CFPB Proposes New Rules for Payday Loans

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On March 26, 2015, the Consumer Financial Protection Bureau (the Bureau) proposed new regulations on short-term loans, commonly known as "payday loans," which are typically issued by non-depository institutions. The Bureau identified certain risks to borrowers who utilize these loans, such as a borrower (1) repeatedly rolling over loans to create a seemingly endless cycle of short-term debt, (2) pledging his vehicle as collateral for a short-term loan, or (3) providing a lender with access to deposit accounts and exposing the borrower to costly overdraft fees. Accordingly, the Bureau has crafted these regulations with the goal of reducing these risks and making payday loans safer for consumers.

Short Term Loans

Many of the proposed rules apply to "short-term loans," which the Bureau defines as loans due in full within 45 days, typically in one single installment. According to the proposed rules, no lender could make a short-term loan without first considering the borrower's ability to repay. This "ability-to-repay" analysis requires consideration of the borrower's income, major financial obligations and borrowing history. The Bureau is still considering what should constitute a "major financial obligation," but the current proposal includes in its definition housing payments, debt payments, child support obligations and other legally required payments. In conducting the "borrowing history" portion of the analysis, the Bureau expects lenders to review their own records and utilize "commercially available reporting systems" to determine the borrower's loan history with other lenders. After considering these criteria, the lender then must make a "reasonable determination" regarding a borrower's ability to repay the loan.

The proposed rules include certain rebuttable and conclusive presumptions regarding a borrower's ability to repay a short-term loan. If a borrower takes out a short-term loan within 60 days of a prior short-term loan, he is presumed to lack the ability to repay the loan. The borrower can rebut this presumption by demonstrating an improved financial condition, such as a pay raise. However, a borrower may never take more than three short-term loans within a 60-day period, regardless of his financial situation. In such cases, the presumption of the borrower's inability to repay the loan is conclusive.

Recognizing the administrative burdens that lenders may face in underwriting a borrower's ability to repay a short-term loan, the Bureau has also proposed conditions through which a lender could issue a short-term loan without conducting an "ability-to-repay" analysis. To qualify, the following conditions must be met:

1. The lender must verify the borrower's income and borrowing history.
2. The borrower must not have any outstanding short-term loan with any lender.
3. The borrower has not taken more than three short-term loans within 60 days of a prior short-term loan.
4. Following completion of the term for the loan in question, the borrower will have not been in debt on short-term loans for more than 90 days in the aggregate during a rolling 12-month period.
5. The amount financed does not exceed $500.
6. The loan has no more than one finance charge.
7. The consumer does not provide a vehicle for security.
8. The loan is structured to "taper off."

Currently, the Bureau is considering two options for this final "tapering off" requirement. The first requires that the principal be amortized over the course of the three-loan sequence, as opposed to a lump sum due at the end of the sequence. The second option would allow a borrower to stretch the final short-term loan into four installments without incurring any additional fees.

Regulations Governing Collections

Payday lenders often will have access to a borrower's bank account through debit authorizations or post-dated checks to better secure repayment. This can be especially problematic for borrowers. For example, when a borrower fails to pay a short-term loan, the lender may attempt to draw the money directly from the borrower's deposit account, often resulting in costly overdraft fees. This makes repayment even more difficult.

The proposed regulations seek to curb these collection methods. Under the proposed rules, borrowers must receive notice from a lender at least three days before the lender attempts to withdraw directly from a borrower's account. This notice must specify the amount and date of the collection attempt, the channel through which it will be made, and certain additional information about the loan to be paid through the withdrawal. Additionally, lenders may not draw directly from a borrower's account after two previous attempts have failed. In such cases, the lender must obtain new authorization from the borrower before it may attempt another withdrawal from the borrower's account.

Steps Before Implementation

Pursuant to the Small Business Regulatory Enforcement Fairness Act (SBREFA),[1] a Small Business Review Panel will meet with representatives from small-loan lenders, consumer advocacy groups and the Bureau itself to consider the issues associated with implementation of the proposed rules. Within 60 days of this meeting, the panel shall issue a report addressing the comments from the various stakeholders. The Bureau will then consider the panel's report, make adjustments as needed and issue final rules for implementation.

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[1] 15 U.S.C. § 609(b).