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FACTSHEET: THE CFPB CONSIDERS PROPOSAL TO END PAYDAY DEBT TRAPS

Today the Consumer Financial Protection Bureau (CFPB) announced it is considering proposing rules that would end payday debt traps by requiring lenders to take steps to make sure consumers can repay their loans. The proposals under consideration would also restrict lenders from attempting to collect payment from consumers' bank accounts in ways that tend to rack up excessive fees. The strong consumer protections being considered would apply to payday loans, vehicle title loans, deposit advance products, and certain high-cost installment and open-end loans.

Overview

The proposals under consideration cover both short-term and longer-term credit products that are often marketed heavily to financially vulnerable consumers. The CFPB recognizes consumers' need for affordable credit but is concerned that the practices often associated with these products – such as failure to underwrite for affordable payments, repeatedly rolling over or refinancing loans, holding a security interest in a vehicle as collateral, accessing the consumer's deposit account for repayment, and performing costly withdrawal attempts – can trap consumers in debt. Consumers can be forced to choose between re-borrowing, defaulting, or falling behind on other obligations, and also may face deposit account fees and closures, vehicle repossessions, and other harms.

For short-term loans, the CFPB has found that for consumers living paycheck to paycheck, the short timeframe can make it difficult to accumulate the necessary funds to pay off the principal and fees before the due date. Borrowers who cannot repay often roll over the loan – pay more fees to delay paying off the loan or take out a new loan to replace the old one. For many borrowers, what starts out as a short-term loan turns into an unaffordable, long-term cycle of debt. For longer-term loans, many consumers struggle to keep up with unaffordable payments, which can result in defaults, costly refinancing, or falling behind on other bills.

The proposals under consideration provide two different approaches to ending debt traps – prevention and protection. Under the prevention requirements, lenders would have to determine at the outset that the consumer is not taking on unaffordable debt. Under the protection requirements, lenders would have to comply with various restrictions designed to ensure that consumers can affordably repay their debt. Lenders could choose which set of requirements to follow.

The CFPB is publishing the outline of proposals under consideration in preparation for convening a Small Business Review Panel to gather feedback from small lenders, which is the next step in the rulemaking process.

Products Covered by Proposals

- **Payday loans:** Payday loans typically are structured as single-payment, short-term loans with repayment due at the time of the consumer's next paycheck or benefit payment. Payday storefronts

have been commonplace in many states since the 1990s, and many online lenders also offer payday loans. About 2.5 million households used payday loans over a 12-month period, according to the 2013 "National Survey of Unbanked and Underbanked Households" by the Federal Deposit Insurance Corporation. And, according to another study, payday lenders (storefront and online combined) collect about $8.7 billion annually in interest and fees.

- **Deposit advance products:** In the past, a small number of banks and credit unions offered deposit advance products. The bank or credit union would automatically collect payment on the loan from the borrower's incoming qualifying electronic deposits. Following recent guidance from two federal prudential regulators, however, nearly all of these products have been discontinued. To the extent that depository institutions may offer replacement products, those products may be subject to today's proposals under consideration.

- **Vehicle title loans:** Vehicle title loans typically are expensive credit, backed by a security interest in the consumer's vehicle. About 1 million households use vehicle title loans each year according to the FDIC study. They spend approximately $3 billion annually in fees, according to the Pew Charitable Trusts. Title loans may be short-term or longer-term, and the lender may repossess the consumer's vehicle if the consumer is unable to pay.

- **High-cost installment loans:** The proposals under consideration would cover many types of installment loans. Installment loans have multiple payments, often over several months, and have loan amounts ranging from a hundred dollars to several thousand dollars. They may carry very high interest rates. Some have balloon payments.

- **Open-end lines of credit and other loans:** Open-end lines of credit and other loans that fall within the CFPB's proposal under consideration, regardless of how they are named or marketed to consumers, would also be covered.

<u>Ending Debt Traps: Short-Term Loans</u>

The proposals under consideration would cover short-term credit products that require consumers to pay back the loan in full within 45 days. Typical short-term loans include many payday loans, deposit advance products, certain open-end lines of credit, and some vehicle title loans. The CFPB is considering using 45 days to define short-term loans to distinguish those loans that are required to be repaid in one income and expense cycle. Many short-term loans are 14 days or one month to match the timing of consumers' paychecks. However, loans taken out shortly before a consumer is paid may not be due until the following paycheck. The 45-day definition would capture these slightly longer loans.

The proposals under consideration include two ways that lenders could extend short-term loans without causing borrowers to become trapped in long-term debt. Under the proposals, lenders could either prevent debt traps at the outset of each loan, or they could protect against debt traps throughout the lending process. Specifically, all lenders making covered short-term loans would be required to adhere to one of the following sets of requirements:

- **Debt trap prevention requirements:** This option would eliminate debt traps by requiring lenders to determine at the outset that the consumer can repay the loan when due – including interest, principal, and fees for add-on products – without defaulting or re-borrowing. For each loan, lenders would have to verify the consumer's income, major financial obligations, and borrowing history to determine

whether there is enough money left to repay the loan after covering other major financial obligations and living expenses. Other requirements include:

- Lenders would generally have to adhere to a 60-day cooling off period between loans.
- The consumer could not have any other outstanding covered loans with any lender.
- To make a second or third loan within the two-month window, lenders would have to document that the borrower's financial circumstances have improved enough to repay a new loan without re-borrowing. They would have to verify, for example, that the consumer's income had increased following the prior loan.
- After three loans in a row, all lenders would be prohibited from making a new short-term loan to the borrower for 60 days.

- **Debt trap protection requirements:** These requirements would protect against debt traps by limiting the number of loans that a borrower can take out in a row and requiring lenders to provide affordable repayment options. These protections would include the following restrictions:
  - The loan could not exceed $500, last longer than 45 days, carry more than one finance charge, or require the consumer's vehicle as collateral.
  - The consumer could not have any other outstanding covered loans with any lender.
  - Rollovers would be capped at two – three loans total – followed by a mandatory 60-day cooling-off period.
  - The second and third consecutive loans would be permitted only if the lender offers an affordable way out of debt. The Bureau is considering two options for this. The first would require that the principal decrease over the three-loan sequence so that it is repaid in full when the third loan is due. The second would require the lender to provide a no-cost "off-ramp" if the borrower is unable to repay after the third loan, to allow the consumer to pay the loan off over time without further fees.
  - The consumer could not be more than 90 days in debt on covered short-term loans in a 12-month period.

Ending Debt Traps: Longer-Term Loans

The proposals under consideration would also apply to high-cost, longer-term credit products of more than 45 days where the lender has access to repayment from the consumer's deposit account or paycheck, or holds a security interest in the consumer's vehicle, and the all-in annual percentage rate is more than 36 percent. This includes longer-term vehicle title loans, some high-cost installment loans, and similar open-end products. In order to reduce compliance burdens for lenders, the CFPB is considering using existing lines in federal law for the coverage threshold, such as the Military Lending Act's 36 percent all-in annual percentage rate, which includes interest, fees, and add-on product charges.

Installment loans typically stretch longer than a two-week or one-month payday loan, have loan amounts ranging from a hundred dollars to several thousand dollars, and may impose very high interest rates. The principal, interest, and other finance charges on these loans are typically repaid in installments. Some have balloon payments. The proposal would also apply to high-cost open-end lines of credit with deposit account, paycheck, or vehicle title access.

The CFPB's proposals under consideration for longer-term loans would eliminate debt traps by requiring lenders to take steps to determine that borrowers are able to repay their debt. Just as with short-term loans, lenders would have two alternative ways to meet this requirement – prevent debt traps at the outset or protect against debt traps throughout the lending process. Specifically, lenders making covered longer-term loans would have to adhere to one of the following sets of requirements:

- **Debt trap prevention requirements:** This requirement would prevent debt traps by requiring lenders to determine at the outset that the consumer can make each payment on the loan when due – including interest, principal, and fees for any add-on products – without defaulting or re-borrowing. For each loan, lenders would have to verify the consumer's income, major financial obligations, and borrowing history to determine whether there is enough money left to make payments on the loan after covering other major financial obligations and living expenses. Other requirements include:
  - Lenders would be required to determine if a consumer is able to repay the loan each time the borrower seeks to refinance or re-borrow.
  - If the borrower has been delinquent on a payment, the lender would be prohibited from refinancing into another loan with similar terms without documentation that the consumer's financial circumstances had improved enough to be able to repay the loan.

- **Debt trap protection requirements:** The Bureau is considering two specific approaches to the debt trap protection requirements for longer-term products. Under either approach, loans would have a minimum duration of 45 days and a maximum duration of six months.
  - Under the first approach, lenders could provide generally the same terms as loans offered under the National Credit Union Administration program for "payday alternative loans." Under this requirement, the following restrictions would apply:
    - The loan principal is between $200 and $1,000, and the balance decreases over the loan term.
    - The lender could not charge an interest rate higher than 28 percent and an application fee higher than $20.
    - The consumer has no other covered loans.
    - The lender would only be able to provide two of these loans to a consumer within six months, and the consumer could only have one at a time.
  - Under the second approach, lenders could make a longer-term loan provided the following conditions are met:
    - The amount the consumer is required to pay each month is no more than 5 percent of the consumer's gross monthly income.
    - The consumer has no other covered loans.
    - The lender does not provide more than two of these loans to the consumer in a 12-month period.

Restricting Harmful Payment Collection Practices

Lenders of both short-term and longer-term loans often obtain access to a consumer's checking, savings, or prepaid account to collect payment through a variety of methods, including post-dated checks, debit authorizations, or remotely created checks. However, this can lead to unanticipated withdrawals or debits and transaction fees. When lenders attempt to get their money through repeated, unsuccessful withdrawal attempts, consumers are charged insufficient funds fees by their depository institution and returned payment fees by the lender, and may even face account closure. These fees add to the spiraling costs of falling behind on these loan products and make it even harder for a consumer to climb out of debt. To mitigate these problems, the Bureau is considering proposals that would:

- **Require borrower notification before accessing deposit accounts:** Under the proposals being considered, lenders would be required to provide consumers with three business days advance notice before submitting a transaction to the consumer's bank, credit union, or prepaid account for payment. The notice would include key information about the forthcoming payment collection attempt. This

requirement would apply to payment collection attempts through any method and would help consumers better manage their deposit accounts and overall finances.

- **Limit unsuccessful withdrawal attempts that lead to excessive deposit account fees:** Under the proposals being considered, if two consecutive attempts to collect money from the consumer's account were unsuccessful, the lender would not be allowed to make any further attempts to collect from the account unless the consumer provided a new authorization. This would limit fees incurred by multiple transactions that exacerbate a consumer's financial woes.

The Rulemaking Process

As the next step in the rulemaking process, the Bureau is publishing an outline of the proposals under consideration in preparation for convening a Small Business Review Panel to gather feedback from small lenders.

An outline of the proposals under consideration will be available on March 26 at:
http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf

In addition to consulting with the Small Business Review Panel, the Bureau will continue to seek input from a wide range of stakeholders before issuing a proposed rulemaking. Once the Bureau issues its proposed regulations, the public will be invited to submit written comments which will be carefully considered before final regulations are issued.

A factsheet summarizing the Small Business Review Panel process is at:
http://files.consumerfinance.gov/f/201503_cfpb_factsheet-small-business-review-panel-process.pdf

A list of questions on which the Bureau will seek input from the small business representatives providing feedback to the Small Business Review Panel will be available on March 26 at:
http://files.consumerfinance.gov/f/201503_cfpb_list-of-questions-from-small-business-review-panel.pdf

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The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.