Initial Analysis of CFPB's Final Rule to Address Payday & Car Title Loans

Policy Brief October 18, 2017

The following provides an overview of CFPB's final rule addressing payday and car title lending and CRL's initial reactions to it. As we review the rule more closely, our initial reactions may evolve. Beginning in Part II., summarized rule provisions are in regular type, while CRL's reactions are *italicized*. For more detail on our positions on the proposed rule, see the comment letter we filed jointly with other groups in October 2016.

I. Overview

The Consumer Financial Protection Bureau (CFPB) has issued the first part of a final national rule that addresses payday and car title lending. For years, civil rights organizations, consumer advocates, faith groups, working families, and others across the country have pushed for a rule to protect their communities from the payday lending debt trap. This rule represents another step forward in protecting the millions of people lenders intentionally trap in 300-plus percent interest loans. We expect payday and car title lenders to aggressively attempt to block the rule, which is based on the commonsense principle of determining whether borrowers can afford to repay a loan before making it. Fifteen states plus the District of Columbia have already implemented strong state laws against the payday debt trap by enforcing a rate cap of 36% interest or less. States should continue to enact and enforce such rate caps, as the CFPB does not have legal authority to do so.

A. CFPB's Rule at a Glance

The rule establishes an ability-to-repay principle, based on consideration of a borrower's income and expenses, for short-term payday and car title loans. This is extremely significant and is particularly important for these high-cost loans where lenders require the power to seize a borrower's bank account or car. Thus, with this rule, it is clear that payday and car title lenders cannot continue business as usual.

However, the rule permits, over the objections of consumer advocates, six short-term payday loans a year to be exempt from the prescribed underwriting standards if other requirements are met. Appropriately, car title loans cannot use this exemption. The rule also fails to limit the total annual indebtedness in payday and car title loans to 90 days a year, which would be consistent with longstanding FDIC guidelines for the banks it supervises.

The rule finalized this month includes only some portions of the proposal. The CFPB finalized the ability-to-repay standard for short-term loans and payment protections for short-term and certain high-cost longer-term loans. Concurrently, the CFPB stated that it has considerable concerns about the broader longer-term loan market and will continue to scrutinize those practices through supervision, enforcement, and a future rulemaking.

The final rule conditionally exempts occasional accommodation loans and loans that are generally like the National Credit Union Association's payday alternative loans. These changes are expected to minimize the rule's impact on community banks and credit unions.

We expect payday and car title lenders to sue to delay or undo the rule, even though the rule is the culmination of over five years of stakeholder input and extensive research showing clear evidence of the harm caused by making these loans without regard to ability-to-repay.

B. Congress Must Defend the Rule and Pass a Federal 36% Rate Cap

We expect payday lenders to push Members of Congress to file a repeal of the rule under the Congressional Review Act, which could undo the rule with a majority vote in both chambers and prevent CFPB from future rulemakings addressing these toxic products. Congress should reject these efforts and instead pass a federal 36% interest rate cap applicable to all Americans (which CFPB lacks the authority to do), just as Congress did in 2006 for active military servicemembers at the urging of the Department of Defense.

C. States Must Continue to Play a Critical Role

Fifteen states plus the District of Columbia have interest rate limits that effectively prevent short-term payday lending, and more than half of states have interest rate limits on longer-term loans. The Bureau's focus on ability-to-repay rules for high-cost loans is right in light of its statutory lack of authority to set a usury limit. And its preamble to the final rule states that state usury limits are more protective of consumers than the rule's provisions will be:

> "[C]ertain States have fee or interest rate caps (i.e., usury limits) that payday lenders may find are set too low to sustain their business models. The Bureau regards the fee and interest rate caps in these States as providing greater consumer protections than, and thus as not inconsistent with, the requirements of the final rule."

In addition, the Bureau states: "The Bureau recognizes that States may wish to prevent more harms than are prevented by this rule, and they are free to do so because . . . this rule should be considered a floor and not a ceiling."

We expect payday lenders to escalate their attacks on strong state laws. States should continue to protect residents from high-rate loans altogether by enacting a fee-inclusive rate cap of 36% or less. And State Attorneys General should vigorously enforce both the CFPB's rule, as they have explicit authority to do, as well as existing state usury caps.

D. CFPB Must Move Forward to Address Abuses of Debt Trap Longer-Term Loans

The Bureau must move forward to rein in the harms of all longer-term debt trap loans, including loans secured by access to borrowers' checking accounts, car titles, personal property, wage garnishment, and any other loans exceeding a 36% fee-inclusive annual percentage rate. CFPB must also vigorously monitor and enforce this month's rule to protect against evasion by payday lenders notorious for skirting laws that aim to rein them in.

II. Scope of CFPB's Rule

A. Included:

1. The rule's ability-to-repay requirements apply to short-term loans (substantially due in 45 days or less) and longer-term loans with a large balloon payment (more than twice as large as any other payment). These include payday loans, car title loans (including those

characterized as title pawn loans under state law, where the consumer retains use of the pledged vehicle during the loan), and bank "deposit advance" payday loans.

2. The rule's payment protections apply to these loans, as well as to longer-term loans without a large balloon payment that (i) exceed 36% APR under the Truth in Lending Act and (ii) have a leveraged payment mechanism, meaning the lender has the right to initiate payment from the borrower's account through any means.

B. Exclusions:

1. Credit cards
2. Wage advance loans if:
    a. made against earned wages;
    b. charge no fee other than a participation fee; and
    c. the lender has no claim or remedy, and will not engage in debt collection activities, if the amount is not repaid in full
3. No-cost advances if the lender has no claim or remedy, and will not engage in debt collection activities, if the amount is not repaid in full
4. Certain purchase money security interest loans, real estate secured credit, student loans, non-recourse possessory pawn loans (where lender has sole possession and use of the pledged property during the loan term), overdraft lines of credit, and fee-based overdraft programs.

C. Conditional exemptions:

1. "Alternative loan" made by any lender: These loans must meet the following parameters, which generally track the requirements of National Credit Union Administration (NCUA) "payday alternative loans" (PAL):
    a. Term of 1 month to 6 months
    b. $200-$1000
    c. At least two payments; all substantially equal payments; not open-end
    d. No charges other than the rate and application fees permissible under NCUA's PAL program (currently 28% interest plus an application fee not exceeding $20)
    e. No more than three such loans from the same lender in a 180-day period
    f. Income documentation: must comply with policies and procedures for documenting proof of recurring income

    Safe harbor: PAL loans made by Federal credit unions in compliance with PAL program are deemed in compliance with this exemption.
2. "Accommodation loans," meaning that the lender and affiliates collectively have made 2,500 or fewer covered loans in each of the current and preceding calendar year, and covered loans do not produce more than 10% of revenue.

While the proposed rule established ability-to-repay requirements for both short- and longer-term payday and car title loans, the final rule, at this time, establishes them only for short-term loans and longer-term loans with a large balloon payment. However, the Bureau makes clear that its work to address longer-term loans is ongoing:

> The Bureau "**remains concerned that failing to underwrite such products may nonetheless pose substantial risk for consumers**" and "will continue to gather evidence about the risks and harms of such products for consideration as a general matter in a **later rulemaking**, and will continue in the meantime to scrutinize such lending for potential unfair, deceptive, or abusive acts or practices pursuant to its **supervisory and enforcement** authority."

We urge the Bureau to complete this work as quickly as possible. We also urge states to regulate longer-term loans with interest rate caps: Many states have caps in place already and should defend them, and states without them should implement them.

In addition, CRL urged a far broader definition of balloon payment loan for these relatively small dollar loans to distressed borrowers, where payment shock can be severe. We recommended that it be any loan where all payments are not substantially equal, rather than only loans where one payment is more than twice the size of another payment.

With respect to the scope of loans covered by the rule's payment protections, these are limited to longer-term loans with an APR under the Truth In Lending Act (TILA) exceeding 36%. The proposed rule used a 36% APR threshold based on the Military Lending Act (MLA) APR, rather than the TILA APR. The MLA APR is far broader, including fees that the TILA APR does not include. The Bureau's discussion of this choice makes clear that its use of the TILA APR for payment protections is not an indication it would use the TILA APR as the threshold for determining which high-cost loans should require ability-to-repay requirements at a later time. We urge using the MLA APR as the threshold for determining whether a loan is "high-cost," as it is far more reflective of the true cost of a loan, and as the TILA APR risks inviting lenders to shift costs from the periodic rate into fees that are excluded from the APR. We also urge vigilant supervision of lender practices as to the payment protections to ensure they are not evading the scope in this manner.

In addition, the payment protections apply only to loans for which the lender has a leveraged payment mechanism. As a result, longer-term car title loans without a large balloon payment and for which the lender does not also take a leveraged payment mechanism—regardless of how high the loan's cost—are not covered by any provisions of the rule finalized this month. This underscores the need for the Bureau to take further action to address longer-term loans and for states to either enact or enforce existing rate caps applicable to longer-term loans.

CRL urged the Bureau to narrow or eliminate exceptions from the rule's scope with respect to, among other products, credit cards. The rule relies on a definition of "credit card" in Regulation Z, which is very broad and could be easily evaded. In addition, some credit cards have very high rates and fees and are not sufficiently protected by the weaker ability to repay standard in the Credit CARD Act. Lender use of so-called credit cards to evade the rule's protections must be vigilantly monitored and enforcement action taken as needed.

With respect to the conditional exemptions for accommodation loans and alternative loans, these represent a reasonable approach to minimize impact on credit unions and banks with respect to less risky loans than those the rule primarily seeks to address. The exemptions are available to all lenders, however, and they must be closely monitored to ensure that they are not being used in a way that evades the aims of the rule and causes harm to borrowers, and adjusted as needed.

Note: A 2015 preliminary outline of the CFPB's proposal had included a potential exemption from an ability-to-pay determination for certain longer-term loans if the loan's payments did not exceed 5% of a borrower's gross income (a payment-to-income, or PTI, ratio of 5% or less). This exemption was not included as part of the Bureau's formal proposed rule or the final rule. We opposed an exemption from ability-to-repay based on a PTI ratio because it does not take a borrower's expenses into account and thus will not prevent unaffordable loans and consequent harms.

III. Ability-to-Repay Standard

A. It is an unfair and abusive practice for a lender to make a covered short-term (ST) or covered longer-term balloon (LTB) loan without reasonably determining that the consumer will have the ability to repay (ATR) the loan according to its terms, i.e., without needing to reborrow.

B. Lender may make loans subject to an ability-to-repay determination ("ATR Loans") loans or certain loans without an ability-to-repay determination ("Exception Loans"), in accordance with their respective requirements. One borrower could be made both ATR Loans and Exception Loans from the same or different lenders (but could not have both an ATR Loan and an Exception Loan outstanding at the same time, or one within 30 days of the other, from the same or different lenders).

C. Ability-to-repay determination required on ATR Loans:

1. Lender must reasonably determine the borrower can repay the loan and meet other major financial obligations and basic living expenses for, typically, 30 days following the loan's due date.

2. Lender may use either a **debt-to-income** or a **residual income** approach, but with either approach must include rental expense as part of major financial obligations (see 3b. below) and must consider the borrower's basic living expenses (see 3c. below).

3. ATR determination must include the following components, in addition to the loan payment(s) due under the prospective loan:

    a. **Net Income**, which approximates "take-home" pay:
        i. Must be verified when a reliable record is "reasonably available," which includes when a consumer receives and can access a paystub. If a reliable record is not reasonably available for income in whole or in part, the lender may reasonably rely on consumer's written statement for that portion of income.
        ii. May include another's income to which consumer has reasonable expectation of access, if such income and access can be verified.
    b. **Major Financial Obligations**, consisting of:
        i. **Housing expense**
            (a) **Mortgage:** verified per national credit report
            (b) **Rent:** lender may reasonably rely on consumer's written statement (if no evidence that it is implausibly low and no lender pattern of underestimating rent)
        ii. **Minimum payments on other debt obligations** based on a national credit report, lender and affiliate records, and a "registered information system" to which covered ST and LTB loans must be reported; and
        iii. **Child support and alimony obligations** per national credit report
    c. **Basic Living Expenses**, meaning expenses necessary to maintain health, welfare, and ability to produce income for borrower and household. They include food, utilities, transportation, out-of-pocket medical expenses, phone and Internet services, and childcare.
        i. Lender may reasonably estimate the dollar or percentage of net income needed for basic living expenses based on lender's own experience in making covered loans to similarly-situated consumers;

reasonably reliable information available from government surveys or other publications about the basic living expenses of similarly-situated consumers; or some combination thereof. Ex: Consumer Expenditure Survey of the Bureau of Labor Statistics or the Internal Revenue Code's Collection Financial Standards, or a combination of those two sources.

ii. If individualized estimate, lender may consider, when reasonable, whether other persons are regularly contributing toward the consumer's payment of basic living expenses. (This is not reasonable if lender is also including another's income to which consumer has reasonable access in the consumer's projected net income.)

iii. Estimate is not reasonable if it assumes implausibly low basic living expenses.

d. Additional notes:

i. For a line of credit, must assume the line is fully utilized at consummation and that the consumer will make only the minimum payments. In addition, any advance more than 90 days after the previous determination requires a new ATR determination.

ii. No credit report required if (1) lender obtained credit report within 90 days and (2) borrower has not reached the mandatory cooling-off period under the "principal-payoff option," described below.

iii. Lenders must obtain borrowers statements of income and obligations, and certain provisions apply where stated and verified amounts differ.

4. ATR determination must be consistent with written policies and procedures and grounded in reasonable inferences and conclusions.

5. ATR determination <u>is not</u> reasonable if it:
   a. Assumes consumer will obtain additional credit,
   b. Assumes consumer needs implausibly low funds to meet basic living expenses under residual income or debt-to-income methodology,
   c. For covered longer-term balloon loan, relies on assumption consumer will accumulate savings

6. Evidence of unreasonable ATR determination may include without limitation the following factors. These factors may be evaluated across a lender's entire portfolio or with respect to particular products, geographic regions, time periods, or other categorizations, including loans made in reliance on consumer stated income. They may be considered either individually or in combination with one another. They are not absolute in their application but exist on a continuum and may apply to varying degrees. These factors are viewed in the context of the facts and circumstances relevant to whether the lender's ATR determinations are reasonable. Relevant evidence may also include a comparison of the factors to that of other lenders, but comparative performance is secondary to non-comparative performance:
   a. Default rates, during and at end of covered loan sequences, per sequence and per consumer;
   b. Reborrowing rates, including the frequency of loans within a sequence;
   c. Patterns of lending across loan sequences, including the frequency with which lenders make multiple sequences of loans and make new loans immediately or soon after expiration of a 30-day cooling-off period;

  d. Evidence of delinquencies and collateral impacts, including the portion of consumers who incur late fees, failed presentments, delinquencies, and car repossessions;
  e. Patterns of non-covered lending, including the frequency with which the lender makes non-covered loans shortly before or shortly after repayment of a covered loan and the non-covered loan bridges all or a substantial part of either the period between the two loans that otherwise would be a part of a loan sequence or a 30-day cooling-off period. Ex: Lender, affiliate or service provider frequently makes 30-day non-recourse pawn loans to consumers shortly before or soon after repayment of a covered loan and then makes additional covered short-term loans soon after repayment of the pawn loan.

7. Examples of applying the above factors:

  a. Evidence suggesting ATR determination <u>is not</u> reasonable:
     i. Significant percentage of consumers with ST covered loans at a lender reborrows within 30 days of first loan, within 30 days of second loan, and shortly after the end of the cooling-off period following the third loan.
     ii. Lender frequently makes at or near the maximum number of Exception Loans early within a 12-month period and then makes a large number of additional covered short-term loans (i.e., ATR Loans) to those same consumers within the same 12 months, where those loans are part of a sequence of two or three loans and the sequences begin soon after the cooling-off periods.

  b. Evidence suggesting ATR determination <u>is</u> reasonable, absent other evidence to the contrary:
     i. Lender frequently makes at or near the maximum Exception Loans permitted and then only occasionally makes ATR Loans to those same consumers, few of which are part of loan sequences longer than one loan.
     ii. A small percentage of the covered ST loan portfolio's loans default, consumers generally have short (i.e., fewer than three) loan sequences, and the consumers who take out multiple loan sequences typically do not begin a new loan sequence until several months after the end of a prior loan sequence. No evidence of non-covered loans to bridge cooling-off periods.

8. Other limitations on ATR Loans, which apply across lenders:
  a. Prohibition on loan if it would be the fourth ATR Loan in a sequence, where a loan made within 30 days of repayment of the prior loan is part of a sequence;
  b. Prohibition on ATR Loan if an Exception Loan is outstanding and for 30 days thereafter.

CRL strongly supports the general long-standing definition of ATR the rule applies, including consideration of income, obligations, and expenses, and the requirement that the loan be affordable according to its terms, which the Bureau makes clear means without reborrowing. An ATR requirement is particularly important for payday, car title, and similar loans, where the market incentive to underwrite is flipped on its head because the lender takes control over the borrower's checking account or access to the car title to coerce repayment. In this context, the lender is counting not on the borrower's ability to repay the loan, but rather on the lender's ability to collect on the loan, whether or not the borrower can afford to repay it.

CRL urged that the rule require verification of income as well as, generally, verification of rental expense. As the final rule permits lenders to rely on stated income in some instances and on stated rent generally, as well as on a reasonable expectation that a borrower shares basic living expenses, vigilant supervision and enforcement will be critical to prevent lenders from exploiting this flexibility in order to make unaffordable loans.

CRL also urged that the rule make clear that lenders cannot continue business as usual by reviewing loan performance primarily as compared to other covered lenders – that is, that a lender's defaults, delinquencies, reborrowings, and other signs of unaffordable loans not be deemed acceptable only because they are on par with those of other abusive lenders. The final rules provides a wide range of factors that are relevant to determining whether a lender's ATR determinations are reasonable, and it states that a non-comparative review is primary, while a comparative review as to other lenders is only complementary.

Further, CRL urged that total indebtedness in short-term loans be limited to a maximum of 90 days' indebtedness in a 12-month period, consistent with the FDIC's longstanding guidelines for the banks it supervises. The rule does not adopt this clear standard. However, the rule does provide the examples of high loan frequency noted above that make clear that the keeping borrowers in routine high frequency loans is an indication that lenders are violating the rule by not making reasonable determinations of ability-to-repay.

The rule does not prohibit a lender from making a borrower either a covered longer-term loan without a large balloon payment, or a non-covered loan, during the 30 days following a sequence of three ATR loans during which another ATR Loan or an Exception Loan are prohibited. There is risk that a lender will attempt to keep borrowers in continued indebtedness by flipping borrowers from covered short-term loans into longer-term loans and back into short-term loans again. As noted above, however, the rule does provide that patterns of non-covered lending may provide evidence that ATR determinations are unreasonable. This aspect of lender behavior must be closely monitored and enforcement actions and modifications to the rule carried out as needed.

Finally, CRL strongly opposes any exceptions from the ability-to-repay standard, discussed in section that follows.

IV. Exceptions to Ability-to-Repay Standard for Short-Term Payday Loans

A. First loan in a sequence (meaning the first loan at least 31 days following any prior Exception Loan) cannot be larger than $500;

B. Subsequent loans in a sequence (within 30 days of the prior loan), require proportional principal decrease over a maximum three-loan sequence (e.g., loans of $450, $300, $150);

C. Borrowing history requirements:
   1. No ATR Loan outstanding or during past 30 days; and
   2. Loan would not result in consumer having:
      a. More than three Exception Loans in a sequence; or
      b. In a 12-month period, more than six covered short-term loans outstanding or more than 90 days' indebtedness in covered short-term loans, across all lenders.

D. Other structural requirements:
   1. Fully amortizing;
   2. Not open-end;
   3. No car title.

E. In addition, a lender may not make any loan (whether a covered loan or a non-covered installment loan) to the consumer while an Exception Loan from that lender is outstanding or for 30 days thereafter (except another Exception Loan in compliance with this section).

F. Disclosures are required with the first and third Exception Loans in a sequence.

CRL categorically opposes any exemptions from an ability-to-repay (ATR) requirement for covered loans, as even a single unaffordable loan can cause substantial harm. We urge vigilant monitoring of this area, and as harms from Exception Loans are identified, further action be taken to eliminate this exemption.

V. Payment Practices

The rule also includes protections addressing lenders' payment practices, summarized here:

A. Limits attempts to collect payment from a consumer's account to two failed consecutive attempts, at which point a new consumer authorization is required for that and future payments.
B. Requires notice to consumers prior to attempting to collect payment from account.
C. Transfers for loans by the institution that holds the deposit account are exempt from these requirements if the lender agrees not to charge an overdraft or insufficient funds for a payment related to the loan, or close the account due to a negative balance from transfers in connection with the loan.

These requirements underscore the tremendous harm that payday and car title lenders cause borrowers through first-in-line access to their checking accounts. In our comments, we urged that these requirements be strengthened to require reauthorization following only one failed payment attempt.

VI. Enforcement

A. Anti-evasion clause: "A lender must not take any action with the intent of evading the requirements of this part."
B. Both the Bureau and the state Attorneys General and state regulators have the authority to enforce the provisions. This shared enforcement authority is provided in the Dodd-Frank Act, which recognizes the significant power of states to enforce against predatory lending practices.

We support a broad anti-evasion provision and urge CFPB and Attorneys General to vigorously monitor and enforce the final rule, particularly in light of payday and car title lenders' history of evasive practices.

VII. Additional Requirements

A. Reporting covered loan activity to "registered information systems," for which the rule lays out a registration process. *Centralized reporting is essential to enable compliance with critical components of the rule, including limitations on loan sequences across lenders. Many lenders already report to and consult with private commercial databases, and we support this requirement.*
B. Compliance program, including written policies and procedures and loan-level record-keeping requirements.
C. Effective date: 21 months following publication of the final rule in the Federal Register.

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