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INSIGHT

CFPB Finalizes New Payday Lending Rule, Reversing Prior Regulation

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On July 7, 2020, the Consumer Financial Protection Bureau (CFPB) released a new final rule to amend its regulations for payday, vehicle title, and certain high-cost installment loans. The rule rescinds a significant part of a 2017 final rule that requires small-dollar, short-term lenders to determine a consumer's ability to repay before issuing a new loan.

This Insight begins with an overview of payday loans and then briefly summarizes the 2017 rule and major changes finalized by the CFPB. It also reviews the data and analysis supporting these rules, and the different conclusions each version of the rule reached using this same evidence. Although the CFPB's rule covers other small-dollar markets (e.g., auto title loans and other installment loans), this Insight focuses on payday loans, currently the largest market covered by the rule.

For general information on the payday loan market, see CRS Report R44868, *Short-Term, Small-Dollar Lending: Policy Issues and Implications*.

Payday Loans Overview

Payday loans are designed to be short-term advances that allow consumers to access cash before they receive a paycheck. These loans are generally paid back on a consumer's next payday. Payday loans are offered through storefront locations or online for a set fee. The underwriting of these loans is minimal, with consumers required to provide little more than a paystub and checking account information to take out a loan. Rather than pay off the loan entirely when it is due, many consumers *roll over* or renew these loans. *Sequences* of continuous "roll overs" may result in consumers being in debt for an extended period of time. Because consumers generally pay a fee for each new loan, payday loans can be expensive.

In this market, policy disagreements exist around balancing access to credit with consumer protection. Currently 17 states and DC either ban or limit the interest rates on these loans. The Dodd-Frank Wall Street Reform and Consumer Protection Act gave the federal government—the CFPB—the power to regulate payday loans for the first time.

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Regulation Changes

In October 2017, during the leadership of President Obama-appointed Director Cordray, the CFPB finalized a rule covering payday and other small-dollar, short-term loans. The rule asserts that it is "an unfair and abusive practice" for a lender to make certain types of short-term, small-dollar loans "without reasonably determining that consumers have the ability to repay the loans," also called loan underwriting. The rule, which mandated underwriting provisions, exempted some short-term, small-dollar loans if made with certain loan features.

The July 2020 rule, issued under President Trump-appointed Director Kraninger, rescinds the mandatory underwriting provisions before the 2017 rule goes into effect. The rule maintains other consumer protection payment provisions in the 2017 rule.

Media reports have suggested that opponents of the new rule may sue the CFPB, alleging that, by rescinding the 2017 rule and issuing the 2020 rule without considering substantially changed evidence, the CFPB acted in an arbitrary and capricious manner in violation of the Administrative Procedure Act. To successfully defend against such a challenge, the CFPB would have to "demonstrate that it engaged in reasoned decision-making by providing an adequate explanation for its decision" to rescind part of the 2017 rule.

Same Mixed Evidence, Different Perspectives

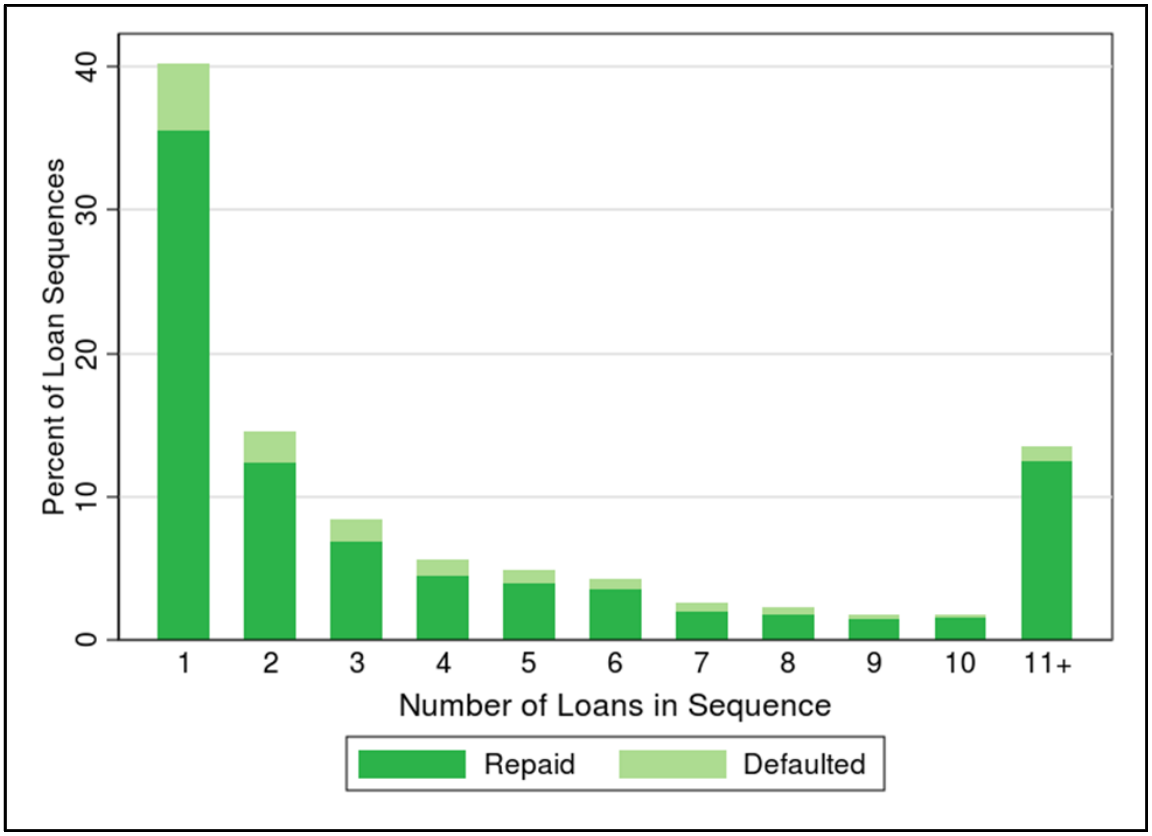
Notably, the new rule principally relies on the same estimated impacts and academic research as the former 2017 rule. In general, this evidence reflects that consumers' experiences with payday loans are mixed, and different CFPB leadership has weighed this evidence differently, as discussed below.

A survey of academic research suggests that access to payday loans does not have a large impact on consumer wellbeing, either positively or negatively. This mixed evidence may be masking diverse effects among consumers, where particular loans help certain consumers and harm others.

A 2014 CFPB research report finds, as shown in **Figure 1**, that most consumers pay off payday loans quickly, but a sizable minority are in debt for a long period of time. In the sample, 36% of new payday loan sequences were repaid fully without rollovers, while 15% of sequences extended for 10 or more loans, and half of lenders' outstanding loans consisted of loans that were a part of these long sequences.

A 2014 academic study asked consumers how long they estimate it will take to pay back their loan. Prior to taking out a new loan, most people expected to pay this debt off quickly. The study found that 60% of consumers accurately estimated the time it will take to pay back their loans, while consumers in long sequences generally underestimated how long they will be in debt.

Figure 1. Duration of Payday Loan Sequences



Source: CFPB Data Point: Payday Lending.

CFPB's internal analysis, which is generally the same under both rules, suggests that the 2017 rule's mandatory underwriting provisions would reduce new payday loan sequences by approximately 6%, but reduce the total number of payday loans made by half. The CFPB estimates that these provisions will lead to a large consolidation of the payday loan industry, reducing loan volume by about 65% and reducing the number of storefronts by 71%-76%.

The 2020 rule reflects a different understanding of the evidence underlying the mandatory underwriting provisions than the 2017 rule. In the 2017 rule, the CFPB stated that "extended loan sequences of unaffordable loans" lead to consumer harm. For this reason, the CFPB's 2017 rule attempts to mandate underwriting without "reduc[ing] meaningful access to credit among consumers." However, in the 2020 rule, the CFPB finds that under the 2017 rule, "some borrowers might still have been able to borrow, but for smaller amounts or with different loan structures, and might have found this less preferable to them than the terms they would have received." Therefore, in the 2020 rule, although the CFPB considers the same research, it "determine[s] that the key evidence is insufficient to support finding an unfair and abusive act or practice as well as warranting regulatory intervention."

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