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No-Brainer Nonprime Lending Reforms We Should All Get Behind

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In recent years, the nonprime lending industry has been under a microscope, and for good reason.

According to data from Fair, Isaac and the Corporation for Enterprise Development, there are now nearly 150 million nonprime consumers in the US — a market larger than prime consumers — yet nonprime credit options remain limited and in many ways problematic. Although regulators, consumer groups and industry leaders have debated ways to improve nonprime credit products, so far these efforts to find common ground have fallen short.

I believe we ultimately can and will make progress on the toughest issues facing our industry with solutions that ensure all nonprime consumers are treated fairly. But for a moment, why don't we take a break and tackle a cause that should be easy for all parties to get behind — eliminating onerous and unnecessary fees. Punitive and add-on fees can drive vulnerable customers deeper into debt, ultimately hurting their long-term financial health. While these types of fees aren't unique to nonprime lending, their impact on nonprime consumers can be especially devastating and deserves immediate attention.

Understanding the Nonprime Borrower

As nonprime lenders (those serving consumers with FICO scores typically below 700 who are often ineligible for traditional prime credit offerings), we have to think about the distinct challenges facing our customer base and account for this in how we structure and collect on our credit offerings. According to a report this year from the Federal Reserve, nearly half of Americans had less than $400 available to cover a financial emergency and in a recent study by JP Morgan Chase, 40% of accountholders see their income vary by 30% from month to month. Such reports of widespread financial fragility suggest that despite their best intentions, nonprime consumers will see significantly higher rates of late payments — and even default — no matter how thorough the upfront underwriting. This implies that the goal shouldn't be perfect underwriting or "ability to repay" analysis to eliminate defaults, but rather improved products that are appropriate for a consumer with a higher likelihood of default and limited financial resources.

It isn't news that many nonprime consumers will at some point during the course of a loan have trouble making on-time payments, yet legacy nonprime credit products have been notoriously hard on consumers for nonpayment. They typically charge returned payment fees, late fees and in the case of title loans, can even take ownership of the customer's car. Lending laws in many states often enable and even incentivize these types of lending practices that are used to enhance the effective returns on credit.

Rather than punish consumers who are already facing financial stress, we should focus our efforts on offering products that support the unique financial needs of nonprime consumers. Pricing the product to the risk of the borrower, eliminating fees and rewarding those that demonstrate responsible behavior with progressive rates are just a few things that could help a consumer work towards a brighter financial future.

Not Just a Nonprime Problem

While it is easy to paint all nonprime credit providers with the same brush, it is important to note that the issue of onerous fees is not unique to the nonprime space. Prime borrowers also find themselves paying more than what their APR suggests once the fees are tallied up. In fact, a recent survey indicated that the average credit card carries six different fees. Almost all cards charge late fees and cash advance fees. Some are charging for items that anyone would consider a stretch including account reopening fees, statement hard-copy fees and fees to make payments over the phone. The difference is that for prime consumers these fees are largely a source of frustration and annoyance, but for nonprime consumers they can lead to meaningful financial hardship and make it increasingly difficult to get their financial situation back in order.

Raising the Standard

Regulatory action is needed to weed out patently unfair fee structures, but I believe as an industry we should and can do better on our own. If nonprime credit providers need to rely on punitive or add-on fees or repossession of important collateral to achieve target profitability, there is something fundamentally wrong with the business model. It is possible to responsibly and profitably serve nonprime consumers denied by mainstream options, but it requires greater sensitivity to the financial hardships of this customer base and a smarter approach to pricing and underwriting that accounts for the borrower's unique needs and challenges.

Providing more responsible credit options for nonprime consumers is not going to happen overnight, but I believe it is one of the prevailing challenges of the post-recession era. An ongoing commitment to positive and constructive conversations amongst regulators, industry and consumer advocates will be critical to reshaping nonprime financial services for the better. In the immediate term, we should all be able to agree that there is no place for punitive, deceptive or aggressive tactics for those serving the nonprime market. Nonprime credit providers have to set a higher standard for how we treat our customers. At the end of the day, having happy customers, treated fairly, is not just good business. It's simply a no-brainer.

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