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California Looks to Curb High-Interest Installment Loans

By Evan Weinberger

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- Advocates see a growing chance that California enact law capping interest rates on some installment loans
- Earlier efforts to pass the legislation had foundered amid industry resistance

California may be ready to close a usury cap loophole that has allowed some lenders to offer installment loans with triple-digit interest rates.

Legislation that caps interest rates on installment loans between $2,500 and $10,000 at 36 percent plus the federal funds rate sailed through the California Assembly in May and a hearing is set in the Senate on June 26.

Two members of the California Senate's seven-member Banking Committee, including one Republican, have already pledging their support for the bill and all eyes will turn to the committee's chairman, Sen. Steven Bradford, a Democrat from the Los Angeles area. If Bradford indicates support for the legislation (Assembly Bill 539) at the hearing, then the bill is likely to make it to Democratic Gov. Gavin Newsom's desk.

"I think we have the momentum behind us," said Graciela Aponte-Diaz, the Center for Responsible Lending's California Policy Director.

The bill is part of the state's effort to enhance standards in areas including small-dollar and payday lending as the Consumer Financial Protection Bureau and other federal banking regulators pursue deregulatory agendas, said Assemblymember Monique Limon, a Democrat and one of the bill's authors.

"If it is not in the interest of consumers in California, California will speak up," Limon said in an interview with Bloomberg Law.

Growing Market

Although payday loans up to $300 with triple-digit interest rates are legal in California, most lending in the state is governed by California's usury laws, which caps interest rates on some loans as low as 10 percent.

One exception is the market for installment loans between $2,500 and $10,000, which often have interest rates that soar into triple digits.

Lenders issued 547,002 loans valued between $2,500 and $4,999 in 2017, the last year full statistics are available, according to the California Department of Business Oversight. Of those loans, nearly 60 percent carried annual percentage rates of 100 percent or more, the DBO said.

The total volume and dollar value of loans in that range with triple-digit interest rates grew more than 5 percent from 2016, the DBO said.

Lenders issued 30,784 loans valued between $5,000 and $9,999 in 2017. Around 15.5 percent of those loans carried triple-digit interest rates, the DBO said.

Quick Cash

Most of those loans were issued by lenders that specialize in this type of consumer loan rather than traditional banks.

The typical consumer looking to get a loan valued at $2,500 to $10,000 needs a quick infusion of cash to either cover an unexpected expense or fund a small business. A large percentage of those borrowers are immigrants, according to Gwendy Brown, the research director at the Opportunity Fund, a California-based micro-lender.

It's those types of borrowers that can get often sucked into debt traps, according to Jeffrey Probst, a professor at San Diego State University's Fowler College of Business.

"Somebody getting a 150 percent loan, it's very tough for them to get out of that hole," he said.

But new rate restrictions could result in reduced access to credit as installment lenders pull back on their offerings, Probst said.

"It could push these people off the regulated lending areas, where they can be taken advantage of more so," he said.

Try, Try Again

Previous attempts to put a cap on interest rates for loans between $2,500 and $10,000 foundered in the California legislature for various reasons.

Earlier legislation proposed a hard 36 percent cap. The addition of the federal funds rate, now around 2 percent, to that 36 percent cap has allowed some business groups to sign on to the bill.

"If this bill passes, Californians would still have access to both appropriate short-term credit products that are regulated separately, and now, exclusively to the responsible larger personal loan products that can help borrowers who need affordable credit options," the Marketplace Lending Association said in a June 19 letter to Bradford.

The letter noted that all of the MLA's members, including LendingClub and Prosper, offer loans that comply with the rate cap considered by the bill.

Another development that helped give this year's legislation a better chance was a California Supreme Court decision in August 2018 that allows judges to deem some high interest rates on consumer loans "unconscionable."

Referendum Threat

Consumer advocates feel they have compromised enough by adding the federal funds rate to the proposed 36 percent rate cap for the subject loans. They could push for a constitutional amendment if the legislation fails in the Senate.

If there is a ballot initiative, it is likely to call for an interest rate as low as 27 percent, Aponte-Diaz, who is part of a coalition of consumer advocates pushing the bill, said.

"We haven't decided on a number, but I'm thinking that it would be close to that," she said.

Eyes on the Chair

With that added boost and pressure, AB 539 passed the California Assembly on a 60-4 bipartisan vote on May 23, with 16 members not voting. It also got the vocal support of California House Speaker Anthony Rendon, a Democrat.

Attention now turns to the state Senate and Bradford, whose office did not respond to a request for comment.

"We believe the odds of AB539 becoming law currently stand at 40%, but ultimately the tone and tenor of the upcoming Senate hearing will determine its fate," Isaac Boltansky, an analyst with Compass Point Research & Trading.

The banking committee hearing was originally scheduled for June 19, but was delayed. Multiple sources said that senior Senate leadership were working with Bradford on amendments that would ease his concerns about issues like access to credit while retaining the support of consumer advocates.

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