Banking and Finance Law Daily Wrap Up, TOP STORY—CFPB takes first step in addressing consumer loan 'debt traps', (Mar. 26, 2015)

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Katalina M. Bianco, J.D.

The Consumer Financial Protection Bureau is considering proposals that would require lenders to make certain that consumers can repay their loans while also restricting lenders from attempting to collect payment from consumers' bank accounts in ways that tend to rack up excessive fees. The proposals are intended to stop the "debt traps" caused by payday loans, vehicle title loans, deposit advance products, and certain high-cost installment loans and open-end loans. The bureau said the proposals are "an important step" toward ending debt traps that "plague" so many consumers.

"With payday loans, vehicle title loans, and many types of installment loans, the pattern is all too common," CFPB Director Richard Cordray said in prepared remarks for a field hearing on payday lending. "A consumer facing difficult financial circumstances is offered quick cash with no questions asked and in return agrees to provide access to a checking account or paycheck or vehicle title in order to get the loan. No attempt is made to determine whether the consumer will be able to afford the ensuing payments," Cordray said.

Small Business Review Panel. The CFPB is publishing an outline of the 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. The bureau provided a fact sheet that summarizes the Small Business Review Panel process. In addition, the CFPB issued a list of questions for input on potential rulemaking.

In conjunction with the fact sheet and list of questions, the bureau posted information on the Small Business Review Panel to its blog. The post describes how the panel works and which businesses participate. According to the post, the panel meetings are not public. However, the bureau intends to publish meeting materials on its website.

Overview of proposals. A fact sheet provides an overview of the proposals under consideration. The proposals cover both short-term and longer-term credit products that are often marketed heavily to financially vulnerable consumers. 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, paying 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.

For both short-term and longer-term loans, the proposals provide lenders with two options. Lenders would be required to adhere to debt trap prevention requirements or debt trap protection requirements.

Short-term loans. 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.

Debt trap prevention requirements 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. In addition:

- lenders generally would have to adhere to a 60-day cooling off period between loans;

- the consumer could not have any other outstanding covered loans;
- 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; and
- 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 for short-term loans 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 require that:

- the loan not exceed $500, last longer than 45 days, carry more than one finance charge, or require the consumer's vehicle as collateral;
- the consumer not have any other outstanding covered loans with any lender;
- rollovers be capped at two, for three loans total, followed by a mandatory 60-day cooling off period;
- the second and third loan be permitted only if the lender offers an affordable way out of debt; and
- the consumer not be more than 90 days in debt on covered short-term loans within a 12-month period.

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. The CFPB said that it 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, in order to reduce regulatory burden.

Debt trap prevention requirements 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 product— 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. In addition:

- 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; and
- 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.

As for debt trap protection requirements for longer-term loans, the CFPB said that it is considering two specific approaches. Under each approach, loans would have a minimum duration of 45 days and a maximum duration of six months. Under the first approach, lenders generally could provide the same terms as loans offered under the National Credit Union Administration program for "payday alternative loans." Additionally:

- the loan principal would have to be between $200 and $1,000, and the balance would decrease 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 could have no other covered loans; and
- the lender would be able to provide only two of these loans to a consumer within six months, and the consumer could only have one loan at a time.

Under the second approach, lenders could make a longer-term loan provided that:

- 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; and

- the lender does not provide more than two of these loans to a consumer in a 12-month period.

Payment collection practices. The CFPB is considering proposals, for both short-term and longer-term loans, that would restrict harmful payment collection practices that lead to insufficient funds and returned payment fees. The proposals would require borrower notification before accessing deposit accounts and limit unsuccessful withdrawal attempts to two consecutive attempts.

Center for Responsible Lending response. The Center for Responsible Lending has expressed support for the CFPB's proposals. According to the CRL, payday lenders should be expected to do what responsible mortgage and other lenders already do, which is check a borrower's ability to repay the loan on the terms it is given. "This is a significant step that is long overdue and a profound change from current practice. If made mandatory, the ability to repay standard will help millions of borrowers avoid dangerously high-cost payday and other abusive loans.

MainStory: TopStory CFPB DebtCollection Loans