CFPB Issues Proposed Rule for Payday Lending

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Yesterday the CFPB released its long-awaited proposed rule covering payday loans, auto title loans, deposit advance products and certain high-cost installment and open-end loans. The Bureau proposes that this population of loans be defined as (1) loans with a term of 45 days or less; and (2) loans with a term greater than 45 days, provided that they have an all-in APR greater than 36 percent and are repaid directly from the consumer's account or income or are secured by the consumer's vehicle.

The CFPB stated that products in this targeted population commonly set consumers up to fail "by keeping borrowers in so-called debt traps with loan payments that they are unable to repay. Faced with unaffordable payments, consumers must choose between defaulting, borrowing, or skipping other financial obligations like rent or basic living expenses like food and medical care." The full text of the proposal comes in at 1334 pages and can be found here.

To address the concerns identified by the CFPB, the proposal lays out certain obligations and restrictions lenders offering these products will have to follow. Some of the major points include:

- Conduct a "full-payment test" prior to loan approval. Here, a lender would be required to make an upfront determination regarding a consumer's ability to repay the loan. This fairly detailed test will include requirements for determining affordability, parts of which approach underwriting procedures for a mortgage loan. For example, there will be calculations of debt to income ratios, income verification and credit checks to verify the amount of other outstanding loans. Lenders will also be required to estimate a reasonable amount of basic living expenses for the consumer. This type of front-end underwriting will be time-consuming and costly to lenders. Additional requirements include having to justify additional loans, and a cap of three consecutive loans to one consumer in a row.
- Lenders must provide a written notice before attempting to debit the consumer's account to collect payment for any loan covered by the proposed rule, and there is a limit on the number of unsuccessful attempts a lender can make before a new authorization is required.
- An option for lenders to offer up to $500 as a short term loan for those who cannot meet the "full payment test" discussed above. There are restrictions on this option, however, including requiring the debt to be repaid either in a single payment or with up to two extensions.

As expected, this latest proposed rule from the CFPB continues to divide members of Congress when it comes to anything the Bureau initiates. The main criticism is illustrated by Representative Randy Neugebauer (R-Texas), Chairman of the Financial Institutions and Consumer Credit Subcommittee, who stated, "The CFPB's proposed rule represents Washington at its worst and will harm America's unbanked and underbanked consumers. Short-term, small dollar credit is essential to the roughly 51 million American consumers who don't have sufficient access to traditional banking services or products. These customers are disproportionately drawn from low or moderate-income segments of the population, vulnerable to unexpected expenses." On the other side of the aisle, Representative Maxine Waters (D-CA), Ranking Member of the House Financial Services Committee, took a different view, stating, "The CFPB has taken an important step today to rein in payday lenders that prey on financially vulnerable Americans. These loans often come with outrageous terms, such as interest rates that can top 1,000 percent, and trap millions of Americans a year in a cycle of debt that many of them are never able to exit."

As we always advise, the best approach to limit your institution's liability is to be proactive in efforts to ramp up training and compliance well in advance of any new rule promulgated by the CFPB. With this proposed rule lenders should be looking at how they could begin to implement these requirements efficiently. The proposed rule is open for public comment and after your review of the proposed rule, if you feel the burdens placed on those in the payday loan and/or auto title loan industry are too great, please take this opportunity to register a comment with the CFPB on or before September 14, 2016. The online comment process is easy to use and you can begin the process here. If you have any questions regarding the proposed rule, CFPB compliance, exam or investigations, please contact a member of Baker Donelson's Financial Services Litigation Practice Group or our CFPB Team at any time.