Prepared Remarks of CFPB Director Richard Cordray on the Payday Rule

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Thank you for joining us. After a long process of research, outreach, and review of over one million public comments, the Consumer Bureau today has issued a rule aimed at stopping debt traps on payday and auto title loans. The rule is guided by the basic principle of requiring lenders to determine upfront whether people can afford to repay their loans. These strong protections cover loans that require consumers to pay all or most of the debt at once, including payday loans, auto title loans, deposit advance products, and longer-term loans with large "balloon" payments. The new rule also curtails repeated attempts to debit checking accounts that rack up fees and make it harder for consumers to get out of debt. This provision applies to the same kinds of loans and to high-cost installment loans as well. These protections bring needed reform to a market where far too often lenders have succeeded by setting up borrowers to fail.

About 16,000 payday loan stores operate in the 35 states that allow payday lending, along with online lenders. About 95 million people live in the other 15 states and the District of Columbia, where payday lenders do not operate because of caps on interest rates and fees. Payday loans are generally for $500 or less, and they are typically due in full by the borrower's next paycheck, usually in two or four weeks. They are expensive, with annual interest rates of over 300 percent or even higher. As a condition of the loan, the borrower writes a post-dated check for the full balance, including fees, or allows the lender to electronically debit funds from their account. Single-payment auto title loans also have expensive charges and short terms, usually of 30 days or less, but the borrowers have to put up the title to their car or truck as collateral. Some lenders also offer longer-term loans with a series of smaller payments for more than 45 days that then require the entire large balance of the loan to be repaid at the due date. These balloon-payment loans often require access to the borrower's account or auto title.

Loans like these are heavily marketed to financially vulnerable consumers. Though they offer cash-strapped consumers

access to credit, the full-payment requirement can make these loans unaffordable. If a borrower living paycheck to paycheck needs a payday loan to cover basic expenses or to recover from a large expense or drop in income, they will probably face the same cash shortfall when they get their next paycheck. Only now, they have the added cost of loan fees or interest. Faced with unaffordable payments, consumers must choose between defaulting, re-borrowing, or failing to pay basic living expenses or other major financial obligations.

Many borrowers in this difficult situation end up rolling over or refinancing their loans again and again. More than four out of five payday loans are re-borrowed within a month, usually right when the loan is due or soon thereafter. In fact, about one-in-four initial payday loans are re-borrowed nine times or more, as consumers pay far more in fees than they borrowed in the first place. Just like payday loans, the vast majority of single-payment auto title loans are rolled over or re-borrowed on the day they come due or soon thereafter. And one-in-five borrowers end up having their car or truck seized by the lender because they cannot repay the debt.

This cycle of piling on new debt to pay back old debt can turn a single unaffordable loan into a long-term debt trap. It is a bit like getting into a taxi for a ride across town, then finding yourself stuck in a ruinously costly cross-country journey, with no exit ramps. With each renewed loan, the consumer pays more fees or interest on the same debt. The consequences are severe. Even those borrowers who renew the loan repeatedly, and at great cost, may still wind up in default and get chased by debt collectors or have their car or truck repossessed. And the repeated attempts by lenders to debit payments from their accounts can add significant penalties, as overdue borrowers get hit with multiple fees and may even have their bank accounts closed.

Our research has shown that the business model for payday and auto title lenders is built on miring people in debt. Whether the borrower is paying to roll over a short-term loan or making interest-only payments on a longer-term loan, the key is that these charges are not reducing how much they owe. And that is how the payday lenders make their profit. Lenders actually prefer customers who will re-borrow repeatedly rather than simply repaying the loan when it comes due. They can continue collecting fees or interest as long as the borrower does not fully repay. So these lenders have no incentive to check to see if borrowers can afford to repay on time because it is more profitable if they cannot. The example of the consumer who takes out one payday loan for an emergency and then pays it right back is a misleading exception to the norm. Most of these loans go instead to people who are re-borrowing the same loan many times.

The rule takes square aim at the practices that produce these outcomes – the failure to underwrite these loans and the business model built on repeated re-borrowing. The primary way the rule stops debt traps is by requiring lenders to do a "full-payment test" upfront to determine whether a consumer can afford to repay their loan without re-borrowing in the next month. Under this approach, lenders have to verify the consumer's income if evidence is reasonably available and pull a credit report to verify financial obligations. The rule also protects borrowers by capping at three the number of short-term loans that lenders can make in quick succession.

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For certain short-term loans under $500, lenders do not have to satisfy the components of the full-payment test if they instead offer a "principal-payoff option" to allow borrowers to pay off debt more gradually. With this option, consumers could still take out one loan that meets the restrictions and pay it off in full. For those needing more time to repay, lenders may offer up to two subsequent loans, but only if the borrower pays down at least one-third of the original principal each time. Under this option, lenders cannot lend to borrowers who are still repaying another short-term or balloon-payment loan. They cannot make more than three such loans in quick succession. And they cannot make loans under this option if the consumer has already had more than six short-term loans or has been in debt on such loans for more than 90 days over a rolling 12-month period. The principal-payoff option is also unavailable for loans that take an auto title as collateral.

The new rule also addresses how lenders extract loan payments from consumers' accounts. This part of the rule covers short-term loans, balloon loans, and high-cost longer-term loans where the lender has account access. After two straight unsuccessful attempts, the lender cannot debit the account again unless it gets a new authorization from the borrower. In addition, lenders must notify consumers in writing before attempting to debit an account at an irregular time or for an irregular amount. This allows consumers to question or dispute any unauthorized or erroneous debit attempts, and to arrange to cover unanticipated payments that are due. As a result, fewer consumers will be debited for payments they did not authorize or anticipate, and fewer will be slammed by multiple fees for returned payments and insufficient funds.

In addition to allowing loans to be made under the principal-payoff option, our new rule provides other means for people who need money in an emergency to get an affordable loan. Notably, we have no intention of disrupting lending by community banks and credit unions. They have found effective ways to make small-dollar loans that consumers are able to repay without high rates of failure. For instance, the rule exempts loans made by a lender that makes 2,500 or fewer short-term or balloon-payment loans per year and derives no more than 10 percent of its revenue from such loans. These are usually small personal loans made by community banks or credit unions to existing customers or members. The rule also exempts loans that generally meet the parameters of "payday alternative loans" (or "PAL" loans) authorized by the National Credit Union Administration. These low-cost loans cannot have a balloon payment and have caps on the number of loans that can be made over six months. The rule also excludes from coverage some new "fintech" innovations, such as certain no-cost advances and programs to advance earned wages when offered by employers or their business partners.

The Bureau has spent five years developing this rule. Over that time, we conducted supervisory examinations and enforcement investigations that have given us deep insight into the business practices of many of these lenders. We analyzed millions of loan records, and published five reports with our findings. We conducted field hearings to hear from local communities and stakeholders on all sides of these issues. We heard stories from faith leaders all over the country about the tragic ways these loans shatter financial stability for the people they serve. And we carefully reviewed well over a million comments on our proposal from all sides: payday and auto title borrowers, consumer advocates, lenders, tribal leaders, state officials, and others.

The final rule issued today applies the underwriting requirements only to lenders of short-term and balloon-payment loans. This is a change from our proposal, which would have required underwriting for a wider swathe of longer-term loans. We want to take more time to consider how the longer-term market is evolving and the best ways to address practices that are currently of concern and others that may arise as the market responds to the reforms prompted by this new rule. We also made many other changes in the rule in response to the comments we received. These changes include crafting the provisions just described for community banks, credit unions, and "fintech" innovations, among others. We modified many components of the full-payment test to make them more manageable and practical and we refined our approach to the principal-payoff option. These changes took considerable time and effort, but they led to the improved rule we are issuing today.

We believe this rule will have a positive impact on communities and borrowers and will improve the market for these products. The principle that lenders must actually evaluate the borrower's chances of success before making a loan is just plain common sense. These protections also are in addition to existing requirements under state or tribal law, which can go beyond federal law to be even more protective of consumers. The states that do not authorize payday loans will not be affected by our rule. In the states that do authorize payday loans, we believe most people will be able to get the credit they need by passing the full-payment test or through one of the other options. And all those who use payday or high-cost installment loans will be safeguarded against multiple attempts to extract payments from their accounts that cause mounting fees and penalties. Ultimately, we believe this rule will allow for responsible lending while ensuring that people are not saddled with unaffordable loans that undermine their financial lives. That important goal is worth all the efforts we have made here. Thank you.

The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.