APPENDIX A

Methodology

This report compares the maximum APR permitted for two sample installment loans under the laws of the 50 states and the District of Columbia. The purpose of an APR is to express the full cost of a loan on an annual basis, so that the costs of loans of different amounts, different lengths, and different mixtures of interest and fees can be compared to each other.[10] The APR is especially important for revealing the full cost of a loan that charges fees in addition to a periodic interest rate. For example, Arizona allows 36% interest on a $500 six-month loan, but also allows an origination fee of 5% of the principal. Taking both the interest and this origination fee into account, the APR is 54%. If only the interest were allowed, the APR would be 36%.

A number of states have more than one statute under which our two sample loans—a $500, six-month loan and a $2,000 two-year loan—can be made. If a state has several statutes, or its statute allows several different rates, we have used the highest rate allowed. Appendix C gives citations and some basic details for the statutes under which we made our calculations.

In many states, the allowed rates produce a higher APR for the $500 loan than for the $2,000 loan. This occurs for two reasons. First, some states impose lower rate caps on larger loans. Second, in states where lenders are permitted to charge a fixed fee on top of the interest rate, that fee will have a greater impact on a smaller loan than a larger one. For example, an additional $50 charged on a $500 loan will have more of an impact on the APR than the same $50 fee will have on a $2,000 loan.

Many state lending laws have ambiguities that affect the calculation of the APR. For example, a lending law may allow a lender to charge an origination fee without specifying whether it can also charge interest on that fee. In the absence of clear statutory language or regulatory guidance, in our calculations we treated origination fees as amounts that can be added to the principal and on which interest can be charged. For other ambiguities, we have used our best judgment to find an interpretation that seems consistent with the statutory language and the intent of the statute, subject to correction if we are able to get clarification from regulators. Policymakers should consider issuing regulations or other guidance to close loopholes created by these ambiguities that high-cost lenders could exploit.

A thorough discussion of credit math calculations under state lending laws may be found in National Consumer Law Center, *Consumer Credit Regulation* Ch. 5 (3d ed. 2020), *updated at* www.nclc.org/library.

