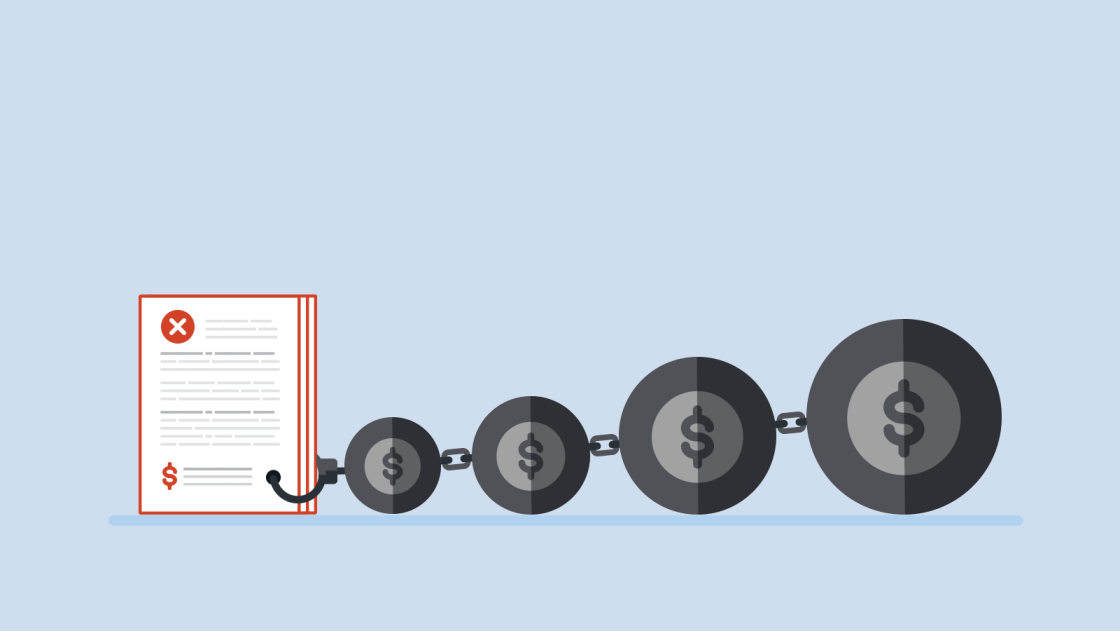
We've proposed a rule to protect consumers from payday debt traps

New data shows payday and similar loans lead to consumers trapped in debt and our proposed rule aims to help those consumers.

By David Silberman – JUN 02, 2016



When cash is tight, some people turn to payday and similar loans to make ends meet. Though these loans offer quick access to money, they often carry an average annual interest rate of over 300 percent, in addition to other fees. For some people these loans become debt traps.

The Consumer Financial Protection Bureau is working to end payday debt traps. Today, we're announcing a proposed rule that would require lenders to determine whether borrowers can afford to pay back their loans. The proposed rule would also cut off repeated debit attempts that rack up fees and make it harder for consumers to get out of debt. These strong proposed protections would cover payday loans, auto title loans, deposit advance products, and certain high-cost installment loans.

What are payday loans and how do they work?

A payday loan is a short-term loan, often for $500 or less, that is typically due on your next payday. When you take out a payday loan, you typically have to give lenders access to your checking account or write a post-dated check for the full balance that the lender can deposit when the loan is due.

The cost of the loan (finance charge) may range from $10 to $30 for every $100 borrowed. A typical two-week payday loan with a $15 fee per $100 borrowed equates to an annual percentage rate (APR) of almost 400 percent.

Debt Trap Dangers

We began researching payday and other similar loans in 2012. Since then, we've found that most consumers who take out payday loans can't afford to pay back all of the money they owe by their next paycheck. In addition to looking at storefront payday lenders, we studied online payday loans, and single payment auto title loans, and longer-term, high-cost loans and their effects on consumers. Here are some key findings:

- **Repeat short-term borrowing:** Within a month, almost 70 percent of payday loan borrowers take out a second payday loan. And, one in five new borrowers ends up taking out at least ten or more loans, one after the other. With each new loan, the consumer pays more fees and interest on the same debt.
- **Penalty fees:** Online lenders' repeated attempts to debit payments from a borrower's checking account can add significant costs to online payday loans. Our research found that half of online borrowers are charged an average of $185 in bank penalties.
- **Auto seizure:** Auto title loans often have issues similar to payday loans, including high rates of consumer reborrowing, which can create long-term debt traps. A borrower who cannot repay the initial loan, which typically lasts 30 days, must reborrow or risk losing their vehicle. If the loan is repaid, the title is returned to the borrower. However, we

found that 1 in 5 short-term auto title borrowers lose their vehicle because they fail to repay the loan.

- **High default rates for long-term installment loans:** Over one-third of payday installment loan sequences default, sometimes after the consumer has already refinanced or reborrowed at least once. Nearly one-third of auto title installment loan sequences end in default, and 11 percent end with the borrower's car seized by the lender.

We're inviting public comments on our proposed rule, Notice of Proposed Rulemaking on Payday, Vehicle Title, and Certain High-Cost Installment Loans. If you or someone you know has had an experience with payday and other similar loans, we'd like to hear from you. Once the proposal is published in the Federal Register in the coming weeks, we welcome comments online at www.Regulations.gov (we will update our website to include the www.Regulations.gov link as soon as it is available). Instructions for submitting comments by additional methods are available in the ADDRESSES section of the proposed rule.