Report: State Installment Loan Laws Leave Borrowers Vulnerable in New Wave of Predatory Lending

NCLC's 50 State Survey Analyzes Strengths and Gaps in Consumer Protections, JULY 30, 2015 (**Contacts**)
Full analysis of the laws of 50 states and Washington, D.C., plus maps, charts and tables as well as the complete list of recommendations are available at: http://bit.ly/1LXA9mc

(BOSTON) Payday lenders are moving into the installment loan market, and state laws vary greatly in whether they protect borrowers from unaffordable rates on longer term loans, according to a new report from the National Consumer Law Center (NCLC). The report analyzes the strengths and weaknesses of the laws in the 50 states and the District of Columbia that regulate installment loans, including loans structured as credit card cash advances or other open-end lines of credit. "In theory, installment loans can be safer and more affordable than balloon payment payday loans. But states need to be vigilant to prevent the growth of larger and longer predatory loans that can create a debt trap that is impossible to escape," said Carolyn Carter, director of advocacy at the National Consumer Law Center and co-author of Installment Loans: Will States Protect Borrowers from a New Wave of Predatory Lending?.

With fees included, for a $500 loan, 33 jurisdictions cap the full annual percentage rates (APR) from 16% to 54%, with most under 36%. But 10 states have higher caps between 61% and 116%, and 8 states place no cap on the interest rate. (Some of those states, though, prohibit unconscionable loan terms – terms so one-sided that they shock the conscience). States almost always impose lower caps for larger loans, for example by reducing the allowable interest rate to 21% on amounts over $1000. For a $2000 loan, with fees included, the full APRs run from 17% to 41% in 38 jurisdictions. Two states allow APRs around 80%, and 11 do not cap the APR, although about half of these states prohibit unconscionable loan terms.

In some states, interest rate caps that seem reasonable on their face can be evaded through fees. Louisiana, for example, caps the interest rate for a $500 loan at 36% but fees can bring the full APR to 85%. Additionally, many states have looser restrictions on the interest rates or fees for open-end lines of credit, which give lenders an incentive to structure loans as open-end to evade rate caps. For a $500 cash advance, 14 states fail to cap the rate and another 14 have a big loophole for fees.

Payday lenders are already lobbying legislatures to enact more of these loopholes. Last year, Tennessee enacted an open-end credit law that purports to limit interest to 24%, but allows a daily charge of 0.7% that brings the full APR up to an unconscionable 279%.

"Reasonable interest rates align the interests of the lender and the borrower and provide an incentive to make loans that a borrower can afford to repay," added report co-author Lauren Saunders, also an attorney at the National Consumer Law Center. "We hope this report will prompt states to examine their laws to eliminate loopholes or weaknesses that can be exploited and to be on the lookout for seemingly minor proposals to make changes that could gut consumer protections."

Key Recommendations for States

- Place clear, loophole-free caps on interest rates for both installment loans and open-end credit.

A maximum APR of 36% is appropriate for smaller loans, such as those of $1000 or less, with a lower rate for larger loans. Prohibit or strictly limit loan fees, which undermine interest rate caps and provide incentives for loan flipping.
- Ban the sale of credit insurance and other add-on products, which primarily benefit the lender and increase the cost of credit.
- Prohibit formulas for rebating unearned finance charges that unfairly favor the lender loans are refinanced or paid off early and prohibit prepayment penalties.
- Limit balloon payments, interest-only payments, and excessively long loan terms. An outer limit of 24 months for a loan of $1000 or less and 12 months for a loan of $500 or less might be appropriate, with shorter terms for high-rate loans.
- Require lenders to ensure that the borrower has the ability to repay the loan according to its terms, in light of the consumer's other expenses, without having to borrow again or refinance the loan.
- Prohibit devices, such as security interests in household goods, auto titles and post-dated checks, which coerce repayment of unaffordable loans.
- Employ robust licensing and public reporting requirements for lenders.
- Tighten up other lending laws, including credit services organization laws, so that they do not serve as a means of evasion.
- Minimize differences between state installment loan laws and state open-end credit laws, so that high-cost lenders do not simply transform their products into open-end credit.
- Make unlicensed or unlawful loans void and uncollectible, and allow both borrowers and regulators to enforce these remedies.

This report builds on NCLC's extensive work of predatory lending. For more information, please visit: https://nclc-old.ogosense.net/issues/usury.html

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