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POLICY & ACTION FROM CONSUMER REPORTS

October 7, 2016

Monica Jackson
Executive Secretary
Bureau of Consumer Financial Protection
1700 G St., NW
Washington, DC 20552

Re: Payday, Vehicle Title and Certain Other High-Cost Installment Loans [Docket No. CFPB-2016-0025]

Dear Ms. Jackson:

Consumers Union, the policy and mobilization arm of Consumer Reports,[1] appreciates the opportunity to comment on the Bureau's proposed rule for high-cost loans such as payday, installment and auto-title loans.

We applaud the Bureau for taking this historic step to set national minimum standards for a range of high-cost loans that have posed well-documented risks to consumers for many years. We are encouraged that the proposed rule:

- Adopts ability-to-repay as a general principle throughout the rule;
- Limits repeated debit attempts on consumers' accounts;
- Covers both shorter- and longer-term loans; and
- Acknowledges the importance of stronger state laws.

However, we have concerns that the rule would exempt lenders from crucial underwriting requirements in certain circumstances, and believe that the Bureau should do more to ensure that lenders can no longer engage in the kinds of risky practices that put consumers into cycles of abusive debt. We urge the Bureau to strengthen the final rule in the following ways:

- Apply the rule to all loans where the lender obtains vehicle title or bank account access at any time, or where the lender retains the right to seize property or garnish wages;
- Apply a robust ability-to-repay requirement, without exception;
- Allow only one unsuccessful debit attempt before obtaining reauthorization from a consumer; and
- Strengthen the enforceability of stronger state laws.

[1] Consumers Union is the public policy and advocacy division of Consumer Reports. Consumers Union works for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves, focusing on the areas of telecommunications, health care, food and product safety, energy, and financial services, among others. Consumer Reports is the world's largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit organization rates thousands of products and services annually. Founded in 1936, Consumer Reports has over 8 million subscribers to its magazine, website, and other publications.

General Comments

Today, all too many families struggle to make ends meet. According to recent U.S. Census data, 43 million people live in poverty – and one in five children are poor.[2] The Federal Reserve has found that only three in ten households with incomes under $40,000 a year have $400 saved up for an emergency expense.[3] Even among those who are in the "middle income" category – $40,000-$100,000 a year – only 56% would have $400 on hand for an emergency.

Furthermore, communities of color continue to experience higher rates of poverty and scarcity. Approximately one in four Black households and one in five Latino households are living in poverty, compared with just under one in ten White households.[4] In fact, racial and ethnic wealth gaps are at or about their highest levels observed in the 30 years for which we have data.[5]

For households barely making it from paycheck to paycheck, the most immediate need they have is for a little help: a safety net. Recent data shows that in 2015, over nine million people came out of poverty thanks to low-income tax credits; 4.5 million came out of poverty thanks to SNAP benefits for food; and 2.5 million came out of poverty thanks to housing subsidies.[6] Child support and school lunch programs also helped more than 2.5 million people combined avoid poverty in 2015.[7]

High-cost lenders may claim that they are providing a service or "safety net" to struggling families, but their business models rely on keeping people in debt, not helping them build assets. These lenders have made profits based on predatory business practices that endanger consumers' economic security.

Data on payday loan borrowers suggests that the typical borrower is working and has some baseline level of assets, but they just don't go far enough each month. Payday loan borrowers tend to have low or moderate incomes and most are working at least

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[2] U.S. DEP'T OF COMMERCE, U.S. CENSUS BUREAU, INCOME AND POVERTY IN THE UNITED STATES: 2015 12-14 (2016), *available at* http://www.census.gov/content/dam/Census/library/publications/2016/demo/p60-256.pdf (19.5% poverty rate for children).

[3] FED. RESERVE BD., REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2014 18 (2015), *available at* http://www.federalreserve.gov/econresdata/2014-report-economic-well-being-us-households-201505.pdf (31% have $400 saved).

[4] *See* U.S. DEP'T OF COMMERCE, U.S. CENSUS BUREAU, INCOME AND POVERTY IN THE UNITED STATES: 2015 12-14 (2016), *available at* http://www.census.gov/content/dam/Census/library/publications/2016/demo/p60-256.pdf (24.1% rate for Black households; 21.4% rate for Hispanic households; 9.1% rate for White households).

[5] Pew Research Ctr., Wealth Inequality Has Widened Along Racial, Ethnic Lines Since End of Great Recession (Dec. 12, 2014), *available at* http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/ (fact sheet analyzing data from Survey of Consumer Finances).

[6] *See* U.S. DEP'T OF COMMERCE, U.S. CENSUS BUREAU, THE SUPPLEMENTAL POVERTY MEASURE: 2015 13 (2016), *available at* http://www.census.gov/content/dam/Census/library/publications/2016/demo/p60-258.pdf (Table 5b).

[7] *See id.* (1.38 million benefitted from child support, and 1.26 million benefitted from school lunch programs).

part-time.[8] One in four also have access to public assistance or retirement benefits.[9] Pew research has found that payday loan borrowers are largely female, white, and between ages 25-44.[10] However, certain demographic traits are more predictive of loan usage. Renters are slightly more likely to turn to payday loans than homeowners; those who are separated or divorced are twice as likely as those with another marital status to have payday loans; and those who are Black are also twice as likely as people of other ethnicities to have payday loans.[11] Payday lenders tend to concentrate more in communities of color, even when controlling for income.[12]

Once a person takes out that first high-cost loan, odds are high they'll come up short and end up with more loans. Repeat lending is not an anomaly – it's a feature of the payday lending business model. The Center for Responsible Lending estimates that roughly three-quarters of all payday loan volume comes from "loan churn," defined as borrowing a loan and then having to borrow again within two weeks.[13] The Bureau's own research has uncovered high levels of repeat borrowing. Four out of every five payday loan borrowers – or 80% – have to reborrow from the same lender within 14 days, and almost 90% end up reborrowing within 60 days.[14] More likely than not, a person with a loan will end up taking out ten loans in a sequence.[15]

Many people may be forced to borrow money from friends or family to end the cycle. In a 2013 survey, Pew found that four in ten people with payday loans ended up using friends, family, tax credits – other methods they could have used in the first place – to

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[8] *See* CONSUMER FIN. PROTECTION BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS 18 (2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf (finding median income of $22,476, with three quarters of all customers working full- or part-time).

[9] *See id.*

[10] PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 8 (2012), *available at* http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

[11] *Id.* at 9.

[12] *See, e.g.*, CTR. FOR RESPONSIBLE LENDING, PERFECT STORM: PAYDAY LENDERS HARM FLORIDA CONSUMERS DESPITE STATE LAW 6-8 (2016), *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_perfect_storm_florida_mar2016.pdf (Florida payday lenders are more highly concentrated in communities of color, even when accounting for income); HOWARD UNIV., CTR., ON RACE & WEALTH, THE ECONOMIC IMPACT OF PAYDAY LENDING IN ECONOMICALLY VULNERABLE COMMUNITIES 4 (2014), *available at* https://consumermediallc.files.wordpress.com/2015/01/crw-report-on-payday-lending-in-the-srabc-states.pdf (examining trends in Alabama, Florida, Louisiana and Mississippi); CTR. FOR RESPONSIBLE LENDING, PREDATORY PROFILING: THE ROLE OF RACE AND ETHNICITY IN THE LOCATION OF PAYDAY LENDERS IN CALIFORNIA 2 (2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf (payday lenders nearly eight times as concentrated in Black and Latino neighborhoods compared with White neighborhoods).

[13] CTR. FOR RESPONSIBLE LENDING, THE STATE OF LENDING IN AMERICA AND ITS IMPACT ON U.S. HOUSEHOLDS: PAYDAY LENDING ABUSES AND PREDATORY PRACTICES 3 (2013), *available at* http://www.responsiblelending.org/sites/default/files/uploads/10-payday-loans.pdf.

[14] CONSUMER FIN. PROTECTION BUREAU, SUPPLEMENTAL FINDINGS ON PAYDAY, PAYDAY INSTALLMENT, AND VEHICLE TITLE LOANS, AND DEPOSIT ADVANCE PRODUCTS 111 (2016), *available at* http://www.consumerfinance.gov/data-research/research-reports/supplemental-findings-payday-payday-installment-and-vehicle-title-loans-and-deposit-advance-products/.

[15] *Id.* (55% of loans end up in a loan sequence of 10 or more).

get out of their payday borrowing cycle at least once.[16] Others without a support network may be forced into bankruptcy. If that first loan isn't affordable, more loans simply make the problem worse.

Short-term auto-title loans are equally troubling, and come with the added risk of losing one's car. The Bureau's research has shown that approximately one in every five people who takes out an auto-title loan with a balloon payment ends up carless due to eventual repossession.[17] Losing a car could put many working Americans at risk of losing a job, or struggling to meet other obligations that require a car for transportation.

The Bureau has also found troubling trends with payday installment and auto-title installment loans. Though there are fewer car repossessions associated with auto-title installment loans compared with single-payment options, 22% still end up in default.[18] For payday installment loans, 24% end up in default – and for consumers stuck in a series of online payday installment loans, 55% end up in default.[19] A default rate of *more than half* should give anyone serious pause.

To date, high-cost lending practices have flourished wherever regulation is lax. However, 14 states and the District of Columbia have said no to high-cost loans – and their efforts have saved billions of dollars for their residents.[20] In New York, where state law has long imposed a 25% criminal usury rate cap, residents have been spared approximately $790 million in fees that lenders would have otherwise charged on high-cost loans.[21]

In states that do authorize high-cost payday, installment and auto-title loans, such as California, reform efforts are often undercut by industry pressure to keep high-cost lending only lightly regulated. Lawmakers in the state have attempted to encourage smarter installment lending through the Pilot Program for Increased Access to Responsible Small Dollar Loans, which requires ability-to-repay underwriting for all program loans, limits repeat refinancing, and sets tiered interest rate and fee caps resulting in approximate APRs of 40-70%.[22] However, because installment loans above $2500 have no rate caps[23] or meaningful underwriting requirements, most lenders feel no incentive to make loans under the pilot program. Meanwhile, others in the California

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[16] PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 36 (2013), *available at* http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf (41% of borrowers surveyed used some other method to get out of debt).

[17] CONSUMER FIN. PROTECTION BUREAU, SINGLE-PAYMENT VEHICLE TITLE LENDING 4 (2016), *available at* http://files.consumerfinance.gov/f/documents/201605_cfpb_single-payment-vehicle-title-lending.pdf.

[18] CONSUMER FIN. PROTECTION BUREAU, *supra* note 14, at 22.

[19] *Id.*

[20] CTR. FOR RESPONSIBLE LENDING, STATES WITHOUT PAYDAY AND CAR-TITLE LENDING SAVE $5 BILLION IN FEES ANNUALLY 1 (2016), *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_fee_savings_jun2016.pdf.

[21] *Id.* at 2.

[22] The first version of the pilot program, the Pilot Program for Affordable Credit-Building Opportunities (SB 1146, enacted in 2010), was later replaced with the current pilot (SB 318, enacted in 2013) (codified at CAL. FIN. CODE §§ 22365-22381). The pilot has just been extended through January 1, 2023 (SB 984, enacted 2016).

[23] CAL. FIN. CODE §§ 22303-04 (2016) (exempting loans above $2500 from rate regulation).

Legislature have made recent attempts to deregulate consumer lending laws even further.[24]

The Bureau's primary charge is to protect consumers – not to keep bad lenders in business. This rulemaking presents a historic opportunity to set a robust federal floor that prevents lenders from trapping consumers into unaffordable loans that could wreak havoc on their bank accounts, cost them their automobiles, and push them into distress. Given the challenges that some states have faced over the years in rooting out predatory lending practices, while others have had to defend against deregulation attempts, this rule can and should settle the national debate as to what constitutes responsible consumer lending.

Specific Recommendations

Covered loans. We have concerns that certain loans would be entirely exempt from the proposed rule. Although we appreciate that the Bureau anticipates lower risk associated with loans that bear rates of 36% APR or lower, we still believe that the requirement to underwrite loans is essential, in all cases, to ensure that lenders are acting responsibly. There's also no clear rationale for exempting these lenders from requirements around repeated debits, the use of a national information registry, and other important provisions in the rule.

For some people, paying off *any loan* could pose an economic hardship. While the issue of social safety nets may fall outside the Bureau's direct purview, the Bureau's regulations should uphold sound principles of responsible lending; it should not legalize lenders' ability to steer consumers into inappropriate financial products.

Furthermore, the exemption for longer-term loans without a "leveraged payment mechanism" – defined as securing access to a consumer's vehicle title or bank account within 72 hours after loan origination – will be all too easy to game. Lenders could simply obtain access to an account or title when the first payment is due, or simply retain the right to garnish wages later on. We recommend applying the rule to any longer-term loan where the lender obtains access to a vehicle title or bank account, period, or where the lender retains the right to garnish wages or seize personal property to repay the loan.

Ability to repay. We appreciate that the Bureau employs ability-to-repay underwriting as the cornerstone principle of its proposed rule. We believe it should be a cornerstone requirement of the rule, applied without exception.

Underwriting is at the heart of responsible lending. The Bureau's rule must support lenders seeking to ensure that when they benefit from lending to a consumer, the consumer benefits too. If a lender does not know or care whether the consumer is reasonably able to pay it back, then its business model should be considered flawed by definition.

Underwriting criteria. We appreciate that the proposed ability-to-repay standards for both short-term and longer-term loans would involve verification of income and

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[24] *See, e.g.*, AB 268, 2015-2016 Reg. Sess. (Cal. 2016) (stalled in Sen. Banking Comm.) (proposed raising rates and fees for installment loans up to $2500).

outstanding debt obligations, as well as estimates of housing costs and other basic living expenditures needed for "health, welfare and ability to produce income," in order to reasonably project whether a person can afford the loan. However, we have some concern that the minimum standard for forecasting "basic living expenses" is rather vague, and could allow lenders to underestimate a person's actual needs. It is not enough to require an assessment of what is necessary to cover all "major financial obligations" – lenders could still exclude other contingencies, exacerbating the very thin margins that push borrowers to seek more money to begin with. The rule should require lenders to review comprehensive information about a person's actual recurring obligations – not just for housing and financial services, but out-of-pocket health care costs and utility bills as well – to ensure that the loan payments will be sustainable. The rule should also require a look back at a person's borrowing history, again to ensure that the lender has made a reasonable determination that a prospective borrower would succeed in making loan payments.

Furthermore, we believe that the proposed ability-to-repay standards do not require sufficient cooling off periods. The proposed standards define ability-to-repay as the ability to repay the loan and meet other financial obligations without having to reborrow within 30 days. We urge the Bureau, at minimum, to increase the cooling off period to 60 days.

Exemptions. We find it troubling that the Bureau's proposed rule would still allow lenders to make up to six short-term loans a year without performing any underwriting. Though we appreciate that this exemption requires a step-down in the amount of principal that can be borrowed on subsequent loans, the proposal nonetheless allows the kind of frequent borrowing that we know can cause serious harm. Even borrowing a small amount that a person cannot repay can have a snowball effect on already strained finances. It is simply too risky to allow lenders to make frequent short-term loans to the same borrower without an ability-to-repay analysis.

We also have concerns that lenders could make longer-term loans in some circumstances without performing any underwriting. The proposed rule exempts loans modeled on the NCUA payday alternative loan program, with a 28% APR cap and application fee of $20, as well as loans with 36% APR and origination fees of $50 or a fee "reasonably proportionate" to the lender's underwriting costs, where default rates are 5% or lower. This second exemption in particular would allow lenders to charge unspecified additional amounts that add to the overall cost of the loan. Furthermore, the 5% default rate cap could easily be gamed through refinancing to keep borrowers just barely out of default. These loopholes could encourage evasions of the rule, add further complexity, and complicate the Bureau's efforts to ensure compliance.

We strongly urge the Bureau to apply ability-to-repay underwriting to all covered loans. We believe that any exemptions – even those that require lenders to rebut presumptions of unaffordability – will encourage lenders to exploit those exemptions to the greatest extent possible. We also encourage the Bureau to consider restrictions on refinancing, to prevent lenders from using it as a tool to hide a person's inability to repay.[25]

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[25] California's pilot program limits lenders to two refinancings per original loan (with exemptions for business loans, as defined), requires the consumer to have paid down at least 60% of the principal, and requires the lender to perform an updated ability-to-repay analysis before extending additional principal. CAL. FIN. CODE § 22370(b)(3) (2016).

Repeated debit attempts. We appreciate the Bureau's intent to prevent lenders from repeatedly debiting consumers' bank accounts in order to grab funds as soon as they come into the account. Repeated debits can cause substantial overdraft fees and even lead to forced account closures. These additional damages can add insult to injury for consumers already struggling to repay their debts.

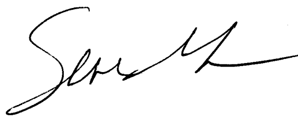
The Bureau should declare it an unfair and abusive practice to attempt another debit after one previous failed attempt. The proposed threshold of two failed debits could still enable multiple overdraft fees in a short period of time, thereby making it even more difficult for a borrower to catch up. If a borrower owes $300 on a payday loan, for example, and is already hit with two $34[26] overdraft fees before the lender seeks reauthorization, the borrower would need to come up with $368 immediately in order to pay off the loan and keep the account balance from going negative again. This would essentially make the loan 20% more expensive.

Relation to State law. We appreciate the Bureau's acknowledgement that states have an important role to play in reining in abusive lending practices – especially since the Bureau itself is not allowed to set usury caps under Dodd-Frank. To provide states with more authority to enforce their own laws and protect their residents, we urge the Bureau to define violations of state consumer lending laws, as well those pertaining to rate caps, loan servicing, and debt collection, as unfair, deceptive or abusive practices under Dodd-Frank.

Conclusion

We thank the Bureau for the opportunity to comment on this important new regulation, and look forward to a strong final rule that sets the nation on a new course toward more responsible lending practices.

Sincerely,



Suzanne Martindale
Staff Attorney

[26] This was the median overdraft fee amount in 2012, per the Bureau's research. CONSUMER FIN. PROTECTION BUREAU, CFPB STUDY OF OVERDRAFT PROGRAMS 52 (2013), *available at* http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf.