**Habitat for Humanity Task Force on Predatory Loans and Payday Lending**

September 7, 2016

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552
FederalRegisterComments@cfpb.gov

Re: **Payday, Vehicle Title, and Certain High-Cost Installment Loans (RIN 3170-AA40)**

Dear Director Cordray:

Thank you for the opportunity to comment on the proposed rule on payday, vehicle title, and certain high-cost installment loans issued by the Consumer Financial Protection Bureau (CFPB) on June 2, 2016.[1] A group of leaders from Habitat for Humanity (Habitat), including Habitat for Humanity International (HFHI), state support organizations (SSOs), and local Habitat affiliates came together to form a task force to consider the proposal and share their recommendations with the CFPB. In general, the Habitat for Humanity Task Force on Predatory Loans and Payday Lending (Task Force) believes that the proposed rule represents a bold step toward securing financially healthy communities.

Habitat's vision is a world where everyone has a decent place to live. Anchored by the conviction that housing provides a path out of poverty, Habitat, a nonprofit Christian housing organization, has helped more than five million people around the world improve their housing conditions since 1976 through home construction, rehabilitation and repairs, housing finance, housing support services and technical assistance, and advocacy. In addition, Habitat organizations are 501(c)(3) nonprofit charitable organizations that lend responsibly, providing mortgage loans to Habitat homebuyers who demonstrate the ability to repay.

For 40 years, Habitat has worked diligently with our Habitat homebuyers, donors, and volunteers to ensure everyone in our communities has the stability, strength, and self-reliance to lead better lives. However, predatory lending has always undermined our efforts. Predatory payday and car title lending are no different. In fact, we believe

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[1] 81 Fed. Reg. 47864 (July 22, 2016) or at Regulations.gov.

payday and vehicle title loans are barriers to affordable housing and a threat to housing security.

In this letter, the Task Force will explain why Habitat for Humanity concerns itself with this proposed rule, and share its assessment of the strengths of the proposal, as well as identify some notable concerns. Lastly, the Task Force will make several recommendations toward making individuals, families, and communities financially stable, by finalizing a stronger version of this rule.

**Why is Habitat Concerned with Payday Lending?**

Habitat typically serves low-income families at 30-to-80 percent of the area median income, the same population being inundated with payday and vehicle title lenders. The Pew Charitable Trusts has done extensive research into understanding the population of users and reported in 2012 that there are five primary groups that use payday loan products, which the Task Force believes is consistent with its anecdotal findings:

> Most payday loan borrowers are white, female, and are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: those without a four-year college degree; home renters; African Americans; those earning below $40,000 annually; and those who are separated or divorced. It is notable that, while lower income is associated with a higher likelihood of payday loan usage, other factors can be more predictive of payday borrowing than income. For example, low-income homeowners are less prone to usage than higher-income renters: 8 percent of renters earning $40,000 to $100,000 have used payday loans, compared with 6 percent of homeowners earning $15,000 up to $40,000.[2]

Habitat affiliates provide financial education to their homeowners that helps minimize the number of victims to predatory lending. Unfortunately, some Habitat homeowners enter their mortgages with outstanding payday loan debt, because such debts are rarely reported and are virtually invisible in credit reporting systems. Sometimes loans have been refinanced several times, resulting in debts significantly larger than the original cash advance, undermining Habitat's family selection and underwriting processes, and threatening families' ability to repay their mortgages.

While all low-income households throughout the United States are always cash strapped, individuals in low-income households have wages that are often stagnant, are underemployed, and their cost of housing typically exceeds what is widely considered affordable (which is anything under 30% of area median income). Whenever individuals and families that face a "cash crunch", where they require money they do not have in an urgent manner, it is a challenge for the individual and family involved and a test for the business and regulatory system of the community. While nonprofits that provide

[2] Nick Bourke, et al, Payday Lending in America: Who Borrowers, Where They Borrow, and Why, The Pew Charitable Trusts (2012)

financial education and counselling play a vital role, it is also necessary that the businesses and regulators provide a system that responds to consumers' urgent needs, and lends responsibly with the borrower's ability to repay in mind.

## How Does the Proposal Meet the Needs of Individuals and Families?

The CFPB proposal seeks to regulate all payday, vehicle title, and high-cost loans by establishing an ability-to-repay standard applicable in most situations. Specifically, the proposed rule would require lenders to make a reasonable determination that the borrower has the ability to repay the loan, while continuing to meet other major financial obligations and basic living expenses, and without needing to re-borrow.[3] The determination of ability-to-repay requires consideration of income (which must be verified), major financial obligations (including housing expenses, other debt, and any court- or government-ordered child support), and basic living expenses (such as expenses necessary to maintain health, welfare, and ability to produce income for the borrower and household.)

For underwriting income and major financial obligations, the lender also must obtain a written statement from the borrower of these payment amounts and the timing of bills. The lender may use the stated amounts instead of verified amounts in certain circumstances. Also, evidence of whether ability-to-repay determinations are reasonable may include the lender's rates of delinquency, default, and re-borrowing, including how those compare to rates of other lenders making similar loans to similarly situated consumers.

The Task Force discussed the CFPB's proposal at length over an intense two-month period. The Task Force investigated alternative approaches, including a proposal favored by the Pew Charitable Trusts, and interviewed consumer advocates and several financial services regulatory experts to better understand what impact the proposal would likely have. It was also hoped that these conversations would help identify and address any unintended consequences before the proposal is finalized and put into effect. The Task Force made the following assessment of the CFPB proposal, through adopting other stakeholder's observations and concerns as their own, as well as forming some additional positions. Here they are in two categories:

### *Strengths of the Proposed Rule*

1. Broad in scope and would, for the first time, apply national standards to many loan products that have been allowed to harm low-income consumers because of lax regulation and limited underwriting;
2. Establishes an ability-to-repay standard that includes income *and* expenses. As mortgage lenders, Habitat for Humanity affiliates understand the critical value of this standard in their own lending practices, as it ensures a higher likelihood of borrower success;

[3] Proposed Rule at §§ 1041.5 and 1041.9.

3. Focuses on preventing the cycle of debt, popularly referred to as the “debt trap,” the most abusive aspect of high-cost lending;
4. Includes strong anti-evasion language;
5. Includes an “all-in” annual percentage rate definition that takes into account all interest and fees;
6. Limits repeated bounced check fees and overdraft fees;
7. Establishes registration of information systems for tracking outstanding payday loans and requirements for furnishing loan information to and obtaining consumer reports from those registered information systems;
8. The proposal’s preamble recognizes and supports state usury limits (rate caps); and
9. The rule would not preempt stronger regulations at the state level in the future.

***Areas of Concern***

1. Explicitly allows exceptions to the ability-to-repay requirement, including exempting six high-cost, short-term payday loans from an ability-to-repay requirement altogether. There are also some exceptions for longer-term loans, including loans that carry high fees, in addition to periodic interest.
2. May also leave loopholes in the ability-to-repay requirement. The rule may not go far enough to ensure that, after repaying the loan, the borrower will have enough money left over to pay basic living expenses without re-borrowing. While the rule prohibits dubiously low estimates of living expenses, the proposal appears to require only that the lender not have default or re-borrowing rates above those of other high cost lenders, sanctioning a bar that is likely too low.
3. May not adequately protect consumers against the repeated flipping of loans. The waiting period between loans has been reduced from 60 days in the 2015 preliminary proposal to 30 days in the proposed rule. Protections against repeat refinancing of longer term loans without a balloon are particularly weak, sanctioning repeat refinancing early in the loan term, even if the borrower is up to seven days delinquent. Loopholes in the long-term portion of the rule are particularly concerning because lenders, anticipating stricter rules on short-term loans, are increasingly making long-term loans.
4. Underwriting the ability to repay may be effort- and time-intensive for both the lender and borrower, which will diminish the key feature of payday and vehicle title and other high-cost loan product: Getting a borrower liquid cash in an urgent manner. In many ways, the need for “speed” is the other side of the coin of regulation but cannot be discounted for the typical borrower of these loans.

## <u>Covered Loans Should be Tracked</u>

The proposed rule calls for establishing “registration of information systems, and requirements for furnishing loan information to and obtaining consumer reports from those registered information systems,"[4] which the Task Force will refer to as "the registry." The registry would be among the most significant positive outcomes from this rulemaking, if it is made accessible to all interested creditors. While there are reporting agencies used exclusively by payday and vehicle title lenders, they are not all consolidating and sharing data across systems to ensure, at a minimum, that borrowers are not taking out multiple loans through multiple creditors.

As mentioned earlier, Habitat financial education helps prevent Habitat homeowners from taking on unaffordable debt. However, because such debts are rarely reported through mainstream credit reporting bureaus, like Experian, Equifax, and TransUnion, which are commonly used by most creditors, including Habitat, outstanding payday loan debt does not appear in consumer reports unless it is in collection. This makes payday, vehicle title, and similar high-cost loans virtually invisible to creditors like Habitat. This has prompted some local Habitat affiliates to ask about these loans during the application process. However, even then consumers oftentimes respond "no," alleging that they do not have any payday or vehicle title loans outstanding, while they are merely hoping that they will settle the debt prior to closing on their Habitat mortgage.

The registry would be a necessary utility to help payday, vehicle title, and high-cost loan lenders comply with the rule. It would ensure consumers are not taking out multiple loans from multiple lenders and that the number of permissible successive loans is not exceeded. While the proposed rule establishes the registry for the benefit of consumer protection and compliance, the Task Force believes that there are many benefits to allowing the registry to be available to creditors. Opening the registry to all creditors would:

1. Protect consumers from taking out unaffordable debt;
2. Help creditors have a wider financial perspective of the consumer's present and past debt to make informed lending decisions; and
3. Allow the consumer to be presented with appropriate loan and/or financial education options.

The Task Force also considered attributes that were not beneficial to consumers if the consumer data in the registry would be available to creditors and possibly on consumer credit reports. The Task Force considered what if a low-income individual without any credit history had taken out a payday loan, refinanced several times before paying it off, how would creditors treat this as the sole entry? And what if the same individual defaulted? Would that keep them from obtaining housing elsewhere or obtaining employment? The Task Force consulted experts at banks, credit unions, The Pew Charitable Trusts, and the Consumer Data Industry Association (CDIA) and concluded that a single entry of payday debt would not necessarily be damaging; while every creditor makes its own decision on its own criteria, a single entry does not necessarily provide a great deal of information to make an informed credit decision and it would more than likely be likened to not having any credit history. Furthermore, such entries

[4] 81 Fed. Reg. 47864 (July 22, 2016).

might not be unexpected considering the income characteristics of the credit applicant, even to a creditor, landlord, or employer.

**Balancing Urgent Cash and Consumer Protection**

While the Task Force looks forward to the CFPB issuing a final version of the proposed rule, it has one significant concern that the proposal does not seem to be adequately acknowledge or address: Getting a borrower liquid cash in an urgent manner, as stated in the previous section. Financial services experts with banks and credit unions, with a greater range of underwriting experience than payday and vehicle title lending operations are accustomed to, told the Task Force that they estimate the time required to verify income, major financial obligations, and basic living expenses could take three to seven days to complete and deliver funds to the borrower. In addition, the Task Force observed that the ability to repay requirements for verified documentation also placed a new higher burden on the borrower of these loans. Previously, borrowers of payday loans were only required to show identification, demonstrate employment, and have a bank account; all things that were mostly quickly obtainable.

In addition, based on input from the same financial services experts, as well as consumer advocates, the Task Force theorizes that the proposed rule, if finalized without modification, could lead to one of, or a combination of, several outcomes: Limit the volume of payday loan originations, because fewer borrowers will qualify; eliminate payday and vehicle title lending altogether, due to the regulatory compliance costs and other factors; or see a migration from short-term loan products to longer-term products because the longer-term loans receive more favorable regulatory treatment under the rule. While these outcomes ensure consumer protection, they do not help provide for individuals and families during a cash crunch, and in fact may do more harm than good.

During its investigation, the Task Force considered the alternative approach favored by The Pew Charitable Trusts, which would limit payments to five percent of a borrower's paycheck, set a maximum six-month term, and require loans to be fully amortizing.[5] If lower costs are key to consumer protections, even over excellent and comprehensive underwriting, then Pew's approach offers advantages if such "five-percent loans" could be made by banks and credit unions. The Task Force acknowledges that banks and credit unions have systems and operational efficiencies that could conduct such lending at a lower cost, in theory, than payday or vehicle title lenders. For instance, banks and credit unions have a unique insight into their own customers because they can see their bank accounts and know their income and payment patterns and history, which might be important to making better quality loans in a fast and efficient manner during a "cash crunch." However, the Task Force recognizes that banks feel significant regulatory and reputational risks, and thereby dissuaded, in engaging in any kind of payday-like lending. At the same time, credit unions are rarely, if ever, offering consumers the "Payday Alternative Loans" (PAL loans) product, which is sanctioned by the National Credit Union Administration (NCUA), the credit union's federal regulator, because they

[5] 81 FR 48040 (July 22, 2016).

are not simple or cost-effective to originate. CFPB recognized PAL loans in its proposed rule as a safe and reasonable alternative to other payday loans on the market. The CFPB solicited feedback on the five-percent approach in 2015 and ultimately chose the ability-to-repay standard.

The Task Force supports the CFPB's proposed adoption of an ability-to-repay standard, particularly under the current business and regulatory landscape in which the only institutions making payday and vehicle title loans are not banks or credit unions. The Task Force believes that it is unfortunate that banks and credit unions have pulled back so significantly on small dollar lending for their consumers. If consumer access to urgently-needed cash is further reduced as an unintentional consequence of a final version of this rule, it will be critical that the approach and participants eligible to participate be reexamined.

Similarly, the Task Force would be supportive of an intentional expansion of alternative loans made by financial institutions, including PAL loans, and possibly a new or modified small dollar, short-term debt product, developed in coordination with the depositories and the regulators, that would also be explicitly covered as a safe harbor loan under the proposed rule. In fact, the Task Force believes that banks and credit unions have the most potential to offer lower-costing small-dollar loans, if they are properly supervised and have clear regulatory guidance. (The Task Force recognizes that such institutions can be exempted from its regulations under Section 1022 of Title X of the Dodd-Frank Act, and believe under the right circumstances might be appropriate for the benefit of financially healthy communities.)

For all of these reasons, the Task Force recommends that the CFPB call for the convening of a forum of institutions, including financial institutions, nonprofit lenders, and other stakeholders, to assist the CFPB in monitoring the effectiveness of the proposal, as well as weigh any modifications that would safely provide credit for low-income consumers.

## **How the CFPB Should Finalize the Rule**

Despite any criticism of the proposed rule, the Task Force believes the proposal takes a bold and necessary step toward securing financially healthy communities. The Task Force respectfully urges the CFPB to enhance its proposal in the following ways in order to improve the long-term financial success of Habitat homeowners, affiliates, and communities throughout the US:

1. Remove any exemptions and close any loopholes in the proposal so that all payday, vehicle title, and other high-cost loans are covered by the ability-to-repay standard in the proposed rule as follows:

    a. Require an ability-to-repay determination, which includes income and expenses, on every loan, with no exceptions.

   b. Prevent flipping of short-term/balloon payment loans:
      i. Limit indebtedness in *all* short-term loans to 90 days per year, consistent with long-time FDIC standards.
      ii. Restore the 60-day waiting period after balloon-payment loans.
   c. Prevent flipping longer-term loans:
      i. Limiting refinancing unless the borrower has repaid 75% of the loan.
      ii. Restrict repeat refinancing.
   d. Close the “business as usual” loopholes in the ability-to-repay test:
      i. Require objective measures for how much borrowers need to live on after making the loan payment.
      ii. Make clear that industry-wide default, reborrowing, and bounced payment rates are far from acceptable.
   e. Cover all loans that provide lenders extraordinary leverage to extract repayment, including loans where account access/car title are taken after a few days; loans secured by personal property; and loans that permit wage garnishment.

2. Open a central registry for tracking payday, vehicle title, and other high-cost debt so that it may be accessed by all creditors, including nonprofit lenders like Habitat for Humanity (as discussed in detail earlier in this letter);
3. Clearly establish that the ability-to-pay requirements in the final rule are not intended to override or replace interest rate caps or outright prohibitions of payday, vehicle title, or similar debt products already in law;
4. Explicitly state that while the CFPB is establishing an ability to repay standard, this in no way should be interpreted as a best practice for conducting business in states that effectively prohibit payday loans and payday-like loans; and
5. Call for the convening of a forum of institutions, including financial institutions, nonprofit lenders, and other stakeholders, to assist the CFPB a) in monitoring the effectiveness of the proposal, as well as b) weigh any modifications that would safely provide credit for low-income consumers (as discussed in detail earlier in this letter.)

The rule proposed by the CFPB would create the first nationwide ability-to-repay standard for payday, vehicle title, and certain high-cost installment loans. We believe that this rule, when finalized, will be an important step to supporting Habitat homeowners, applicants, and others in our communities from being trapped in a cycle of unaffordable debt.

## **Conclusion**

Thank you for the opportunity to comment on this important matter. Habitat strongly supports your efforts to effectively balance consumer protection with credit availability in low-income communities. For clarification or more information, please contact Andrew

Szalay, who is serving as secretary of the Habitat for Humanity Task Force on Predatory Loans and Payday Lending, at (202) 239-4432 or aszalay@habitat.org.

Sincerely,

Andrew Szalay

Andrew Szalay
Secretary
Habitat for Humanity Task Force on Predatory Loans and Payday Lending