CFPB Proposes Strong Rules to Protect Payday Borrowers Yet Worrisome Loopholes Need Tightening

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(WASHINGTON) The Consumer Financial Protection Bureau (CFPB) has proposed rules that make a strong start in improving the protections for high-cost payday and installment loans, according to advocates at the National Consumer Law Center (NCLC). But the rules need to be tightened up to close loopholes, and state interest rate caps will remain important to protect families from high-cost lending.

“The CFPB has proposed the common-sense rule that lenders should only make loans that borrowers have the ability to repay without re-borrowing. The limits on repeat debits to borrower’s accounts are also important,” said Lauren Saunders, associate director of the National Consumer Law Center in Washington, DC, speaking on behalf of NCLC’s low income clients. “It is sad that we need a rule to get lenders to be responsible, but high-priced payday and installment loans shouldn’t generate profits while plunging families into an unaffordable debt trap. The CFPB’s proposal should make loans significantly safer as long as it is tightened to prevent evasions.”

However, the proposal has worrisome loopholes. Lenders could make up to three back-to-back payday loans and could start the sequence again after only 31 days. Longer term loans could also have balloon payments that trigger re-borrowing. “All loans should meet ability to pay requirements, and reborrowing in only 31 days indicates a debt trap,” Saunders explained.

The proposal covers not only two-week balloon payment payday loans, but also longer-term payday loans with installment payments. “High-priced longer term payday loans have the same features that make two-week loans a debt trap: Access to the borrower’s bank account, no underwriting for ability to pay, payments tied to payday, and a high, unaffordable cost that leaves families struggling to pay other expenses and exposed to overdraft fees,” Saunders explained.

“Longer term payday loans can be a longer-term debt trap. The devil is in the details, but effective protection requires robust up-front underwriting, tough limits on high defaults, rules against loan flipping, and limits on up-front fees,” she said.

The CFPB does not have the authority to impose interest rate caps, and state laws will remain important. “Even a strong CFPB rule will not prevent all dangerous loans, and state rate caps remain critical. A 36% interest rate cap is the simplest and most effective way of protecting families from unaffordable loans and giving lenders the incentive to ensure ability to repay,” Saunders said.

For more information on the National Consumer Law Center’s body of work on high cost loans, visit: https://www.nclc.org/issues/payday-loans.html.

NCLC Resources

- Report: Installment Loans: Will States Protect Borrowers from a New Wave of Predatory Lending?, July 2015

- Guidelines for Affordable Small Dollar Loans, January 2014
- Report: Why 36%? The History, Use, and Purpose of the 36% Interest Rate Cap, April 2013
- Report: Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don’t, June 2010

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