Client Alert

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CFPB Report on Online Short-Term Lending Finds Borrowers Face Hidden Costs

By Obrea O. Poindexter, Joe Rodriguez, and Meredith M. Cipriano

On Wednesday, April 20, 2016, the Consumer Financial Protection Bureau ("CFPB," or "Bureau") released a report, entitled "Online Payday Loan Payments" ("Report"), which examines short-term, small-dollar loans—or payday loans—originated by online lenders. The Report is the CFPB's third study on the short-term lending market and is released just weeks in advance of the Bureau's anticipated proposed rule on this issue.

Notwithstanding the fact that borrowers expressly provide prior authorization for the lender to collect payments by initiating an electronic transaction, the CFPB alleges that borrowers often face unanticipated costs in connection with their online short-term loans due to overdraft or bank fees charged when borrowers have insufficient funds in their bank accounts. In announcing the Report, CFPB Director Richard Cordray emphasized that online loans "may impose large costs, both tangible and intangible, that go far beyond the amounts paid solely to the original lender. So the true costs of these loans, taken in the aggregate, must be kept in mind as we assess the effects" on consumers.

FOCUS OF THE STUDY

The Report focused on online lenders' use of the Automated Clearing House ("ACH") to initiate electronic debit transactions to collect payment from a borrower's deposit account and the potential fees associated with such electronic debit transactions charged by the lender or the account-holding depository institution. For example, if a borrower lacks sufficient funds in his or her deposit account to cover the amount of the electronic debit transaction, the account-holding depository institution may cover the amount of the electronic debit and charge the borrower an overdraft fee, or it may decline the electronic debit and charge the borrower a non-sufficient funds ("NSF") fee. According to the Report, in 2012, typical overdraft fees and NSF fees were $34. (In addition to fees assessed by the account-holding depository institution, if an electronic debit is declined, the lender may charge the borrower a returned payment fee or late payment fee; however, the Report does not discuss these lender-assessed fees in detail.)

The Report is based on data collected in connection with a study conducted almost five years ago. The data was from an 18-month period in 2011 and 2012 that examined online lending products, including installment loans and longer-term loans with balloon payments, made by approximately 330 online lenders. The data analyzed came from consumer checking accounts and was obtained from several large depository institutions through the CFPB's supervisory authority.[1]

[1] Depository institutions provided transaction data including the transaction amount; the type of transaction, such as a debit from a debit card or a credit from a personal check; whether the transaction was paid normally, was paid as an overdraft or was refused because of insufficient funds; and associated overdraft and NSF fees. The CFPB studied only lenders providing "high-cost, short-term installment loans and operating strictly over the internet or by phone." The Bureau identified these lenders based on merchant descriptions in the transaction data.

SUMMARY OF THE CFPB'S FINDINGS

- Online short-term borrowers made mean total payments to one or more identified online lenders of $2,164 during the period studied, although the CFPB was unable to distinguish what portion of those payments covered fees or interest and what portion covered principal repayments.
- Online borrowers were charged a mean total of $92 in overdraft and NSF fees during the 18-month period studied by their depository institutions for ACH debits where borrowers did not have sufficient funds in their accounts to cover the debits that the borrowers previously authorized.
- Ninety-four percent of initial transactions are successful, although approximately six percent are successful only because the borrower's depository institution covers the transaction, putting the account in overdraft.
- Seventy-five percent of declined ACH debits are re-presented.
- Checking accounts with one or more failed transactions from an online lender are more likely to be closed by a depository institution than accounts generally.

CFPB'S SHORT-TERM LENDING RULEMAKING PROCEEDING

The Report provides insight into the Bureau's anticipated proposed rule on short-term lending. The Bureau's March 2015 "Outline of Proposals Under Consideration and Alternatives Considered" ("Outline") to regulate certain short-term lending products categorizes provisions for "short-term loans" and "longer-term loans" and sets forth two different approaches from which a lender would be able to choose: "debt trap prevention" and "debt trap protection."

The Outline contemplates restricting lenders from initiating more than two successive transactions if there are insufficient funds in the borrower's account. Based on the Report, the CFPB is likely to propose such limitations on the ability of a lender to re-present a transaction.

In February 2016, Director Cordray made remarks suggesting that, despite feedback received from the industry, the CFPB is unlikely to significantly modify the proposals in its March 2015 Outline. A proposed rule is anticipated from the CFPB this spring. We will continue to monitor developments relating to the CFPB's short-term lending proposal.

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