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CFPB Sets Sights On Payday Lending 'Cycle Of Debt'

By **Evan Weinberger**

Law360, New York (March 25, 2014, 7:27 PM ET) -- With the Consumer Financial Protection Bureau closing in on new rules for the payday lending industry, consumer advocates and industry attorneys predict the bureau is likely to force payday lenders to verify consumers have the ability to repay those loans just as mortgage lenders and others must do.

In conjunction with a report released Tuesday highlighting how some payday loan borrowers can get trapped in a "cycle of debt," CFPB Director Richard Cordray said that the bureau was moving closer to finalizing rules for such small-dollar, short-term loans. Those rules will be intended to help consumers “manage to repay” payday loans “without becoming mired in a prolonged and costly struggle,” according to remarks Cordray delivered at a field hearing in Nashville.

To consumer advocates and attorneys representing the industry, that phrasing means that the CFPB will look to make sure payday lenders check to make sure that their customers can actually repay the loans they are taking out, a requirement that already exists in the mortgage, credit card and other consumer financial markets.

Consumer advocates have long pushed for restrictions on payday lending, arguing the industry's business model is based on trapping vulnerable borrowers.

“It is hard to argue that the ability to turn around a loan application a few hours or days faster is justification for trapping the average borrower in triple-digit interest rate debt for more than half the year,” said Tom Feltner, the Consumer Federation of America's director of financial services.

The industry, and even some of its critics, counter that the loans, when used properly, can serve as a lifeline to low-income people without access to the banking system who encounter a surprise medical bill, needed car repair or some other form of immediate financial shock.

Payday loans are small-dollar loans typically of less than $500 that are structured around a borrower's pay period.

If a borrower receives either a pay or benefit check every two weeks, for example, he or she will have 14 days to pay the loan back. Rather than a straight interest rate, payday loans usually come with a fee of between $10 and $20 for every $100 borrowed, which could mean an annual percentage rate of just under 400 percent if a borrower falls behind, the CFPB said in a report last year.

Borrowers can renew those loans on the same day they expire in some states, while others require a break between loans but allow borrowers to renew their loans after the waiting period expires, according to the CFPB.

Only 28 states allow for payday lending, and there is currently no single federal regulatory structure for the loans. Because of that, they operate with a hodgepodge of sometimes conflicting state rules, D. Lynn DeVault, a board member of payday lender Check Into Cash and a representative of industry group the Consumer Financial Services Association of America, said at the CFPB's Nashville field hearing.

“One of the challenges the industry has is it's built layers of state regulation over the years that in hindsight are not the most effective,”she said.

The CFPB's Tuesday report found that 80 percent of payday loans are renewed in 14 days or less, and that nearly three in five borrowers take out seven or more payday loans in a sequence.

The CFPB found that around 80 percent of borrowers who rolled over a loan owed the same amount or more than the initial loan, and that around 22 percent of borrowers end up renewing their loans six times or more. Because the typical fee attached to a payday loan is 15 percent, borrowers who take out an initial loan with six renewals will end up paying more in fees than the original amount they borrowed, the CFPB said Tuesday.

Consumer advocates say the best way to avoid the trap many borrowers find themselves in would be to make sure that payday lenders confirm that their customers can repay their loans, similar to what mortgage lenders now have to do.

If the CFPB makes a simple rule that would require payday lenders to only confirm a borrower has sufficient expected cash flow in the next pay period to cover the repayment, then payday lenders should be able to adjust without disrupting their services too much, said Sabrina Rose-Smith, a partner with Goodwin Procter LLP.

CFSA members, including more than half of storefront payday lenders nationwide, already follow those procedures as part of an industrywide best practices.

“If the requirements get more complex — and history has shown us that the CFPB will favor complex rules without sufficient evidence of their practical effects — then I think the loans may become cost-prohibitive for lenders to make, and/or the increased scrutiny into their finances will turn borrowers off,” she said in an email.

And that could lead to borrowers having equally bad outcomes, since payday borrowers typically need their cash fast, Rose-Smith said.

Those concerns simply highlight the problems with payday lenders' business models, Feltner said.

The likely ability-to-repay requirements are expected to be part of a broader package of rules that could include new disclosures, cooling-off periods that would force borrowers to space out their loans or a principal reduction requirement for a second loan within 14 days of a prior one, Rose-Smith said.

The CFPB is going to have to strike a balance between protecting borrowers and allowing them access to needed cash when it crafts the new rules.

“Payday borrowing is like alcohol in that it is a positive for some and an utter disaster for others," said St. John's University School of Law professor Jeff Sovern. "The CFPB's challenge is to come up with rules that enable those for whom payday borrowing is a positive to have access to it while keeping those for whom it is a disaster away.”

--Editing by Jeremy Barker and Philip Shea.
