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New Consumer Protections in Payday Lending

Earlier this month, the Consumer Financial Protection Bureau (CFPB) released its final rule on small-dollar and payday loans establishing much needed borrower safeguards and protections to help families break out of the payday debt cycle. For far too long, the payday loan lenders—who have more branches nationwide than Starbucks—operated with little oversight, depleting consumers' bank accounts along the way. New consumer protections take commonsense steps to prevent predatory lenders from targeting vulnerable working Americans.

Small-dollar loans, such as payday loans, provide borrowers quick access to cash in exchange for full payment plus variable interest rates, typically within two to four weeks after the loan was provided. Payments are guaranteed through a prewritten personal check or an automatic withdrawal from a bank account. Auto title loans operate in much the same way, but instead, borrowers risk losing their vehicles in exchange for a temporary loan. Many borrowers use small-dollar and payday loans as a quick fix when ordinary living expenses get too high—the average payday loan borrower makes about $30,000 a year with a credit score in the low 500s.

While payment arrangements like these might seem like a commonplace practice or reasonable solution to some, the underlying rates and conditions are far from reasonable. In many cases, the loans and high fee structures that come with them actually push cash-strapped consumers further into debt. Lenders have historically operated with little regulation and oversight, charging annual interest rates around 400 percent on a single loan, well above industry standards for credit cards or other consumer loans.

These extreme interest rates and harsh fee structures on small-dollar loans can balloon into payments that exceed the amount of the initial loan and kick borrowers into dangerous, ongoing debt traps of loan rollovers. On an average small-dollar loan of $375, borrowers can easily pay $520 in fees and be indebted for five months out of the year. Moreover, more than 80 percent of payday loans are rolled over or renewed within 14 days.

The new CFPB rule establishes borrower safeguards and protections on the most troublesome loans. Lenders will be restricted from making loans that borrowers are unable to pay back with accrued interest. The rule also attempts to break the debt trap cycle by limiting the number of consecutive loans that can be taken, and requiring longer repayment timelines, making repayment of loans more manageable.

With more than 19 million American households using payday loans to help make ends meet, including those in rural areas where access to traditional banks is limited or non-existent, small-dollar lenders can provide a critical financial stopgap. Unfortunately, for far too long these lenders have determined the rules of the game, charging borrowers exorbitant fees and interest rates. The CFPB's action protects consumers from these predatory lending practices, while preserving small-dollar loans as an important source of credit for working families.