Insight

The CFPB Now Decides if You Are Able to Repay Your Loan

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Today the Bureau of Consumer Financial Protection (CFPB), at a field hearing in Kansas City, released its latest proposed rule, this one targeting small-dollar and short-term lenders across the country. In the 1334-page rule, the CFPB proposes to, among other things, require lenders before making a loan to "determine that the consumer has the ability to repay the loan." Further, "[t]he proposed rule would identify it as an abusive and unfair practice for a lender to make a covered longer-term loan without reasonably determining that the consumer will have the ability to repay the loan." Of course, a lender's determination is bound to a list of considerations stipulated by CFPB's proposed rule, including, but not limited to forecasting a "reasonable about of basic living expenses for the consumer," verifying the consumer's net income, and predicting the consumer's future net income for the duration of the loan term.

The proposal claims to impose some 6,629,201 annual paperwork burden hours on the 10,442 lenders that it will affect, which even at the $8.05 minimum wage in Florida (one of the states with the most small-dollar and short-term lenders) is an average of over $5,000 in new compliance costs each year for these lenders. Further, the CFPB estimates that each lender storefront will spend at least $10,000 making required upgrades to their software systems and $3,000 purchasing new hardware and software .

And those aren't the only new costs. Since the proposed rule does not lay out specific penalties for lenders that are found to be in violation of the rule, but, instead, only ambiguously defines what actions or inactions could be found to be an "abusive or unfair practice," lenders are subject to potentially-limitless enforcement actions and consent orders from CFPB – the Bureau's preferred method of precedent setting and rulemaking. Last year alone the CFPB issued over 50 enforcement actions totaling almost $1.8 billion in penalties.

As with anything else, such costs eventually affect consumers more than the lenders as the costs will either be passed on or the costs will be so high that the lenders will go out of business and the consumers will lose a sometimes vital, if not ideal, lending service. A Federal Deposit Insurance Corporation (FDIC) study of unbanked and underbanked households found that nearly two thirds (64.9 percent) of unbanked households use alternative financial services such as these small dollar and short term lenders, many of whom rely on these loans as a financial lifeline because traditional banks refuse to extend credit as a result of insufficient or outdated credit history. Now the CFPB has issued a vaguely written rule that adds considerable business burden without fundamentally changing those practices that it deems to be abusive, and at the same time threatens to remove lines of credit to people who need them most. It's another mixed message from the CFPB.