend to out-of-state residents through physical or online platforms. These customers are often not physically located "in New Mexico" when a loan is made, which has caused confusion for reporting requirements for licensees. However, HB132's "consumer" definition clarifies which loans are required to be reported in the annual small loan report.

HB132 requires the FID to post notice of any possible increase or mandatory decrease in the maximum allowable permitted APR. Rate increases and decreases are triggered when the prime loan rate increases or decreases during "three consecutive months." Interest rate movements in the prime rate may or may not occur in such consecutive intervals but may still take place over time.

The expanded APR calculation and disclosure changes for both BILA and SLA, as proposed in HB132, would create a conflict of law between the BILA/SLA and federal law, 12 CFR Part 1026 – Truth in Lending (Regulation Z). The conflict concerns the definition and required disclosure of the APR. Regulation Z allows charges incident to the extension of credit to be included in the APR calculation, However, HB132 requires inclusion and disclosure of certain fees in the BILA/SLA version of the APR that are not included in the Regulation Z APR calculation.

To avoid this conflict, RLD suggests either: (1) simplifying the calculation of APR in HB132 to mirror Regulation Z or (2) requiring separate disclosures for both Regulation Z's APR disclosure and a second calculation titled something other than "APR". Regulation Z provides that charges incident to the extension of credit are included in the calculation, dependent upon certain criteria. See chart below for a detailed breakdown of the determinations that must be made in order to know whether a specific charge will be included in the calculation of interest for a particular loan under Regulation Z.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Related to SB107, SB129, and HB78.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

According to FID, licensing requirements in New Mexico will continue to apply to any non-depository entity who makes consumer loans or refinances of up to $5,000 with a maximum APR of 175 percent. Loan products made under the SLA or BILA would continue to be in the form of either a refund anticipation loan or an installment loan with a term of at least 120 days, repayable in at least four substantially equal payments, with no maximum loan term.

Lastly, retail commerce product transactions up to $5,000 of the “buy-now pay-later” type which do not comply with the current requirements for installment loans (term of at least 120 days, repayable in at least four substantially equal payments) would continue to be considered illegal in New Mexico, even if the lender is licensed under the SLA.

Attachment

1. Finance Charges

CR/LG/al

Attachment 1

Finance Charges