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Data Will Be Key In Evaluating CFPB Payday Proposal

By **Evan Weinberger**

Law360, New York (May 31, 2016, 8:26 PM ET) -- The federal government's consumer finance watchdog is expected to face tough scrutiny of the data it used to write first-of-their-kind rules for payday, auto title and other short-term loans when it unveils a formal proposal later this week.

The Consumer Financial Protection Bureau is expected to release a proposal that will govern the way payday loans are issued and collected, among other changes, that could fundamentally alter the way the industry operates and do away with some market participants. Consumer advocates say they hope that the coming proposal will be the next step in eliminating the perils of those financial products, but the industry argues it could limit options for consumers with nowhere else to turn when they face a short-term cash crunch.

But with huge policy changes in play and huge dollars at stake for the industry, observers expect that the data the CFPB used to back up its actions will become a key factor as the coming proposal is digested.

"The quality of the rule rises and falls in large part with the integrity of the data," said Valerie Hletko, a partner at BuckleySandler LLP.

Payday lending, and its cousin auto title lending, has become one of the key battlegrounds in the fight between consumer advocates and the financial services industry.

Payday lenders issue small-dollar loans with a set fee that are structured around a borrower's pay period. The loans are typically around $350, according to CFPB data.

Rather than a straight interest rate, payday loans usually come with a fee of between $10 and $20 for every $100 borrowed, which could work out to an annual rate of just under 400 percent if a borrower falls behind, according to research released by the CFPB.

Vehicle title loans have similar characteristics but also give the lender the right to take a car or truck if the borrower falls behind on the loans.

Critics of the products, including consumer advocates and the CFPB, say that payday loans entrap borrowers in a cycle of debt that can see them renew loans repeatedly, ultimately forcing them to pay back more than they originally took out in the initial loan.

"There is a profound harm that is caused by both payday and car title loans," said Tom Feltner, the director of financial services at the Consumer Federation of America.

The industry argues that the rules could shut off a vital source of credit for working people who have trouble meeting unexpected expenses.

“It is well documented that millions of Americans need financial flexibility and credit choices to cover things like an unexpected $400 expense,” the Online Lenders Alliance, an industry group, said in a statement to Law360.

The regulatory landscape for payday loans is mixed, with 14 states and Washington, D.C., banning the small-dollar, high-interest loans altogether and the rest allowing the loans to be issued with varying degrees of restrictions.

The CFPB revealed its thinking on how to regulate the payday loan industry, as well as auto title loans and other short-term credit products, in a March 2015 announcement that was part of the small business review process under the Small Business Regulatory Enforcement Fairness Act, or SBREFA.

Because the 2010 Dodd-Frank Act blocked the CFPB from imposing rate caps and other cost controls on payday loans, the bureau’s outline focused on forcing payday lenders to make sure that borrowers can repay the loans they take out and restricting collection practices, including lenders’ access to consumers’ bank accounts — payday borrowers need to have bank accounts in order to receive the loans.

At the center of the CFPB’s proposals is extending an ability-to-repay requirement that is used in other lending contexts, including the mortgage industry, to payday loans and other markets.

Lenders would have to determine that borrowers could pay back their loans and monitor changes to their financial situations when they apply for new credit, including whether they would be able to cover other expenses like rent and child care.

The framework also restricts harmful payment collection practices, including lenders accessing borrowers' bank accounts and making repeated unsuccessful withdrawal attempts that lead to fees charged by both the bank and the lender. The CFPB says its proposed rules could require lenders to give borrowers advance notice of its withdrawal attempts and cap unsuccessful attempts at two.

Most observers expect the CFPB’s Thursday proposal to follow those broad outlines.

“The expectations are that that outline will turn out to be pretty predictive about what the proposed rule says, and that the surprises may come in the details,” said Kristie D. Kully, a partner at Mayer Brown LLP.

And battles over the rules are likely to focus on those details.

Consumer advocates want to see strong ability-to-repay standards that will require lenders to determine not just the borrowers’ chances of paying back a loan, but also how repaying those loans will affect their ability to cover their regular costs of living.

Not taking into account those expenses is one of the reasons borrowers end up renewing their payday loans, causing the costs to spiral, said Diane Standaert, the leader of the Center for Responsible

Lending’s push against payday loans.

“Even a single unaffordable loan can create a cascade of consequences for borrowers,” she said.

There will also be close scrutiny paid to the bureau’s restrictions on payday lenders’ collection practices, because consumers can frequently be hit with additional overdraft fees when payday lenders have access to their bank accounts.

“The CFPB has also indicated that they share our concerns around making sure that account access is not being abused,” Feltner said.

However, while those details will be key for consumer advocates, they will also become a rallying point for lenders.

They will look to see just how the CFPB defines the expenses they will have to measure and how much weight each detail receives, Kully said.

“These are just incredibly subjective designations that the regulator is going to have to put some concrete guidelines on,” she said.

But lenders will have another fight to consider. The CFPB put out several reports leading up to Thursday’s proposal, including a recent report on the effects of auto title lending.

Each of those reports highlighted what the CFPB said were problems with the industry, and the industry has challenged the accuracy of the CFPB’s data and the bureau’s interpretation of those results.

And that is likely to continue as the rulemaking process, and potential litigation when the rules are done, proceeds.

Given the potential shock to the industry when the rules are in place, that review and challenge of the data is likely to be fierce.

“If the [SBREFA] outline turns out to be the rule, it will be difficult to structure a small installment loan within those parameters that is profitable,” Hletko said.

--Editing by Mark Lebetkin and Philip Shea.