CENTER FOR RESPONSIBLE LENDING

The CFPB's Upcoming Payday Lending Rule: What to Look For and What It Means

May 2016

The Consumer Financial Protection Bureau (CFPB) is widely expected to soon propose a new national rule that addresses payday and car title lending. If strong enough, the rule has the potential to rein in the worst abuses of these kinds of high-cost loans, which carry triple-digit interest rates. Payday lenders are pushing for loopholes in the rule that would make it look like they were making changes but in fact would allow them to continue business as usual.

What Products Will The Rule Cover?

The CFPB's 2015 preliminary outline offered a glimpse into what to expect from the proposed rule. The rule is likely to cover two major categories of loans, which carry average costs exceeding 300% APR:

- **Payday loans**, meaning that the lender takes payment directly from the borrower's bank account on the borrower's payday. These include:
  - **Short-term payday loans** (defined as loans 45 days or less): These are typically due in full on the borrower's next payday. Fourteen states plus the District of Columbia prohibit these loans by enforcing rate caps of about 36% annually.
  - **Long-term payday loans** (defined as loans longer than 45 days): These also carry triple-digit interest rates and carry terms anywhere from 46 days to years. In important ways, the longer loan term makes these loans more harmful than short-term loans, not less.
- **Car title loans,** meaning that the lender takes access to a borrower's car title as collateral and can threaten repossession of the car to coerce payment. Like payday loans, these loans can be structured as short-term or long-term. While these loans are illegal in a majority of states, there is a significant car title loan presence in 23 states.

** Long-term loans costing less than 36% fee-inclusive APR are excluded from the preliminary proposal.*

What's the Problem?

Given this extraordinarily high cost and extraordinary leverage – control over the borrower's bank account and/or ability to repossess the borrower's car – payday and car title lenders lack the incentive to make loans that borrowers have the ability to repay while affording their other expenses. In fact, lenders have just the opposite incentive: They make more when they can trap borrowers in *unaffordable* debt for extended periods of time. Then they grab the payment from the borrower's account on payday, leaving the borrower unable to pay rent or another basic necessity, and flipping the borrower into another loan.

This is the debt trap, and it is the core of the business model. According to the CFPB, over 75% of payday loans are made to borrowers with more than 10 loans a year. Research shows that the typical car title loan is refinanced 8 times. This debt trap extracts billions of dollars annually from people with an average income of about $25,000 and leads to a cascade of financial consequences like bank penalty fees, delinquency on other bills, and even bankruptcy.

What are We Asking For?

We are asking the CFPB to stop this debt trap. The CFPB can do this by requiring lenders to determine whether a borrower has the ability to repay the loan in light of the borrower's income and expenses. This is how responsible lenders already do things. An affordable loan is one that can be repaid without having to borrow again, and while being able to pay for other basic necessities like rent, transportation, and food. As the CFPB moves forward, the question will be whether this ability to repay requirement is meaningful.

What makes an ability-to-repay requirement meaningful?
In order for the CFPB's rule to ensure lenders do not trap borrowers in unaffordable loans, it must:

- Ensure that the "ability-to-repay" standard is the long-recognized definition: ability to repay (1) while meeting other expenses *and* (2) without reborrowing, renewing, or refinancing.
- Require an ability-to-repay determination on every loan.
- Require that the lender determine and verify with documentation whether the borrower has enough money to meet other expenses after repayment of the loan.
- Require that the lender show more than its past seizure of payments from a borrower's bank account to meet an ability-to-repay test.
- For short-term loans, establish a backstop that ensures that borrowers are not trapped in "short-term" loans for more than 90 days in a 12-month period, consistent with the FDIC's standard.
- For short-term and long-term loans, establish strong protections against flipping a borrower from one loan into another.
- Include in the rule's scope *all* loans that provide lenders extraordinary leverage to extract repayment, including loans secured by personal property and loans where the lender retains the right to garnish wages.

What are examples of potential loopholes that would undermine an ability-to-repay requirement?

- *Exempting some high-cost loans from an ability-to-repay requirement.* Even a single unaffordable loan can create a cascade of financial consequences for borrowers.
- *Reducing the waiting periods between short-term loans.* This would mean that lenders could continue to make many short-term loans to borrowers every year – inconsistent with an ability-to-repay standard where loans should not fuel reborrowing.
- *Permitting an "ability-to-repay" determination based on income alone, without regard to expenses.* This would not ensure that loans are affordable.
- *Permitting lenders to claim that its seizure of payments in the past means that the borrower has a true ability to pay going forward.* This is circular, because many loans are repaid only because the lender has extraordinary leverage to aggressively collect the loan, not because the loans are affordable. This would perpetuate the debt trap business model.
- *Permitting a lender to use only recent income and expenses to make an ability-to-repay determination for a longer-term loan.* Having sufficient income in one month to make a loan payment does not mean a borrower can sustain that payment over many months or years. Thus, longer-term loans should require consideration of a borrower's past income and expenses over a longer lookback period.
- *Permitting loan flipping of long-term loans*. Repeated refinances of payday and car title loans are a strong indication that the borrower does not have the ability to repay.

Why Not Just Set a Mandatory Interest Rate Limit?

CFPB does not have Congressional authority to set an interest rate cap, but states can. States should continue to use their authority to protect residents from high-rate loans altogether by enacting a fee-inclusive rate cap of 36% or less.

What Happens Next?

After the rule is proposed, the public will have some number of days (likely somewhere between 60 and 120) to submit comments on the proposal to the CFPB. The CFPB will consider the comments and is expected to issue a final rule during 2017.

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