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Scorecard Shows Consumers Pay Steep Rates for Small Loans

Financial Reform Should Include a Strong Consumer Financial Protection Agency

WASHINGTON, D.C. -- Many states are failing to provide adequate protections for consumers against extremely expensive credit according to a new report by the National Consumer Law Center, Consumer Federation of America, and Consumers Union. The Scorecard updates a 2008 report and grades states on how well they protect consumers from excessive interest charges on small loan products. It illustrates why Americans need a strong Consumer Financial Protection Agency as part of the financial reform package currently under consideration in the Senate.

"Steep rates for short-term small loans trap borrowers in unaffordable debt," said Jean Ann Fox, director of financial services for Consumer Federation of America. "As consumers struggle to make ends meet in a tight economy, they need protection against rate gouging."

States traditionally regulate the rates and terms for nonbank small loan products. The report evaluates how well states are doing on curbing usury by examining the statutory maximum annual percentage rate (APR) of interest and fees for four typical small-dollar loan products and whether these products' APRs are limited by the state's criminal usury cap. The four loan products evaluated in the report are payday loans; auto title loans; six-month, $500 unsecured installment loans; and one-year, $1,000 unsecured installment loans.

States received a "Passing" grade if the loan product's APR was 36 percent or less or if they prohibited payday or auto title loans. States that did not have a cap on the loan product's APR or those that allowed a loan product's APR to exceed 36 percent received a "Failing" grade.

"The 2010 Scorecard shows that consumers need effective loan protections at both the state and federal level," said Gail Hillebrand, manager of Consumers Union's DefendYourDollars.org campaign. "Congress should make sure that financial reform includes a strong, independent watchdog in Washington to protect consumers from unfair lending practices no matter what state they live in. And states should have the power to enforce the law and enact even stronger safeguards."

Legislation was introduced in both the House and Senate in 2009 to cap the cost of credit at 36 percent (S. 500 Durbin and H.R. 1608 Speier). In 2006, Congress enacted a 36 percent rate cap to protect Service members and their families from abusive lending. Thirty-six percent is the limit set by the FDIC's Responsible Small Dollar Lending Guidelines and is double the cap for federally-chartered credit unions. The 36 percent rate cap on small loan lending became a part of civil law in most states by the mid-twentieth century to address the widespread problem of loan sharking.

Based on a review of state laws governing the four loan products, the report found that:

- Eight jurisdictions protect consumers against abusive lending practices for all four small dollar loan products: Arkansas, Connecticut, District of Columbia, Maryland, New Jersey, New York, Pennsylvania, and Vermont. In addition, Massachusetts and West Virginia come close to earning a perfect score but fees added to low interest for $500 unsecured installment loans in those states push the APR to 37 and 38 percent, respectively.

- Fifteen states currently fail to protect consumers against abusive lending for all four products: Arizona, Delaware, Idaho, Illinois, Minnesota, Mississippi, Missouri, Montana, Nevada, New Mexico, South Carolina, South Dakota, Tennessee, Utah, and Wisconsin. When Arizona's payday loan law sunsets July 1, 2010, the state will get a passing grade on that product.

- States scored the worst when it came to payday loans. Thirty-six states fail to protect consumers against high cost payday loans. Thirty-one states fail to protect consumers from high-costs for six-month, $500 unsecured installment loans and twenty states fail to protect consumers against expensive auto title loans.

- States scored better when it came to protecting consumers against expensive one-year, $1,000 unsecured installment loans. Twenty-eight states and the District of Columbia received a "Passing" grade.

- Five states set no usury caps for small loans, including Delaware, Idaho, South Dakota, Utah, and Wisconsin.

- Since states were graded in 2008, voters in Ohio and Arizona rejected triple-digit rates charged by payday lenders. New Hampshire imposed 36 percent rate caps for both payday and car title loans. The Arkansas Supreme Court ruled that payday lending violated the state's constitutional usury ceiling and the Attorney General shut down payday lending. This year, Maryland closed a loophole to prevent online payday lenders from evading that state's small loan protections.

"Now more than ever, consumers are finding it hard to make ends meet," said Leah Plunkett, National Consumer Law Center. "States must vigorously exercise their historic responsibility to protect consumers from falling prey to abusive practices if they take out small dollar loans. Predatory loans do consumers more harm than good. Many states have risen to the challenge.

States that fail to enact and enforce reasonable rate caps permit both consumers and the economy to be harmed."

A copy of the Scorecard can be found online at:
http://www.consumerfed.org/elements/www.consumerfed.org/File/Updated%20Scorecard%205-12-10%20FINAL.pdf
and http://www.nclc.org/reports/content/cu-small-dollar-scorecard-2010.pdf

A copy of the Statutory Backup can be found online at:
http://www.consumerfed.org/elements/www.consumerfed.org/File/Updated%20Scorecard%20backup%205-12-10%20FINAL.pdf
and http://www.nclc.org/reports/content/cu-small-dollar-scorecard-backup-2010.pdf

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