|BD|

FOR YOUR REVIEW

CFPB Targets Payday Lenders

In June, the Consumer Financial Protection Bureau (CFPB) announced a proposed rule to end so-called "payday debt traps," referring to a cycle where borrowers end up stuck in loans with high interest rates. The rates are often so high that the borrower can't repay the loan, forcing them to reborrow again and again.

This news followed a late May announcement by Google that the search engine would no longer allow advertisements for loans with a 60-day or less term or an annual percentage rate of 36 percent or higher, effective July 13.

The CFPB's proposed rule specifically targets loans with short terms, 45 days or less, or longer term loans with an annual percentage rate that exceeds 36 percent. Long-term loans that use a vehicle as collateral or allow the lender to directly access the consumer's account or paycheck are also included. In order to make these types of loans, lenders will need to determine the borrower's ability to repay, something that is already required of mortgage lenders. "It requires the lender to not only take into account income and debt obligations, but also requires that the lender do some type of analysis with respect to living expenses, and that really goes far beyond just credit risk," says Obrea Poindexter, a partner at the law firm Morrison & Foerster.

The lender will also be restricted from making these types of loans to borrowers with current or recent outstanding short-term or balloon payment loans. Other consumer protections include restrictions on the lender's ability to withdraw payments from the consumer's account. Most of the types of loans offered by the banking industry, including loans to finance a vehicle purchase, are excluded from the proposed rule.

The proposal is open for comment until September 14.

Several states cap the interest rates charged by lenders, but the CFPB lacks this authority. Also, the proposed rule doesn't override stronger protections at the state level, including states that have banned payday lending outright.

More than 5 percent of U.S. adults have used a payday loan, with borrowers averaging eight payday loans annually, according to the Pew Charitable Trusts' research on small dollar loans in 2012. The products offered by the payday loan industry are predatory, but they also put cash in hand for millions of Americans who need it. What will happen when these consumers can't access credit?

"If the final rule is similar, you're really looking at a significant reduction in credit availability," says Poindexter. "I don't see any real benefits coming out of the rule."

Most banks aren't willing to underwrite loans this small, since they're just too costly. "As it is right now, banks have little incentive to get in this space, says David Pommerehn, senior counsel at the Consumer Bankers Association.

Emily McCormick is director of research and a writer for *Bank Director* magazine.

Economic Growth Leaves Out Banks

Here's the good news for the next year or so, according to Moody's Investors Service: Stability. Consumer credit quality promises to be strong. Modest economic growth is expected to continue. Housing prices will continue to rise, and the unemployment rate will continue to decline.

Stability is a wonderful thing, but not for banks that have seen modest improvement in the last few years and continue to struggle to maintain an acceptable level of profitability in today's onerous operating environment. It's good news, but it's not great news.

Moody's also anticipates a modest and gradual rise in short-term interest rates. As many bankers are well aware, short-term rates declined and remained effectively at zero for seven years. Rates finally rose in December 2015 when the Federal Reserve increased the federal funds rate by a modest 0.25 percent, but expectations for additional rate hikes haven't yet born fruit. The Federal Reserve won't commit to a timetable, but Fed Chair Janet Yellen affirmed in June that she expects the economy to continue to improve and, along with that, "further gradual increases in the federal funds rate are likely to be appropriate."

Moody's expects the fed funds rate to rise to 1.75 percent by the end of 2017.

To deal with the challenge of depressed net interest margins, banks have worked to cut costs, which is difficult to do when, concurrently, they are facing rising costs due to greater regulatory compliance requirements. Financial institutions are also spending more on technology. "Banks are trying to improve how they interact with their customers," by keeping up with technology, says Joseph Pucella, senior credit officer at Moody's. Banks are also spending more to protect their banks from cyberattacks. "Banks are investing a lot in that area, and that's another expense that's not going away."

Faced with these challenges, along with competitive pressures, the industry has been chasing every dollar it can. Underwriting standards have loosened over the past few years. As a result, Moody's expects commercial credit quality to deteriorate. Banks will have to provision more for commercial loan losses, which will dampen any potential net interest margin gains from a possible rate increase.

"Weakening commercial credit is probably the key challenge going forward," says Pucella. Charge off rates are historically low, and problem loans are trending downward, but "we know that, given some above-average growth in certain asset classes, and some weakened underwriting that the regulators have highlighted over the last couple of years, that there are problems that will bubble up."

Emily McCormick is director of research and a writer for *Bank Director* magazine.