CFPB’s Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans

October 2016

Note: This document was used in support of a live discussion. As such, it does not necessarily express the entirety of the discussion nor the relative emphasis of topics therein.
June 2 Releases

• **Notice of Proposed Rulemaking**
  - Proposes underwriting and payment protections for payday, auto title, and certain high-cost installment loans (“covered loans”)
  - Covered loans are typically used by consumers who are living paycheck to paycheck, have little to no access to other credit products, and seek funds to meet recurring or one-time expenses
  - Comments due October 7, 2016

• **Request for Information**
  - Seeks information on lending products not covered by the NPRM that are targeted to consumers facing cash shortfalls, particularly as to underwriting practices
  - Seeks information on practices in covered markets that are not addressed by the NPRM, such as wage garnishment and back-end pricing
  - Comments due November 7, 2016

• **Supplemental Findings Report**
  - Presents research on six additional topics to supplement the Bureau’s four prior research releases
Market Concerns

• The CFPB is concerned that practices in payday, auto title, and certain other high-cost lending markets deviate from other credit markets in at least two key respects: underwriting and payment practices

∇ Underwriting: Lenders may screen for up-front default risk, but fail to assess consumers’ ability to repay their loans. When loans are unaffordable, consumers are left to choose between three harms:
  ▪ Take out additional covered loans;
  ▪ Default on the covered loan (including loss of vehicle where applicable); or
  ▪ Make the payment on the covered loan but fail to meet other major financial obligations or basic living expenses

∇ Payment practices: Lenders make unpredictable and repeated attempts to collect payments from consumers’ bank accounts, exposing consumers to increased risk of harms:
  ▪ Substantial bank fees (overdraft, non-sufficient funds) and lender penalties;
  ▪ Potential account closure
Notice of Proposed Rulemaking (NPRM)

• The CFPB is proposing to issue these regulations primarily pursuant to Section 1031 of the Dodd-Frank Act to identify and prevent unfair, deceptive, and abusive acts and practices

⇒ The CFPB is proposing protections because it has preliminarily identified certain practices in these markets as unfair and abusive

  ▪ Unfairness standard: an act or practice is unfair if it causes or is likely to cause substantial injury to consumers which is not reasonably avoidably by consumers and such injury is not outweighed by countervailing benefits to consumers or to competition

  ▪ Abusiveness standard: an act or practice that takes unreasonable advantage of (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service or of (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service

• Other provisions are proposed pursuant to other Dodd-Frank Act authorities, including Section 1022 (exemptions), 1024 (supervision of certain non-bank entities), & 1032 (disclosures)
Proposed Coverage

• **Covered loans:** Includes payday loans, vehicle title loans, deposit advance products, and certain high-cost longer-term loans
  - **Short-term loans:** All loans due 45 days or less from consummation or advance of funds
  - **Certain longer-term loans:** Loans with terms of 46 days or longer if:
    ▪ Cost over 36% all-in APR, and
    ▪ Account access, paycheck access, or vehicle title

• **Proposed exclusions**
  - Purchase-money loans for autos and consumer goods
  - Real-estate secured loans
  - Credit cards
  - Student loans
  - Non-recourse pawn loans
  - Overdraft services and overdraft lines of credit
Proposed Requirements

- **Underwriting:** Lenders generally would be required to make a reasonable determination that consumers have the ability to make all scheduled payments while meeting major financial obligations and basic living expenses
  - Proposal specifies a residual income methodology
  - Limited exemptions for loans satisfying conditions designed to protect consumers from being saddled with unaffordable debt

- **Payments:** Lenders generally would be subject to two requirements when collecting payments on covered loans directly from consumers’ accounts
  - Pre-withdrawal notices
  - Prohibition on further withdrawals after two unsuccessful attempts unless obtain new and specific consumer authorization

- **Other:** Lenders generally would be required to develop compliance policies and procedures, retain records, and satisfy certain credit-reporting related requirements
ABILITY-TO-REPAY REQUIREMENTS
Ability-to-Repay Test

- Consumer financial information & verification: Lenders would need to consider and obtain documentation of certain consumer financial information
  - Consumer net income
  - Specified major financial obligations: Housing, debt payments, child support
  - Borrowing history on covered loans
    - With the same lender and affiliates; and
    - With other lenders by obtaining consumer report from a registered information system
Ability-to-Repay Test

• **Underwriting**: In general, lenders would need to make a reasonable determination that the consumer has the ability to repay the loan

  ➔ **Residual income analysis**: Does the consumer have enough projected residual income (net income – major financial obligations) to make payments on the loan and meet basic living expenses?
    - Proposal would provide flexibility on methods to estimate basic living expenses
    - For short-term and balloon-payment loans, must assess ability to repay without reborrowing within 30 days of largest payment

  ➔ **Open-end loans**: Must assume that the consumer will draw down all funds at origination and make minimum payments until the end of the contractual period. Must re-underwrite if advance funds more than 180 days after last assessment

  ➔ **Assessment of borrowing history**: Proposal would specify certain presumptions and limitations if consumer’s recent borrowing history raises concerns about ability to repay new loan
CONDITIONAL EXEMPTIONS
Conditional Exemption for Short-Term Loans

- Lenders would not have to make an ability-to-repay determination for limited number of loans made under the conditional exemption:
  
  ➞ **Payoff feature:** Maximum $500 principal on first loan; lender could offer up to two extensions on the loan, but only if the borrower pays off at least one-third of the principal with each extension.
    - A mandatory 30-day cooling off period would apply after the third loan

  ➞ **Other restrictions:** Lenders would need to check reports from and furnish information to registered information systems. Full ATR underwriting would be required under certain conditions:
    - Where the borrower has already been in debt on short-term loans for more than 90 days or six loans in a rolling 12-month period; or
    - Where open-end credit or auto title is involved

  ➞ **Disclosures:** Lenders would need to provide plain-language notices before making the first and third loan under the conditional exemption
PAL Option for Longer-Term Loans

• Lenders would not have to make an ability-to-repay determination for limited number of loans that generally meet the National Credit Union Administration’s Payday Alternative Loan (PAL) program parameters

⇒ Product restrictions:
  ▪ Total cost of credit of no more than what is permitted for Federal credit unions under PAL regulations, currently annualized 28 percent interest and an application fee of no more than $20.
  ▪ Loans must be fully amortizing, with terms between 46 days and 6 months
  ▪ Principal amounts between $200 and $1,000

⇒ Reborrowing restrictions: A borrower could not be indebted on more than three such loans from a lender in a rolling 180 day period
Portfolio Option for Longer-Term Loans

• Lenders would not have to make an ability-to-repay determination for a limited number of loans where the portfolio default rate did not exceed five percent

⇒ **Product restrictions:**
  - Total cost of credit less than or equal to an annual rate of 36 percent, not including single origination fee reasonably proportionate to lender’s costs of underwriting, with safe harbor for fees at or below $50
  - Loans must be fully amortizing, with terms between 46 days and two years

⇒ **Reborrowing Restrictions:** A borrower could not be indebted on more than two such loans from a lender in a rolling 180 day period

⇒ **Portfolio limits:** If portfolio default rate is exceeded, lender must refund origination fees to all borrowers
Reporting of Covered Loans

• The proposal would create a reasonably comprehensive system for lenders to obtain information about consumers’ borrowing history with covered loans in real time

⇒ Lenders would be required to report covered loans made under the ability-to-repay requirements and the conditional short-term exemption to “registered information systems” and to pull a report from such a system in the course of originating such loans

⇒ The “registered information systems” would need to meet Bureau criteria regarding technical capacity, compliance with federal consumer financial laws and information security requirements, etc.

⇒ The Bureau expects to work to encourage the development of standardized data formats

⇒ The proposal would provide a two-stage process for information systems to become registered with the Bureau, and seeks comment on a number of issues relating to stand-up of the reporting systems
OTHER ACTIVITY
Larger Participants and Non-Depository Lender Registration

• The Bureau expects that its next larger participant rulemaking will focus on the markets for consumer installment loans and vehicle title loans, for purposes of supervision

⇒ Payday loans are already subject to the Bureau’s supervisory authority

• The Bureau is considering whether rules to require registration of consumer installment lenders, vehicle title lenders, or other non-depository lenders would facilitate supervision

⇒ This suggestion has been made by consumer advocates and industry groups