The CFPB's 2017 Payday Lending Rule: A Step Forward To Stop the Debt Trap

In October 2017, the Consumer Financial Protection Bureau (CFPB) issued 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 a step forward in protecting the millions of people lenders intentionally trap in 300-plus percent interest loans. Payday and car title lenders have moved aggressively to try to block the rule, which is based on the commonsense principle of determining whether borrowers can afford to repay a loan before making it. Sixteen states plus the District of Columbia have already implemented strong state laws against the payday debt trap by enforcing a rate cap of 36 percent interest or less.

The Products at Issue: Payday and Car Title Loans

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

- **Payday loans** - loans in which the lender repays itself directly from the borrower's bank account on the borrower's payday. These are typically due in one lump sum. Sixteen states plus the District of Columbia prohibit these loans by enforcing rate caps of 36 percent or less.
- **Car title loans** - loans in which the lender requires the power to immediately seize and sell the car as collateral, and uses this power to coerce payment. While they are illegal in most states, they are prevalent in 22 states.

Both payday and car title loans can be **short-term** (45 days or less, typically due in a single balloon payment) or **longer-term** (where the lender collects payment every payday on an ongoing basis, for longer than 45 days). The Bureau's proposed rule would have required ability-to-repay determinations on both short-term loans and higher-cost longer-term loans. Its final rule does so only for short-term loans.

The Problem the Rule Takes Aim At: The Debt Trap

The problem is that payday and car title loans are a deliberate debt trap that lock the borrower into long-term debt because they cannot afford to repay the high-cost loan. 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, these 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 are "flipped into" 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 lender business model. This trap extracts billions of dollars annually from people with average incomes of about $25,000 and leads to a cascade of financial consequences like bank penalty fees, lost bank accounts, delinquency on other bills, reduced credit scores, and even bankruptcy.

Lenders have long made short-term payday and car title loans in states that permit them, and we've seen them expand their debt trap business model by making longer-term payday and car title loans in the states where high-cost longer-term loans are permitted.

The CFPB's Rule

The CFPB's 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 Federal Deposit Insurance Corporation (FDIC) guidelines for the banks it supervises.

The final rule includes only some portions of the proposed rule. The CFPB finalized the ability-to-repay standard for short-term loans and payment protections for short-term and certain longer-term loans. The CFPB, when it finalized this rule, also stated that it had considerable concerns about the broader longer-term market and would 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, which their trade associations noted when the rule was finalized.

Payday and car title lenders filed suit to stop the rule, even though the rule is the culmination of more than 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.

Congress Must Pass a Federal 36 Percent Rate Cap

Payday lenders pushed Members of Congress to repeal the rule under the Congressional Review Act, which would have nixed the rule with a simple majority vote. Congress wisely did not take up this unpopular measure and the deadline for this action expired in 2018. Moving forward, Congress should enact a federal 36 percent 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 and with broad bipartisan support.

States Must Continue to Play a Critical Role

Nearly 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 protect residents from high-rate loans altogether by enacting a fee-inclusive rate cap of 36 percent 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.

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

The CFPB should implement the payday rule as written, without delay. It should also move forward to rein in the harms of all debt trap longer-term loans, including loans secured by access to borrowers' checking accounts, car titles, personal property, wage garnishment, and any other loans exceeding a 36 percent fee-inclusive annual percentage rate. The CFPB must also vigorously monitor and enforce today's rule to protect against evasion by payday lenders notorious for skirting laws that aim to rein them in.

Key Facts on Payday Lending:

- Polling shows that nearly four out of five American voters support the payday rule with support highest among Republicans and Independents.
- Payday lenders typically charge interest rates of 391 percent.
- 75 percent of payday lending fees are generated from borrowers with more than 10 loans a year.
- The typical payday borrower is stuck in 8 loans a year, paying more in fees than the amount first borrowed.
- 16 states and D.C. have capped payday loan rates at 36 percent or less, saving residents over $2 billion in fees annually. Since 2008, five states have put this issue to their voters through ballot initiatives; in all cases, they voted overwhelmingly in favor of a cap.
- Regardless of whether they are structured as short-term or long-term, these high-cost payday and car title loans are destructive debt traps that cause significant harm to borrowers, such as increased likelihood of bankruptcy, delinquency on other bills, bank penalty fees, and involuntary bank account closures.

The #StopTheDebtTrap campaign is powered by more than 700 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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