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Summary: CFPB Small Dollar Rule

On Wednesday, October 5, 2017, the CFPB released its small dollar rule. According to the Bureau, the rule aims to stop debt traps and applies to loans that require consumers to repay all or most of the debt at once. Under the new rule, lenders must conduct a "full-payment test" to determine upfront that borrowers can afford to repay their loans without re-borrowing. All lenders who regularly extend credit are subject to the CFPB's requirements for any loan they make that is covered by the rule, including banks, credit unions, nonbanks, and their service providers. Lenders are required to comply regardless of whether they operate online or out of storefronts and regardless of the types of state licenses they may hold. These protections are meant to be a floor with regards to existing requirements under state or tribal law.

Loans within the scope of the rule (covered loans) are subject to the "full-payment test," which will require lenders to determine whether the borrower can afford the loan payments and still meet basic living expenses and major financial obligations. For payday and auto title loans that are due in one lump sum, full payment means being able to afford to pay the total loan amount, plus fees and finance charges within two weeks or a month. For longer-term loans with a balloon payment, full payment means being able to afford the payments in the month with the highest total payments on the loan. The rule also caps the number of loans that can be made in quick succession at three.

Under the full-payment test, lenders of covered loans would be obligated, prior to extending a loan, to review the borrower's ability to repay the full amount of the loan, including the principal, fees, and interest. The rule requires lenders to consider and verify factors including a consumer's:

1. Net income,
2. Basic living expense, and
3. Major financial obligations, including housing costs, amounts due on existing debt obligations, and other recurring expenses such as child support.

Lenders must verify the above-enumerated items using a reliable record of income payment, unless a reliable record is not reasonably available. In this case, the lender may make a "reasonable determination." For example, lenders can verify a borrower's monthly debt obligations using a national consumer report and a consumer report from a "registered information system" as described below or otherwise rely on the borrower's written statement of monthly housing expenses. Lenders most also forecast a reasonable amount for basic living expenses, other than debt obligations and housing costs; and determine the consumer's ability to repay the loan based on the lender's projections of the borrower's residual income or debt-to-income ratio. For long-term loans, the lender must reasonably account for the possibility of volatility in the consumer's income, obligations, or basic living expenses during the term of the loan.

Covered Loans

Loans within scope:

- Short-term loans: Includes loans where a consumer is required to repay substantially the entire amount of the loan within 45 days or less. These loans include, but are not limited to, 14-day and 30-day payday loans, vehicle loans, and open-end lines of credit where the plan ends within the 45-day period or is repayable within 45 days. The CFPB chose 45 days as a means of targeting loans within a single income and expense cycle. (e.g. payday, DAP, Title loans, etc.)

- Longer-term balloon-payment loans: For longer-term loans with a balloon payment, lenders are required to ensure a borrower can pay all of the payments when due, including the balloon payment, as well as major financial obligations and basic living expenses during the term of the loan and for 30 days after making payments during the month with the loan's highest payment. Balloon payments are defined as any payment twice the amount of any other payment. However, the term covered longer-term balloon-payment loan would include loans that are repayable in a single payment.

- Other long-term loans: While not subject to the "full-payment test," all long-term loans with an annual percentage rate over 36 percent (APR as defined under Regulation Z) that includes authorization for the lender to access the borrower's checking or prepaid account are subject to the debit attempt cutoff provisions of the rule (see below under Payment Practices Rules).

Loans out of scope:

- The rule excludes or exempts several types of consumer credit, including:
  - loans extended solely to finance the purchase of a car or other consumer good in which the good secures the loan;
  - home mortgages and other loans secured by real property or a dwelling if recorded or perfected;
  - credit cards (only those that are subject to CARD Act);
  - student loans;
  - non-recourse pawn loans;
  - overdraft services and lines of credit;
  - wage advance programs (no required charges or fees and entity advancing the funds warrants that it has no legal or contractual claim or remedy against the employee based on the employee's failure to repay);
  - no-cost advances;
  - alternative loans (similar to loans made under the Payday Alternative Loan program (PAL) administered by the National Credit Union Administration (NCUA)); and
  - accommodation loans (fewer than 2,500 loans in 12 month period and less than 10 percent of institutions revenue).

- The final rule does not apply ability-to-repay protections to all of the longer-term loans that would have been covered under the proposal. The CFPB is conducting further study to consider how the market for longer-term loans is evolving and the best ways to address concerns about existing and potential practices.

Exemptions from the rule for otherwise covered loans:

- Principal-payoff options: For certain short-term loans, lenders can skip the full-payment test if they offer a "principal-payoff option" that allows borrowers to pay off the debt more gradually.

  – Consumers would be able to borrow up to $500 through a short-term loan, provided that the loan does not include a security interest in a vehicle.
  – Lenders could extend the loan only two times, provided that the principal is reduced by one-third each time (e.g. 2nd loan 1/3 less than original, 3rd loan 2/3 less than original).
  – Lenders would be prevented from extending the loan if it would result in the consumer having more than six covered short-term loans over the most recent 12 consecutive months.
  – A 30-day cooling period would apply after a three loan sequence the sequence.

- Accommodation Loans: The rule allows for lenders to make covered loans to forgo the full-payment test and the principal-payoff requirement if:

  – The loans made by a lender who makes 2,500 or fewer covered short-term or balloon-payment loans per year and derives no more than 10 percent of its revenue from such loans.
  – Loans that generally meet the parameters of PAL loans authorized by the NCUA.

- No-cost wage advances: The rule excludes from coverage certain no-cost advances and advances of earned wages made under wage-advance programs offered by employers or their business partners.

Other Provisions

<u>Credit Reporting System</u>: Under the rule, lenders would be required to use CFPB-registered "credit reporting system" to report and obtain credit information about covered loans.

- This requirement includes the duty to report basic loan information and updates to that information.
- The registered information systems will have to be created by companies that will provide this service once the rule is finalized. The CFPB will publish a list of registered systems.
- Lenders must provide basic information about the loans and the borrower at the time of origination, updates during the life of the loan, and additional information when the loan period ceases.
- Lenders must solicit and review a consumer report about the borrower from a registered information system before making the loans.

Compliance Program: Lenders must establish and follow a compliance program and retain certain records, such as the initial loan agreement, documentation obtained for a covered loan, and calculations surrounding presumptions of unaffordability.

Payment practices Rules:

- Debit attempt cutoff - The rule includes a debit attempt cutoff that applies to short-term loans and balloon-payment loans. Please note this provision also applies to longer-term loans, regardless of balloon-payments, with an annual percentage rate over 36 percent that includes authorization for the lender to access the borrower's checking or prepaid account. After two straight unsuccessful attempts, the lender cannot debit the account again unless the lender gets a new authorization from the borrower.

- Notice of withdrawal: Lenders must give consumers written notice before the first attempt to debit the consumer's account to collect payment for any loan covered by the rule. This notice alerts consumers to the timing, amount, and channel of the forthcoming payment transfer. If a subsequent payment transfer is for a different amount, at a different time, or through a different payment channel than the consumer might have expected based upon past practice, the lender must give a notice specifically alerting the consumer to the change.

Anti-evasion: The rule prohibits lenders from evading the intent of the proposed rule. The CFPB will take into consideration the "actual substance" of the lender's action as well as "other relevant facts and circumstances" to determine if the lender's action was taken with the intent of evading the requirements of the proposed rule. Such evasive action can be knowing or reckless. The Bureau acknowledges that it cannot anticipate every possible way in which lenders could evade the requirements of the proposed rule, but it does provide a short, non-exclusive list of actions that might be taken with such intent. These include various fee structures as well as methods of changing the nature of a loan after consummation.

Implementation: The rule takes effect 21 months after it is published in the Federal Register, although the provisions that allow for registration of information systems take effect earlier.

