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CONTACT:
Office of Communications
Tel: (202) 435-7170

CONSUMER FINANCIAL PROTECTION BUREAU PROPOSES RULE TO END PAYDAY DEBT TRAPS

Rule Would Require Lenders to Determine Whether Consumers Have the Ability to Repay Payday, Auto Title, and Certain Other High-Cost Loans

WASHINGTON, D.C. — The Consumer Financial Protection Bureau (CFPB) today proposed a rule aimed at ending payday debt traps by requiring lenders to take steps to make sure consumers have the ability to repay their loans. The proposed rule would also cut off repeated debit attempts that rack up fees. These strong proposed protections would cover payday loans, auto title loans, deposit advance products, and certain high-cost installment and open-end loans. The CFPB is also launching an inquiry into other products and practices that may harm consumers facing cash shortfalls.

"The Consumer Bureau is proposing strong protections aimed at ending payday debt traps," said CFPB Director Richard Cordray. "Too many borrowers seeking a short-term cash fix are saddled with loans they cannot afford and sink into long-term debt. It's much like getting into a taxi just to ride across town and finding yourself stuck in a ruinously expensive cross-country journey. By putting in place mainstream, common-sense lending standards, our proposal would prevent lenders from succeeding by setting up borrowers to fail."

Watch a video about payday lending at: https://www.youtube.com/watch?v=2PATJPkj4sw

The proposed rule would apply to certain short-term and longer-term credit products that are aimed at financially vulnerable consumers. The Bureau has serious concerns that risky lender practices in the payday, auto title, and payday installment markets are pushing borrowers into debt traps. Chief among these concerns is that consumers are being set up to fail with loan payments that they are unable to repay. Faced with unaffordable payments, consumers must choose between defaulting, reborrowing, or skipping other financial obligations like rent or basic living expenses like food and medical care. The CFPB is concerned that these practices also lead to collateral damage in other aspects of consumers' lives such as steep penalty fees, bank account closures, and vehicle seizures. Loans covered by the proposal include:

- **Payday and other short-term credit products**: Payday loans are generally due on the borrower's next payday, which most often is within two weeks, and typically have an annual percentage rate of around 390 percent or even higher. Single-payment auto title loans, which require borrowers to use their vehicle title for collateral, are usually due in 30 days with a typical annual percentage rate of about 300 percent. Most consumers end up rolling over these short-term loans when they come due or reborrowing within a short period of time. The consumer pays more fees and interest each time they reborrow, turning a short-term loan over time into a long-term debt trap. CFPB research shows that more than four-in-five single-payment loans are reborrowed within a month. One-in-five payday loan sequences end up in default and one-in-five single-payment auto title loan borrowers end up having their car or truck seized by the lender for failure to repay.

- **High-cost installment loans:** The proposal would cover loans for which the lender charges a total, all-in annual percentage rate that exceeds 36 percent, including add-on charges, and either collects payment by accessing the consumer's account or paycheck or secures the loan by holding the title to the consumer's vehicle as collateral. Some of the installment loans covered by the proposal have balloon, or lump-sum, payments required after a number of interest-only payments. The Bureau's research, which looked at loans from several payday installment lenders, found that over one-third of loan sequences end in default, sometimes after the consumer has already refinanced or reborrowed at least once. The Bureau further found that nearly one-third of auto title installment loan sequences end in default, and 11 percent end with the borrower's car being seized by the lender.

A summary of CFPB research on payday and installment loans is available at: http://files.consumerfinance.gov/f/documents/Payday_Loans_Highlights_From_CFPB_Research.pdf

Proposal to End Debt Traps
The CFPB is proposing a rule that would put an end to the risky practices in these markets that trap consumers in debt they cannot afford. The proposed ability-to-repay protections include a "full-payment" test that would require lenders to determine upfront that consumers can afford to repay their loans without reborrowing. The proposal includes a "principal payoff option" for certain short-term loans and two less risky longer-term lending options so that borrowers who may not meet the full-payment test can access credit without getting trapped in debt. Lenders would be required to use credit reporting systems to report and obtain information on certain loans covered by the proposal. The proposal would also limit repeated debit attempts that can rack up more fees and may make it harder for consumers to get out of debt.

Specifically, the proposal includes the following protections:

- **Full-payment test:** Under the proposed full-payment test, lenders would be required to determine whether the borrower can 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 reborrow within the next thirty days. For payday and auto title installment loans without a balloon payment, full payment means affording all of the payments when due. The proposal would further protect against debt traps by making it difficult for lenders to push distressed borrowers into reborrowing or refinancing the same debt. The proposal also would cap the number of short-term loans that can be made in quick succession.

- **Principal payoff option for certain short-term loans**: Under the proposal, consumers could borrow 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 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.

- **Less risky longer-term lending options:** The proposal would also permit lenders to offer two longer-term loan options with more flexible underwriting, but only if they 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 where 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 attempt cutoff**: 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. Repeated unsuccessful withdrawal attempts by lenders to collect payment from consumers' accounts pile on insufficient fund fees from the bank or credit union, and can result in returned payment fees from the lender. A CFPB study found that, over a period of 18 months, half of online borrowers had at least one debit attempt that overdrafted or failed, and more than one-third of borrowers with a failed payment lost their account.

This proposed rulemaking is the latest step in the CFPB's efforts to reform the markets for these payday and installment loan products. The Bureau already exerts supervisory oversight of payday lenders and takes enforcement actions as appropriate to address violations of the law. With its action today, the Bureau continues to seek input from a wide range of stakeholders by inviting the public to submit written comments on the proposed rule once it is published in the Federal Register. Comments on the proposal are due on Sept. 14, 2016 and will be weighed carefully before final regulations are issued.

A factsheet summarizing the proposed rule is available at:
http://files.consumerfinance.gov/f/documents/CFPB_Proposes_Rule_End_Payday_Debt_Traps.pdf

The CFPB's proposal is available at:
http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf

Inquiry into Emerging Risks
Today, the CFPB is also launching an inquiry into other potentially high-risk loan products and practices that are not specifically covered by the proposed rule. The Request for Information is focused on:

- **Concerns about risky products not covered:** The Bureau is seeking information about forms of non-covered loans such as high-cost, longer-duration installment loans and open-end lines of credit where the lender does not take a vehicle title as collateral or gain account access. The CFPB's inquiry seeks information about the range and volume of installment and open-end credit products that are offered in this market, their pricing structures, and lenders' practices with regard to underwriting. The Bureau is also interested in learning whether these loans keep borrowers in long-term debt with a structure where borrowers pay down little to no principal for an extraordinarily long period.

- **Concerns about risky practices not covered:** The Bureau seeks to learn more about practices that can impact borrowers' ability to pay back their debt. This includes methods lenders may use to seize borrowers' wages, funds, vehicles, or other forms of personal property in a way that could pose consumer protection concerns. The Bureau is also interested in learning more about the sales and marketing practices of credit insurance, debt suspension or debt cancellation agreements, and other add-on products. Other practices subject to the inquiry include loan churning, default interest rates, teaser rates, prepayment penalties, and late-payment penalties.

Comments on the Request for Information are due on Oct. 14, 2016.

The Request for Information is available at:
http://files.consumerfinance.gov/f/documents/RFI_Payday_Loans_Vehicle_Title_Loans_Installment_Loans_Open-End_Credit.pdf

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The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.