The CFPB's Payday Lending Proposed Rule: What Works, What Doesn't

The Consumer Financial Protection Bureau (CFPB) has proposed a new national rule that addresses payday and car title lending. If carefully written, the rule has the potential to help the millions of people intentionally trapped in 300-plus percent interest loans. But payday lenders have successfully pushed for loopholes in the proposed rule. These lenders evaded the Military Lending Act to continue exploiting service members and have defied state referendums enacted by voters. If the loopholes in this rule are not closed before it is finalized, lenders will aggressively exploit them as well, creating the appearance of change while largely continuing business as usual.

The Products Covered: Payday and Car Title Loans

The rule covers two major categories of loans, both of which carry, on average, more than 300 percent APR:

- **Payday loans** - defined as loans in which the lender takes payment directly from the borrower's bank account on the borrower's payday. These include:
    - **Short-term payday loans** (loans of 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 percent annually.
    - **Long-term payday loans** (loans longer than 45 days): These also carry triple-digit interest rates and last anywhere from 46 days to years. In important ways, the longer loan term makes these loans more harmful than short-term loans, not less. Lenders are increasingly making these loans.
- **Car title loans** - in which 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 they are illegal in a majority of states, they have a significant presence in 23 states.

** Long-term loans costing less than 36 percent fee-inclusive APR are excluded from the proposed rule.*

The Problem: The Debt Trap

The problem is that these products are a purposeful debt trap. Given the astronomical cost of borrowing and the lenders' 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 still being able to afford basic necessities of life. In fact, lenders have just the opposite incentive: They make more when they can trap borrowers in unaffordable debt for extended periods of time. They grab the payment from the borrower's account on payday, leaving the borrower unable to pay for rent or food unless they immediately take out or "flip to" another loan – and keep paying interest for another two weeks, and then another, and so on.

This is the debt trap, and it is the core of the payday and car title loan business model. According to CFPB data, more than 75 percent of payday loan fees are from borrowers stuck in more than 10 loans a year. More than two-thirds of car title loan volume comes from borrowers stuck in seven or more loans. 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, lost bank accounts, delinquency on other bills, and even bankruptcy.

CFPB's Role: Stop the Debt Trap

The CFPB can stop the debt trap by requiring lenders to make affordable loans. An affordable loan is one that a borrower has the ability to repay the loan in light of the borrower's income and expenses without defaulting on other bills and without re-borrowing to make ends meet. This is how responsible lenders already do things.

The CFPB's Proposed Rule

What Works: The proposed rule gets the fundamentals right by *establishing an ability-to-repay principle, <u>based on income and expenses</u>, at the core of the rule.* This is extremely significant; while a long-standing tenet of responsible lending, it's ignored by these abusive industries driven by unaffordable loans. It is particularly important for these high-cost loans where lenders have the right to seize a borrower's bank account or car. For this reason, the Bureau was right to eliminate an exemption from the ability-to-repay test based only on income, if a payment did not exceed 5% of the borrower's income; new Bureau research shows that 40% of payday installment loans at that payment level still default. The rule is also right to cover both short-term loans and long-term loans. Lenders have long made short-term balloon payday and car title loans, but, anticipating stricter rules on short-term loans, they are increasingly making long-term loans. Long-term loans can create even longer and deeper debt traps than short-term loans.

What Doesn't Work: The proposal contains loopholes that must be closed:

- *Exceptions to the ability-to-repay requirement:* The proposal exempts six high-cost payday loans from an ability-to-repay requirement altogether. Six unaffordable loans is six too many, as even a single unaffordable loan can create a cascade of financial consequences for borrowers. There are also exceptions for certain long-term loans. Though these exceptions carry periodic interest of 36% or less, they can carry origination fees of up to $50 and an unaffordable debt load.
- *Repeated flipping of loans, particularly of loans longer than 45 days:* The rule's protections against flipping of short-term loans are not strong enough; the waiting period between loans has been cut to 30 days, versus 60 days in the preliminary proposal last year. This change, combined with the six "exception loans," could permit lenders to continue putting borrowers in 10 or more payday loans a year. And the protections are even weaker if the loan is structured as longer than 45 days. Early refinances, after only a few payments, of loans structured as long-term loans effectively turn them into a string of short-term loans. The payday lenders exploited the 90-day loan definition under the original Military Lending Act regulations, and they will exploit the 45-day demarcation here.
- *"Business as usual" loophole in the ability-to-repay requirement:* The rule does not go far enough to ensure that, after repaying the loan, the borrower will have enough money left over to pay basic living expenses without reborrowing. While the rule prohibits implausibly low estimates of living expenses, the proposal appears to require only that the lender not have default or reborrowing rates above those of other high cost lenders – sanctioning a bar that is too low. Moreover, even low rates of default and reborrowing are not sufficient evidence that loans are affordable since lenders seize repayment directly from the account (and even if the payment overdraws the borrower's account).

What's Needed to Fix It:

- Require an ability-to-repay determination on every loan, with no exceptions.
- Limit total indebtedness in short-term loans – which have been exempted from some state interest rate caps based on lenders' claims that they are intended to be for very short terms – to 90 days per year, consistent with the long-time FDIC's standard.
- Strengthen protections against flipping loans, especially for loans longer than 45 days.
- Close the "business as usual" loophole in the ability-to-repay test by requiring lenders to show that loan payments will leave borrowers with enough money to be able to pay their necessary expenses.
- Cover all loans that provide lenders extraordinary leverage to extract repayment, including loans where the lender obtains access to the borrower's checking account even after the first few days of the loan term, loans secured by personal property, and loans where the lender retains the right to garnish wages.

States Must Continue to Play a Critical Role

CFPB does not have Congressional authority to set an interest rate cap, but states can. Close to a third of states have rate caps on short-term loans, and more than half have caps on long-term loans. 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.

CFPB Needs to Hear From Us: Close the Loopholes

The public has 90 days to submit comments on the proposal, to urge the CFPB to close the loopholes. The CFPB will consider the comments and is expected to issue a final rule during 2017.

The #StopTheDebtTrap campaign is powered by more than 500 civil rights, consumer, labor, faith, veterans, seniors and community organizations from all 50 states. Analysis provided by the Center for Responsible Lending.

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