ILLINOIS AUTOMOBILE DEALERS ASSOCIATION

FACT SHEET SB 2306

36% APR CAP ON MOTOR VEHICLE INSTALLMENT CONTRACTS

WE SUPPORT

BACKGROUND

Lame duck legislation creating the Predatory Loan Prevention Act (PLPA) was intended to prohibit predatory lending practices like high-interest payday loans. Unfortunately, the PLPA's use of Military Lending Act APR (MAPR) distorts the cost of credit under the Motor Vehicle Retail Installment Sales Act and impairs dealers' ability to arrange motor vehicle financing and to offer voluntary protection products to customers.

ANALYSIS

The PLPA has been portrayed as imposing a 36% interest rate cap on motor vehicle retail installment contracts. The PLPA's 36% rate cap is based on Military APR, however, which distorts the cost of credit. MAPR treats the cost of voluntary protection products like GAP waivers and extended service contracts as finance charges, part of the cost of credit. The MAPR makes a similar change for customers who take advantage of cash out financing in a vehicle retail installment contract to pay off the lien on a trade-in. Under the 50-year-old definition of APR under the Truth in-Lending Act (TILA) these charges are part of the amount financed. For example, a customer who finances a $20,000 vehicle with a $1,500 extended service contract is purchasing the same dollar amount of products as a customer who finances a $21,500 vehicle with no additional products. Although each customer is purchasing the same dollar amount of products, the customer with the extended service contract sees the $1,500 fee shown as part of the finance charge for PLPA purposes. Artificially inflating the finance charge as required under PLPA makes it appear that the cost of credit is much higher than it actually is under TILA. Offering voluntary protection products is not a predatory lending practice. Voluntary protection products like extended service contracts and GAP waivers help vehicle customers protect one of their largest investments—second only to a home for most people.

The MAPR cap creates a second problem for dealers and lenders. Federal and state regulators are unable to provide guidance on which fees and charges should be transferred from the amount financed to the finance charge. The menu of fees and charges that could potentially get transferred from the amount financed to the finance charge includes GAP waiver, credit insurance, and service contract fees and the amount of any cash-out financing. Until there is guidance on calculating the PLPA's APR, dealers will be left in a compliance trick bag--offer products and services that are of value to many of their customers or risk violating the PLPA. Applying MAPR to motor vehicle retail installment contracts was so problematic that even the Department of Defense withdrew interpretive guidance that would have applied MAPR to motor vehicle retail installment contracts.

SOLUTION

SB2306 caps the APR for motor vehicle installment contracts at 36% APR, as defined under TILA. TILA has been in place for over 5 decades and allows consumers to compare competing offers of credit on an "apples to apples" basis. The 36% APR cap in SB2306 protects consumers from abusive vehicle lending practices without taking away the option to purchase valuable vehicle protection products.

COMMENTS

The Illinois Automobile Dealers Association supports a 36% APR cap on motor vehicle retail installment contracts. For more information, please contact Larry Doll, Joe McMahon, or Pete Sander at 217-753-0220.