Banking and Finance Law Daily Wrap Up, TOP STORY—Final payday loan regulation adopted by CFPB, (Oct. 5, 2017)

Banking and Finance Law Daily Wrap Up

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The Consumer Financial Protection Bureau has adopted its anticipated short-term, small-dollar loan regulation. According to the Bureau, loans that require full or nearly full repayment at one time, such as payday loans, vehicle title loans, and deposit advance products, are the final rule's focus. Some longer-term loans that have balloon payment features also are covered. Most of the rule, which is based on last year's proposal (see *Banking and Finance Law Daily*, June 2, 2016), will take effect 21 months after it is published in the *Federal Register*.

The CFPB says that loans of this type frequently are made to financial vulnerable consumers who are unable to repay the credit in full when it is due. As a result, many of them end up rolling the loan over into a new loan, and they continue to pay annual percentage interest rates of up to 300 percent. The Bureau says that more than 80 percent of payday loans are rolled over within one month and nearly 25 percent are rolled over at least nine times, resulting in a "debt trap."

Rule provisions. According to the Bureau, the rule:

- establishes a full-payment test for installment loans to ensure that consumers can afford their payments and still meet their basic living expenses and major financial obligations;
- limits to three the number of loans that can be made in close succession (while a prior loan is outstanding or within 30 days after a prior loan is repaid);
- creates an exception to the full-payment test for very small loans if the lender offers a way the consumer can get out of debt more gradually;
- creates a separate exemption for loans that pose less risk for consumers; and
- prevents lenders that make short-term loans, balloon-payment loans, and longer-term loans with an annual percentage rate of more than 36 percent from continuing to attempt to debit consumer accounts for payments after two consecutive failures.

The Bureau also has offered a factsheet that summarizes the rule.

Full-payment test. The full-payment test is a core feature of the rule. The Bureau describes it as a test that will determine whether a consumer will be able to make the required loan payments, meet his basic living expenses, and cover his major financial obligations during the shorter of the life of the loan or 45 days after the credit is extended, and for 30 days after the highest payment required by the loan. The lender musty verify the consumer's income and financial obligations and estimate the consumer's living expenses for the month in which the highest payment will be due.

In the case of a loan that is due to be repaid in a single payment, such as a payday loan or title loan, the lender must verify that the consumer can meet the test during the loan's term and for the following 30 days. The lender can include the income of another member of the consumer's household if the consumer has access to that income and that person and the borrower share the payment of their living expenses and financial obligations.

If the loan lasts longer and includes a balloon payment, the lender must verify that the consumer will be able to make all of the payments, including the balloon, as they come due, and will be able to meet his living expenses and major financial obligations (a) during the loan term and (b) for 30 days after the month that includes the loan's highest payment (presumably the balloon).

The rule explicitly says that making a covered loan without reasonably determining that the consumer passes the full-payment test is unfair and abusive.

Test exceptions. The rule includes what is called a principal-payoff option that covers loans that do not exceed $500. This lending option must allow the consumer either to pay the loan off either in a single payment or to roll the loan over once or twice as long as each roll-over reduces the original principal by at least one-third. Specified plain-language disclosures must be made.

The option is available only for types of loans the CFPB perceives as lower-risk. The loan cannot be open-end credit, and the lender cannot take a security interest in a car title.

Also, a consumer is not eligible for a principal-payoff loan if she:

- has an outstanding or recent short-term or balloon-payment loan;
- has recently had three such loans in quick succession;
- has already had more than six short-term loans; or
- has been indebted for longer than 90 days for short-term loans over a rolling 12-month period.

Lower-risk loans. Other lower-risk loans are not subject to the full-payment test at all. These include loans made by a lender that makes no more than 2,500 covered loans per year and earns no more than 10 percent of its revenue from such loans. The CFPB believes that these loans usually are made by community banks or credit unions to existing members or customers. Credit that would be considered a payday alternative loan under National Credit Union Administration standards is exempt.

Cost-free wage advances under an employer's program also are exempt, but only if the sole repayment method is a deduction from the employer's paycheck or bank account on the next payday.

Collection restrictions. The rule also is intended to protect consumers from insufficient funds fees that can result from a lender's repeated attempts to deduct payments from consumer bank accounts. In the case of a short-term loan, balloon-payment loan, or any loan with an annual percentage rate of more than 36 percent, the consumer must be told in writing of the time, amount, and method of the first payment, and must be given the same notice if there are any changes.

Also, deduction attempts must stop after two successive failures unless the lender obtains a new authorization from the consumer. As is the case with the full-payment test, attempting banned account deductions is explicitly said to be unfair and abusive.

Director's explanation. In remarks prepared for a press call, CFPB Director Richard Cordray said that 16,000 payday loan stores operate in 35 states, and that payday loans are made online as well. In addition to noting the loan roll-over numbers, he added that about 20 percent of title loan borrowers have their vehicles repossessed due to nonpayment.

"Our research has shown that the business model for payday and auto title lenders is built on miring people in debt," Cordray said. "[T]hat is how payday lenders make their profit." As a result, they have no incentive to consider whether a consumer has the ability to repay a loan.

Cordray also pointed out that the Bureau decided to apply the full-payment test to a smaller group of lenders than would have been covered under the 2016 proposal. The exemption for small personal loans, that will benefit credit unions and community banks, is another change from the proposal.

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