October 7, 2016

Director Richard Cordray
Attn: Monica Jackson, Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

RE: Proposed Rulemaking on Payday, Vehicle Title and Certain High-Cost Installment Loans (Docket No. CFPB-2016-0025, RIN 3170-AA40)

Dear Director Cordray,

The Corporation for Enterprise Development (CFED) is pleased to submit comments to the Consumer Financial Protection Bureau (CFPB) regarding the proposed rules for regulating the small-dollar lending industry, released on June 2, 2016. These rules are greatly welcomed, and we are pleased to have the opportunity to recommend ways to make an already impressive proposal even stronger.

CFED is a national nonprofit organization based in Washington, DC, that works to expand economic opportunity for low- and moderate-income Americans by building wealth. Our work helps these households achieve the American dream: buying a home, pursuing higher education, starting a business, building financial capability and saving for the future. We are particularly focused on communities of color who have been left even further behind by a growing racial wealth divide. With insights from our research, programs on the ground and from local community leaders in our network, we advocate for systems-level change through policy analysis, development and advocacy. CFED recognizes that strong consumer protections are an essential and necessary condition to help low- and moderate-income families get ahead.

CFED convenes several networks of local and state advocates, the largest of which is our Assets & Opportunity Network ("the Network") that was formed in 2012. The Network is a group of advocates, practitioners, policymakers and others working nationally to expand the reach and deepen the impact of asset-building strategies. It is comprised of more than 2,000 General Members, from all 50 states and the District of Columbia, and is convened locally by 93 State, Local and Native Leaders who are on the frontlines of federal, state and local policy advocacy, coalition building and service delivery. The Network is both a learning and advocacy community, which aims to enhance each member's capacity to advocate and deliver critical community services, and to lead the growth of the asset-building movement. Payday lending is one of the key advocacy issues that the Network has focused on over the years at the local, state and federal levels.

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CFED and the A&O Network's Perspective and Work on Payday and Small-Dollar Lending

Wealth building is the key to economic advancement for all Americans, but it is difficult for low- and moderate-income households to build any wealth in the first place if they are carrying heavy debt burdens. Traditional payday loans can make this even worse by trapping individuals in a cycle of debt from which it is difficult to break free, upending the financial lives of these households.

CFED understands that the economic conditions by which many American households are living in today leaves them with few options to make ends meet. Through our own research, we know that 44% of American households are liquid asset poor, meaning they do not have enough in savings to get by for at least three months if they lost their main source of income.[i] Further, many Americans do not even have $400 saved to cover a surprise expense or loss of income.[ii] They are one medical bill or fender bender away from a financial crisis. Millions more lack a high enough credit score to borrow money at prime rates, meaning they need somewhere to turn to weather a financial storm.[iii]

An estimated 15 million people in the United States turn to small-dollar loans, usually to cover one or more of the situations above.[iv] With speedy access to cash as the primary driver for these borrowers, few have time to shop around.[v] One result is that small-dollar loan consumers may not be as price sensitive as consumers of other types of credit. Predatory small-dollar lenders, which may include some banks as well as some storefront and online nonbank institutions, take advantage of this need in order to prey on these consumers by offering fast cash at highly unaffordable terms. With small-dollar loan borrowers at a clear disadvantage, regulation is necessary to ensure a functional, fair and competitive market. Perhaps most importantly, the vast majority of borrowers want more regulation of these products.[vi]

The Bureau's own data indicate many payday borrowers are low- to moderate-income,[vii] and the proposed rule cites research that indicates almost half of all payday loan borrowers have household incomes under $30,000, while almost one in five are receiving public benefits ("p. 206").

CFED is appreciative of the Bureau's extensive research and other efforts to understand and bring to light predatory, deceptive and abusive problems that are present within small-dollar loan products and markets. Based on the Bureau's supervision of larger participants in the small-dollar market, independent research conducted by a number of organizations and what we hear from our on-the-ground Network members, it is clear that further regulatory action is necessary to ensure that unfair and abusive products do not dominate the market and cause undue harm to millions of borrowers.

At the same time, we recognize that in addition to removing abusive products from the market, there is also a need to replace them with safe and affordable small-dollar credit products. From what our Network members have seen on the ground, having access to responsible short-term credit and credit-building products is important, especially in underserved communities.

Since its inception, the Network has been actively involved in pushing for stronger protections against predatory payday lending practices at the local, state and federal levels. Across the country, Network members have been active—and successful—throughout a number of localities and states towards protecting communities against predatory short-term loans. At the same time, they have

also pushed for federal protections that can further protect consumers against these unfair and deceptive products. The Network has submitted recommendations to the Bureau over the past four years not only on the regulation of payday lending, but on other important consumer protection topics as well, such as debt collection and prepaid cards.

Last year, the Network launched its Consumers Can't Wait campaign, specifically focused on supporting the Bureau's efforts to release strong regulations for the payday lending industry and to do this as quickly as possible given the extensive damage they do to low- and moderate-income Americans and their communities across the country. Over the past year, the campaign has grown in size and enthusiasm, focusing on developing recommendations for the Bureau that are detailed below, and building momentum for sustained advocacy to see through the entire rulemaking process and ensure that strong final rules are enacted. The recommendations in this letter reflect the opinion of CFED and all the other signatories below who have offered their support as part of the Consumers Can't Wait campaign.

CFED's Comments on the Proposed Rules and Recommendations for Strengthening Them

In this letter, CFED has structured its comments and recommendations regarding the proposed rules around ten core issues. Below are our key recommendations for each of them. Ultimately, these recommendations are based on CFED's core principles for creating a safe and robust small-dollar lending marketplace: simplicity, eliminating loopholes, promoting responsible practices, and facilitating access to safe and affordable credit alternatives.

1. **Ability-to-Repay (ATR) Should be Required Across the Board**
2. **Exemptions to ATR Should Be Strengthened, if Not Removed**
3. **Default Rates of 10% or Higher Should Trigger Heightened Regulatory Scrutiny**
4. **Prevent Fee and Interest Rate Front-Loading in the Longer Term Space**
5. **The "Cooling Off" Period Should be Lengthened from 30 Days to 60 Days**
6. **Remove the 72-Hour Limit Loophole for Longer-Term ATR Loans**
7. **Streamline the Registered Information Systems and Furnishing Requirements and Require Lenders to Participate**
8. **Longer-Term Loan Lengths Should be Limited**
9. **Establish Strong Limits on Bank Account Withdrawals and Notice Requirements**
10. **Explore Safer Alternatives**

These elements will ensure that consumers continue to have access to needed credit but that limit predatory loan features and business practices that harm small-dollar lending borrowers. Eliminating loopholes will prevent bad actors from finding workarounds to continue their predatory practices. Increasing simplicity will make it easier for consumers to understand their rights, for regulators at the CFPB and in the states to supervise lenders and enforce the rules, and for responsible lenders to adhere to the rules. Incentivizing responsible practices will make it easier for lenders to identify and follow through with best practices, and facilitating access to safe and affordable credit products will ensure that good alternatives will be available to replace the predatory ones.

Recommendation 1: Ability-to-Repay (ATR) Should be Required Across the Board

We are very pleased the Bureau has placed affordability at the heart of these rules for loans of both shorter and longer duration. Simply put, lenders should not offer small-dollar loans to borrowers who cannot afford them. Embracing affordability as a central requirement is a very important step that will help families make ends meet and build financial security without sacrificing income and savings to manage debt.

Assessing a borrower's ability to repay (ATR) through proper underwriting is standard practice for nearly all loan products. As the Bureau acknowledges in the proposed rule, in "virtually every other credit market," lenders engage in the practice of assessing a borrower's ability to repay through proper underwriting as a matter of standard practice ("p. 259"), and we do not think a compelling argument exists for exempting small-dollar lending from this requirement.

Because payday lenders do not typically determine ATR, they extend a "one size fits all" product to all borrowers with the minimal pay stub and checking account requirements, and make their profits by repeatedly rolling over the debt of those borrowers who do not "fit the loan," meaning those without enough money to pay the debt off in full. Automatic access to bank accounts also allows lenders to prioritize the satisfaction of their debt over competing obligations, making it even easier for lenders to avoid ATR under current practices.

The Office of the Comptroller of the Currency (OCC) deems rollovers similar to "loan flipping," which they consider an element of predatory lending, along with the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System. Furthermore, well-structured small-dollar credit can help borrowers repay their loans without requiring costly rollovers.[viii]

Tellingly, CFPB's own research indicates the majority of borrowers fall into this category. The Bureau's 2014 Data Point[ix] on payday lending indicates that 80% of loans are rolled over, and around half of borrowers end up taking out ten or more loans. Moreover, if a loan is rolled over more than once, the last loan in the sequence is at least as large as the first 80% of the time.[x] In short, vulnerable borrowers are needlessly embarking on a financially draining journey that lasts well beyond the two-week pay cycle, which the average borrower often does not realize when taking out a loan. (Consider our reasoning for the importance of notice requirements discussed below.)

This evidence suggests that these loan products are significantly flawed. This is a lender-centered approach that focuses on their ability to collect, rather than the more borrower-centered ability to repay. An ATR standard allows borrowers to be extended credit, but on terms they can afford. It also realigns lender incentives more closely with those of the borrowers, so that lender profitability is contingent on a borrower being able to successfully repay their loan.

Finally, some lenders argue that an ATR standard is not operationally feasible. We could not more vigorously disagree. According to the CFPB's own estimates referenced in the proposal ("p. 1008"), the operational costs associated with implementing an underwriting process and the time it would

take are modest, and would get less burdensome once standard operating procedures take hold, particularly for the larger lenders.

Finally, since this is a new and relatively untested approach, there is some value in exploring alternative methods to measure ATR through pilots or other vehicles that are potentially more efficient and effective than what is currently proposed. At such an early stage, it is important to keep the door open for promising alternatives that could alleviate burdens and increase simplicity.

Determining ATR - Income, Major Financial Obligations and Basic Living Expenses

Overall, we support the approach the Bureau is proposing for determining ATR. We think considering income, major financial obligations and basic living expenses that are confirmed with consumer statements and verifiable evidence should help lenders fashion a loan product that allows borrowers to meet these expenses and not have to reborrow. This basic approach was also endorsed by the OCC for their 2013 guidelines aimed at ensuring consumer safety and soundness for deposit advance products.[xi]

While we agree that lenders should have some flexibility to define and measure these obligations and expenses, we think the process should have some foundation separate from lender discretion when it comes to estimating basic living expenses. We think a happy medium between allowing some flexibility and a carte blanche approach should be struck.

On the one hand, there is too much variation from community to community (local context) for the Bureau to come up with an immutable, fixed list of expenses. We are also persuaded by the Bureau's argument that innovation is needed, particularly in the early stages of regulatory implementation, which requires some degree of flexibility.

On the other hand, the risk with this approach is placing so much decision-making control in the hands of lenders who have little incentive to adequately underwrite. As was mentioned earlier, making loans that are unaffordable is key to profitability in this space, because unaffordability leads to lucrative cycles of reborrowing.

It is also worth noting that limits on rollovers like what is achieved with the presumption of unaffordability (discussed more below), as well as the restrictions on bank account withdrawals that are proposed by the Bureau (more below), should do much to incentivize stronger ATR practices, since lenders would not be able to rely on unlimited debt rollovers to rack up fee and interest profits or unfettered banking account access to place them in a position of advantage over other debt.

In our opinion, an effective foundation would be to include objective measurements in the final rule that would rein in the high level of discretion currently afforded to lenders as proposed, and give the determination a data-based underpinning. Examples include the Economic Policy Institute's Family Budget Calculator[xii] and MIT's Living Wage Calculator.[xiii] These frameworks estimate the costs associated with typical living expenses based on geography and family size in an effort to determine what households will need to make in order to subsist in particular locations. The cost thresholds are generated by pulling data from a variety of public sources, including a number of federal agencies. Lenders could consult these numbers to help them gauge the quality of their

underwriting, and the Bureau could do the same. If the portfolio of a particular lender comes up with numbers that are consistently at odds with these estimates, they could be subjected to heightened Bureau scrutiny.

We are not endorsing a specific framework, but think something akin to these models that are tailored for ATR and have objective, data-driven estimates would be prudent.

As part of this discussion, we also want to mention that we are happy to see the Bureau requiring lenders to consider borrowers' income volatility. We think the rule is currently short on specifics and would be stronger if accounting for volatility was defined with more precision, but think the idea of estimating a cushion is a good starting point.

Presumption of Unaffordability and Loan Sequence Caps

Instead of assuming that lenders will adopt quality underwriting practices as required under the ATR standard, the Bureau has built a presumption into the proposal that when triggered, disallows the extension of any additional loans to a particular borrower unless improved financial circumstances can be verified for a second or third loan in a sequence, defined as being extended within a 30-day timeframe (the clock starts the day the first loan is extended). After the third loan, a "cooling-off" period must be adhered to, which is also true if improved circumstances cannot be established, meaning a second or third loan would be prohibited until the cooling-off period expires.

If the presumption of unaffordability is strictly monitored and enforced, we think this is a reasonable approach for pinpointing poor underwriting practices. Much reborrowing and loan flipping takes place during this 30-day timeframe that is fueled by a loan being unaffordable, not because other obligations or emergencies surfaced that a borrower needed money to address. Because lenders have little incentive to adequately underwrite, a stop-gap measure of some type would be prudent. Indeed, we think these limits will force lenders to do quality underwriting upfront, since they cannot rely on profits from endless reborrowing to make up for default losses (as mentioned earlier).

The approach taken with the second and third loans within a sequence that requires verifying an "improvement in financial capacity" before any additional loans are extended is also welcome. We agree with the Bureau that few borrowers will have some windfall or other financial advantage that will make them eligible for an additional loan under this structure, particularly for short term loans where there is less room for volatility. But in the instances in which a borrower does experience a change in finances, this approach allows credit to be available.

We are also happy to see a cooling-off period required after the third loan in a sequence, but think the duration should be the 60 days proposed earlier by the Bureau, rather than the 30 days in the current version of the rules. Our reasoning for this is discussed below.

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Exceptions to Presumption

As written, the proposal allows lenders to circumvent the presumption under specified circumstances. For short-term debt, the initial loan is required to be paid off in full first, and the new loan must be for no more than half the amount of the original loan. For rollovers, the amount allowed for a second loan cannot exceed what was paid off on the older loan. For longer-term debt, an additional loan must be "substantially smaller" than the largest payment due under the original loan.

While we support the presumption of unaffordability and the cap on loan sequences, we are not comfortable with these exceptions to the presumption and recommend removing them. Other than the verification of changed financial circumstances described above, we think there should be no exceptions to the presumption for the following reasons.

First, as we have stated, we strongly favor ATR, and think these exceptions circumvent this standard, as well as creating more complexity than is necessary. While we recognize there is some utility to an approach that requires an additional loan to be for a smaller amount, underwriting is not required to ascertain whether this new loan, while smaller, is affordable. In addition, the reasoning provided by the Bureau for why this provision is safe for consumers seems to hinge on conjecture, rather than solid evidence. For example, on Page 362 of the proposal, the Bureau argues that a lender could "reasonably infer" that a person who pays off a $400 loan, then returns to take out a $100 loan within 30 days, will be able repay the new amount. The Bureau further argues that a request for a second loan of $350 rather than a $100 does not "support" the same "inference," meaning the presumption would apply and a new loan could not be extended.

While a $100 loan is certainly less than a $350 loan, that does not necessarily make it affordable for a particular borrower. According to the Bureau's own demographic data, almost half of payday borrowers make less than $30,000 per year, and reports from research organizations like the Pew Charitable Trusts suggest the average payday borrower can only afford to pay $100 per month ($50 per pay check for those on a bi-monthly pay cycle) for a payday loan.[xiv] Underwriting is the gold standard for assessing what is truly manageable for a particular borrower.

Moreover, the structure of reducing the amounts allowed for successive loans is similar to what is proposed for the short-term exemption principal reduction approach (discussed more below). If this is followed, ATR does not need to be established, much like these exceptions. In a sense, the Bureau is letting the short-term exemption that gets around ATR creep into the back door of what is supposed to be the ATR option.

Second, it adds a layer of complexity to the rule that we think is burdensome and unnecessary. Consumer safety is compromised when a rule becomes a challenge to explain to consumers, meaning there is less transparency that could lead to abuse.

Recommendation 2: Exemptions to ATR Should Be Strengthened, if Not Removed

As described above, CFED believes that ATR should be required for all loans. We understand that the three exemptions were crafted to provide alternative safe product options to make it easier for certain types of lenders to continue or begin to provide products in this marketplace. Given that another of CFED's recommendations is for the Bureau to promote safe and affordable small-dollar credit alternatives, we appreciate this effort and the motivations behind it. However, we think the simplicity of requiring ATR across the board is more important, for all the reasons previously described. Furthermore, we are concerned that the exemptions will create loopholes, particularly the short-term option, which could lead to a continuation of predatory practices.

Many states already have restrictions in place, both in terms of loan amounts, rollover caps and cooling-off periods, and these regulations have done little to curb some of the worst lending abuses. For example, the CFPB's 2013 White Paper[xv] and 2014 Data Point[xvi] contain numerous examples of excessive rollovers and fee collections, as well as high APRs, and the 2016 Supplemental Report[xvii] includes compelling data that compares states with rollover restrictions to those without, and reveals that virtually no difference exists between the two when it comes to reborrowing rates. Overall, three-quarters of both categories are rolled over within 14 days of taking out an initial loan.

While we agree that including additional features in these exemptions, such as a principal reduction approach or limits on the number of loans that can be extended is better than some of the more permissive lending markets that exist, any loopholes can still potentially lead to unaffordable lending in an environment where ATR is not required. We realize that having clearly stated restrictions requires less legwork for lenders than determining ATR and takes some of the discretion away from them as well, but without affordability as a foundation, loans will still be extended with unmanageable terms, and consumer safety remains a concern.

While our primary recommendation is to eliminate all of these exemptions and require ATR for all loans, if the Bureau decides that it is necessary to keep all or some of these exemptions, below are additional recommendations on how they can be improved to eliminate any dangerous loopholes for consumers.

Short-term Exemption

Under the short-term exemption that was proposed, only three loans are allowed in a sequence (within 30 days of one another), and the first loan cannot be for more than $500, with succeeding loans capped at lower amounts (principal reductions). No more than six loans can be extended over the course of a year, and a borrower cannot be in debt for more than 90 days over the same timeframe. Taking possession of car titles is prohibited, and loans must be fully amortized. While CFED appreciates some of the restrictions created for this exemption, such as the loan sequence cap, principal reductions and 90-day maximum indebtedness feature, we still have several concerns about this model that are described below.

- Six loans in 12 months – The safety and soundness of allowing six loans without ATR is highly problematic. Ideally, even one loan should not be extended if affordability is not assured (please refer to evidence provided below).
- No fee limits – Unlike the longer-term provisions, there are no explicit fee limits. We think allowing fees of any size could encourage lenders to adopt excessively high amounts to keep profit margins from eroding.
- 30-day cooling-off period – We favor a 60-day cooling-off period for the same reasoning provided above.
- The model is untested – While some of the limitations under this option seem reasonable, this is a new and untested framework without any solid evidence that it would actually be safe for consumers.

A maximum of $500 (for the first loan in a sequence) is a common limit in several states, yet borrowers frequently roll over or eventually default on loans this size. According to the 2013 White Paper,[xviii] the median loan amount is $350 and the average is $392, which are even lower amounts than the maximum under this option, and yet borrowers still frequently fall into cycles of debt.

As mentioned before, research from the Pew Charitable Trusts suggests the typical payday borrower can afford to pay $100 a month for a payday loan, which is significantly lower than the $500 maximum that is commonly offered.[xix] The cycles of debt that recur with these loans supports Pew's conclusions. While the principal reduction approach and other features recommended here are a better structure than what is currently allowed, these loans could still be unaffordable for quite a few payday borrowers. Given these issues, CFED strongly urges the Bureau not to move forward with the short-term exemption, unless these concerns have been addressed and there are better guarantees that these loans can be truly affordable for consumers.

Long-term Exemption 1 (The NCUA Framework)

Under this framework, loans can be for between $200 and $1,000, have a 28% interest rate cap, an application fee limit of $20, and the loan length must be 46 days at a minimum and six months at a maximum. No more than three loans can be extended over a six-month period, and loans must be fully amortized. There are also prepayment penalty and account sweeping prohibitions. For this product, we do not have any particular recommendations to make.

Long-term Exemption 2 (The Default Rate Exemption)

These loans have a 36% cost of credit limit, and allow an origination fee of $50 or more. The loan length must be 46 days at a minimum and two years at a maximum, and instead of setting limits on loan amounts, this approach has a five-percent default threshold, wherein if the portfolio default rates of a particular lender are greater than five percent, they are required to refund all origination fees to their borrowers. No more than two loans can be extended over a six-month period, and loans must be fully amortized. There are also prepayment penalty and account sweeping prohibitions.

CFED thinks some of the features of this model would help to provide protections for consumers, such as prohibition on prepayment penalties, limits on the cost of credit and default rate limits.

However, below are the areas that we believe could be exploited as loopholes and create consumer harms.

- Origination fee that could be $50 or more. The most troubling aspect of this provision is the section where lenders are allowed to recoup a "reasonable proportion" of underwriting costs that leaves it to individual lenders to define. Such an indistinct requirement means fees in excess of $50 are allowed, potentially well in excess, which amounts to having no limits at all, unless carefully enforced.
- Duration – 46 days to 24 months– As will be argued in greater detail below in Recommendation 7, unnecessarily long payback periods can rack up high interest payments that are technically affordable and, although profitable for lenders, unsafe for consumers.

To improve this long-term exemption, CFED believes there should be a lower limit on origination fees than what is proposed, as well as a lower limit on the maximum duration of these loans (see more of our discussion on loan lengths below).

Additional Concerns Regarding the Exemptions

Throughout the proposed rule, the Bureau makes recommendations regarding what reports should be consulted to determine lending activity, which loans are subject to certain presumptions and limitations on extensions, which lender records must be reviewed for data on borrowing patterns and which loans must be reported to the Bureau for tracking purposes. For each of these provisions, the Bureau exempts some lenders or loan products from being covered.

In virtually all of these areas, the longer-term exemptions fall outside reporting, furnishing and counting requirements. For example, the limit on having no more than three loans in a sequence under ATR only applies to loans of shorter duration. If a lender wants to extend a long-term loan during this timeframe, it will not be counted as part of a sequence, and can be made without adhering to cooling-off periods or other restrictions.

This means if a borrower returns to a lender within 30 days after the extension of the first or second loan in a sequence and cannot verify improved financial capacity, they could still be offered a longer-term loan, including a $1,000 loan under the NCUA option or a high-fee loan product under the default exemption.

We understand the core reason for the permissiveness toward longer-term exemptions is to allow credit unions and community banks that currently use these types of products to continue their operations. As mission-driven entities, they are not primarily motivated by profit, and are more likely to use these products selectively for particular customers and only under certain circumstances.

With this said, we are not certain what typical payday lenders would do if they were given the opportunity to extend these loans. Unlike credit unions, they are profit-driven entities by nature, and are less concerned with consumer safety.

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For example, there is a risk that traditional lenders could use these loans as a bridge to buy time and keep borrowers coming through the door, providing them with an opportunity to offer a more predatory product down the line, or engage in some other questionable practice. Moreover, whether a loan is short-term or longer-term, it is still a debt obligation that will need to be repaid, and longer-term loans can be just as unaffordable and predatory as short-term single-payment products.

This complexity among the exemptions and in combination with ATR loans creates loopholes and the potential for exploitation of the rule in many ways that are uncertain and may not be realized until after the final rule is implemented. This is one of the chief reasons CFED is arguing for increased simplicity and transparency in the final rule, particularly with ATR required across the board. If the Bureau decides to keep the exemptions, however, one additional recommendation that we propose that could help to limit these concerns is a waiver system.

Under a waiver system, the Bureau could set a certain standard for institutions that would be allowed to offer any of the exemption products without some form of review and approval first. For example, the Bureau could allow only institutions already offering these types of products to continue without a waiver. Alternatively, any nonprofit or mission-driven financial institutions—such as credit unions, community banks, community development financial institutions (CDFIs) and others—could be exempted from the waiver process to offer these products as they see fit, given their generally lower-risk to consumers. But any other lenders would have to apply for a waiver first to offer them. This would spare the entities with existing experience or a history of mission-driven lending from the burden of having to apply for a waiver, but would force other lenders to be accountable for their practices by spelling out how they think the loan will benefit their operations and how they plan to use them. The Bureau could even add additional supervisory elements to traditional lenders offering these products to ensure the loans are not being used in a predatory fashion.

How high a barrier the waiver would be and exactly how complex the requirements would be could be determined by the Bureau, but CFED recommends a minimal level of requirements—just enough to ensure consumer safety—so as to not discourage any other responsible lenders from offering these products. There are other lenders not currently offering these products or that are not necessarily mission-driven that might want to offer them in a responsible manner and we would not want to discourage that with an overly burdensome waiver process. We prefer a system that is as simple as possible without sacrificing basic consumer safety. This approach is a reasonable medium between cutting these products off completely and opening them up for anyone to take advantage of, and we hope the Bureau seriously considers this option if they decide to include exemptions to the ATR standard in the final rule.

To reiterate, this recommendation does not contradict our primary preference for an overarching ATR standard without any exemptions. Ideally, the final version of the rule will not include the alternatives that circumvent ATR in both the short and long-term lending markets.

Recommendation 3: Default Rates of 10% or Higher Should Trigger Heightened Regulatory Scrutiny

Replace Default Rate Comparisons with 10% Default Rate Standard

In order to gauge the "reasonableness" of a lender's underwriting practices, the Bureau is recommending that the "delinquency, default and reborrowing" rates of particular lenders be compared with other similarly situated lenders. The results of this comparison would be used as evidence of whether a lender is satisfactorily fulfilling ATR obligations (higher rates would suggest unreasonableness and lower rates would signal the opposite).

While default rates could be used effectively to help discover whether lenders are adequately estimating affordability, we think a provision that relies on comparisons with other lenders is the wrong approach, and the core reasons are laid out by the Bureau in the proposal. Essentially, we believe the arguments for why such a comparison should not be the "sole basis" for determining reasonableness are actually compelling reasons for abandoning this standard altogether, and replacing it with something more concrete that is not pegged to the performance of peers.

The Bureau flags two potential problems—the risk of lenders engaging in aggressive collection tactics to lower default rates, and the fact that similarly situated peers may have poor underwriting practices—that makes a comparison with them an inaccurate assessment of quality standards.

These are significant concerns, and we are recommending the Bureau replace a provision that involves comparisons with a 10% default framework that our colleagues at the National Consumer Law Center (NCLC) have proposed.[xx] This approach addresses concerns about comparisons to lenders that engage in weak underwriting, and while it may not put a complete stop to aggressive collection tactics, the 10% threshold is more forgiving than the five-percent rate proposed for the default exemption in the longer-term space, and may lessen the incentive for hard-lined practices. It is also a simpler approach than what is proposed.

Under this approach, if a lender has a default rate that exceeds 10%, they would be subject to heightened Bureau scrutiny. If a resulting examination of lender practices reveals that rates topping 10% are primarily the product of macro-level economic downturns or other non-predatory factors, such lenders would not be subject to additional enforcement measures.

The NCLC settled on 10% by increasing a five-percent rate vetted by the Bureau in order to create some flexibility for lending institutions that do not engage in predatory practices, but they also back a recalibration of this number if time reveals that this threshold is too lenient, which we think is very sensible. Overall, this is a simple approach with a clear ceiling that can alert the Bureau to potential problems, but also gives the lenders an opportunity to defend themselves. We think this approach is preferable to what is currently being proposed, and urge the Bureau to endorse this standard instead.

Recommendation 4: Prevent Fee and Interest Rate Front-Loading in the Longer-Term Space

To discourage the front-loading of fees and interest that can lead to excessive refinancing, particularly in the longer term space, we also think the Bureau should prohibit prepayment penalties for the longer-term ATR standard. In addition, we recommend the Bureau introduce a refundable fee structure for longer-term products wherein if a borrower pays off a loan early, they will recoup a pro-rata share of the origination fee. We also recommend prohibiting interest rate front-loading, much like what is currently being done in Colorado.[xxi] This is an approach that seems to have worked successfully in that state, and could do the same on a national level. Refinancing creates repeated cycles of debt, which is one of the most predatory elements of payday lending. Finding ways to curb this practice is critical, and we think these provisions would help do this.

Recommendation 5: The "Cooling Off" Period Should be Lengthened from 30 Days to 60 Days

We are disappointed that the Bureau has decided to reduce the cooling-off period from 60 days as proposed under the Small Business Advisory Review Panel for Payday, Vehicle Title and Similar Loans (released in March 2015) to 30 days in the latest version of the rule, essentially cutting the protective barrier timeframe in half. We agree with the reasoning put forth by the Bureau defending the 60 day length in this outline that loan repayments could impact "multiple cycles of household expenses" and a cooling-off period that is longer than the typical monthly expense cycle would allow the impact of loan debt to dwindle to safer levels than with a cooling-off period that is half as long and the same length as a typical recurring household expense cycle (30 days).[xxii]

Under the short-term ATR standard, a 30-day cooling-off period could amount to 12 loans extended to a particular borrower per year, even if a borrower is not eligible for a second or third loan in a sequence. This is possible because 30 days after the extension of an older loan, another loan can be offered without being subject to presumptions or requiring older loans to be paid off first, amounting to one per month. If the borrower is eligible for additional loans in a sequence (within 30 days of one another), the number of loans per year could be even higher. In contrast, the short-term exemption caps the number of loans that can be extended per year to six, which is half (or less) of what is possible under ATR with a 30-day cooling-off period.

We are concerned that so many loans suggest a borrower is using them to habitually pay down recurring expenses each month, rather than using them for emergency expenses or other non-recurring costs, which is what these loan products are supposed to address.

Some may push back and argue that as long as they are affordable, there should be no concerns. While we have some sympathy for this view, we still find the practice a concern, particularly because fees and interest are charged for every loan, and repeated use can become expensive quickly, particularly for low- and moderate-income households that could use the money to increase their financial security rather than paying down high-APR loans, placing these households in a position to rely on savings instead of predatory products the next time they face a financial hardship.

Recommendation 6: Remove the 72-Hour Limit Loophole for Longer-Term ATR Loans

We would like to see the removal of the 72-hour restriction regarding possession of a "leveraged payment mechanism" for a long-term ATR loan. Under this provision, only lenders that secure a loan by obtaining possession of a leveraged mechanism (bank account access, vehicle title, etc.) within the first three days after disbursement are covered by the rule. This means if possession is taken by the lender after 72 hours, the transaction falls outside the rule and is therefore not subject to any of the regulations. In our opinion, this is a potentially dangerous loophole. We think a lender who gets possession of a payment mechanism should be covered by the rule regardless of when the possession takes place.

In the proposal, the Bureau argues that a lender's ability to exert influence over a borrower is most acute during the first 72 hours after disbursement of funds with respect to getting possession of a payment mechanism and diminishes after this timeframe (title must be taken quickly after disbursement, or it will be harder to obtain). The Bureau also asserts that lenders would be less incentivized to carefully underwrite if they already have possession of title ("p. 180"). If our interpretation of the Bureau's concerns are accurate, we are not convinced by these assertions.

With respect to exerting influence, we think a lender's authority is always influential, or at least does not meaningfully diminish over time. A lender is in a position of authority, and people tend to defer to their guidelines, particularly the borrowers that typically seek out small-dollar lenders. These borrowers tend to have less access to traditional credit (lower credit scores, fewer credit cards, etc.) compared to people who do not use these products, they tend to have lower incomes and they are often in financial distress and need access to credit quickly.[xxiii] This makes them especially vulnerable to the repayment expectations of lenders. Adding to this is a history of negative experiences with traditional products, leading these borrowers to feel like they have little leverage.

While the ATR argument is potentially true, it is important to keep in mind that only underwriting that satisfies the definition of ATR is allowed under this part of the rule, and the goal of this standard is quality underwriting. As such, the problem of disincentivizing ATR could be addressed by the Bureau properly enforcing the ATR standard as envisioned. Identifying problem practices and making sure the lenders responsible for them are held to account for their choices should go a long way toward curbing ATR abuse.

Moreover, it is unclear why the Bureau has settled on 72 hours, rather than some other period of time. The agency appears to have chosen this timeframe based on speculation, rather than evidence that influence wanes over time, particularly after three days. Along with the arbitrariness of this number, the addition of this provision only serves to complicate the rule more than is necessary, and we worry it has the potential to become a significant loophole.

In short, we worry that this 72-hour limit could be abused to circumvent the rule. If a lender stated it was store policy for borrowers to return to a storefront 72 hours after loan disbursement to fill out additional forms and transfer title, we are concerned that many borrowers would comply, at which point the lender is not covered by the rule.

Recommendation 7: Streamline the Registered Information Systems and Furnishing Requirements and Require Lenders to Participate

Registered Information Systems

The Bureau has proposed developing a registered information system that would track the loan portfolios of most lenders for many but not all loan types. The systems would be used for debt verification and borrowing history requirements, or to furnish lending information to these systems for tracking and knowledge-sharing purposes.

The goal of the system is to have a space that tracks loan activity, regardless of which lender is originating the debt, like some of the state systems that already exist. This would allow lenders to uncover loans extended to particular borrowers by other lenders. Having a system that comprehensively tracks all lending activity would help lenders accurately determine whether a borrower has the ability to repay, and fills in any knowledge gaps with respect to borrowing history.

We are convinced that a need for such a system exists, because some borrowers do indeed use more than one lender, and lenders tend to only track the activity of their own borrowers. According to one study, 30% or more of online borrowers use more than one lender, and about 25% of storefront borrowers do the same.[xxiv] The study also indicates that with concurrent borrowing or pending defaults, the percentages go up. In the online space, if a borrower has more than three loans outstanding, more than 70% use multiple lenders, and 28% of storefront users will seek out a different lender when an older loan defaults. As this research reveals, while the majority of borrowers stick with the same lender, a meaningful minority will switch, particularly online borrowers, and a system that keeps track of all activity will capture these multi-lender borrowers.[xxv]

As proposed, private entities can apply to become a "registered information system" capable of collecting, tracking and disseminating information about the loan product portfolios of various lenders.

In order to be eligible, an entity must comply with a set of standards (receiving and reporting capacity, compliance with the law, etc.) and collect a specific set of information about the loans being extended (loan type, amount borrowed, payment due date, etc.). The Bureau would be responsible for reviewing applications and determining which entities are eligible to become registered systems, and any eligible organization must agree to Bureau supervision. The Bureau will also have the authority to revoke registration if an entity does not fulfill their obligations under the rule. All registered systems would be listed on the CFPB website as well as in the Federal Register, and lenders subject to reporting requirements (more below) must share their lending activity with each registered system.

However, there are no limits on the number of entities that can register, and the proposed rule requires lenders to report to "each" of the registrants, which could become financially burdensome; the Bureau itself suggests that this provision might lead to lenders incurring multiple fee expenses ("p. 943"). It is also unnecessarily duplicative to report the same information to multiple sources. Given this, CFED strongly recommends that the Bureau use as much authority as it has to encourage

the creation of a limited number of registered information systems. The credit bureaus are a potential model. There are only three major credit reporting agencies. Such an approach would make underwriting more accurate and easier for lenders who would not have to seek and report lending data to numerous systems.

We recognize that the political landscape and other realities might work against the creation of a limited number of databases, particularly a system that is run through or directly managed by a government entity. Nonetheless, we think it is very important to highlight why we think this approach is more effective. If a private-market solution wherein multiple private entities participate simultaneously is the only feasible approach, we would recommend the Bureau monitor the system carefully to ensure lender expenses and system inefficiencies are not creating excessively high operational cost burdens and error rates that reduce the accuracy and quality of the data system. If a future examination uncovers these issues, we think it would be wise for the Bureau to revisit the possibility of constructing a model with a limit on the number of entities.

Furnishing Requirements

To complement what is said above regarding the registered information system, we think loan data furnishing requirements should also be uniform across lending products and should be reported to a limited number of databases. Right now, the rule gives loans made under either long-term exemption the option to report to a registered information system or a national consumer reporting agency. We think this loophole should be closed, and all loans (irrespective of type) should be required to be reported to a national database like the one proposed above.

Recommendation 8: Longer-Term Loan Lengths Should be Limited

The rule as proposed encourages the small-dollar lending industry to migrate toward longer-term installment products, and there is ample evidence that this is already happening.[xxvi] This means the rules that concern loans with longer durations (46 days or more) need to be crafted carefully, keeping in mind that the future of small-dollar lending is increasingly a long-term installment market.

As currently written, the longer-term option has no limits on how long a loan term can be, which we believe could lead to problems. NCLC recently released a report on the dangers of high-cost, long-term installment loans,[xxvii] and provided some real world examples of these products at work that highlight just how predatory they can be. For example, they describe a $2,600 installment loan offered by CashCall that is paid off over 47 weeks at 135% interest. After only 14 months of making payments, the loan becomes profitable for the lender, but only $60 of the principal is reduced. Meanwhile, if the borrower pays off the loan in full over 47 weeks and satisfies the obligation in full, they will end up paying over $14,000 over the life of the loan. The report also illustrates how long durations for small loan amounts can be predatory. Speedy Cash offers a $300 loan at 430% that is paid off over 18 months. After one year, only $40.51 of the principal is paid down, and the total amount paid out by the loan's end is almost $2,000.

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While NCLC places much of the blame on high interest rates, they also point out the perils of lengthy loan durations, stating an excessively long duration "exacerbate[s] the potential for profitable defaults and misaligned incentives," making it "more likely that the borrower will default after the lender has recovered substantial payments."[xxviii] They also discuss how lengthy terms that make slow progress in reducing principal are at greater risk of falling victim to income- and expense-related household volatilities.

While the Bureau does not have the authority to cap interest rates, they can regulate in ways that limit or disincentivize excessive loan durations, and we think this issue deserves the Bureau's attention. CFED would encourage the Bureau to exercise its Unfair, Deceptive, and Abusive Acts and Practices authority for any particularly egregious cases of excessive loan durations. This can set some guidelines and discourage predatory practices from perpetuating throughout the industry. Lengthy loans are particularly toxic when paired with high interest rates, and this is a serious concern when so many states allow triple-digit rates.[xxix]

Moreover, the individual payments made with these loans will not necessarily run afoul of the ATR standard as currently proposed. The CashCall product amounts to payments of $294.46 per month, and the Speedy Cash product is only $40.61 per payment (made biweekly). There are consumers who could pay this without compromising their ability to cover basic living expenses and major financial obligations without reborrowing during monthly expense cycles, yet the amount of wealth drained over time is significant, which is especially troubling for low- to moderate-income consumers who often turn to these products in times of need and economic distress. As was mentioned earlier, this is money that could be saved to build individual wealth, but instead is being used to pay off costly loans.

We are persuaded that loan durations can be excessive, and when they are, they can be very dangerous for consumers. The Pew Charitable Trusts described similar concerns in their report on Colorado's 2010 payday rule change and in their Issue Brief released in August 2016. They suggest excessive durations could be avoided by capping fee and interest payments at half of principal, and have some evidence that loan terms should rarely exceed one year for small-dollar loan products.[xxx]

These are interesting guideposts, but additional evidence would be useful to help pinpoint the safest loan term lengths. Because the small-dollar market is increasingly a long-term installment industry, we would encourage the Bureau to look into this issue carefully, and explore any options available to limit longer loan durations.

Recommendation 9: Establish Strong Limits on Bank Account Withdrawals and Notice Requirements

Payment Transfers

Under the proposed regulation, lenders will only be allowed to access a borrower's account twice before being required to explicitly ask for continued access, which is much more limited than the unfettered access currently granted.

We consider the caps on account withdrawal attempts and notice of withdrawal requirements (more below) to be some of the strongest elements of the proposed rule. The Bureau's very informative Online Payday Lending Payments report released this past April reveals that lenders often make multiple attempts to collect debt from borrower accounts without notice, and the financial consequences are born exclusively by the borrower. After an initial attempt by a lender to withdraw funds from an account fails, 70% of additional attempts also fail. Lenders can make as many attempts as they wish without incurring any costs, while borrowers are usually penalized with overdraft or similar fees each time a failure occurs. There are no disincentives in place to discourage repeated attempts, despite the low probability of success after an initial failure that only puts borrowers at a disadvantage.

Limiting the number of attempts to two before additional approval is required from the borrower is the right approach. An added bonus of this provision is it will likely incentivize lenders to do strong underwriting, since they can no longer rely on a superior repayment position over other debt obligations (as mentioned earlier).

Disclosure of Transfer Attempts

We are also pleased to see the inclusion of a requirement that payday lenders provide written notice, either electronic or written, before attempting to withdraw funds from a consumer's bank account.

For the sake of consumer safety, we applaud the approach the CFPB has suggested, wherein the disclosure would include additional information about the loan, including potential penalty fees, the loan APR and whether any principal will be paid down (Model Forms A-3 through A-8). We particularly like Model A-3 that includes the loan APR, and would suggest adding language about the potential for lengthy terms of indebtedness. The typical short-term loan is marketed as lasting two weeks, when in reality, borrowers are often faced with months of payback time for one debt. A more detailed notice requirement should make this clear to consumers by listing what the typical periods of indebtedness are for certain loan products. Taking this step would be similar to recent regulations around credit cards that have shown to be successful at helping consumers better understand how long it could realistically take them to pay back their debt.[xxxi]

This could encourage borrowers to be more proactive with their accounts, helping them make sure there is enough money to cover their expenses, and increases the likelihood that lenders will be repaid (lower the default rates). Moreover, we believe knowledge and transparency is very powerful for consumers and can help them make more informed decisions about their finances.

The CFPB's Supplemental Report presents evidence that disclosure requirements can impact consumer behaviors by highlighting the results of disclosure rules in Texas. When consumers were given a disclosure that explained how much a single payment loan would cost and the potential length of borrower indebtedness, loan volume declined by 13% compared with other states, and the responsiveness was greater among lower-income consumers.[xxxii] Providing this information gives a consumer agency, and would not be cost-prohibitive in this case, as lenders are already required to provide notice.

Finally, additional and continued research by the Bureau on the effectiveness of various disclosure practices related to small-dollar credit and beyond would also be welcome and is encouraged by CFED.

Recommendation 10: Explore Safer Alternatives by Supporting Research and Testing of Safe and Affordable Small-Dollar Loan Alternatives

5% Payment-to-Income (PTI) Ratio Pilot

CFED supports the Bureau's decision to remove the five-percent payment-to-income (PTI) ratio from this version of the rule, primarily because we think the default rates for loans with this ratio reported in the CFPB's 2016 Supplemental Report are too high. According to this research, the default rate for longer-term installment loans that are originated from either storefront or online lenders is around 40%.[xxxiii] This is excessive, and we would not feel comfortable endorsing a loan product with such a high default rate.

With this said, we do appreciate the simplicity and clarity of this option. The Pew Charitable Trusts also has data that supports a five-percent PTI approach,[xxxiv] and we think this option is easy for lenders—particularly banks—to understand and implement. For these reasons, we think it would be worth exploring this product further through the adoption of a five-percent PTI pilot program. Pilots are testing vehicles by nature, and reduce risk by determining whether a program can achieve positive results on a smaller scale before making the program available to a much wider audience. And, when conflicting data exist, a well-designed pilot can provide evidence that tips the scale for one side over another. Carrying little risk and being an avenue for knowledge-building are meaningful benefits, and we would strongly support the CFPB if the agency chooses to develop a pilot. If the pilot clearly demonstrates that a five-percent PTI approach is indeed safe and can encourage increased access to responsible small-dollar credit, we would support the CFPB revising these rules to include this approach. However, CFED does not support such a revision absent further data demonstrating the likely impact of this approach on a larger scale.

Additional Alternatives

Beyond just piloting a five-percent PTI approach, CFED also recommends that the Bureau think beyond this rulemaking and use its direct regulatory authority to test other potentially promising approaches to increasing the supply of safe and affordable small-dollar credit products. As previously mentioned, new technology and data are making it easier for lenders to determine ATR and develop better credit products for consumers, but there is a need to better understand the overall impact and effectiveness of many of these strategies. Furthermore, beyond its important regulatory, supervisory and enforcement powers, the Bureau is also directly charged with facilitating access to safe financial products and services. In few areas is there more of a need for viable alternatives than in the small-dollar credit marketplace. We think the Bureau can and should play an important role in cultivating these alternatives by actively encouraging and studying continued innovation in the small-dollar lending industry, particularly with mission-driven entities like community development finance institutions (CDFIs) and credit unions.

Conclusion

We appreciate the CFPB taking the time and effort to thoughtfully construct a proposed rule that outlines how small-dollar lending will be regulated to remove the most predatory practices that exist in the industry. The latest version of the rule is a great improvement on current practices, but it can be made even stronger. In this letter, we have presented a series of recommendations that we think will go a long way toward improving the rule. We appreciate the opportunity to present feedback on the proposal, and hope the final rule will incorporate these changes. We look forward to the Bureau's final rules in the near future.

Sincerely,

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CFED – Corporation for Enterprise Development

A Call to College
AHC Greater Baltimore
Alameda County Community Asset Network
Baltimore CASH Campaign
Bingham Crisis Center
Brunch & Budget
CAFE Montgomery MD
California Association for Micro Enterprise Opportunity
Capital Region Assets & Opportunity Network
CASA of Oregon
CA$H Maine
CASH Prosperity Campaign
Catalyst Miami
Catholic Charities Archdiocese of San Antonio
Catholic Charities of Northeast Kansas
COASAP
Committed Citizens Of Waverly Inc.
Consumer Credit Counseling Services of Puerto Rico
Consumers Council of Missouri
Credit Builders Alliance
Dominion Financial Management, Inc.
East LA Community Corporation
Economics of Compassion Initiative
El-Amin Family Trust
Financial Empowerment Committee of University City

Florida Alliance for Consumer Protection
Florida Prosperity Partnership
Four Bands Community Fund, Inc.
Genesee County Habitat for Humanity
Heartland Alliance for Human Needs & Human Rights
Illinois Asset Building Group
Indiana Assets & Opportunity Network
Innovative Changes
JamLe's Agency
Koreatown Youth & Community Center
LaCasa, Inc.
Leviticus 25:23 Alternative Fund, Inc.
Lutheran Social Service of Minnesota
Michigan Community Reinvestment Coalition
Mission Asset Fund
MitiGate, Inc.
National Foundation for Debt Management
Native American Development Center
Neighborhood Partnerships
New Life Federal Credit Union
North Carolina Assets Alliance
North Dakota Economic Security and Prosperity Alliance
North Omaha Foundation
Northwest Indian Community Development Center
Occupy Hingham
Opportunity Fund
Partners for Prosperity
Pathfinders of Tarrant County
PEC Finances
Pennsylvania Assistive Technology Foundation
People's Community Action Corporation
Pockets Change
PolicyLink
Polk Prosperity Campaign
Prince George's CASH Campaign
RAISE Texas
Renaissance Entrepreneurship Center
Sant La, Haitian Neighborhood Center
SAW Fitness
Southern Professional Solutions PA
Springfield Partners for Community Action, Inc.
St. Vincent de Paul Society of Lane County
Statewide Poverty Action Network
The Collaborative
The Community Foundation for Financial Literacy

The Economic Progress Institute
The Financial Clinic
The Middleburg Institute
Thomas Dunn Learning Center
TTA
United Way of Amarillo & Canyon
United Way of Buffalo & Erie County
United Way of Central Jersey
United Way of Indian River County
United Way of Kern County
United Way of Lake and Sumter Counties
United Ways of California
University United Methodist Church
Uplift, Inc.
Urban Asset Builders
Urban League of Palm Beach County, Inc.
Utah Coalition of Manufactured Homeowners
Wayne Metropolitan Community Action Agency
West Philadelphia Financial Services Institution
Wilkinson Center
Women's Resource Center of Florida, Inc.

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