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The Economic Impact of Prop 209, An Interest Rate Limit on Debt From Healthcare Services and New Collection Exemptions

October 2022

Summary and Key Findings

Arizona Proposition 209, called the 'Predatory Debt Collection Protection Act', intends to protect Arizonans from high interest rates and predatory collection on medical debt. This proposition would place a cap on the interest rates for medical debt and increase the value of assets exempt from forced sale or other predatory practices. However, the protections proposed in this measure also have the potential to harm borrowers and market participants by hampering the market for lending.

Debt collectors in Arizona must adhere to the federal Fair Debt Collection Practices Act which protects consumers from predatory debt and lending practices while still allowing some freedom in the market. Arizona law additionally protects $250,000 in home value, $6,000 for a motor vehicle, $300 in a bank account, and $6,000 in household furnishings from forced repayment practices from debt agencies. Further, the interest rate on loans in Arizona is legally presumed to be 10% unless another rate is agreed to in writing by both parties.[i]

In general, economic theory suggests that there are trade-offs involved with consumer protections in credit markets. For example, prior to rate deregulation, the American credit card market was characterized by high-fees and high-selectivity, which meant most consumers had no or very little access to revolving credit card accounts.[ii] Regulatory proposals which cap rates or make it harder to ensure repayment on delinquent debt may have the unintended effect of raising costs on other borrowers (through higher fees) or incentivizing lenders to be more stringent in their lending criteria, limiting debt access for some folks.

Proposition 209 would increase the assets and earnings protected from all debt collection and fix the interest rate on medical debt to 3%. This would likely reduce the willingness to lend and make it more difficult for borrowers to receive desired funds. Because the interest rate is limited to 3% only on medical debt, we may see an increase in (unregulated) fees on these loans, an increase in interest rates on other kinds of debt, or an increase in lending standards to lower lender risk and restrict market access to only the most credit-worthy borrowers.

CSI Arizona surveyed studies on the effects on limiting interest rates and, if the conditions for these markets are applicable in Arizona, there could be an estimated 26.8% decrease in willingness to lend for medical purposes due to the interest rate caps proposed in Proposition 209. Because of the increased values in exempted assets, lenders in all debt markets may be less willing to lend because of the increased difficulty in collecting from riskier borrowers, but CSI was unable to estimate precisely the magnitude of these effects.

Prop 209 Estimated Effects

26.8% Reduction in willingness to lend

73% decrease in interest rates on medical debts

Possible increase in lending fees

To the extent the new law would also apply to the rate of interest on medical accounts receivable sold to a collections agency, this may also reduce the marketability of unpaid medical bills (and therefore increase risk to, and revenue of, medical service providers). While hospitals are legally required to provide services regardless of ability to pay, the

law may encourage private healthcare providers (e.g., primary care offices) to require up-front payment, raise other non-capped fees, or more carefully select clients for ability to pay.

What is Proposition 209?

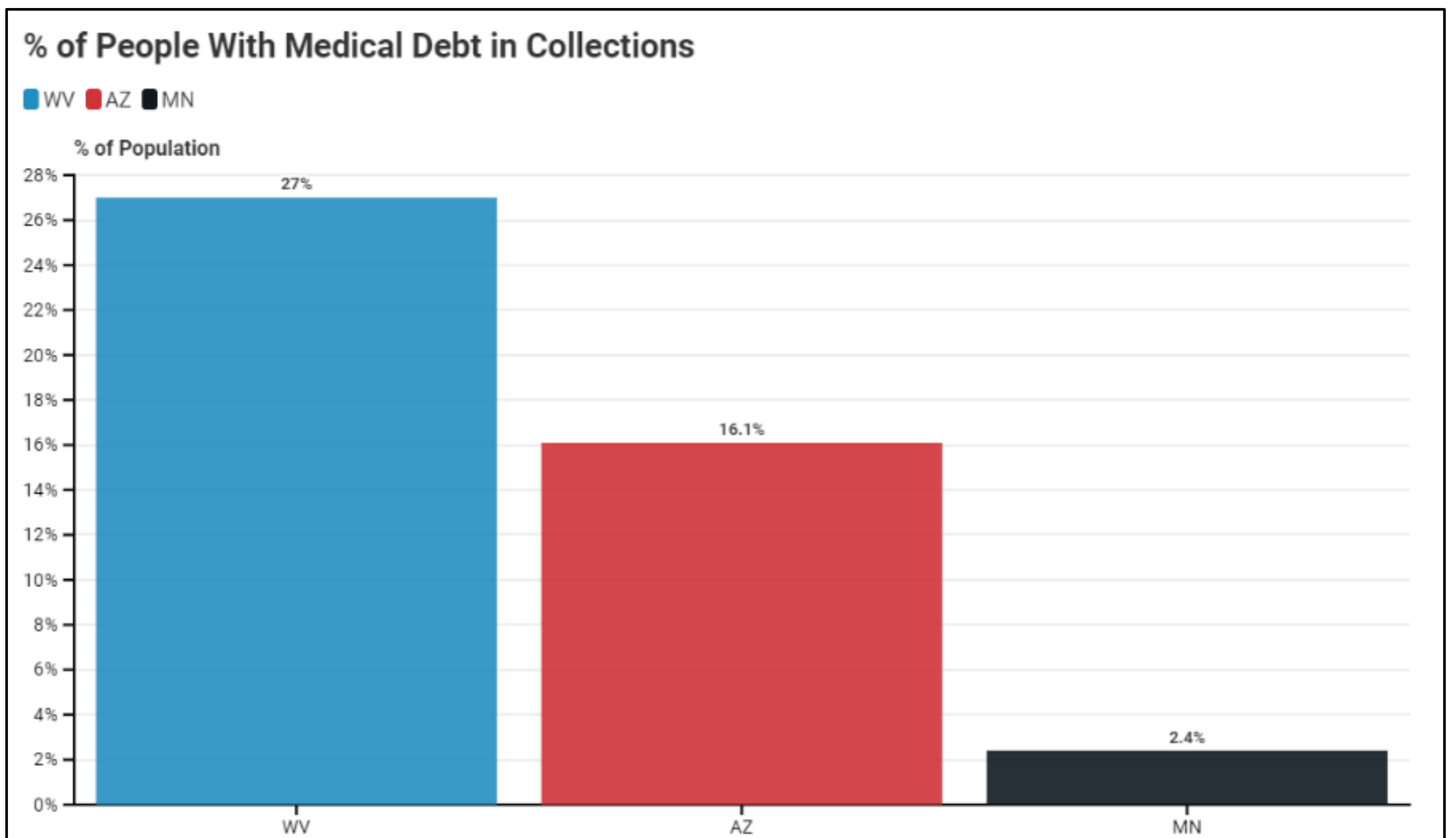
Proposition 209 was petitioned to be put on the November ballot by the Arizonans Fed Up with Failing Healthcare PAC, and seeks to increase the values exempt from debt collection practices:

- From $250,000 to $400,000 of the value of a home
- From $6,000 to $15,000 for a motor vehicle
- From $300 to $5,000 in a bank account
- From $6,000 to $15,000 in household goods

It would also lower the limit for disposable earnings subject to debt collection from 25% to 10% and place a ceiling on interest rate accrued from "medical debt" to 3%/year.[iii]

The stated rationale for this proposition from Healthcare Rising Arizona, the organization funding the PAC, is to protect consumers from predatory debt collection. With the changes proposed, Healthcare Rising AZ seeks to:

- Match the protected value of people's home to Arizona's median home value
- Reduce the amount of people losing their vehicles due to medical debt
- Prevent predatory lending practices and reduce the medical debt burden



While these changes could succeed in meeting those goals, they could also make it more difficult to collect on overdue debts and could worsen lending terms for borrowers with other kinds of debt.

This measure is funded in part by SEIU-UHW, a California based healthcare workers union. SEIU-UHW donated $4,067,179.07 to support Proposition 209 and they partnered with Healthcare Rising Arizona to circulate petitions and get this measure on the ballot.[iv]

Medical Debt Background

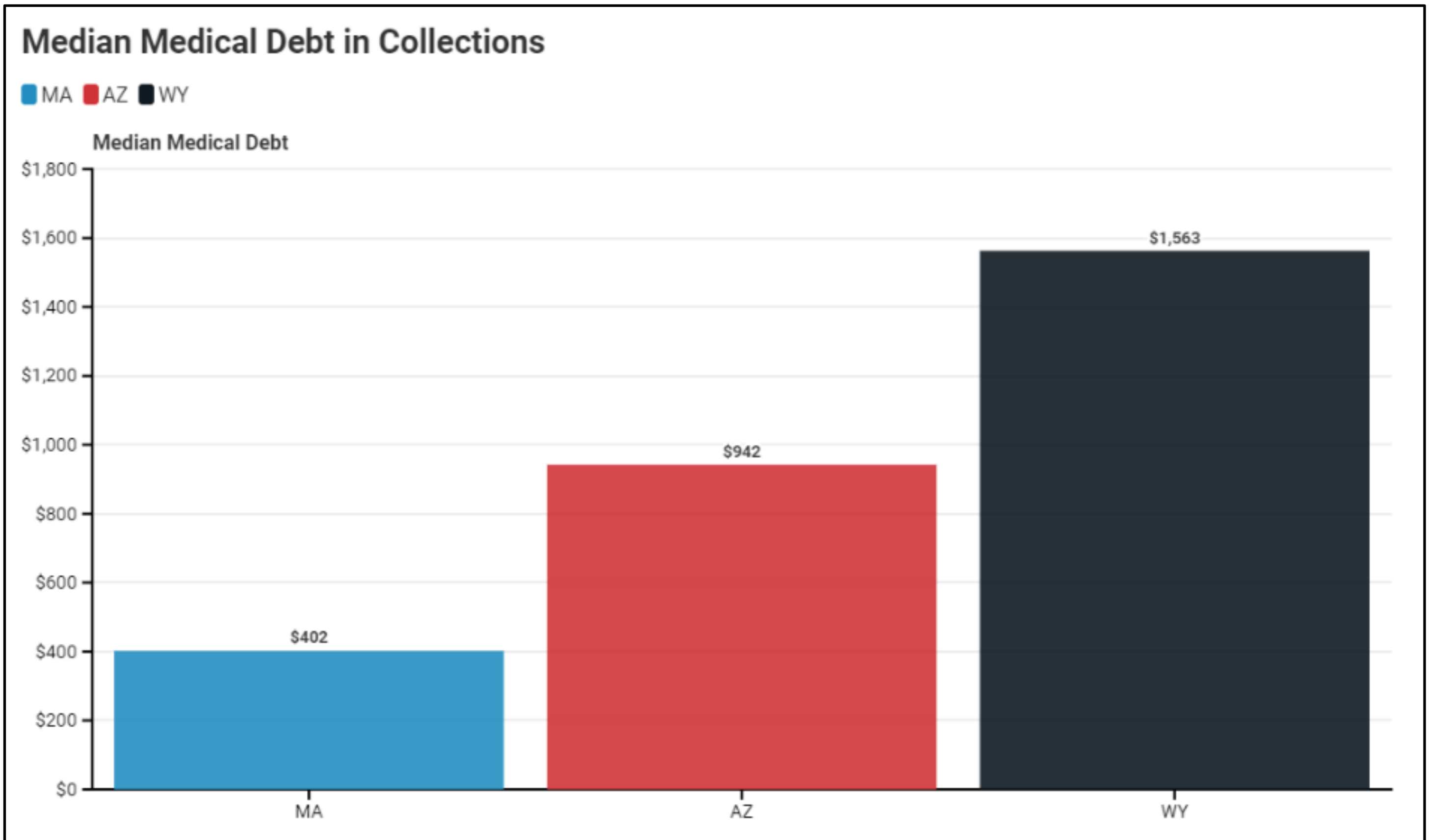
While the assets protected from debt collection would be increased for all kinds of debt, the interest rate is only limited for "medical debt" (defined in the proposition to be "any loan, indebtedness or other obligation arising from the receipt of healthcare services")[v]. Medical debt is considered very different from other forms of debt because it is often something consumers take on involuntarily due to some emergency treatment[vi].

Interest rates on medical debt are particularly unpopular because of perceptions that families can be trapped with debt from seeking medical care for a family member. One of the primary supporters of Proposition 209 cited this as the reason for limiting interest rates solely on medical debt to better protect consumers from the burden of debt.[vii]

However, even with much of the concern surrounding medical debt, it appears to affect only a minority of Arizonans. According to one source, 16% of Arizonans have medical debt in collections with the median debt being $942.[viii] While Proposition 209 exhibits concern for those burdened, the amount of people with medical debt in Arizona does not seem to warrant this concern, and the measures approach does not attempt to differentiate between truly predatory lending, and borrowers who benefit from their loans.

Further, medical debt is reported differently on credit reports because it is less predictive of payment on other kinds of debts. Starting in 2023, medical debt under $500 will not be reported on consumer credit reports by the 3 major credit reporting agencies.[ix] This will eliminate around two thirds of medical collections from appearing on credit reports.[x]

Since most medical collections seem to be under $500, and most of this debt is likely short-term, limiting the interest rate on medical debt could easily do more harm than good - even at higher interest rates, interest costs of short-term, low-dollar loans are likely already low. Regulations such as these almost always come with economic tradeoffs, and, in this case, reducing the amount that can be earned from interest encourages lenders to seek revenue other ways. In order to recuperate the loss from charging less interest or to cover any fixed cost they have from taking on this debt, agencies would have to take on higher amounts. So, while the previous median amount owed on medical debt is $942, this amount would likely be much higher under Proposition 209.



Debt collectors would also be more affected by Proposition 209 due to the increased value of assets protected from all kinds of debt practices. While medical debt would be less appealing to a collection agency, these regulations would encourage agencies to be more selective with other kinds of debt. In order to ensure repayment of debts, lenders can seek a judgement on the debt and potentially force the sale of assets, garnish wages, and take funds directly from bank accounts in order to cover consumers debts.

Because more value in assets, wages, and bank accounts are protected under Proposition 209, debt collectors would be highly selective about whose debt they buy in order to ensure repayment. To the extent that many people in medical debt do not have more than these protected values in assets, lenders will be more hesitant to lend to those people because they risk never being repaid if they cannot seize payment on overdue debts.

While much of the language surrounding this measure is to protect against predatory debt collection, the interest rate limit applies directly to loans people take out specifically to cover medical procedures. The same tradeoffs apply to these loans as well but could have a wider effect on the credit market. Lenders would be less willing to lend smaller amounts to cover medical services. As the majority of medical debt reported on consumer credit reports is under $500, a limit on interest rates would encourage lenders to only lend larger amounts in order to maintain the same level of revenue.

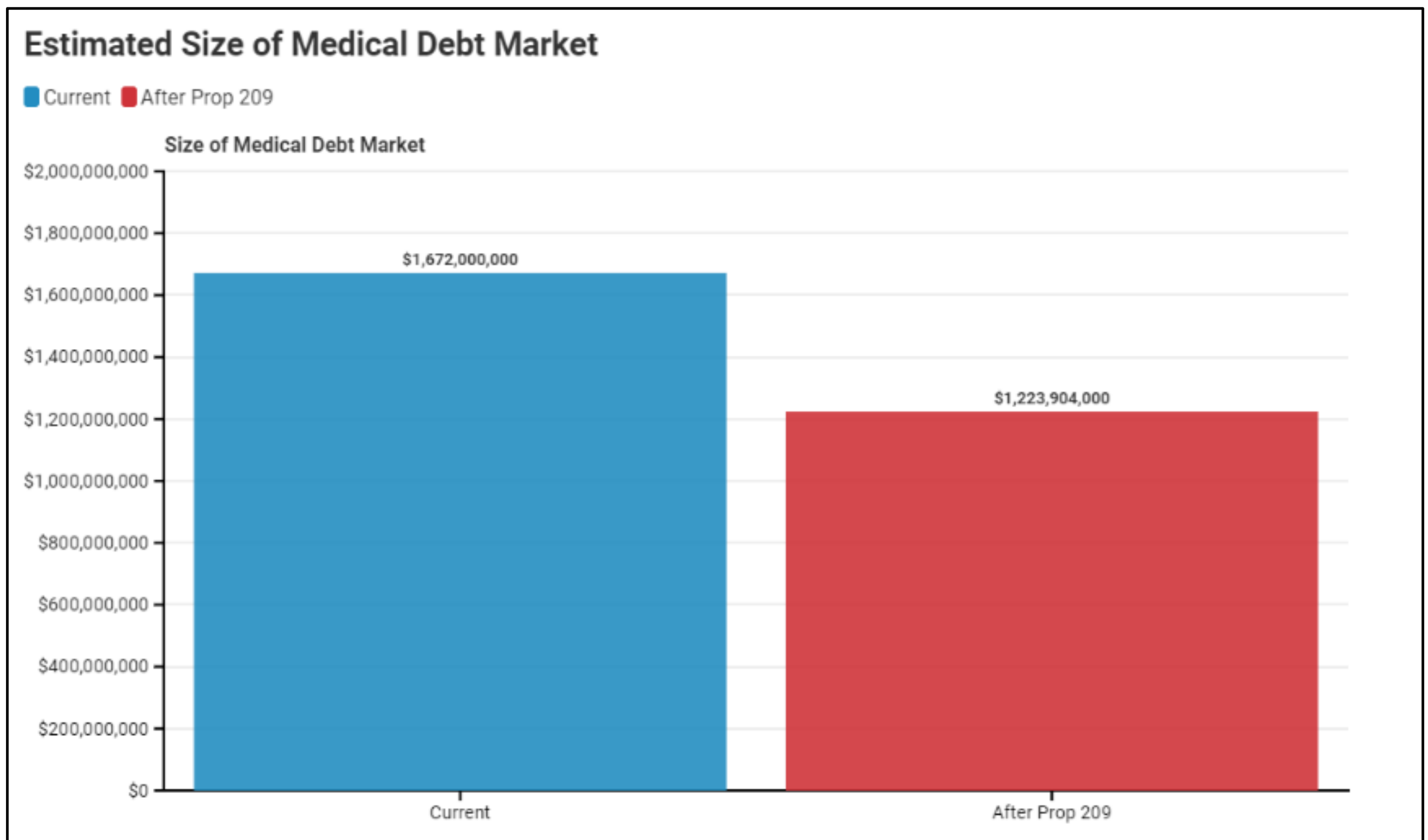
With both debt collection and direct loans effected by this measure, more consumers could find themselves unable to obtain credit for all types of debt. Although the stated end of Proposition 209 is to protect consumers, the unintended consequences could place them in a worse position than before.

Economic Implications & Proposed Clarifications

Considering the effects of a limit on interest rates, CSI Arizona can estimate the expected effects of a 3% limit on interest rates for medical debts. We would expect to see:

- Reduced willingness to lend
- Higher fees on medical loans and from medical care providers
- Higher selectivity from lenders and private medical care providers
- More consumers seeking less urgent medical care

The Consumer Financial Protection Bureau estimates the total amount of medical debt on consumer credit reports to be $88 billion[xi]; assuming approximately 1.9% of this is attributable to Arizona borrowers (roughly in line with the state's share of national Personal Income), CSI Arizona estimates the amount of medical debt in Arizona to be $1.6 billion.



A study on the effects of Kenya placing a ceiling on their interest rates at 14%, down from an 18% market rate, found that lending decreased 5.8% after the ceiling was put in place.[xii] In another study estimating the effects of removing a ceiling on interest rate, it was found that the number of new loans

increased 4.5% for every percentage point lift in the microcredit lending interest rate.[xiii] In order to estimate these effects for Arizona with a 3% interest rate cap on medical debt, CSI Arizona assumes an 11% market interest rate. This rate was found by taking the simple average interest rate when credit cards are used to cover medical debt (16%) and the interest rate when a personal loan is taken out to cover the debt (6%), according to an article by Bankrate.[xiv] Averaging the effects of the two studies on the effects of interest rate ceilings, a 73% decrease in the interest rate (11% to 3%) could result in a 26.8% decrease in willingness to lend for medical expenses.

This reduction in willingness to lend due to the limit for the interest rate on medical debt means that not only would consumers have less access to credit from financial institutions for medical debts, but they would also face higher fees with these loans and possibly higher interest rates on loans of other kinds. Lenders could also likely only lend very large amounts for medical services so they can cover any fixed costs that would usually be paid by higher interest rates. It is difficult to estimate the extent of these changes due to the individual nature of these kinds of loans, but these kinds of tradeoffs can be expected if Proposition 209 passes.

To the extent that this measure applies to debt in collections, the 3% interest rate ceiling would reduce the value of the debt and could result in higher fees from medical service providers and higher selectivity from private care facilities to recuperate some of the losses from not being able to sell medical debt at a higher price.

Proposition 209 could encourage consumers to seek out necessary medical care without fear of debt burdens, as the lower interest rate could lower the total amount paid on medical debt. Although this measure could make it harder to receive medical care from private care facilities if consumers have bad credit or are unable to pay for services up front, the lower interest rate and increased asset exemptions could ease consumers may have about taking on medical debt to receive necessary care. Further, this measure could help those burdened with medical debt taken one due to family members. While this could have significant changes to the credit market, it could help those willing to take on debt but worried about higher interest rates impacting their financial standing.

However, the act is vaguely written. It broadly applies itself to "medical debt", defined to be any loan or debt that directly arises from the provision of medical services. It does not exclude anything from this definition, nor provide guiding examples for readers, regulators, and the courts to rely on when interpreting the statute. For example, do the interest rate limits apply to regular credit card loans, if the credit card was used in the purchase of healthcare services? And do the limits apply to cosmetic procedures provided in a healthcare setting? The lack of clarity may lead stakeholders to read the statute broadly and this creates vast potential for unintended consequences.

Overall, Proposition 209 as written and if approved by voters could assist those with medical debt while causing some adverse effects on the credit market and consumers access to credit; the public should consider whether the Act balances these competing interests successfully.

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[i] "Arizona Interest Rate Laws". *FindLaw.com.* Accessed October 3, 2022.

[ii] Sherman, Matthew. "A Short History of Financial Deregulation in the United States". *Center got Economic and Policy Research.* May 2009.

[iii] "Our Initiative". *Healthcare Rising Arizona*. Accessed October 3, 2022.

[iv] "Arizonans Fed Up With Failing Healthcare". *Seethemoney.az.gov.* Accessed October 3, 2022.

[v] "Proposition 209". *Arizona Secretary of State.* April 2021.

[vi] "Measure to cap interest rates for medical debt will likely be put on November ballot". *State of Reform*. July 2022.

[vii] "Our Initiative". *Healthcare Rising Arizona*. Accessed October 3, 2022.

[viii] VinZant, Nick. "Medical Debt and Rising Health Care Costs". April 2021.

[ix] "CFPB Estimates $88 Billion in Medical Bills on Credit Reports". *Consumer Financial Protection Bureau*. May 2022.

[x] "CFPB Publishes Analysis of Potential Impacts of Medical Debt Credit Reporting Changes". *Consumer Financial Protection Bureau*. July 2022.

[xi] "Medical Debt Burden in the United States". *Consumer Financial Protection Bureau.* February 2022.

[xii] Safavian, Mehnaz and Bilal Zia. "The Impact of Interest Rate Caps on the Financial Sector". *World Bank Group.* April 2018.

[xiii] Roa, et al. "Effects of interest rate caps on credit access". *Journal of Regulatory Economics.* December 2021.

[xiv] "Medical Loans: A Complete Guide". *Bankrate.* March 2022.