PREDATORY INSTALLMENT LENDING IN THE STATES

HOW WELL DO THE STATES PROTECT CONSUMERS AGAINST HIGH-COST INSTALLMENT LOANS? (2023)

November 2023

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Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services; and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state governments and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

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ABOUT THE AUTHORS

Carolyn Carter is the Deputy Director at the National Consumer Law Center (NCLC). She has specialized in consumer law issues for over 30 years. She was the 1992 recipient of NCLC's Vern Countryman Award. She is admitted to the Pennsylvania bar. From 2005 to 2007 she was a member of the Federal Reserve Board's Consumer Advisory Council. She is a graduate of Brown University and Yale Law School. She is co-author of NCLC's *Consumer Credit Regulation*, *Unfair and Deceptive Acts and Practices*, and *Collection Actions* and is a contributor to a number of other NCLC treatises.

Lauren Saunders is Associate Director at NCLC and manages the Washington, D.C., office, where she directs NCLC's federal legislative and regulatory work. Lauren is a recognized expert in various areas, including small dollar loans, fintech, prepaid cards, credit cards, bank accounts, and consumer protection regulation. She is the lead author of *Consumer Banking and Payments Law*, contributes to *Consumer Credit Regulation*, and has authored several reports and white papers.

Margot Saunders is a senior attorney with NCLC after serving as managing attorney of NCLC's Washington, D.C., office from 1991 to 2005. Margot has testified before Congress more than two dozen times regarding a wide range of consumer law issues, including predatory mortgage lending, high cost small loans, payments law, electronic commerce, protecting benefits in bank accounts, privacy issues, and robocalls. Margot has served as an expert witness in over 50 consumer cases in more than 20 states, and as a consultant to private attorneys and state and federal enforcement agencies on dozens of cases. She is a co-author of NCLC's *Consumer Banking and Payments Law*, many articles, and a contributor to numerous other manuals.

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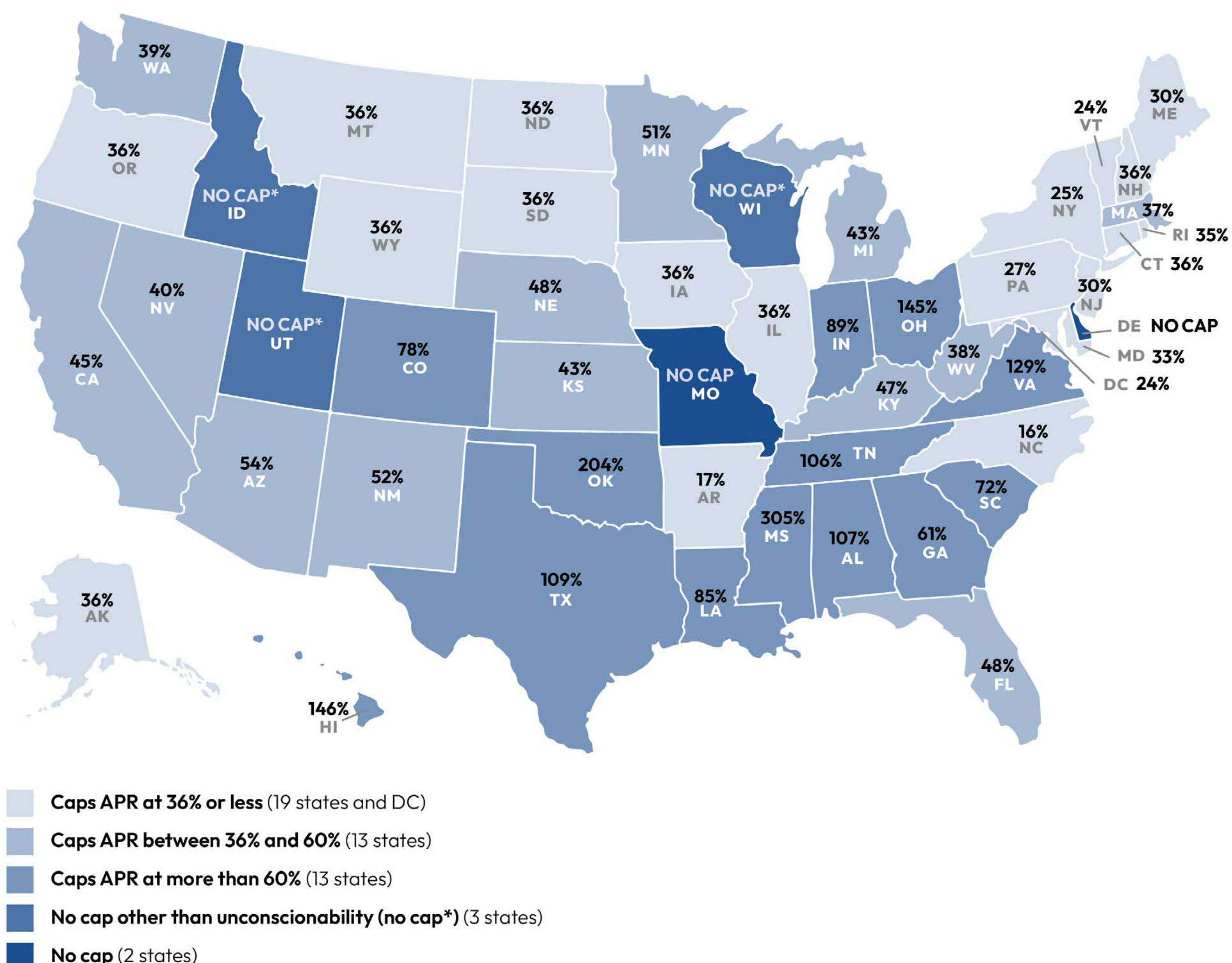
INTRODUCTION

Caps on interest rates and junk fees are the primary vehicle by which states protect consumers from predatory lending. Forty-five states and the District of Columbia currently cap interest rates and loan fees for at least some consumer installment loans, depending on the size of the loan. However, interest rate caps vary greatly from state to state, some states allow lenders to pile on junk fees, and a few states do not cap interest rates at all. We recommend an airtight 36% interest rate cap for small loans and lower limits for larger loans.

Map 1: APRs Allowed for a Six-Month $500 Installment Loan

This map shows the maximum APRs allowed by the states for closed-end installment loans (loans in which the amount borrowed and the repayment period are set at the outset) by licensed non-bank lenders.



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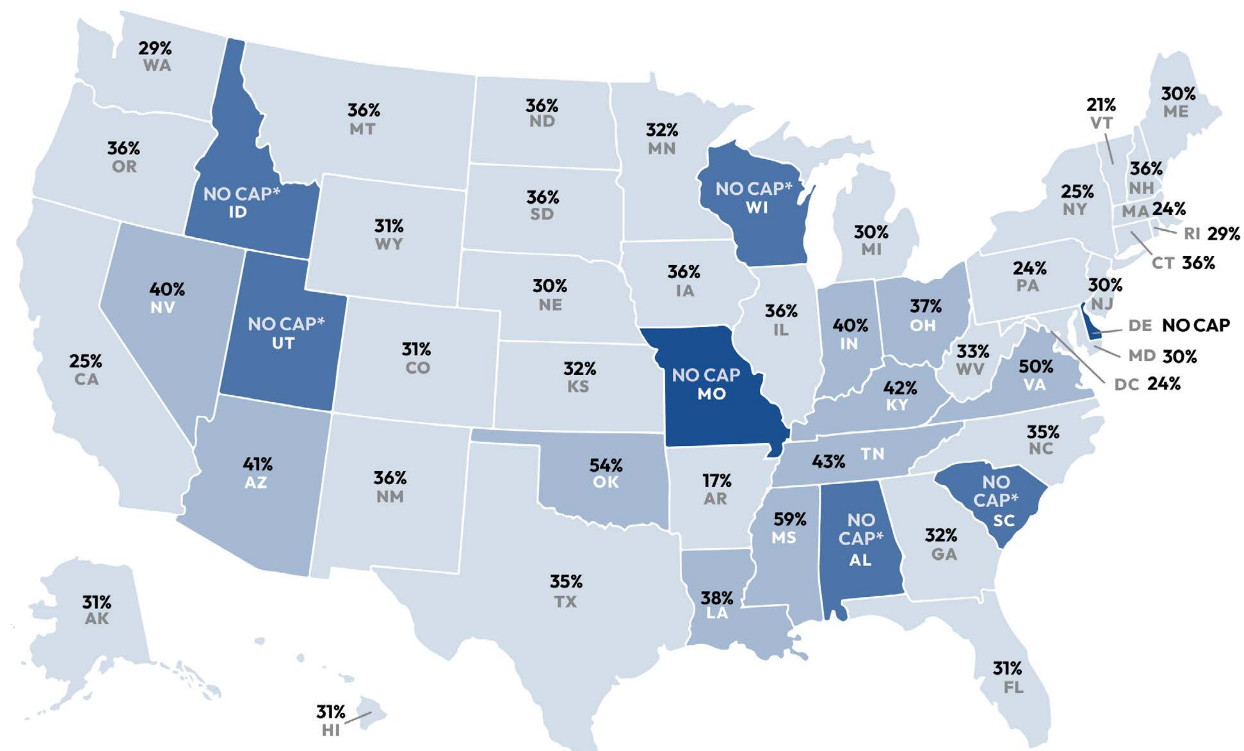
For a $500, six-month installment loan, 45 states and DC cap rates, at a median of 39.5% APR.

- 19 states and the District of Columbia cap the annual percentage rate (APR) at 36% or less.
- 13 states cap the APR between 36% and 60%.
- 13 states cap the APR at more than 60%.
- Three states—Idaho, Utah, and Wisconsin—require only that the loan not be "unconscionable" (a legal principle that bans terms that shock the conscience).
- Two states—Delaware and Missouri—impose no cap at all.

Map 2: APRs Allowed for a Two-Year $2,000 Installment Loan

This map shows the maximum APRs allowed by the states for closed-end installment loans by licensed non-bank lenders.



- **Caps APR at 36% or less** (33 states and DC)
- **Caps APR between 36% and 60%** (10 states)
- **Caps APR at more than 60%** (no states)
- **No cap other than unconscionability (no cap*)** (5 states)
- **No cap** (2 states)

For a $2,000, two-year installment loan, 43 states and DC cap rates, at a median of 32.5% APR.

- 33 states and the District of Columbia cap the APR at 36% or less.
- 10 states cap it between 36% and 60% APR.
- Five states—Alabama, Idaho, South Carolina, Utah, and Wisconsin—require only that the loan not be "unconscionable."
- Two states—Delaware and Missouri—impose no cap at all.

WHY STATES SHOULD CAP INTEREST RATES AND FEES

Caps on interest rates and loan fees are the primary vehicle by which states protect consumers from predatory lending. In the absence of caps, exploitive lenders move into a state, overwhelming the responsible lenders and pushing abusive loan products that trap low-income consumers in never-ending debt.

"It was like I asked for help to dig out of this hole and just created a deeper hole for me to inhabit."

NPR interview of Sarah Ahmed, who borrowed $2,300 at 98% to rent an apartment and get her young son set up in an after-school program.

Interest rate caps are more than numbers: they are reflections of society's collective judgment about moral and ethical behavior. Interest rate caps embody fundamental values.[1] Interest rate caps also reflect an assessment about the upper limits of sustainable lending that does not undermine individual or societal economic stability. When states eliminate high-cost loans by imposing rate caps, consumers generally agree that they are better off and express relief that the loans are no longer available.[2] Elimination of high-cost loans spurs an increase in affordable loans, benefiting all borrowers.[3]

Rate caps also encourage lenders to ensure that the borrower has the ability to repay the loan. Excessive interest rates enable lenders to profit from loans even if many borrowers eventually default.[4] Knowing that it will be made whole even if the borrower defaults, or that it can recoup defaults from exorbitant rates on others, the lender has little incentive to ensure that each borrower can actually afford to repay the loan in full on its terms.

High-cost loans, including high-cost installment loans, have a disproportionate impact on communities of color.[5] Use of high-cost non-bank installment loans increased between

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2021 and 2022 only for Black and Latino/Hispanic households, almost tripling for Black households.[6] Payday lenders have long targeted these communities.[7] High-cost loans do not promote financial inclusion. They add to debt, increase struggles, drive borrowers out of the banking system, and exacerbate existing disparities.[8]

The APR is an Essential Standard for Measuring and Comparing the Cost of a Loan

The rates listed above are the annual percentage rates (APRs) as calculated under the Truth in Lending Act (TILA) for installment loans. The APR is a critical way to measure and compare the cost of a loan, because it takes both interest and fees, and the length of the repayment period, into account. Otherwise, lenders could pile junk fees on top of interest without reflecting the full cost of the loan in the APR.

For example, a $500 line of credit offered by a predatory lender in Pennsylvania in 2006 charged just 5.98% interest, but required a $149 junk fee every month, producing an actual APR of 431% if repaid over six months.

The APR provides a common, apples-to-apples comparison of the cost of two different loans, even if they have different rate and fee structures or are used to borrow different amounts for different periods of time. For example, a payday loan at 360% APR is 10 times more expensive than a 36% APR credit card would be if both were used to borrow $500 for 14 days. Some lenders have diverted attention from the APR to focus instead on the dollar cost. But $15 for a $100 loan is a lot more expensive if you only have the loan for two weeks and not a full year – just like a $100 car rental would be far more costly if one company gave it to you for one day and the other for two weeks.

The Military Lending Act (MLA), which places a 36% APR cap on loans to members of the military and their families, requires the APR to take into account not just interest and fees but also credit insurance charges and other add-on charges. The MLA is also far more accurate than TILA as a disclosure of the cost of open-end credit such as credit cards. Because of this, the MLA APR is the gold standard, both for purposes of cost comparison and for purposes of legal rate limits. However, because of the difficulty of identifying the cost of credit insurance and other add-ons allowed, in the abstract, by the various state laws (as opposed to calculating the MLA APR for a given loan), we have used the TILA APR rather than the MLA APR in the rates displayed above.

Why 36% for Small Loans, Lower for Larger Loans?

The 36% rate cap is a widely accepted measure of the top acceptable rate for a small dollar loan, and the rate has been broadly supported by both lenders and the general public.[9]

But for loans in the thousands of dollars, 36% is too high. Interest increases dramatically with larger, longer loans, even if the rates are not in the triple digits. For example, in 2023 the Florida governor vetoed a bill that would have increased the rate for a $25,000 loan from a blended 20.5% rate to 36%—adding $14,076 in interest over five years.

Many states recognize the need for lower rates on larger loans by adopting tiered interest rate caps. For example, for loans up to $10,000, Alaska allows 36% on the balance up to $850, and 24% on the remainder, with no additional fees.[10] For a five-year $10,000 loan the borrower will pay $7,766 in interest. If the state allowed 36% on the whole amount, the same loan would cost the borrower $11,680 in interest—almost $4,000 more.

Accordingly, a tiered structure that lowers rates as loans get bigger is appropriate.

SIGNIFICANT CHANGES IN THE STATES SINCE MID-2022: FEWER EVASIONS, BUT MORE JUNK FEES

Since mid-2022, **Colorado**, **Connecticut**, and **Minnesota** significantly strengthened their protections against evasions of their consumer lending laws. In addition, **Colorado** and **Minnesota** reduced the allowable APR on certain small short-term loans.

On the other hand, **Alabama** amended its consumer lending laws to allow an additional junk fee, and **North Carolina** increased both the allowable interest rate and the amount of a "processing fee." **Oklahoma** expanded one of its high-rate lending laws so that it applies to larger loans, increasing the maximum APR for a two-year $2,000 loan from 34% to 54%. It also increased the interest rates allowed under its more general consumer loan law.

Details about the new laws:

Alabama weakened its protections against high-cost lending by authorizing another junk fee: a closing fee of 4% or $50, whichever is less, for loans of up to $1,500. (2022 H.B. 335). As a result, the maximum APR for a $500 6-month loan increased from 94% to 107%.

Colorado reduced the allowable finance charges for small short-term loans (2023 H.B. 23-1229), with the result that the maximum APR for a $500 six-month loan is now 78% instead

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of 91%. The same bill opted out of a federal law that allowed certain out-of-state banks to ignore Colorado's interest rate caps when making loans in Colorado.

Connecticut substantially strengthened its protections against evasions of its consumer loan laws, making it even clearer that the state's 36% APR cap encompasses all amounts a consumer pays in connection with the loan, and tightening restrictions on rent-a-bank lending. (2023 S.B. 1033).

Minnesota added strong protections against evasions of its lending laws, effective January 1, 2024. (2023 S.F. No. 2744). The bill also imposed a 50% APR cap for certain small short-term loans that are not covered by this report. Minnesota law formerly allowed APRs in the 90% range or higher for those loans.

North Carolina weakened its protections against high-cost lending by increasing both the maximum interest rate (from 30% to 33%) and a junk "processing" fee (from $25 to $30) for loans of 12 months or more for up to $12,000. (2023 S.B. 331). The result is an increase of the maximum APR for a two-year $2,000 loan from 31% to 35%.

Oklahoma expanded one of its high-cost loan laws to apply to installment loans of up to $3,450. Formerly it applied only to loans of $620 or less (2022 S.B. 1687). The result is that the maximum allowable APR for a $2,000 two-year loan increased from 34% to 54%. Of the states that cap APRs for a loan of this size and length, Oklahoma is now second only to Mississippi in the APR that it allows. The state also increased the maximum interest rate for consumer loans under one of its lending laws from 32% to 32% plus the federal funds rate. (2023 S.B. 794). It also announced an inflation adjustment for a "closing fee," increasing it from $167.33 to $178.87.

Texas announced annual inflation-based increases to the allowable amounts of various fees for consumer loans. The increases only affect loans larger than those analyzed in this report, however.

RECOMMENDATIONS: A 36% APR CAP FOR SMALL LOANS, LOWER FOR LARGER LOANS

To protect consumers from high-cost lending, states should:

- **Cap APRs at 36%** for smaller loans, such as those of $1,000 or less, with **lower rates** for larger loans.
- **Prohibit loan fees or strictly limit them** to prevent fees from being used to undermine the interest rate cap and acting as an incentive for loan flipping.
- **Include all payments in the APR calculation, whether or not they are deemed "voluntary."** Some lenders have tried to disguise fees as purportedly voluntary "tips," expedite fees, or donations.
- **Prevent loopholes for open-end credit.** Rate caps on installment loans will be ineffective if lenders can evade them through open-end lines of credit with low interest rates but high fees.
- **Ban the sale of credit insurance and other add-on products**, which primarily benefit the lender and increase the cost of credit.
- **Examine consumer lending bills carefully.** Predatory lenders often propose bills that obscure the true interest rate, for example, by presenting it as 24% per year plus 7/10ths of a percent per day instead of 279%. Or the bill may list the per-month rate rather than the annual rate. Get a calculation of the full APR, including all interest, all fees, and all other charges, and reject the bill if it is over 36%.
- **Include anti-evasion provisions** to prevent lenders from laundering their loans through out-of-state banks to evade state rate caps or disguising their loans as sales, wage payments, or other devices.

In addition, states should make sure that their loan laws address other potential abuses. States should:

- Require lenders to evaluate the borrower's ability to repay any credit that is extended.
- Prohibit mechanisms, such as security interests in household goods and post-dated checks, that coerce repayment of unaffordable loans.
- Require proportionate rebates of all up-front loan charges when loans are refinanced or paid off early.
- Limit balloon payments, interest-only payments, and excessively long loan terms. An outer limit of 24 months for a loan of $1,000 or less and 12 months for a loan of $500 or less might be appropriate, with shorter terms for higher-rate loans.

- Employ robust licensing and reporting requirements, including default and late payment rates, for lenders.
- Include strong enforcement mechanisms, including making unlicensed or unlawful loans void and uncollectible and providing a private right of action with attorneys' fees.
- Tighten up other lending laws, including credit services organization laws, to prevent evasions.

See NCLC's 2015 report on high-cost small loans and our Rent-a-Bank Lending and Fintech Credit pages for more details on these issues and recommendations.

In the absence of rate limits at the federal level, state interest and fee caps are the primary bulwark against predatory lending. By following these guidelines, states can ensure that their laws are effective at protecting consumers.

RELATED RESOURCES

- NCLC's High-Cost Loans online content
- Issue Brief: National Consumer Law Center, After Payday Loans: Consumers Find Better Ways to Cope with Financial Challenges (March 2022)
- Issue Brief: Why Cap Interest Rates at 36%? (August 2021)
- Issue Brief: State Rate Caps for $500 and $2,000 Loans (March 2021)
- Report: A Larger and Longer Debt Trap?: Analysis of States' APR Caps for a $10,000 Five-Year Installment Loan (October 2018)
- Report: Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016)
- Report: Installment Loans: Will States Protect Borrowers from a New Wave of Predatory Lending? (July 2015)
- Consumer Credit Regulation (see chapters 9 & 10)
- Surviving Debt

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.[11] 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.

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 full 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.

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APPENDIX B

Changes in State Lending Laws: 2017 to Mid-2022

Major changes in the states from 2017 to mid-2022 are summarized in the table below.

Table: Significant State Changes from 2017 to Mid-2022

STATE	CHANGES
California	Capped APRs for loans between $2,500 and $10,000 (previously there was no cap); APR for loan of $2,600 is capped at 41%. (2019 A.B. 539)
Colorado	Capped APR for payday installment loans at 36%. (2019 Prop. 111)
Hawaii	Replaced payday loan law with law allowing larger and longer high-rate loans, e.g. 146% on six-month $500 loan (2021 H.B. 1192)
Illinois	Capped APR for all non-bank loans at 36%, calculated using the Military Lending Act methodology. (2020 S.B. 1792)
Indiana	Increased a $50 junk fee to $75-$200, depending on the size of the loan. (2020 S.B. 395)
Iowa	Increased allowable APR for $2,000 two-year loan from 31% to 36% in 2017 by revising a state regulation. (Iowa Admin. Code r. 187-15.13)
Maine	Added strong anti-evasion provision, targeted at rent-a-bank lending. (2021 L.D. 522 (S.P. 205))
Mississippi	Extended sunset date of its “Credit Availability Act,” which allows highly abusive installment lending, with interest rates of 300% on four- to 12-month loans of up to $2,500. (2021 H.B. 1075)
New Mexico	Capped interest on installment loans at 36%, plus, for loans of $500 or less, a fee of 5% of the loan amount. (2022 H.B. 132) In 2017 it had capped APRs for consumer loans of $5,000 or less at 175%. (2017 H.B. 347) Formerly there was no cap.
North Dakota	Imposed a 36% APR cap on all non-bank loans in the state. (2021 S.B. 2013)
Ohio	Closed loopholes for fees that made rate caps ineffective; now caps the rate on a $2,000, two-year loan at 37% APR, although the law still allows very high rates for loans of $1,000 or less. (2017 Sub. H.B. 199)
Oklahoma	2021: Raised allowable interest rate from 27% to 32% on the installment loans that this report covers, and allowed non-bank lenders to add a junk fee of $28.85 (increased to $167.33 in 2022 under provision requiring an inflation adjustment with 1973 as the base year). (S.B. 796) 2019: Increased allowable APR for $500 six-month loan from 108% to 204%. (S.B. 720)

STATE	CHANGES
Tennessee	Increased junk fees that non-bank lenders can charge. (2021 S.B. 344)
Virginia	Closed a loophole that payday lenders were using to evade the state's rate caps, but greatly increased the caps for non-bank installment loans. (2020 H.B. 789)
Wyoming	Repealed the distinction between "supervised loans" and other loans, thereby allowing higher interest rates to be charged on more loans, without special protections. (2021 H.B. 8)

ENDNOTES

1. See National Consumer Law Center, Consumer Credit Regulation §§ 1.3, 1.4 (3d ed. 2020) (tracing the origin of the general usury laws on the books in many states today to England's laws before American independence).
2. National Consumer Law Center, After Payday Loans: Consumers Find Better Ways to Cope with Financial Challenges (Mar. 1, 2022), *available at* https://www.nclc.org/resources/after-payday-loans-consumers-find-better-ways-to-cope-with-financial-challenges/.
3. *Id.*
4. Financial Health Network, FinHealth Spend Report 2023 26 (June 2023), https://finhealthnetwork.org/wp-content/uploads/2023/06/Spend-Report-2023-Final.pdf ("Use of bank installment loans increased among both White and Latinx households, but nonbank installment loans, which carry higher interest rates on average, significantly increased only among Black and Latinx households. Incidence of holding a nonbank installment loan rose from 3% in 2021 to 8% in 2022 for Black households and from 6% to 9% for Latinx households." (footnotes omitted)); S. Ilan Guedj, Ph.D., *Report Reviewing Research on Payday, Vehicle Title, and High-Cost Installment Loans* 9 (May 14, 2019); National Consumer Law Center, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016).
5. S. Ilan Guedj, Ph.D., *Report Reviewing Research on Payday, Vehicle Title, and High-Cost Installment Loans* 9 (May 14, 2019).
6. Financial Health Network, FinHealth Spend Report 2023 26 (June 2023), https://finhealthnetwork.org/wp-content/uploads/2023/06/Spend-Report-2023-Final.pdf.
7. See, e.g., Brandon Coleman & Delvin Davis, Center for Responsible Lending, *Perfect Storm: Payday Lenders Harm Florida Consumers Despite State Law* at 7, Chart 2 (March 2016).
8. CFPB, *Online Payday Loan Payments* at 3-4, 22 (April 2016).
9. *See* National Consumer Law Center, *Why Cap Interest Rates at 36%?* (August 2021), https://www.nclc.org/wp-content/uploads/2022/09/IB_Why_36.pdf.
10. Alaska Stat. § 06.20.230.
11. *See* 15 U.S.C. § 1601(a) ("It is the purpose of [the Truth in Lending Act, which requires disclosure of the APR] to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him"); National Consumer Law Center, *Truth in Lending* § 1.1.1 (9th ed. 2015), *updated at* www.nclc.org/library (purpose of TILA to provide uniformity and enable comparison of disclosures of cost of credit).

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NATIONAL HEADQUARTERS

7 Winthrop Square, Boston, MA 02110
(617) 542-8010

NCLC.ORG

WASHINGTON OFFICE

Spanogle Institute for Consumer Advocacy
1001 Connecticut Ave, NW, Suite 510
Washington, DC 20036
(202) 452-6252