

[Banking and Finance Law Daily Wrap Up, TOP STORY—Payday loan ‘debt traps’ target of new CFPB proposal, \(Jun. 2, 2016\)](#)

Banking and Finance Law Daily Wrap Up

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The Consumer Financial Protection Bureau has proposed a rule intended to end payday loan “debt traps” by requiring lenders to ensure that consumers are able to repay their loans. The highly anticipated [proposal](#) would ban repeated debit attempts that add to consumer fees and would include not only payday loans but auto title loans, deposit advance products, and certain high-cost installment and open-end loans. [According to the CFPB](#), the bureau is making further inquiry into additional practices or products that may cause consumer cash shortfalls.

The bureau intends to make the final rule effective 15 months after it is published in the *Federal Register*. Comments are due by Sept. 14, 2016.

Proposal overview. The proposed rule would establish a new part 12 CFR Part 1041 that would contain regulations creating consumer protections for certain consumer credit products. The proposal generally would cover two categories of loans: (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 annual percentage rate greater than 36 percent and either are repaid directly from the consumer’s account or income or are secured by the consumer’s vehicle.

Full-payment test. Under the proposal, lenders would be required to determine whether a borrower could afford the full amount of each payment when it’s due and still meet basic living expenses and major financial obligations. For short-term loans and installment loans with a balloon payment, full payment means affording the total loan amount and all the fees and finance charges without having to re-borrow within the next 30 days. For payday and auto title installment loans without a balloon payment, full payment means affording all of the payments when due.

Payoff options. Lenders would have options to make covered loans without satisfying the ability-to-repay requirements if the loans meet certain conditions. Consumers could receive a short-term loan up to \$500 without the full-payment test as part of the principal payoff option that is directly structured to keep consumers from being trapped in debt. Lenders would be barred from offering this option to consumers who have outstanding short-term or balloon-payment loans or who have been in debt on short-term loans more than 90 days in a rolling 12-month period. Lenders would also be barred from taking an auto title as collateral. As part of the principal payoff option, a lender could offer a borrower up to two extensions of the loan, but only if the borrower pays off at least one-third of the principal with each extension.

The proposed rule would permit lenders to offer two longer-term loan options with more flexible underwriting, but only if the loans pose less risk by adhering to certain restrictions. The first option would be offering loans that generally meet the parameters of the National Credit Union Administration “payday alternative loans” program, in which interest rates are capped at 28 percent and the application fee is no more than \$20. The other option would be offering loans that are payable in roughly equal payments with terms not to exceed two years and with an all-in cost of 36 percent or less, not including a reasonable origination fee, so long as the lender’s projected default rate on these loans is 5 percent or less. The lender would have to refund the origination fees any year that the default rate exceeds 5 percent. Lenders would be limited as to how many of either type of loan they could make per consumer per year.

Debit attempts. Under the proposal, lenders would have to give consumers written notice before attempting to debit the consumer’s account to collect payment for any loan covered by the proposed rule. After two straight

unsuccessful attempts, the lender would be prohibited from debiting the account again unless the lender gets a new and specific authorization from the borrower. Notably, a further attempt to withdraw payments without authorization would be identified as an unfair and abusive practice.

Guidance. The CFPB provided [model forms](#) that could be used by lenders to provide required notices to consumers. The bureau also provided a [factsheet](#) outlining and summarizing the proposal.

Request for information. The CFPB has issued a [request for information](#) on: (1) potential consumer protection concerns with loans that fall outside the scope of the proposal but are intended to serve similar populations and needs; and (2) business practices that fall within the scope of the proposal that raise potential concerns not addressed in the proposal. Comments are due by Oct. 14, 2016.

Field hearing. In his [prepared remarks](#) for a field hearing on small-dollar lending in Kansas City, Mo., CFPB Director Richard Cordray discussed the CFPB’s research that led to the rulemaking, stating, “Indeed, the very economics of the payday lending business model depend on a substantial percentage of borrowers being unable to repay the loan and borrowing again and again at high interest rates, incurring repeated fees as they go along.” A summary of the CFPB’s research contains [highlights](#) of the bureau’s findings, as does a [supplemental report](#) issued by the agency.

Blog post. Finally, the CFPB [posted](#) consumer-friendly information on the proposal to the bureau’s blog. The post includes a video on payday loan debt traps.

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