To: **Interested Parties**

From: **Center for Responsible Lending**

Re: **CFPB's preliminary proposal to address payday and similar debt-trap loans**

Date: **March 26, 2015**

This memo provides a summary of the proposal CFPB is considering to address payday and similar debt-trap lending, drawn largely from the CFPB's fact sheet, and CRL's initial reactions to it. As we review the proposal more closely, our initial reactions may evolve. CRL's reactions are provided in *italics.*

I. Summary Overview

Scope: The proposal contains two parts, one addressing short-term loans (45 days or less); and one addressing loans with terms longer than 45 days where the lender has access to the borrower's checking account (through a post-dated check or electronic authorization) or holds security to the borrower's car, and the all-in APR is greater than 36%. *CRL generally supports this scope as both appropriate to address existing abuses and necessary to prevent foreseeable lender efforts at evasion.*

Short-term loans: The proposal for short-term loans would provide the lender with two options: (a) determine ability-to-repay at the front-end, based on a borrower's income and financial obligations, or (2) for loans $500 or less, not determine ability-to-repay at the front-end but limit rollovers to two series of three loans, and no more than 90 days' total indebtedness in a twelve-month period. *CRL strongly supports a front-end ability-to-repay requirement that requires consideration of both income and obligations, and opposes providing the lender an alternative option in lieu of determining ability-to-repay; rather, we support a 90 days' total indebtedness limit coupled with a front-end ability-to-repay determination.*

Longer-term loans: The proposal for longer-term loans would again provide the lender with two options: (1) determine ability-to-repay at the front-end, based on income and financial obligations, or (2) for loans with a term of six months or less: either (a) offer terms generally consistent with the National Credit Union Administration's existing small-dollar loan program, or (b) limit loan payments to 5% of the consumer's gross monthly income (with no consideration of expenses). *Again, CRL supports a front-end ability-to-repay requirement and opposes alternative options, including any underwriting standard that does not require consideration of the borrower's income and expenses.*

II. Short-term Loans

A. Scope: Repayment in full required within 45 days

CRL supports 45 days as a cutoff point between shorter term and longer-term loans. This cutoff helps to ensure that any single-payment loan with repayment timed to a borrower's payday is captured under the short-term protections.

B. Rule: Lender chooses one of two options –

1. Ability-to-repay requirement ("Debt trap prevention requirements")
    i. Determine consumer's ability to repay the loan when due while satisfying major financial obligations and living expenses, without defaulting or re-borrowing
    ii. Verify income, major financial obligations with third party documents, and borrowing history, potentially including whether borrower:
        a. has recently defaulted or is currently delinquent on any covered loan[1]* with that lender/affiliate
        b. has recently defaulted on any covered loan* with any lender
    iii. For any second or third loan made within 60-days of another covered short-term loan, or longer-term balloon payment loan (called a 60-day "underwriting period"), there is a <u>rebuttable presumption of inability to repay</u>. That presumption is only overcome by the lender verifying with evidence a sufficient improvement in borrower circumstances (e.g., increase in income) to afford new loan.
    iv. After a third loan (either short-term or longer term balloon payment), there is a <u>conclusive presumption of inability to repay</u> and a mandatory 60-day "cooling off period" before an additional short-term loan may be made.
    v. Open-end lines of credit: Two possibilities under consideration -- lender would be required to (1) assume that the consumer fully utilizes the credit upon origination and makes only minimum payments until the end of the contract period (followed by a single payment for remaining balance), or (2) assume full repayment on the loan by the payment date specified in the contract.

CRL supports a front-end ability-to-repay requirement on every loan, including verification of income, major expenses, and borrowing history. A cooling off period of at least 60 days is appropriate. As the Bureau's preliminary proposal notes, making a payment on the prior short-term loan could impact multiple cycles of household expenses. The 60-day period helps to allow the impact of the prior covered short-term loan on the consumer's finances to subside before the lender can extend another loan without verifying a change in circumstances.

Full compliance with this and other provisions in the rule will require centralized reporting. The Bureau's preliminary proposal would require lenders to report all covered loans to commercially reasonable databases (as determined by Bureau-determined criteria) and to check one of those databases to review borrower history. Many lenders already report to and consult with private commercial databases, and we support this requirement.

[1] *When "covered loan" is accompanied by "*" herein, we think the proposal is referring to short-term or longer-term covered loans.*

-OR-

2. Back-end protections ("Debt trap protection requirements")
    i. Scope for this option: Loans not exceeding $500, with no more than one finance charge, no car title as collateral, and no outstanding covered loan* with any lender
    ii. Limit of two rollovers (three loans total) followed by a 60-day cooling off period. Rollover would require providing what Bureau describes as "an affordable way out of debt." Bureau is considering two options, and will choose one of the two:
        a. Mandatory principal decrease over the three-loan sequence so that it is repaid in full when the third loan is due (e.g., loans of $300, $200, $100)
        b. A no-cost "off-ramp" if the borrower is unable to repay after the third loan, i.e., by requiring lenders to permit repayment over four additional installments without cost
    iii. Outer limit of 6 loans and 90 days' total indebtedness in any 12-month period

CRL strongly opposes any exemptions from an ability-to-repay (ATR) requirement. The Dodd-Frank Act and the CFPB have established the importance of ability-to-repay in mortgage lending and should extend the concept as a requirement for all lending. An ATR requirement is particularly important for payday loans, where the market incentive to underwrite is flipped on its head because the lender holds first-in-line access to the borrower's checking account. In this context, the lender is counting not on the borrower's ability to repay the loan, but rather on their ability to collect on the loan, whether or not the borrower can afford to repay it. Indeed, because substantial lender revenue is derived through loan flipping – which occurs when the loan is not *affordable – the lender has a* disincentive *to lend to borrowers who do have the ability to repay.*

A forthcoming research paper by CRL demonstrates that a very large portion of borrowers default on their first or second loans, providing further support that an ability-to-repay determination at the outset is required in order to prevent the harm caused by payday loans. Any default may result in lender-imposed late and NSF fees, bank fees, and abusive collection tactics, and cascading financial hardships.

Further, by sanctioning two rollovers, which are evidence of inability to repay, and exempting six very high-cost loans annually from an ATR requirement, the Bureau would undermine the basic principle of requiring universal ATR and existing state laws in about a third of states that do not permit such loans at all. While clearly not preemptive, the Bureau's rule will be seen as a federally approved guideline and will likely set the tone for debates around payday lending in the states. It should not send the message that any loan made without a determination of the borrower's ability to repay is acceptable.

A 90-days' indebtedness limit is a useful backstop against prolonged indebtedness, consistent with the FDIC's 2005 guidelines addressing payday lending. But critically, it should be a backstop, or a check, to ensure that ability-to-repay determinations at the outset are meaningful for all short-term loans—not an option in lieu of determining front-end affordability.

We do support the proposal that no short-term car title loan would be exempted from a front-end ability-to-repay requirement; we urge extending that approach to payday loans as well.

III. Longer-term Loans

A. Scope

1. Longer than 45 days, and
2. Access to repayment from borrower's checking account or security interest in vehicle title, and
3. Over 36% "all-in" APR, including interest, origination and add-on fees

CRL supports an appropriately broad scope for longer-term loans as well as a carve-out for responsibly priced loans of 36% APR or less. This scope would include open-end loans (payday loans made by banks are an example) which are often used to evade protections that apply only to closed-end loans. It would also capture multi-payment (installment) payday loans that payday lenders are either already making or actively seeking authorization under state law to make.

Given deficiencies in the way the APR is often calculated, we strongly support using an "all-in" APR as the CFPB has proposed, which, like the APR under the Military Lending Act, includes fees and add-on products. This "all-in" APR is critical to preventing evasion of coverage under the rule by charging periodic interest rates under 36% but with outsized origination or other fees.

B. Rule: Lender chooses one of two options –

1. Ability-to-repay requirement ("Debt trap prevention requirements")
   - i. Determine consumer's ability to make loan payments when due while satisfying major financial obligations and living expenses, without defaulting or re-borrowing (same as short-term standard)
   - ii. Verify income, major financial obligations with third party documents, and borrowing history (same as short-term requirement)
   - iii. Refinancing/reborrowing:
     - a. ATR determination required for each refinance/reborrowing from the same lender/affiliates, whether or not prior debt is "covered"
     - b. <u>Rebuttable presumption of unaffordability</u> in certain instances, requiring verified evidence of sufficient improvement in circumstances:
       - a. recently delinquent on the loan;
       - b. borrower indicates lack of ability to repay;
       - c. refinance permits skipped or smaller payment without significant cash-out to consumer;
       - d. loan is in default,
   - iv. Longer-term balloon loans: CFPB would treat these the same as short-term loans with respect to presumptions of inability to repay 2nd and 3rd loans within 60 days after the first
   - v. Open-end lines of credit: Lender would be required to assume that the consumer fully utilizes the credit upon origination and only makes minimum payments until the end of the contract period (followed by a single payment for remaining balance) (or within 6 months if no contract period) in order to determine ability-to-repay

Again, CRL supports a required ability-to-repay determination and verification of income, obligations, and borrowing history, in addition to additional protections to ensure that refinancings and defaults are not excessive, particularly considering the lender is first-in-line for repayment.

-OR-

2. Alternative ("Debt trap protection requirement")

    i. Scope: Term of 45 days-6 months, amortizing, no other covered loans*
    ii. Possibility 1 – NCUA's "payday alternative loans" program:
        a. $200-$1,000
        b. Interest rate cap of 28%; application fee limit of $20
        c. Max of two loans within 6 months
    iii. Possibility 2 – Percent of income limit:
        a. Total monthly payments are no more than 5% of expected gross monthly income
        b. No default on covered loan within past 12 months
        c. Max of two loans within 12 months

Again, we oppose alternatives to required determination of ability-to-pay. In particular, income-based underwriting, with no required consideration of expenses, does not ensure affordability and will not prevent harm caused by triple-digit payday and car title loans.

IV. Payment collection practices

The preliminary proposal also includes protections around lender collection practices.

A. Required notice to consumers (at least three days, and no more than seven days) prior to attempting to collect payment from account
B. Limitation on attempts to collect payment from consumer's account (to two failed attempts, total, at which point a new consumer authorization is required for that and future payments)

These preliminary proposals underscore the tremendous harm that payday and car title lenders can cause borrowers through first-in-line access to their checking accounts. For example CRL's forthcoming research paper shows that large portions of payday borrowers incur bank overdraft and NSF fees when the lender repays itself despite insufficient funds in the borrower's account.

V. Compliance measures

A. Policies and procedures for complying with rule required

B. Record-keeping requirements
    1. Until 36 months following entry on the last loan
    2. Annual reports containing data sufficient to monitor performance of covered loans, including information on defaults and reborrowing for short- and long-term loans

CRL strongly supports requirements that facilitate back-end monitoring of loan performance, including reborrowing, in order to help ensure that front-end "reasonable determinations" of ability-to-repay are indeed reasonable and effective.

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