NCLC Report: Why High-Rate Installment Lenders Want Borrowers Who Will Default

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(WASHINGTON) As the Consumer Financial Protection Bureau prepares to tighten rules for payday loans, lenders are moving into dangerous high-rate installment loans, according to a new report from the National Consumer Law Center (NCLC). *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* details how high-rate installment lenders can make a profit on unaffordable loans.

"Just like short-term payday loans, high-rate installment loans produce dysfunctional dynamics where the lender can turn a profit even if the borrower defaults and is left with the devastating consequences of an unaffordable loan," said Lauren Saunders, associate director of NCLC and co-author of the report. The report demonstrates how loans that default may in some circumstances even be more profitable than ones that are repaid early.

"For example, the California lender CashCall only needs to collect payments for 14 months to turn a profit on its 47-month, $2,600, 135% loan. CashCall plans for a 35% to 40% default rate and in fact over 43% of its borrowers defaulted in recent years," explained Margot Saunders, of counsel to NCLC and co-author. "Yet after paying over $4,000, a CashCall borrower has made no progress on the loan, still owing more than she borrowed."

Another example in the report shows how after only 14 of 26 payments on a $2,250 loan at 274% offered by Elevate under the Rise brand in Alabama, the lender has recovered the original loan plus another 50% — likely enough to turn a profit even if the borrower defaults. And data collected by the State of California shows that lenders like Cash Central, CashNet USA, and Elevate (Rise), which make installment loans at interest rates of 180% to 400%, have default rates of 30% to 60% or higher.

While longer and larger loans have the strongest potential for profitable defaults, "high rates, disproportionately long terms, and repeat refinancing of smaller installment loans can all make lenders callous to the harm to borrowers who eventually default," Lauren Saunders explained. The report describes a Speedy Cash loan in Missouri that requires 39 biweekly payments of $50 to repay a $300 loan at 185% — potentially generating profits after only 4 months of payments on the 18-month loan. "Speedy Cash's 18-month installment loan is just a two-week payday loan on steroids with rollovers built in," Saunders said.

"The best way to realign incentives so that lenders and borrower rise and fall together is to adopt a 36% interest rate cap, with a lower cap for smaller loans," Lauren Saunders said. "The CFPB should also adopt a strong rule prohibiting loans that borrowers do not have the ability to repay and should scrutinize lenders that have a default rate higher than 10%."

This report adds to NCLC's body of work on payday and other small dollar loans.

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