

October 6, 2016

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20052

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

Dear Ms. Jackson:

The American Financial Services Association (“AFSA”)¹ welcomes the opportunity to comment on the Consumer Financial Protection Bureau’s (“CFPB” or “Bureau”) proposed Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule (the “Proposed Rule”).² Our comment letter will address: (1) what traditional installment loans (“TILs”) are; (2) why the Proposed Rule will restrict access to TILs; (3) why it is important to preserve access to TILs; (4) how the Proposed Rule exceeds the CFPB’s statutory authority and is arbitrary, capricious, and contrary to law (a detailed explanation is included in Appendix II); (5) exemptions for TILs and other credit; and (6) other suggested improvements for the Proposed Rule.

Section-by-section Outline of AFSA’s Comment Letter

- I. An explanation of TILs.
- II. The sheer complexity of the Proposed Rule will have the serious, unintended consequence of restricting access to affordable and beneficial TILs.
- III. Most traditional installment lenders cannot make small-dollar loans under a 36 percent total cost of credit.
- IV. Many traditional installment lenders do not want to make covered loans because of the reputational risk.
- V. Making a covered loan is too complex and too costly.
- VI. It is crucial to preserve access to TILs.
- VII. The Proposed Rule exceeds the CFPB’s statutory authority.
- VIII. Exempting TILs will preserve access to small-dollar credit.
- IX. The Proposed Rule’s exclusion of a purchase money security interest (“PMSI”) loan should be made clear.
- X. Other suggested improvements for the Proposed Rule.
- XI. Conclusion.
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¹ Founded in 1916, the American Financial Services Association (“AFSA”) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

² *Payday, Vehicle Title, and Certain High-Cost Installment Loans*. 81 Fed. Reg. 47863. July 22, 2016.

I. An explanation of traditional installment loans (“TILs”).

AFSA members provide TILs to individuals and families. Their customers are teachers, lawn service employees, lawyers, stay-at-home parents, young adults renting a room with a relative, homeowners, nannies, farmers, etc. In short, they are Americans of almost all professions and socioeconomic classes. Sometimes, these customers are “unbanked” or “under-banked.” They may be “credit invisible” or have credit histories containing insufficient or stale information. The customers often have impaired credit histories, so they may not be served by banks or credit unions. Some of these customers have prime credit scores and regular banking relationships. They may use TILs because they like the product and the personal touch of the branch-based nature of finance companies. Or they may use TILs because they have very little or no savings. Or they simply need quick access to smaller amounts of credit than banks will offer.

Some customers need access to credit to meet an immediate need. Seventy-six percent of Americans live paycheck to paycheck, so if something unexpected happens, many need quick access to credit. In fact, a recent survey by the Federal Reserve found a lack of economic preparedness among many Americans. Only 53 percent of survey respondents indicated that they could cover a hypothetical emergency expense costing \$400 without selling something or borrowing money. Using a home equity line of credit or a credit card is not necessarily an option for people with impaired credit and little or no home equity. Yet, when these consumers hit a bump in the road, they still need access to credit. The demand does not go away. That demand has many faces, including: vehicle repairs (transmission, tires), household appliances (washer, dryer, water heater – repairs or replacement), furniture, back to school expenses, debt consolidation, baby items (crib, car seat), funeral expenses, and medical expenses – generally, the everyday items and services essential to live productive and enjoyable lives, as well as to meet obligations.

Many customers use TILs as a thoughtful process to manage their finances. These customers may use TILs like other Americans use home equity lines of credit or credit cards. After some customers struggled to get out of credit card debt, they simply prefer the more structured nature of TILs. Regardless, they still have a common need for small-dollar credit. And, because many TIL lenders report to one or more of the credit reporting agencies (“CRAs”), customers can use TILs as a way to build or repair their credit.

II. The sheer complexity of the Proposed Rule will have the serious, unintended consequence of restricting access to affordable and beneficial TILs.

The Proposed Rule, if adopted, will result in a significant reduction in legitimate credit options to many customers because most traditional installment lenders: (1) are unable to make small-dollar loans under the 36 percent total cost of credit threshold; (2) will not make loans that result in coverage because of reputational issues; and/or (3) will not make loans that result in coverage due to the complexity and costliness of the Proposed Rule.

The CFPB recognizes that the Proposed Rule “will cover some longer-term installment loans that are made on the basis of an assessment of the consumer’s ability to repay, and where, for example, the lender obtains repayment from the borrower’s account as a convenience to the borrower [sic] not as an alternative to careful underwriting.”³ The CFPB erroneously suggests that the Proposed Rule will only touch a “fraction” of traditional installment loans, that it will not have a “substantial impact on the making of these loans,” and “adjusting to the proposed rule would not be a heavy burden for such lenders.”⁴ The CFPB offers no data to support these conclusions.

³ 81 Fed. Reg. 47987.

⁴ 81 Fed. Reg. 47987, 47987, and 47993.

The Proposed Rule will, in fact, have a material impact on the ability of consumers to obtain TILs, and the number of lenders that will offer TILs, if the CFPB adopts the rule as proposed. For example, one AFSA member who does not make loans above a 36 percent Truth in Lending Act (“TILA”) annual percentage rate (“APR”), has identified that 32 percent of its loans would exceed the 36 percent total cost of credit, only because of a customer’s choice to purchase voluntary protection products important to that customer. Two AFSA members said that approximately 12-13 percent of their loans would be covered loans. Another two said that about 25-27 percent of their portfolios would be affected by the Proposed Rule if it were in effect today. And another said that at least 5 percent would be covered. (Some lenders may not know what the total cost of credit will be until after underwriting is complete and the customer has had the opportunity to either choose their loan amount or whether or not they want voluntary protection products. These lenders will need to underwrite all of their loans as if they were covered loans.) This will result in denying credit to applicants who may be able to repay the loan or making even more loans subject to the rule. This is not a “fraction,” but a substantial impact. It is clear that the Proposed Rule would result in significant harm to consumers by depriving them of loans they can afford.

Finally, make no mistake – the Proposed Rule will affect the availability of credit, but it will not alter consumer demand for small-dollar loans. Consumers will get loans where they can. In the past, consumers turned to unsafe, unregulated loan providers, *i.e.*, loan sharks. Now, they will turn to unregulated, off-shore, and unlicensed online lenders. This will be far worse for consumers than if the CFPB adopted reasonable, consumer-friendly rules.

To preserve access to small-dollar credit, and avoid the significant damage that will result from the proposed approach, the CFPB should revise the Proposed Rule. The final rule should allow traditional installment lenders to continue to make safe and affordable loans to consumers in their communities, as they have done for generations.

III. Most traditional installment lenders cannot make small-dollar loans under a 36 percent total cost of credit.

According to a study done by three academics using industry data, in order to make a break-even loan at 36 percent APR, the loan would have to be made for at least \$2,600.⁵ For a loan to be made profitably with a total cost of credit of 36 percent, the loan would have to be between \$3,500 - \$4,000. Larger loans can be profitable because a lender gets a larger dollar return on a larger loan, even though the proportional return is the same. Many lenders’ costs to originate and service loans are fixed, so lenders need to make a certain amount on each loan.

Below is a chart prepared by Dr. Thomas W. Miller, Jr.⁶ that shows the costs associated with eight hundred \$1,000 loans.⁷ The chart demonstrates why a lender cannot make a profitable \$1,000 loan below a 99 percent APR.

⁵ Durkin, Thomas A., Gregory Elliehausen, and Min Hwang. *Rate Ceilings and the Distribution of Small Dollar Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders*. 2016. Working Paper.

⁶ Dr. Thomas W. Miller, Jr., Ph.D. is a Professor of Finance and the inaugural holder of the Jack R. Lee Chair in Financial Institutions and Consumer Finance at Mississippi State University. He has held positions at Saint Louis University, Washington University in St. Louis, and at the University of Missouri.

⁷ In constructing the chart, Dr. Miller spoke with several different lenders to obtain information about costs.

Each 12-Month Loan Size		\$ 1,000	\$ 1,000	\$ 1,000
Number of Loans Outstanding		800	800	800
Customer Monthly Payment (12-Month Loan)	12	(\$100.46)	(\$119.29)	(\$134.42)
Interest Rate on Loan		36%	72%	99%
Revenue from Loan (Interest Collected)		\$205.55	\$431.49	\$613.03
Revenue from all Loans		\$ 164,436	\$ 345,191	\$ 490,421
Bad Debts (at Bad Debt Rate of 9%)	9.00%	\$ (39,184)	\$ (42,232)	\$ (44,404)
Salaries		\$ (140,000)	\$ (140,000)	\$ (140,000)
Rent/Other Operating Expenses		\$ (25,000)	\$ (25,000)	\$ (25,000)
Cost of Borrowing Money to Lend (at 6%)	6.00%	\$ (18,215)	\$ (19,570)	\$ (20,535)
Overhead Paid to Home Office		\$ (120,000)	\$ (120,000)	\$ (120,000)
Branch Net Income		\$ (177,963)	\$ (1,611)	\$ 140,483
Receivables:		\$ 435,378	\$ 469,242	\$ 493,374
Furniture/Equip:		\$ 20,000	\$ 20,000	\$ 20,000
Total Assets:		\$ 455,378	\$ 489,242	\$ 513,374
Bank Debt:		\$ 303,585	\$ 326,161	\$ 342,249
Equity:		151,793	163,081	171,125
Total D + E:		\$ 455,378	\$ 489,242	\$ 513,374
Debt/Equity Ratio:		2	2	2
Target ROE:	15.00%	\$ 22,769	\$ 24,462	\$ 25,669
Assets/Equity:		3	3	3

Two notes: First, please note that this chart assumes a cost of money to the lender of six percent. In the not-too-distant past, traditional installment lenders paid over 18 percent for the money they subsequently lent to small-loan consumers.⁸ And rates will eventually increase. Furthermore, because TIL rates are state-capped, unlike banks, TIL lenders cannot simply increase their rates to consumers to make up the difference. Second, please note that a traditional installment lender's branches in smaller communities may well have only a few hundred new loan originations in a year. So, the 800 number employed in the chart is a reasonable estimate.

Another helpful table, also prepared by Dr. Miller, shows the amortization of a \$1,000 twelve-month loan at 36 percent interest (not APR).

⁸ This is a substantial issue that cannot be ignored. If rates return to double-digits, say 12 percent, as they invariably will, the cost of money doubles as well. As the states know, lenders must be able to maintain profit margins to remain in business and continue lending to consumers in need. To set rates that do not allow businesses to succeed is contrary to the CFPB's purpose and authority.

		Beginning Principal Balance	Equal Monthly Payment	Interest Payment	Principal Payment	Ending Principal Balance
	Month					
	1	\$1,000.00	\$100.46	\$30.00	\$70.46	\$929.54
	2	\$929.54	\$100.46	\$27.89	\$72.58	\$856.96
	3	\$856.96	\$100.46	\$25.71	\$74.75	\$782.21
	4	\$782.21	\$100.46	\$23.47	\$77.00	\$705.21
	5	\$705.21	\$100.46	\$21.16	\$79.31	\$625.91
	6	\$625.91	\$100.46	\$18.78	\$81.68	\$544.22
	7	\$544.22	\$100.46	\$16.33	\$84.14	\$460.09
	8	\$460.09	\$100.46	\$13.80	\$86.66	\$373.43
	9	\$373.43	\$100.46	\$11.20	\$89.26	\$284.17
	10	\$284.17	\$100.46	\$8.53	\$91.94	\$192.23
	11	\$192.23	\$100.46	\$5.77	\$94.70	\$97.54
	12	\$97.54	\$100.46	\$2.93	\$97.54	\$0.00
Sum:		<u>\$1,205.55</u>	<u>\$205.55</u>	<u>20.55%</u>		

As you can see from the table, it takes ten payments to “pay back” \$1,000 – the principal. Any lender profit comes from the last two payments, nearly a year later. The amount of interest collected is \$205.55 or 20.55 percent of \$1,000.

IV. Many traditional installment lenders do not want to make covered loans because of the reputational risk.

At the outset, it must be acknowledged that many traditional installment lenders may choose not to make loans covered by a “payday” rule that equates their loans to payday and brands them as predatory lenders. They simply do not want to risk their reputations by being associated with payday loans. Traditional installment lenders have worked hard over the past 100 years to be a part of the communities in which they operate. They are proud of the safe and beneficial products they offer and do not want to be branded as “predatory.”

In addition, traditional installment lenders may be risking more than their reputations by making covered “payday” loans. This is because many banks may not lend to lenders making what are considered predatory loans. Witness the effects of Operation Choke Point, whereby established banking relationships with some AFSA member companies were severed merely due to an inaccurate association with payday and title loans.

V. Making a covered loan is too complex and too costly.

Another reason that traditional installment lenders will not make covered loans is because the Proposed Rule is too onerous and inflexible. As discussed next, the requirements in the Proposed Rule are too costly, too burdensome, and there is too much uncertainty about what is required to comply.

The Proposed Rule contains unique underwriting requirements, unique payment processing procedures, restrictions on refinancing, credit reporting mandates, and data retention requirements that are almost impossible to meet. And assuming they are possible to meet, they are prohibitively expensive for many traditional installment lenders. All of the requirements are unique to loans that meet the covered longer-term loan trigger of 36 percent total cost of credit and include either vehicle security or a leveraged payment mechanism. As explained above, while this trigger will not apply to all of the loans provided by a traditional installment lender, it will apply to a large segment of their portfolios. That means that every traditional installment lender will have to have two

different systems for its loan products – one for those that meet the trigger and one for those that do not. That alone will cause many lenders to not make covered loans. Furthermore, the severity of the requirements in the Proposed Rule will prevent many traditional installment lenders from making covered loans. Examples of the severity of the requirements include, but may not be limited to:

Income: The Proposed Rule requires lenders to verify income. Traditional installment lenders will verify income, but they do not employ the onerous methods outlined in the Proposed Rule. When consumers take out a small-dollar loan, they often need the money quickly. They need a loan to fix a transmission so they can get to work later in the week or a loan to pay a plumber to stop water leaking in a basement.⁹ These customers and others come in to a branch office expecting, and sometimes absolutely needing, to be able to walk out with the cash they need. Providing loans in an expeditious fashion is a hallmark of TILs. Customers very often do not have time to produce copious income receipts, possibly from multiple jobs, and they will be very upset by having to do so. They also may not even have receipts or any documentation of some of their income. Additionally, the longer it takes to complete the loan process, the more expensive the loan is to make.

Basic living expenses: The Proposed Rule requires lenders to forecast their customers' basic living expenses, including food, utilities, transportation, day care, etc. The Proposed Rule would allow lenders to use statistical surveys, but does not address whether such surveys exist. Moreover, surveys make assumptions based upon those surveyed that every borrower is approximately the same, when in reality, each borrower's situation is unique. For this reason, a borrower's credit history is a more accurate measurement of that borrower's circumstances. Moreover, if there are no such surveys available, how do lenders guess how much a family may spend on food? Or on day care? Must the lender somehow verify the number of dependents a borrower has for the forecast to be reasonable? Many customers would be quite offended when asked to give such details of their private lives to borrow a few hundred dollars. So, while many consumers may not want to submit all this information, those that do many find it difficult. Again, the longer the loan takes to complete, the more expensive it is to make.

Housing expenses: The Proposed Rule requires lenders to verify housing expenses. While this may work for the 50 percent of consumers who own their own homes, it will not work for the other half. Although it may seem like an easy request to produce a lease, that is not the case for many Americans. According to one AFSA member, it is actually harder to verify rental expenses from large apartment complexes than from small landlords. It can be difficult to reach landlords, and even if reached, without proper "releases," the landlords will not provide the leases to lenders for fear of violating privacy laws. All of this further delays the loan process, hurting the consumer. And, for the significant portion of consumers who do not have a written lease, it will be impossible to produce a lease, which will require other mental or documentary gymnastics to estimate rental expense – all for a few hundred dollars that is needed *now*. Finally, the Proposed Rule does not address consumers who rent a room from a family member or who live with the actual leaseholder, but who are not signatories on the lease. Will these consumers be unable to obtain a loan?

⁹ One AFSA member remembers a very moving story about a customer who came into a branch office on a very hot summer day. It was over 100 degrees and the customer said that she needed a loan right away. Her daughter, who suffered from a debilitating mental illness, was waiting in the car. The customer was worried that her daughter was in imminent danger of harming herself. Luckily, the daughter had agreed to be checked into a mental health facility. From previous experience, this customer knew that the facility required payment before accepting a patient. The customer did not have the money to make that payment and so needed a loan urgently. She did not have time to go back home and find multiple paystubs, her lease, and other information. This is just one example of a customer needing a loan quickly, but there are many others.

Restrictions on Refinancing: The Proposed Rule prohibits a lender from refinancing a loan if the consumer is more than seven days delinquent. This restriction may be appropriate for a payday or title loan with a 14-day term, but it is not appropriate for a TIL with a 12-month term. If it is appropriate to prohibit a lender from refinancing a 14-day loan if the consumer is more than seven days delinquent, then it would be appropriate to prohibit a lender from refinancing a 12-month loan if the consumer is more than 180 days delinquent. Restricting refinancing to loans less than seven days delinquent poses two different types of problems for consumers. First, many lenders do not define a loan as being delinquent when a payment is only seven days late. Many borrowers do not face a late fee until they are at least 10 days delinquent, so they often pay seven days late. Thus, preventing consumers from refinancing a loan when the consumer is within the grace period will confuse and anger borrowers. Not to mention the fact that lenders' current systems will not allow them to know when a customer is seven days past due. Instead of creating a new system, lenders will likely choose not to make covered loans. Second, refinancing a loan that a borrower is temporarily having a problem repaying is a good way to help the borrower. This does not mean that lenders are pushing borrowers to re-borrow money that they will never be able to repay and trapping them in a cycle of debt. This is a situation where the borrower has been making payments, but something happens one month (an extra medical expense or a temporary drop in income due to unpaid sick days, for example) and the borrower cannot afford to make a payment for a month. Instead of missing that payment, being charged a late fee, and facing a drop in credit score, the lender can work with the borrower to resolve the delinquency by either a deferment or by refinancing the loan. Each time the loan is refinanced, a traditional installment lender performs an ability-to-repay test.

Credit Reporting: The Proposed Rule requires lenders to integrate with all Registered Information Systems. This creates several problems. First, if, say, 15 CRAs become Registered Information Systems, a lender would have to establish contractual relationships with all of the 15. This will dramatically increase lender costs (cutting further into paper-thin margins on small-dollar loans). Second, if those 5, 10 or 15 new CRAs do not ascribe to the current Metro II method of credit reporting employed by the "big three," then lenders will have to spend substantial time, effort and resources to report under a different system – all of which cost money further cutting into the paper-thin margins on small-dollar loans. Third, being forced to report to, and maintain accurate reporting on, multiple systems to multiple CRAs will raise lender exposure to liability for inaccurate credit reporting. This is because credit reporting is subject to the Fair Credit Reporting Act, which requires lenders to implement extensive procedures to ensure accuracy and integrity and to devote considerable staff to dealing with all credit disputes filed by the customer with the lender and with the CRAs.¹⁰ While lenders are always happy to work with customers who face legitimate credit reporting errors, many of the credit disputes filed by consumers or by credit repair organizations are simply unfounded. Regardless, lenders must treat each (and often much-repeated) credit dispute as legitimate. Lenders are required to investigate each dispute and respond to the consumer or CRA with the results of that investigation. Because only the nationwide CRAs are allowed to participate in the centralized dispute system (eOscar), this would be primarily a manual communication process with the CRAs, fraught with operational and compliance risk, and could be potentially damaging to consumers. Instead of implementing such a time-consuming, expensive, and risky process, many traditional installment lenders will just not make covered loans, thus negatively impacting credit access in their communities.

Disclosure of Payment Transfer Attempts: The Proposed Rule requires lenders to provide disclosures of payment transfer attempts. These requirements are unnecessarily complex and expensive to implement.

¹⁰ It is not unreasonable to envision, as happens now, that a single consumer will file a credit inquiry or complaint with all of the CRAs to which the lender must report, resulting in the lender having to respond to all those CRAs using the various CRAs' response mechanisms – adding even more costs to making a small-dollar loan.

Moreover, because this disclosure requirement only applies to covered longer-term loans, traditional installment lenders will be forced to have two disclosure procedures – one for covered longer-term loans and one for non-covered loans. The Proposed Rules require disclosures to be provided in writing. The disclosures may only be provided electronically if the consumer affirmatively consents in writing or electronically to the particular electronic delivery method. This would preclude a call center, which currently enables consumers to provide consent to receive electronic payment notices on a recorded line, from obtaining consent. It would add operational complexity and force more notices to be sent via paper. The expense for some lenders is multiplied if, for example, the lender allows customers to pay bi-weekly or semi-monthly.

Data Retention: Again, the data retention requirements would force traditional installment lenders to have a second, different procedure for data retention that applies only to covered longer-term loans. The costs of programming systems to comply with the tabular format for the compliance and/or record keeping requirements would be enormous. The tabular format is unlike anything most state-regulated entities would have to do outside of making covered loans. The result – more employees, more payroll, more computers and computer analysts, and more expense.

Finally, a few other concerns are worth mentioning. First, the CFPB estimates that the Proposed Rule will eliminate 85 percent of the payday and title market. The very purpose of the Proposed Rule is to eliminate the vast majority of payday and title loans. We submit that the purpose is not, or should not be, to kill a large portion of the nearly hundred-year-old, small-dollar traditional installment lending industry along with payday and title lending. Second, the void left by the elimination of these payday and title loans will not be filled by banks and credit unions. Based on comments submitted by the banking and credit union industries,¹¹ and a study¹² by the Federal Deposit Insurance Corporation (“FDIC”), consumers will not be able to get small-dollar loans from banks or credit unions. Therefore, the rule should not further reduce availability of small-dollar credit by over-burdening the TIL space. Third, many traditional installment lenders – who have been making safe and affordable small-dollar loans for over a hundred years – will simply not make loans if the loans are covered by the final rule.

¹¹ Credit Union National Association and Independent Community Bankers of America Letter to CFPB Director Richard Cordray. June 27, 2016. Available at <http://www.icba.org/files/ICBASites/PDFs/cl062716.pdf>.

¹² The FDIC’s small-dollar loan pilot program demonstrated that banks cannot offer small-dollar loans profitably – even though they borrow money to lend at rates dramatically lower than traditional installment lenders do. Banks are unable to make small-dollar loans at a 36 percent APR cap because of: (1) the limited amount of interest earned due to the declining principal balance from amortization, and (2) the fixed operational costs of underwriting, collecting, and managing an amortizing small-dollar loan. Despite the positive headline of the FDIC’s report on the pilot, the FDIC concluded, “However, given the small size of SDLs [small-dollar loans] and to a lesser extent NSDLs [nearly small-dollar loans], the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products.” (p. 32) Non-interest income is also a key component of sustainability and profitability for any financial institution. This is particularly the case for traditional installment lenders because their yields and margins are so tight. The non-interest income generated by loan fees and voluntary protection products help traditional installment lenders maintain their stability so that they may continue to serve the credit needs of their customers.

See Miller, Rae-Ann, Susan Burhouse, Luke Reynolds, and Aileen G. Sampson. *A Template for Success: The FDIC’s Small-Dollar Loan Pilot Program*. FDIC Quarterly 2010, Volume 4, No. 2.

Available at https://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf

VI. It is crucial to preserve access to TILs.

Traditional installment lenders are community-based lenders in cities and towns nationwide. As recognized by so many and for so long, installment lending has proven to be the most affordable and responsible form of consumer credit for working Americans. Payday and title loans are relatively new and are radically different from TILs in the way they are structured, priced, and regulated. These differences are what make TILs a smarter and long accepted option for borrowers, offering them better rates and significantly higher levels of safety and affordability. In fact, CFPB Director Richard Cordray said, “We are trying to make sure there is room for responsible lending, for community banks and credit unions in particular, but [also] ...installment lenders who are traditional and have responsible products.”¹³ Both the National Black Caucus of State Legislators and the National Hispanic Caucus of State Legislators have passed resolutions promoting access to safe and affordable small-dollar credit. (See Appendix I) The resolutions stress the importance of protecting vulnerable elements in society, including some service members, from harmful products, while at the same time preserving their access to beneficial forms of credit.

And, long before the internet, the local branch of an installment lender was often the only legal access to credit for many Americans. There were and are other forms of credit – loan sharks, back-door deals, and organized crime. In the past, due to important state law regulation of small-dollar credit, and persistent local and federal law enforcement initiatives, those non-legal forms of credit have been substantially reduced, but not eliminated. The need for credit existed in the past and it still exists. And if safe, legal, and affordable credit cannot be readily obtained, consumers will meet their needs through much less desirable credit alternatives. In point of fact, in this day and age, trends show that consumers will easily obtain credit from unlicensed and unregulated online lenders. Consider what happened in North Carolina. Because of the restrictions in North Carolina’s Consumer Finance Act, the 2009 Consumer Banking and Finance Survey found that 11 percent of residents surveyed had received a payday or title loan through the internet or by driving to another state. This was an almost three-fold increase since 2007, when the law changed that restricted small consumer credit options.¹⁴ As the Federal Trade Commission has said, “In recent years, the availability of payday loans via the Internet has markedly increased. Unfortunately, some payday lending operations have employed deception and other illegal conduct to take advantage of financially distressed consumers seeking these loans.”¹⁵

These unregulated and unlicensed online lenders can be as dangerous as loan sharks. As Ed Mierzwinski of U.S. Public Interest Research Group said, “Online payday lenders may not be subject to any regulation under your state law, they can ignore any state-issued consumer protections on the industry, like capped interest rates, rollovers and repayment plans.” He continued, “Online payday lenders think they’re beyond the reach of state enforcers and often act like it.”¹⁶

Many online lenders are based in other countries, such as Costa Rica, the West Indies and Malta. This makes it difficult for regulators to track them down. “Last year, we took 18 enforcement actions against unlicensed payday

¹³ United States. Cong. House. Committee on Financial Services. *Hearing on The Semi-Annual Report of the CFPB*. Sept. 29, 2015. (testimony of Richard Cordray, Director, CFPB). Available at <https://www.youtube.com/watch?v=eJmBjHv2RNk>.

¹⁴ MarketSearch Corporation, *Consumer Banking and Finance Survey*, North Carolina Office of the Commissioner of Banks, April/May 2009. pp. 22-23.

¹⁵ Federal Trade Commission, *Payday Lending*. Available at <https://www.ftc.gov/news-events/media-resources/consumer-finance/payday-lending>.

¹⁶ Riddell, Kelly. *Consumers Fear Online Lenders as Option if Feds Squeeze Paydays Out*. Washington Post. Sept. 2, 2015. Available at <http://www.washingtontimes.com/news/2015/sep/2/online-lenders-unconstrained-by-state-laws-fill-vo/>.

lenders and 15 of those were against unlicensed online vendors,” said Tom Dresslar, a spokesman for California’s Department of Business Oversight. “A lot of them are offshore, so it’s an extremely difficult fight, extremely difficult to get any enforcement. It’s like whack-a-mole: You beat one down and another pops up. We do the best we can, but no one here is pretending it’s an easy problem to solve.”¹⁷

A news story outlined the problems with unregulated and unlicensed online lenders:

“Consumer groups say these types of lenders may be even riskier for struggling borrowers than brick-and-mortar lenders, leading consumers into even more hopeless financial quagmires.

““They loan to people not even caring whether they can pay the whole thing off, said Jay Speer, the executive director of the Virginia Poverty Law Center. ‘They just want a certain amount every couple weeks — as much as they can beat out of you until you default.’”¹⁸

For these and other reasons, any federal regulation of small-dollar credit must not drive out the single best form of small-dollar credit – the traditional installment loan. TILs are fixed-rate, fully-amortizing, small-dollar loans repaid in substantially equal monthly payments or installments. They are “plain vanilla” loans with transparent, easy-to-understand terms, due dates, and payment amounts. TILs are offered by state-licensed and regulated lenders who underwrite loans on each customer’s ability to pay. TILs do not trap borrowers in a cycle of debt. They are structured to empower a consumer to pay off his debt.

Though it varies by lender, the average loan is for \$1,500, the average monthly payment is \$120, and the average term is 15 months. Because traditional installment lenders engage in underwriting, TILs are designed to be affordable and allow borrowers to budget their finances. Traditional installment lenders underwrite loans based on consumers’ credit reports and other factors. At the time of origination, each and every loan is made with the highest confidence and expectation that it will be paid back in full and on time. These factors are crucial because: (1) the lender has to borrow funds in order to lend money to its customers; (2) the loan is not and never has been subsidized, and therefore not a burden on taxpayers;¹⁹ and (3) in order to remain in business and continue lending, the lender must make a profit. It is also important to note that if a customer is not satisfied, she will go elsewhere. Reputation is important in small communities. Traditional installment lenders have a strong desire to treat customers fairly because of their involvement in the community. Moreover, they want repeat business and they want satisfied customers to recommend their services through word-of-mouth.

According to the Center for Financial Services Innovation (“CFSI”), an affordable, small-dollar loan is one for which the loan amount, repayment period, interest rate, and fees are such that the borrower can successfully repay the loan without re-borrowing,²⁰ while still meeting basic needs and other financial obligations. In other words,

¹⁷ *Ibid.*

¹⁸ Stuart, Hunter, *Payday Lenders are Using the Internet to Evade State Law*. The Huffington Post. Jan. 21, 2015. Available at http://www.huffingtonpost.com/2015/01/12/payday-lenders_n_6443134.html.

¹⁹ During the recent recession, when some banks were being subsidized and failing, no traditional installment lender sought or obtained any governmental assistance.

²⁰ CFSI specifies that by “without re-borrowing,” they are “making a distinction between borrowing again at some future date because a new credit need arises (which does not necessarily indicate that the original loan was unaffordable) and re-borrowing immediately or shortly after repaying the original loan (which strongly suggests the borrower could not afford to pay back the loan while still meeting basic needs and other financial obligations in the next period).” The point is valid, though we would use the term “refinanced” rather than “re-borrowing” (which may be a good thing), because “re-borrowing” can be confused with “repeat re-borrowing.” Repeat re-borrowing is generally considered to be a bad practice

whether a loan is affordable or not depends on underwriting, structure and pricing – not on price alone. This is because “[S]tructure is just as important as price in determining whether a small-dollar loan is affordable. For example, for borrowers who struggle financially, a two-week loan with a balloon payment structure is often very difficult to repay, even at very low prices. In most cases, loans should be structured in fully-amortizing installment payments; the amount of the loan and the repayment period are variables that should be adjusted to ensure that the borrower can afford to make the regular payments while still having enough left over to meet basic needs and other financial obligations.”²¹

VII. The Proposed Rule exceeds the CFPB’s statutory authority.

AFSA refers the CFPB to a joint letter co-signed by the American Bankers Association, the American Financial Services Association, and the Consumer Bankers Association which more fully outlines our concerns in this section.

In short, AFSA believes that the Proposed Rule exceeds the CFPB’s statutory authority because: (1) it imposes an unlawful usury limit; (2) the CFPB lacks authority to enforce an ability-to-repay requirement with respect to TILs; (3) the Proposed Rule would regulate insurance in violation of the Dodd-Frank Wall Street Reform and Consumer Protection Act; (4) the Proposed Rule exceeds the CFPB’s authority to regulate unfair, deceptive, or abusive practices because the CFPB has not established that TILs are either abusive or unfair; and (5) the Proposed Rule is contrary to the CFPB’s statutory purpose.

The Proposed Rule is also arbitrary, capricious, and contrary to law because the Proposed Rule: (1) is not supported by an adequate cost/benefit analysis; (2) violates the Regulatory Flexibility Act; (3) and violates the Paperwork Reduction Act.

The joint trade letter has been filed separately, but a copy is included as Appendix II to this letter.

VIII. Exempting TILs will preserve access to small-dollar credit.

Because the CFPB has overstepped its statutory authority and because, as described above, TILs are a valuable product and the Proposed Rule would limit consumers’ ability to access TILs, AFSA suggests that the CFPB exempt TILs from the Proposed Rule. Too much regulation is just as harmful to consumers as too little. The CFPB should not control or eliminate consumer choice when it comes to the diverse marketplace of small-dollar lending. Instead, it should craft a rule that targets only those lenders who present the “core harms” identified by the CFPB, while preserving affordable credit options for American consumers. We offer three ways the CFPB could modify the Proposed Rule:

(1) The CFPB could eliminate harmful payday loans, but preserve beneficial TILs by removing the total cost of credit from the APR threshold. Using a TILA APR would still prevent payday lenders from making loans without an ability to repay, while at the same time preserving the flexibility traditional installment lenders need in their ability to repay determinations.

(2) The CFPB could increase the threshold for coverage. AFSA does not believe that just because the Department of Defense used an “all-in” APR in its recent consumer credit regulation, the CFPB must abandon the APR calculation set out in TILA decades ago. And we strongly advise it not do so. However,

associated with payday and title lending. (CFSI, *The Compass Guide to Small-Dollar Credit*. 2014. p. 7. Available at <http://www.cfsinnovation.com/Document-Library/The-Compass-Guide-to-Small-Dollar-Credit>.

²¹ *Ibid*, p. 7.

if the CFPB ultimately decides that it must use a total cost of credit, AFSA suggests that the CFPB consider raising the threshold to 99 percent. This approach would capture harmful loans, while still allowing access to TILs.

(3) The CFPB could provide an exemption for fully-amortized TILs with equal monthly installments, minimum terms of 6 months, no prepayment penalties, closing fee limitations, APRs of 99 percent, monthly reports to the CRAs, ACH/debit processing in compliance with the Electronic Funds Transfer Act (“EFTA”) and NACHA, and renewal or refinancing limitations.

A. *Use a TILA APR.*

There is a simple alternative that would eliminate harmful payday and title loans, but preserve safe and affordable access to small-dollar loans: The CFPB could use a TILA APR as a threshold.

Using a TILA APR makes sense because only fees imposed by a lender, and not for services or products voluntarily selected by the consumer are included in the APR. Using a TILA APR also prevents confusion over what voluntary protection products are part of the total cost of credit. The Proposed Rule bases the use of a total cost of credit APR on the Military Lending Act, but the “all-in” APR should be limited to that law, and not expanded. There is no basis to extend it beyond the military, whereas for decades, TILA has provided a clear standard for lenders and it should be preserved. Lastly, the CFPB’s concern that using a TILA APR would encourage lenders to increase premiums for voluntary protection products or other fees to make up for or mask a lower interest rate threshold is unfounded.

Voluntary protection products should not be deemed part of the cost of credit. TILA itself recognizes that many fees paid are not included in the cost of credit. Even though the total cost of credit APR is a threshold measure and not disclosed to the consumer, it still does not make sense for the cost of credit to include non-credit fees. Moreover, the aim of this rulemaking is to eliminate certain harmful payday and title loans. We understand that payday and title lenders do not offer voluntary protection products, so there is no reason to include those services in the rate threshold.

For example, the proposed definition of total cost of credit includes voluntary protection products such as credit life insurance, disability insurance, debt protection, accidental death and dismemberment insurance, involuntary unemployment insurance, and Guaranteed Auto Protection (or “GAP”) insurance. Some borrowers choose to purchase these voluntary protection products at loan consummation, not during the underwriting phase. Thus, a lender could complete the underwriting process, offer the consumer a non-covered loan and then, when the consumer is ready to sign, he could request credit life insurance. If the premium for the credit life insurance pushes the total cost of credit over 36 percent, the lender would have to begin the underwriting process all over or make a non-covered loan by refusing the customer’s request for credit life insurance. Either way, the customer faces an inconvenience. In short, the customer’s decision whether she wants a voluntary protection product may dictate when the loan is a covered loan and when it is not.²² This makes the total cost of credit 36 percent APR concept illogical and extremely problematic for lenders who offer optional voluntary protection products under the strict guidelines of the TILA APR.

We emphasize, though, that even if voluntary protection products are not included in the APR calculation, they are still included in the lender’s ability-to-repay analysis.

²² This is true unless the lender wants to underwrite all loans as if they were covered loans, even if they are not covered, which, in light of the costs and burdens, is highly unlikely for most lenders.

Including a TILA APR as a threshold instead of a total cost of credit APR eliminates the confusion over what constitutes voluntary protection products. For example, it is unclear if product warranties that could be offered to a consumer separately from the financing would have to be included in the total cost of credit.

One of the reasons given in the Proposed Rule for using a total cost of credit is because it is the same calculation is used in the Military Lending Act (“MLA”). The Proposed Rule states that the total cost of credit or “Military APR” (“MAPR”) as it is called in the MLA, “is familiar to many lenders that must make the MAPR calculation, thus reducing the compliance challenges that would result from a new computation.”²³ First, the computation may not be familiar to some lenders, as some lenders may not make MLA-covered loans. Second, the MLA only applies to a very small subset of consumers – active-duty service members and their dependents. The Proposed Rule applies to all consumers. The MLA’s impact on lenders is small in comparison to the massive impact of the Proposed Rule. There are approximately 1,343,703 active duty service members,²⁴ but there are 321,442,019 American consumers.²⁵ Third, Congress and the Department of Defense were addressing different concerns with the MLA than the CFPB is addressing with the Proposed Rule. The reason for using the MAPR was the duplicative nature of insurance because most military members already had similar coverage. Additionally, members of the military have very different job stability than many Americans who have seasonal employment, hourly wages, or are self-employed. As a result, some voluntary protection products may be less beneficial to service members than they are to other Americans, a great many of who cannot afford monthly life insurance or other premiums. Fourth, every other consumer credit regulation uses a TILA APR that excludes the cost of voluntary protection products from the APR unless they are required by the lender. The fact that one law has created a different measurement is no reason to use the total cost of credit. It makes much more sense to use the calculation that has been in place for decades and used by federal financial regulators and all state regulators.

Instead of following the MAPR standard in the MLA, the Bureau should continue to use the TILA definition of APR. For nearly 50 years, TILA has provided a standard of how to calculate APR so that all references to APR mean the same thing. All creditors calculate APR the same way. The cost of any loan can be measured by the TILA APR; not so for the MAPR. Even though the total cost of credit APR would not be disclosed to consumers, it is important that APR be consistent among all creditors, for all loan products, and in all circumstances. For this reason, five decades of jurisprudence and regulatory guidance have assiduously guarded confidence in the term “APR” – what it means, what is included and what is not included. It is not useful to have the cost of voluntary protection products included as an alleged cost of *credit* by inclusion in an APR.

Thomas A. Durkin, a former senior economist at the Federal Reserve, explained these concepts clearly:

“First, if ancillary products are not required as part of the credit, then the fees for them are not payment for the credit granted and the fees economically are not finance charges. ... Second, in 1968, Congress understood that debt protection that is not required is economically not part of the underlying credit and the fee for debt protection is not part of the finance charge. ... Third, since debt protection fees are not finance charges economically, arbitrarily declaring them to be finance charges confounds the ability of

²³ 81 Fed. Reg. 47909.

²⁴ Defense Manpower Data Center, *DoD Personnel, Workforce Reports & Publications*. Available at https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp. Accessed Sept. 2016.

²⁵ United States Census Bureau, *U.S. Population and World Clock*. Available at <http://www.census.gov/popclock/>. Accessed Sept. 2016.

consumers to shop effectively for credit costs, frustrating the basic purpose and intent of TILA in the first place. This is bad public policy.”²⁶

We might add that Congress has spoken. TILA expressly excludes the cost of certain voluntary protection products from the cost of credit, as long as the products are not required to be purchased by the consumer. Courts and regulators prohibit a creditor from advertising the cost of credit without expressing the APR and they prohibit a creditor from giving the term any meaning different than the one it is assigned in TILA. Not only do courts and regulators prohibit a creditor from advertising an APR term that is calculated differently from how Regulation Z calculates the rate, they regard a creditor’s use of an APR variant as a particularly pernicious TILA violation because such behavior undermines the universality of the term. In fact, some regulators have rejected arguments by payday lenders that an *Annual Percentage Rate* is an inappropriate metric for measuring the cost of a two-week loan, reasoning that APR is always the appropriate tool for measuring the cost of credit, no matter the loan product, because APR enjoys a single and universally-understood meaning.

It is disturbing, therefore, that the CFPB itself – the agency tasked with TILA rulemaking authority and responsible for preserving everyone’s confidence in the single-meaning of APR – proposes to create a different APR term. That decision is clearly a public policy choice and is without “data driven” basis in fact. By creating an APR variant and assigning a non-TILA meaning to the term, the CFPB would radically alter a case and longstanding important consumer protection. The CFPB threatens to dilute consumer confidence in the single-meaning of APR, thereby preventing consumers from effectively shopping for *all* forms of consumer credit.

Lastly, we emphasize that the CFPB’s concern that using a TILA APR would encourage lenders to increase premiums for voluntary protection products or other fees to make up for or mask a lower interest rate threshold is unfounded. First, most voluntary protection products are restricted in the fees that may be charged under state law. For example, credit insurance rates are restricted under state insurance law and strictly enforced by the states’ insurance departments. Second, even if the fees were not restricted by state law, the costs of such products are regulated by the marketplace. If the industry increases costs too much, they will simply not be purchased by consumers.

B. Use a 99 percent total cost of credit.

As stated above, AFSA believes that the CFPB should use a TILA APR as the threshold for loans covered by the Proposed Rule. If the CFPB decides against using a TILA APR, we urge the CFPB to consider using a 99 percent total cost of credit as the threshold. The CFPB’s own data shows that the lowest APR offered by payday, title, and certain high-cost installment loans was 180 percent TILA APR. Therefore, the CFPB could move the trigger to 99 percent total cost of credit and still cover all of payday and title loans, while foregoing the considerable harm to traditional installment lenders.

As noted in a recent report:

“The 36% trigger for ‘covered loan’ status is unarguably an arbitrary choice, based solely on a legislative determination in another context. CFPB has not argued that it found evidence in the Congressional Record in the form of data finding that 36% is an inflection point for greater harm than 35%. The logic of using a rate trigger is a policy choice – to avoid burdening conventional

²⁶ Durkin, Thomas A., *Conceptual Difficulties with the “All In” Finance Charge and APR Proposal from the Consumer Financial Protection Bureau*. Consumer Finance Law Quarterly Report. Vol. 67, Nos. 1-2. p. 53.

bank loans with a severe additional underwriting challenge while providing broad enough coverage to permanently fence in as-yet-unknown future sources of harmful lending.”²⁷

Additionally,

“...the 36% trigger chosen by the CFPB is not associated with any differential in the likelihood that a borrower will have the ability to repay. Nor is there a trend in lender behavior suggesting that higher rates are associated with more insolvent borrowers (by count or by depth of insolvency) until one examines loans at rates ten times higher than 36%. Finally, there is not a clear correlation between increasing APRs and increased rates of financial distress, although there is an increase in rates of defaults for online loans that begins around 80% APR and peaks at 299% APR. Storefront loans maintain low default rates until reaching the 400+% APR range.”²⁸

We realize that some payday lenders are trying to change their business models and “morph” into installment lenders. However, it is impossible for payday lenders to morph into traditional installment lenders. As demonstrated above, the two business models are completely different. By making the loan term a little longer, or decreasing the APR slightly, payday lenders cannot simply become installment lenders. The structure of the loans, the structure of the business, and the state license structure are completely different.

A loan with a 99 percent APR is a TIL.²⁹ It has been around for a hundred years. CFSI has agreed that a TIL is a high-cost, but high-quality loan. As noted in the North Carolina Commissioner of Bank’s comprehensive 2010 study:

“CFSI identifies the following advantages of the installment lending business model: Larger loans; longer terms; fixed rate; equal repayments; loan data reported to major credit bureaus; and direct interaction. To this list, we would add transparency and stability of lending terms.

“Perhaps the most distinguishing feature of the consumer installment business is its traditional, high touch, high cost business model.”³⁰

Small-dollar loans where the lender verifies the ability to repay are expensive to make. That is one of the reasons that banks do not make these loans. Because they are expensive to make, the rates on small-dollar loans must be higher than on larger loans. That banks and credit unions recognize this is discussed in Section V above.

Most traditional installment lenders cannot make small-dollar loans with a total cost of credit of 36 percent or less. According to a study done by three academics using industry data, in order to make a break-even loan at 36 percent APR, the loan would have to be made for at least \$2,600.³¹ For a loan to be made profitably, with current

²⁷ Hackett, Rick. *What’s 36% got to do with it? Does Lender Behavior Support CFPB’s Hypothesis That Installment Loans Are Increasingly Unaffordable As Rates Increase?* Oct. 2016. nonPRIME101 Report #11. p. 16. Available at <https://www.nonprime101.com>.

²⁸ *Ibid*, p. 3.

²⁹ Although rates are capped at 36 percent in some states, they are typically capped at 36 percent TILA APR or some state variant thereof, not total cost of credit.

³⁰ Smith, Joseph A. (Commissioner of Banks), *The Consumer Finance Act: Report and Recommendations to the 2011 General Assembly*. North Carolina Office of the Commissioner of Banks. February 2011. p. 23. Available at http://www.nccob.org/Public/docs/Financial%20Institutions/Consumer%20Finance/NCCOBRReport_Web.pdf.

³¹ Durkin, Elliehausen, and Hwang.

underwriting requirements and with a total cost of credit of 36 percent, the loan would have to be between \$3,600-\$4,000. The loan amount would be even higher if the expenses relating to the proposed underwriting requirements were taken into account. Moreover, all these conclusions are based on historically low borrowing rates that traditional installment lenders now pay rather than the higher borrowing costs of yester-year and future-year.

As noted previously in Sections I and II, the CFPB is not eliminating the demand for these small-dollar loans. And if traditional installment lenders stop making small-dollar loans, then Americans are left with limited options – mainly illegal loans from unregulated and unlicensed online lenders. This was the case in North Carolina. As explained above in Section IV, because of the restrictions in North Carolina’s Consumer Finance Act, the 2009 Consumer Banking and Finance Survey found that 11 percent of residents surveyed had received a payday or title loan through the internet or by driving to another state. This was an almost three-fold increase since 2007.³²

The Center for Public Integrity explains, “One problem is that many online payday lenders claim that state laws don’t apply to them. Some lenders say they are beyond the law because they’re based offshore. ... Still others hide their ownership behind an impenetrable curtain of shell companies. That means that some online payday lenders make loans even in 18 states that essentially ban the practice.”³³ What happened at the state level – consumers going to unregulated and unlicensed online lenders – when payday loans were banned is a good indicator of what could happen at the national level, should the Proposed Rule go into effect without substantial changes.

A number of other studies demonstrate the fact that rate caps cut off access to credit. The Federal Reserve Bank of St. Louis studied the result of North Carolina’s 1999 predatory lending law. The study cited evidence that “the introduction of the North Carolina law substantially reduced the flow of subprime credit. The impact seems to be larger for low-income borrowers and minority borrowers.”³⁴

Even an extensive study done for the European Commission concluded, “High-risk borrowers requesting small-amount credit can only be served when a certain threshold interest rate is exceeded. Hence, they may not be served credit in the presence of interest rate restrictions.”³⁵

A paper issued by professors at the Mercatus Center at George Mason University explains the unintended consequences that regulation can have on consumer credit:

“Government regulators proposing restrictions on specific forms of consumer credit all too often ignore the reality of how and why consumers use credit. They also ignore lenders’ legitimate reasons for pricing their services as they do; consumers’ legitimate reasons for choosing the financing options they do; the risks consumers face when credit offerings are made unavailable to them; and the many consumers who use the particular forms of consumer credit responsibly and effectively.

³² MarketSearch Corporation, *Consumer Banking and Finance Survey*, North Carolina Office of the Commissioner of Banks, April/May 2009. pp. 22-23.

³³ Heath, David. *In Trouble from an Online Payday Loan? You Might Not Have to Repay it*. The Center for Public Integrity. Sept. 30, 2011. Available at <https://www.publicintegrity.org/2011/09/30/6811/trouble-online-payday-loan-you-might-not-have-repay-it>.

³⁴ Ho, Giang and Anthony Pennington-Cross, *States Fight Predatory Lending in Different Ways*. St. Louis Federal Reserve. Jan. 2006. Available at http://www.stlouisfed.org/publications/pub_assets/pdf/re/2006/a/predatory_lending.pdf.

³⁵ Reifner, Prof. Dr. Udo, Sebastien Clerc-Renaud, RA Michael Knobloch, *Study on Interest Rate Restrictions in the EU*. 2010. p. 325. Available at http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf.

“As a result, new laws and regulations on consumer credit have unintended consequences that frequently harm the very people they are meant to help by making credit more expensive and harder to obtain; by inducing lenders to reprice non-interest-rate terms and reduce transparency; and by forcing consumers to substitute less-preferred types of credit. The restrictions also harm individuals and families that don’t use any form of consumer credit by inducing banks to increase fees on bank accounts, ATM transactions, and other services. Low-income individuals and families are particularly harmed by these fees and may even be forced out of the traditional banking system altogether as simple checking accounts become less affordable. Additionally, regulations on some forms of consumer credit may drive consumers into other, perhaps even more problematic, forms of credit.

“Regulators must be mindful not to restrict consumers’ access to credit nor to increase the cost of credit by well-intentioned but misguided laws and regulations.”³⁶

The paper goes on to explain, “Unavailability of credit can result in non-payment of bills or bounced checks, which can put consumers at risk of potentially disastrous financial penalties, termination of bank accounts, eviction, discontinuation of utilities or medical treatment, or other problems.”³⁷

C. Exempt TILs from the definition of a covered longer-term loan.

Many traditional installment loans will meet the definition of covered longer-term loans because, as defined, they have a total cost of credit that exceeds 36 and the lender obtains a vehicle security. AFSA understands that the CFPB has some concerns about certain features of title lending – particularly a lack of underwriting, balloon payments and a high repossession rate. TILs secured by vehicles contain none of those “core harms.” Traditional installment lenders have no incentive to repossess vehicles. Not only do finance companies want to help their customers keep their vehicles, but they typically lose money on most vehicle repossessions, usually several thousand dollars on each repossession.

Unlike title loans, TILs secured by vehicles are still based on the consumer’s ability to repay. Instead of making a bad loan and forcing repayment by threat of repossession, a traditional installment lender “hedges its bet” by sometimes taking a security interest in a vehicle. Traditional installment lenders may take a security interest in a vehicle for the very same reasons that banks, credit unions, automobile dealers, and mortgage lenders take security interests in the property they finance. No matter how well the loan was underwritten, there is a subset of borrowers who will intentionally or unintentionally stop repaying the loan. Many of those non-payers, whether due to their own fault or unforeseen circumstances causing financial failure, will file bankruptcy. And without the security interest, the entire loan and all principal extended is lost unless the lender has a security interest. This same reasoning applies to traditional installment lenders, but with more force because traditional installment lenders may lend to subprime borrowers who default more often than do prime borrowers who obtain loans from banks and credit unions. The CFPB’s recent mortgage rules require an ability-to-repay test, but the CFPB still allows the lender to use the property as collateral because there is nothing inherently “bad” about the use of collateral. Many bank loans require collateral or personal guarantees. It is fundamentally flawed to single out traditional installment lenders for different treatment as to collateral, when frankly, by lending to less credit worthy

³⁶ Zywicki, Todd J. and Robert C. Sarvis, *The Pitfalls of Regulating Consumer Credit*. The Mercatus Center at George Mason University. October 2012. p. 1. Available at http://mercatus.org/sites/default/files/Pitfalls_Regulating_Consumer_Credit_MOP_v1-0.pdf.

³⁷ *Ibid.* p. 2.

individuals than banks, collateral is far more necessary for traditional installment lenders in order to limit their losses.

If the CFPB chooses not to change the covered longer-term loan trigger, AFSA offers the following suggestion for a small-dollar loan exemption to the definition of covered longer-term loans. AFSA staff previously discussed this exemption with the CFPB. AFSA emphasized that by establishing a reasonable structure for small-dollar TILs that would be exempt from the Proposed Rule, the CFPB can meet its objective of strengthening consumer protections with small-dollar credit while ensuring that these options remain accessible and affordable. The proposed exemption will ensure that there is no lender incentive for making a loan that cannot be repaid by the consumer. It will prevent triple-digit APR lenders from “morphing” their existing loan options into TILs through either existing or proposed state statutory provisions. And it will ensure that the long established small-dollar TIL market remains a diversified, viable, and affordable small-dollar credit option for consumers.

Small-Dollar Installment Loan Exemption Requirements

1. Fully-amortized loan term with substantially equal monthly payments. Balloon payments prohibited.
2. Minimum term of six months.
3. No prepayment penalty.
4. Loan origination fee limitation:
 - a. May only be charged twice during a rolling twelve-month period if no pro-rata rebate available.
 - b. May be charged four times during a twelve month-period if pro-rata rebate schedule is available (actuarial line or Rule of 78s) net of state authorized non-refundable portion (maximum 25 percent of fee).
 - c. Loan fee cannot exceed 10 percent of loan principal.
5. Total cost of credit cannot exceed 99.99 percent
6. Pre-authorized ACH agreement:
 - a. Must be in writing (following the requirements set forth by the CFPB in Regulation E on recurring ACH).³⁸
 - b. Maximum two attempts per scheduled payment.
 - c. May only charge one return check fee per scheduled payment (if allowed by state law).
 - d. Fully cancelable within 30 days of notice, written or oral (as per NACHA and Regulation E requirements).
7. Single transaction ACH/debit payment processing:
 - a. May be authorized by the consumer either in writing or orally.
 - b. Limited to a single, scheduled payment (plus any statutorily approved fees or past due amounts) unless otherwise authorized by the consumer.
 - c. Maximum two attempts per payment.
8. Reported monthly to a CRA.
9. Cannot be renewed or refinanced more than four times in a rolling twelve-month period.
10. Cannot be renewed if more than 90 days contractually past due (3 payments due) unless under terms outlined under the CFPB’s covered loan requirements.

³⁸ CFPB Compliance Bulletin 2015-06, *Requirements for Consumer Authorizations for Preauthorized Electronic Fund Transfers*. Nov. 23, 2015. Available at http://files.consumerfinance.gov/f/201511_cfpb_compliance-bulletin-2015-06-requirements-for-consumer-authorizations-for-preauthorized-electronic-fund-transfers.pdf.

Although 99.99 percent may seem high to some parties, it is reasonable in light of the costs associated with originating and securing loans (and other factors). It is also substantially below the CFPB's own data showing that the lowest APR offered by payday and title lenders is 180 percent TILA APR. The PEW Charitable Trust recently said:

“The second strategy to drive down loan prices is to enable lower-cost providers of small loans. Banks and credit unions have large competitive advantages over payday and auto title lenders because they are diversified businesses that cover their overhead by selling other products, could lend to their own customers rather than paying to attract new ones, have customers who make regular deposits in their checking accounts, and have a low cost of funds. **As a result, these financial institutions could profitably make small loans at double-digit APRs, for prices that are six to eight times lower than those offered by payday lenders.** However, to offer these loans sustainably, banks' fee-inclusive rates would generally need to be somewhat higher than 36 percent APR.”³⁹ [emphasis added]

AFSA's proposed exemption caps loans at a double-digit APR, for a price that is significantly lower than payday and title loans. The exempted TILs would still be well underwritten, but in a reasonable way.

IX. The Proposed Rule exclusion of a Purchase Money Security Interest (“PMSI”) loan should be made clear.

The Proposed Rule is intended to cover payday, title, and certain high-cost installment loans. The CFPB states that it is issuing the Proposed Rule to regulate loans that, “...are typically used by consumers who are living paycheck to paycheck, have little to no access to other credit products, and seek funds to meet recurring or one-time expenses.”⁴⁰ That is not a description of PMSI loans, which is why the CFPB states that it is excluding PMSI loans from the Proposed Rule. The Proposed Rule states, “[a]t this time, the Bureau has not determined that purchase money loans pose similar risks to consumers as the loans covered by this part. Accordingly, the Bureau is proposing not to cover such loans at this time.”⁴¹

AFSA agrees that PMSI loans should be excluded from the final rule. As the CFPB states:

“[p]urchase money loans are typically treated differently than non-purchase money loans under the law. The FTC's Credit Practices Rule generally prohibits consumer credit in which a lender takes a nonpossessory security interest in household goods but makes an exception for purchase money security interests. The Federal Bankruptcy Code, the Uniform Commercial Code [“UCC”], and some other State laws apply different standards to purchase money security interests. This differential treatment facilitates the financing of the initial purchase of relatively expensive goods, which many consumers would not be able to afford without a purchase money loan.”⁴²

Additionally, recognizing the importance of credit availability, PMSI loans have been given a superior position over other lien types to afford protections to the merchant who takes significant risk by not only selling the product, but by financing it as well.

³⁹ *From Payday to Small Installment Loans*. Pew Charitable Trusts. Aug. 11, 2016. Available at <http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/08/from-payday-to-small-installment-loans>.

⁴⁰ 81 Fed. Reg. 47864.

⁴¹ 81 Fed. Reg. 47917.

⁴² 81 Fed. Reg. 47917.

That said, the Proposed Rule does not make it clear that PMSI loans should be exempted. The key concern is the sole purpose test in 3(e)(1) of the Commentary.⁴³ Only loans extended “solely” to finance the purchase of a vehicle or other consumer good in which the good secures the loan are exempted. In particular, the following sentence is problematic: “If the item that is purchased with the credit is not a good or if the amount financed is greater than the cost of acquiring the good, the credit is not excluded from the requirements of this part under 1041.3(e)(1).”⁴⁴ The ambiguity created in the sole purpose test could result in numerous credit transactions being covered, even though they are, for example, to purchase a car. For example, if a consumer is financing a car, and includes an extended service contract or taxes, tags, and title in the financing, it is unclear whether it loses its status as a PMSI loan and becomes a covered loan. Similarly, if a consumer finances a television and opts to purchase an extended product warranty, does the finance agreement become a covered loan?

The CFPB has no basis to conclude that the financing of these additional items, beyond the purchase price of the collateral, presents any risks to consumers, not to mention the same types of risks to consumers as are presented by covered loans. To the extent that the CFPB seeks to regulate purchase money loans as covered loans, the proposal is arbitrary, capricious and contrary to law.

AFSA has two suggestions to resolve this ambiguity:

- (1) Loans that are “primarily,” though not “solely” to finance the purchase of a vehicle should be exempted. This would be consistent with the exemption for real estate secured credit which does not have the sole purchase test.
- (2) The CFPB could use the UCC definition of PMSI. The UCC defines “purchase-money collateral” as “goods or software that secures a purchase-money obligation incurred with respect to that collateral.” “Purchase-money obligation” means “an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.” The UCC states that a security interest in goods is a purchase money security interest: “(1) to the extent that the goods are purchase-money collateral with respect to that security interest...”⁴⁵

The use of either of these suggestions would clearly exempt PMSI loans from the Proposed Rule and PMSI loans should be exempted from the Proposed Rule.

X. Other suggested improvements for the Proposed Rule.

If the CFPB does not change the Proposed Rule as discussed in Section VIII above, AFSA urges that the CFPB to consider the changes described below to make the rule more workable.

AFSA has identified eight other improvements that the CFPB should make to the Proposed Rule: (1) eliminate the overreaching prohibition against evasion; (2) revise the definition of total cost of credit (3) eliminate voluntary leveraged payment mechanisms as a trigger for coverage under the Proposed Rule; (4) modify the ability-to-repay requirements to allow lenders more flexibility by using a reasonableness standard; (5) modify the restrictions on refinancing, (6) revise the payment procedures to be more clear and consistent with the EFTA and NACHA; (7) eliminate the mandatory credit reporting requirement; and (8) extend the effective date of the rule.

⁴³ 81 Fed. Reg. 48192.

⁴⁴ *Ibid.*

⁴⁵ U.C.C. § 9-103 (Purchase-Money Security Interest).

A. *The prohibition against evasion should be eliminated.*

This section is an extraordinary departure from the basic construction of common law or a statutory and regulatory framework. The Proposed Rule's entire complicated construction exists because the CFPB is prohibited from imposing a rate cap. So, the Proposed Rule attempts to ring a fence around small-dollar lending by prescribing every term and condition, but then determines that it is still not enough.

Although the CFPB defines and restricts small-dollar lending based on a combination of pricing and the use of certain practices (*e.g.*, the use of ACH payments), the CFPB must be recognizing that its own definitions are either too cumbersome or too unworkable because it seeks to give itself authority to take enforcement actions against companies for actions that do not fall within the parameters defined by the Proposed Rule. **It is absurd that a company could find itself being in noncompliance for being "compliant."** Simply put, if the CFPB cannot show that a covered person engaged in a practice that has been defined as "prohibited," that covered person should not be punished for "evasion."

The Proposed Rule contains specific elements used to determine who is a covered person and what the person can and cannot do. If a lender does not make loans as described in the Proposed Rule, the lender is not covered. In an effort to bring enforcement actions against persons who are not actually covered by the Proposed Rule, the CFPB lurches into the murky world of *scienter*. Not satisfied with a "knowing" standard, the Proposed Rule also imposes a "reckless" standard to prove evasion. Section 1041.19 states that "a lender must not take any action with the intent of evading the requirements of part 1041."

Using particularly Orwellian language, the Proposed Rule goes on to say in determining such intent:

"Fraud, deceit, or other unlawful or illegitimate activity may be one fact or circumstance that is relevant to the determination of whether a lender's action was taken with the intent of evading the requirements of part 1041, but fraud, deceit, or other unlawful or illegitimate activity is not a prerequisite to such a finding."

In other words, fraud, *etc.*, matters until it does not.

Such an approach goes too far, both as a matter of law and public policy. If a covered person changes a product by eliminating one of the enumerated terms or practices, that product has changed. It appears that the CFPB draws a distinction between some form of technical compliance with the Proposed Rule versus what they divine to be the "intent" of the covered person. How then does a company determine compliance and how does it self-test to ensure compliance? After all, the Proposed Rule requires the covered persons to establish compliance programs appropriate to the size and complexity of their company and its affiliates, and the nature and scope of the covered loan lending activities.

The CFPB is understandably concerned with borrowers getting trapped in a cycle of debt. But, as a matter of law and basic fairness, the CFPB should not prohibit something without the person knowing what is prohibited.

B. *The CFPB should revise the definition of total cost of credit.*

As explained above in Section VII, the CFPB should use a TILA APR, not the described total cost of credit. Payday and title lenders, who are the focus of this rulemaking, do not offer voluntary protection products. There is, therefore, no need to include voluntary protection products in calculating the total cost of credit. However, if the final rule includes a total cost of credit, we urge the CFPB to: (1) provide more detail as to how to calculate the total cost of credit, (2) only include certain costs in the total cost of credit, and (3) index the total cost of credit to the lender's cost of credit.

As to the second point, only certain costs should be included in the total cost of credit. For example, the premiums for voluntary protection products expressly excluded from the finance charge by TILA itself, should not be included in the total cost of credit.

On the third point, the Bureau should index the total cost of credit to the lender's cost of credit. This is because the current rates at which traditional installment lenders can now borrow from the banks are historically low. Yet, it is undeniable that rates will increase at some point. As explained previously, if the lender's cost of credit increases, the cost of the borrower's credit must also increase, meaning that lender will have to raise its minimum loan size and term. It seems counterintuitive that the cost of credit would be the only consumer good not allowed to rise. The fees and other thresholds in many other regulations are adjusted, and this threshold should be adjusted as well.

C. The procurement of an optional and voluntary agreement for automatic payments should not be a trigger of coverage under the Proposed Rule.

The leveraged payment mechanism trigger under the Proposed Rule is flawed. Federal law already prohibits lenders from requiring automatic payments as a condition of credit.⁴⁶ Therefore, if the CFPB is concerned that payday, title, and high-cost installment lenders are requiring automatic payments as a condition of credit, the CFPB can use its existing powers to enforce 12 CFR 1002.10(e)(1) and consumers could also challenge such actions under existing laws.

The harm to consumers from the proposed limitations is clear. Traditional installment lenders allow their customers the option to enroll in automatic payments as a courtesy and convenience to the borrower. Automatic payments are always optional and voluntary. Although a customer may be informed about the option to enroll in automatic payments at loan closing, it nonetheless is an optional service that is provided by the traditional installment lender for the convenience of the borrower. The borrower chooses whether and when to enroll in that convenient service. To be sure, the CFPB already recognizes that traditional installment lenders "obtain[] repayment from the borrower's account as a convenience to the borrower as [sic] not as an alternative to careful underwriting."⁴⁷ Whether an agreement for automatic payments is obtained within 72 hours or beyond 72 hours does not change the voluntary nature of the payment option. It is still a payment option that is chosen by the consumer for the consumer's own convenience. And, under Regulation E, the consumer has the right to cancel these authorizations at any time, stop ACH payments, and to assert errors in the manner in which ACH payments were made. The Proposed Rule restricts the consumer's, not the lender's, choices in payment options. The convenience of ACH payments to consumers is obvious as more and more consumers choose to use ACH payments rather than mailing payments to lenders or driving to the lender's place of business to make a payment before a late fee is charged. Limiting consumers' payment options makes even less sense when you consider the continuous growth in mobile payments, virtual currency, and mobile wallets.

If the CFPB is worried that payday, title, and high-cost installment lenders are pressuring their customers into enrolling for automatic payment, the CFPB can use its existing unfair, deceptive, or abusive acts or practices ("UDAAP") authority⁴⁸ to crack down on that practice. When a leveraged payment mechanism is voluntary, as

⁴⁶ 12 CFR 1002.10(e)(1) ("No financial institution or other person may condition an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund transfers, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account.").

⁴⁷ 81 Fed. Reg. 47987.

⁴⁸ 12 U.S.C. §§ 5481, 5531 & 5536(a)

with traditional installment lenders, the harms described by the CFPB are not incurred and therefore making the procurement of a voluntary leveraged payment mechanism part of the covered longer-term loan trigger is illogical and unsupportable.

In a TIL transaction, an ACH authorization primarily benefits the consumer because the ACH system is modern, fast, inexpensive, and convenient. The CFPB should not harm consumers by depriving them of these benefits simply because the loan they wish to repay electronically is a small-dollar loan.

Thus, the final rule should exclude an ACH authorization from the definition of “leveraged payment mechanism,” if the ACH authorization is not required by the lender as a condition of the loan. This result would preserve the substantial benefits of the modern ACH system for consumers while ensuring that small-dollar lenders are not able to use an ACH authorization as mechanisms for unfairly or surreptitiously jumping in front of other creditors on the consumer’s payday.

Finally, we encourage the CFPB to provide additional clarity to the language addressing this issue. The Proposed Rule seems to suggest that if a consumer authorizes payment solely at the time the payment is due (*i.e.*, sends a check or initiates a transaction at his/her account holding bank/credit union), the prohibition against leveraged payment mechanisms is not triggered. Conversely, the commentary expressly covers checks as a “lender-initiated” transfer that is generally covered by the prohibition. We believe that the CFPB is not intending to designate all checks as a leveraged payment mechanism. However, it is not clear when a check would be covered (other than, of course, providing a post-dated check at consummation). We urge the CFPB to clarify that a check is not intended to be included as a prohibited leveraged payment mechanism.

D. The ability-to-repay rules should be modified to allow for a more reasonable determination of a consumer’s ability to repay.

The Proposed Rule would impose substantial new costs on businesses – underwriting, consumer notices, development of written compliance program, training and re-training, furnishing data, and on-going compliance. High costs and strict underwriting will dramatically reduce access to credit – in many cases for consumers who have shown that they are able to repay.

A useful example for the need for modifications to the Proposed Rule can be found in the California Pilot Program for Increased Access to Responsible Small Dollar Loans.⁴⁹ The pilot program has a higher APR than the Proposed Rule and more flexible underwriting standards, but yet it still has low participation rate.

1. Reasonable Determination Required.

The Proposed Rule states that a lender must not make a covered longer-term loan or increase the credit available under a covered longer-term loan, unless the lender first makes a reasonable determination that the consumer will have the ability to repay the loan according to its terms. AFSA members have always assessed their customers’ ability to repay and support a requirement for a reasonable determination that the consumer has the ability to repay the loan. However, the CFPB’s proposed ability-to-repay determination simply does not set forth a reasonable standard with flexibility for traditional installment lenders and their customers. The Proposed Rule would create an unnecessary burden on all lenders that make covered longer-term loans, as well as their customers. Any underwriting requirement needs to be flexible, reasonable, and allow for the consideration of all relevant factors. Unlike payday and title lenders, traditional installment lenders have no incentive to make loans without engaging in an ability to pay analysis because they do not make enough in fees to recapture the principal

⁴⁹ Cal. Fin. Code Section 22370(g)(4)(A).

lent. Unlike mortgage brokers, installment lenders do not make loans with the intent to sell them and let someone else collect them into the secondary market as asset-backed securities. Rather, traditional installment lenders are lending with their own money and need it to be repaid. They therefore take seriously whether each applicant will have the ability to repay the loan.

The proposed ability-to-repay rules are on par with the ability-to-repay requirements in the CFPB's Qualified Mortgage ("QM") rule. For a covered loan, the lender's method for verifying income generally matches the method prescribed by the QM rule.⁵⁰ The lender's method for verifying employment also generally matches the method prescribed by the QM rule. This is worth emphasizing – the standards for checking a borrower's ability to repay a mortgage – likely the largest loan a person will ever take out for their most important asset, a home for their family – will be virtually the same as the standards for taking out a loan to buy back-to-school supplies. While appropriate for taking out hundreds of thousands of dollars of debt, onerous ability-to-repay rules are not appropriate for a \$1,000 loan.

The main differences between TILs and QM loans under the Proposed Rule are that the QM lender must calculate the debt-to-income ("DTI") ratio and inquire as to other assets, while the traditional installment lender must calculate residual income rather than DTI and need not fully inquire as to other assets. Yet, there are no studies that demonstrate that calculating residual income is better than using a DTI ratio. There is also no data showing what amount of residual income is "sufficient."

David Stein, who was previously with the CFPB and the Federal Reserve Board wrote:

"Existing ATR rules provide no guidance for how to determine a consumer's repayment ability using residual income. The CFPB, for example, stated in the mortgage ATR rule that it was not 'necessary or appropriate to specify a detailed methodology in the final rule for consideration of residual income.' ...

"As the CFPB publicly acknowledged, the residual income is only used regularly in underwriting Veterans Administration mortgage loans. Unlike the CFPB's proposed test, however, the VA's residual income test sets minimum dollar thresholds for sufficient residual income based on family size, region of the country, and other factors, summarized in a one-page residual income table."⁵¹

Using a DTI ratio would simplify the Proposed Rule and provide the same benefit to the borrower. DTI has been used effectively in small-dollar state laws. DTI is also used in the California Pilot Program for Increased Access to Responsible Small Dollar Loans.⁵²

If the final rule does not include more flexibility, lenders will not be able to meet the needs of their customers, particularly those who are "credit invisible" (*i.e.* consumers who do not have a credit history) or whose credit histories contain insufficient or out-of-date information. Furthermore, such an inflexible approach could chill future innovative underwriting developments that could be used to provide credit to the "credit invisibles." AFSA agrees with the remarks made by CFPB Director Richard Cordray on a press call releasing a CFPB report on credit reporting:

⁵⁰ 12 CFR Part 1026.

⁵¹ Stein, David. *CFPB's Residual Income Test a Burden to Consumers and Creditors*. Forbes. Oct. 4, 2016. Available at <http://www.forbes.com/sites/realspin/2016/10/04/cfpb-residual-income-test-a-burden-to-consumers-and-creditors/#6112bfde22da>.

⁵² Cal. Fin. Code Section 22370(g)(4)(A).

“[s]o when consumers do not have a credit report, or have too little information to have a credit score, the impact on their lives can be profound. It can preclude them from accessing credit and taking advantage of certain opportunities. And given that we found that consumers in low-income neighborhoods are more likely to be credit invisible or unscored, this may be limiting opportunities for some of the most economically vulnerable consumers.”⁵³

Director Cordray went on to state that, “[o]ur report also found that Black and Hispanic consumers are more likely than White or Asian consumers to have limited credit records.” He concluded by stating, “[a]t the Consumer Bureau, we are dedicated to fostering a responsible marketplace that helps consumers get ahead rather than harming them and setting them back.” If the CFPB is dedicated to fostering a marketplace that helps consumers get ahead, then it is imperative to modify the Proposed Rule to allow lenders flexibility in underwriting. The NBCSL and NCSL resolutions support this (see Appendix I).

Under a general ability-to-repay standard, lenders must make a reasonable, good-faith determination before or at consummation of a covered loan that the consumer has a reasonable ability to repay the minimum loan payment on an on-going basis. Traditional installment lenders, who have been making these types of loans for over a century, already do that. The ability-to-repay determination in the final rule must be based on consideration of the applicant’s income or assets (other than the value of the property that secures the loan) and the applicant’s current obligations at the time of the loan, using information reasonably available to the lender at that time.

AFSA therefore proposes the following alternative ability-to-repay standard:

- (1) A lender that makes a longer-term loan shall make a good-faith, reasonable determination prior to or at consummation of a closed-end loan (and prior to the time an open-end account is opened) that a consumer will have a reasonable ability to repay the loan according to its terms.
- (2) In making the repayment determination, a lender shall consider a consumer’s: (i) income (using reasonable means to estimate the consumer’s net income), (ii) major financial obligations, such as housing expenses (*e.g.*, mortgage, rent payment), other loans, and other legally required payments, using any reasonably available third-party records, such as a credit report, and (iii) borrowing history with the lender and its affiliates.
- (3) A lender may use any reasonable method to determine the amount and timing of a consumer’s income, including but not limited to: IRS Form W-2, IRS Form 1099, recent bank account or other financial asset account statements showing regular/recurring deposits, official government documents/statements reflecting income/benefits of the consumer, payroll statements (including military Leave and Earnings Statements), recent paystubs or other employer-provided information, and, if offered by the consumer, information about “income” received from alimony or child support and the consistency with which the consumer receives such payments. Cash income may be considered in the ability-to-repay determination only if the lender has a reasonable basis to believe that the consumer receives cash income, which reasonable basis may include the consumer’s prior payment history for loans made by the lender, or the consumer’s statement on the application that they receive cash income. Reasonable basis may also include the traditional installment lender’s knowledge of the community.⁵⁴

⁵³ CFPB Director Richard Cordray. Remarks on the Credit Reporting Press Call. May 15, 2015.

⁵⁴ Traditional installment lenders often lend to family, friends, and neighbors. They are deeply involved in and active members of their communities. They know that Taylor, for example, cuts lawns at night and on weekends, or that Morgan cuts hair at home.

(4) A lender may use any reasonable method to determine a consumer's major financial obligations and a consumer's borrowing history with the lender, its affiliates, and other lenders by: (i) reviewing the lender's own records/information and that of its affiliated companies about loans made to the consumer, (ii) obtaining a credit report on the consumer from a consumer reporting agency, and (iii) requesting the consumer to provide information about the consumer's debts and other obligations in connection with the consumer's application for the loan/account.

(5) In making a good-faith, reasonable determination that a consumer will have a reasonable ability to repay the loan according to its terms, a lender may meet this requirement if:

(a) the monthly payment amount for the loan is no more than 25 percent of the expected monthly gross income of the consumer and the loan provides for payments that fully amortize the loan; or

(b) the loan made by the lender provides for payments that fully amortize the loan and the individual monthly payments for the loan are under \$200 (or such amount, as adjusted, based on the year-to-year change in the average of the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers, not seasonally adjusted, for each twelve-month period ending in November, with rounding to the nearest [dollar]); or

(c) (i) the loan provides for payments that fully amortize the loan, (ii) and the lender has prepared a monthly income/debt budget in which the borrower's estimated monthly income exceeds his/her estimated current monthly expenses, including the monthly payments on the proposed loan, and (iii) the consumer affirmatively signs a document verifying the accuracy of the budget and the consumer's belief that he/she has the ability to repay the loan.

2. Problems with determining income and expenses.

One of the biggest problems with section 1041.9 of the Proposed Rule is that it does not recognize the value of cash income. Without a way for lenders to rely on cash income, many consumers who would be able to repay a loan (and improve their credit score) will be unable to get a loan. Cash income makes up a large part of the American economy and ignoring that fact does not make it any less true.⁵⁵

According to Stephen Fishman, the author of several tax publications:

"The 'underground economy' consists of income earned under the table and off the books. ... How big is the underground economy? Huge. It has been estimated that the worldwide underground economy amounts to \$2 trillion per year. ...

"The underground economy includes millions of workers who would like to have legitimate 'on the books' jobs, but who can't find them. Their only alternative is to work off the books and accept payment in cash. This practice is especially common in certain occupations such as construction, domestic work, and small food establishments. ...

⁵⁵ The CFPB should consider whether its exclusion of cash income will have a negative and disproportionate effect on some protected classes.

Another major component of the underground economy are cash-intensive businesses such as liquor and convenience stores, beauty salons, restaurants, bail bond companies, car washes, laundromats, taxicabs, and clothing stores.”⁵⁶

An article in U.S. News and World Report states, “Economists now speculate that the underground economy may have swelled during the last few years, given all the people who can’t find full-time work at decent pay. ‘Severe recessions have historically driven jobless Americans into the shadow economy,’ writes Bernard Baumohl of the Economic Outlook Group. ‘We suspect the destructive nature of the last downturn and the prolonged weak recovery pushed a record number of people into that murky world of cash transactions.’”⁵⁷

The article continues with a discussion on the variety of people who rely on cash income, “The new underground economy may entail a lot of people doing honest work, such as freelancers and consultants who used to be full-time professionals, computer-repair people laid off from corporate IT departments, home remodelers benefiting from a revived housing sector, people running eBay businesses, and retirees earning extra money by running errands for busy parents. The Internet obviously makes it easier to work from home these days, another boon for the gray market.”⁵⁸

By requiring documentation of cash income, which is usually impossible to provide, the Proposed Rule would cut off access to credit for a huge number of people. “Economists estimate the size of the underground economy at somewhere between 8 percent and 14 percent of total GDP, which could amount to as much as \$2 trillion worth of economic activity.”⁵⁹ While it is true that the Proposed Rule allows consumers to document their income in a variety of ways, the practical reality is that most consumers may not be able to show receipts, provide bank statements (especially as many of these cash-income borrowers may also be unbanked or underbanked), etc.

TILs’ high performance shows that traditional installment lenders have found a manner in which to rely on cash income in a way that benefits consumers. As discussed in the third point in the alternative ability-to-repay standard above, a lender should be permitted to use any reasonable method to determine the amount and timing of a borrower’s income. The Proposed Rule uses a “reasonableness” standard in other areas, and such a standard would be appropriate here. For example, in section § 1041.9(c), which discusses projecting consumer net income and payments for major financial obligations, the Proposed Rule allows a lender to reasonably consider other reliable evidence the lender obtains from the consumer, including explanations the lender obtains from the consumer. In the same manner, where cash income is reported, a lender should be able to verify the cash income by reasonably considering an explanation from the borrower.

Another troublesome problem with section 1041.9 is the requirement that a lender determine or verify net income. Lenders do not have information to accurately determine a customer’s tax liability. Lenders do not know whether the dependents claimed on the customer’s payroll are equal to the number of dependents the customer actually has. A paystub is not evidence of net income value, rather, it is evidence of a customer’s cash take-home pay. A lender does not know if the paystub reflects the proper amount of taxes withheld. Lenders should be allowed to obtain and verify a customer’s net income and make a reasonable estimate of a customer’s tax liability based on the lender’s experience with the lender’s customer base and the amounts reported as net by the paystub or other

⁵⁶ Fishman, Stephen, *The Underground Economy of Unreported Income*. NOLO. July 2013. Available at <http://www.nolo.com/legal-encyclopedia/the-underground-economy-unreported-income.html>.

⁵⁷ Newman, Rick, *The New Underground Economy*. U.S. News. March 18, 2013. Available at <http://www.usnews.com/news/blogs/rick-newman/2013/03/18/the-new-underground-economy>.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

payment record and should not have to dig deeper. In fact, customers are highly likely to object to giving this private information out. Requiring net income could also result in lenders having additional non-public, personal information that the lenders would not normally encounter, but would thereafter have to protect.

AFSA also has significant concerns with the proposed estimation of living expenses. Aside from information in a consumer report, there is a reason existing ability-to-repay rules do not require an estimation of living expenses – it is fraught with uncertainty and is nearly impossible to do in a clear and reasonable manner. Living expenses will be a function of where a consumer lives and the number of dependents the consumer has. Asking about ages of dependents, and other similar questions, could potentially raise fair lending issues if the lender must take those factors into account.

In addition, AFSA has concerns with the proposed verification of housing expenses. The Proposed Rule does not address how lenders should treat borrowers who rent a room or live with a friend or relative. Failing to account for these borrowers, who very likely may be unbanked and who may be able to afford a loan because they have lower living expenses, harms the very borrowers the CFPB is trying to protect.

The final rule should allow the lender more discretion in assessing living expenses. Certain housing payments (*e.g.*, private contracts and rentals) are not reported to the credit bureaus and are not readily verifiable. It should, therefore, be up to the lender how to verify what a customer tells the lender. For example, most lenders consider landlords and other similar housing expenses to be non-reporting creditors and only verify such expenses when it is material to the creditworthiness of the consumer. To require such verification for all loans is onerous and will only harm the most vulnerable consumers who will be unable to obtain safe and affordable loans.

An additional concern is that the Commentary specifies that the lender must reasonably account for the possibility of volatility in the consumer's residual income and basic living expenses over the term of the loan. Essentially, the CFPB is saying that a residual income determination is not enough – the determination must also include a “cushion” for downward volatility. This is a trap for the unwary – a lender that has determined residual income and basic living expenses based fairly on existing knowledge, might nonetheless be held liable for making an unreasonable determination in the event of an unforeseen decrease in income or increase in expenses.⁶⁰ Moreover, it changes the relationship between the lender and borrower from an arm's length transaction to more of a fiduciary one, similar to that of a financial counselor. Lenders are not, and should never be, subject to a fiduciary responsibility to consumers.

Finally, predicting what might happen is an impossible and unfair standard. The lender cannot control or predict what might happen. Is the lender supposed to try guess if gas prices might go up? How stable the job market is? Traditional installment lenders support assessing the borrower's ability to repay, but this requirement to include a “cushion” is as inappropriate and unworkable as the evasion provision described above. If a lender has made a reasonable determination of income and expenses, that should be sufficient to borrow a few hundred dollars. These are not long-term mortgages. Traditional installment lenders' default rates, which are usually under 10 percent of their portfolios, show that they are very good at assessing a borrower's ability to repay. Thus, this trap will only serve to constrict credit even further, as even consumers with significant residual income will not qualify for loans because of this provision.

⁶⁰ As an example, look at Louisiana and Mississippi. Lenders made loans to many Louisiana and Mississippi consumers based upon their then-stable employment in the oil industry. Unexpectedly, the oil industry tanked. Thousands of consumers lost good-paying jobs. The loss of those jobs also had a significant and negative effect on the local economies. It would be highly unfair for lenders to be penalized for making those loans when the loans default due to no fault of the borrower or lender. There is no way to predict changes in the economy or the ripple of those changes.

3. *Exemption for five percent portfolio-wide default loans.*

The Proposed Rule contains an exemption from the ability-to-repay requirements for lenders with a portfolio default rate of less than five percent. While traditional installment lenders take pride in their low default rates, five percent is too low for the exemption to be meaningful, especially with the penalties for a higher default rate. The Proposed Rule requires the lender to calculate the portfolio default rate at least once every 12 months and where the portfolio default rate exceeds five percent, the lender must refund all origination fees within 30 days. This is too complicated and no lender will take advantage of this exemption as it is currently drafted. It would be impossible for lenders to refund all origination fees for a year in only 30 days. What if the lender cannot reach the borrower? Even if the lender could find all its customers, the time and effort it would take to track down all the borrowers would be extraordinary. In a small branch office, with only a few employees, it would be impossible.

In addition, default rates can rise for many reasons that have nothing to do with the lender. For example, if gas prices rise, the default rate can go up. If there is a natural disaster, such as the recent flooding in Louisiana, default rates often increase. If there is an economic downturn, default rates will rise. There is no way for a lender to predict these variables. Simply put, this exemption is too risky for a lender to use.

If the CFPB intends this exemption to be meaningful, we suggest some changes. AFSA urges the CFPB to use a default rate of 15 percent and eliminate the look-back provision. The lender would still be required to check the default rate each year, but if the default rate is above 15 percent, the lender would first have to see if there was an outside economic factor that contributed to the rise in defaults. If there was no economic factor, the lender would be required to review its portfolio and make adjustments to lower the default rate. Additionally, there should not be a “liquidated damages” provision here. Enforcement of the rule should be subject to CFPB UDAAP authority, providing the CFPB with flexibility to address violations based on the particular facts and circumstances presented.

4. *Additional suggestions.*

In addition to the overarching changes suggested above, AFSA has a few specific suggestions for this section.

(1) The Proposed Rule requires the lender to obtain a written statement from the borrower for income and expenses and must obtain verification evidence. The final rule should, at most, require validation of the written statement, not verification of data. **For example, the lender should determine whether the written statement is reasonable/plausible, but should not be required to actually collect voluminous verifying information.**

(2) The Proposed Rule does not specify how lenders should treat household income and expenses. AFSA suggests that lenders should be able to treat household income and expenses as joint income and expenses for whichever member of the household applies for the loan. Without this change, consumers who do not work outside the home may find themselves unable to take out a loan. This is what happened with the CARD Act.⁶¹ The CARD Act required credit card companies to consider a person’s independent ability to pay and consumer who did not work outside the home found themselves unable to open a credit card account. In 2013, the CFPB amended the regulations and allowed for household income.⁶²

⁶¹ Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734.

⁶² 78 Fed. Reg. 25818. May 3, 2013.

(3) Returning borrowers should be held to the same ability-to-repay calculation as new borrowers, but not the same verification requirements. The lender is already familiar with the borrower's situation. Having to produce the same information over and over again would be very cumbersome and inconvenient for the borrower, as well as detrimental to the relationship between the lender and the borrower.

(4) The definition of "vehicle" in section 1041.3(d) is too broad and would cover loans secured by the borrower's yacht – presumably not the consumers who are intended to be protected by this provision. To affect the consumer protection purposes of the Proposed Rule, the definition of "vehicle" should be limited to conveyances that are used by consumers for everyday purposes, to get to work, school, etc. Using a very broad definition of vehicle will have a heavier impact on rural consumers who are more likely to own vehicles like ATVs or fishing boats.

E. The restrictions on refinancing ("Presumptions of Unaffordability") should be modified.

1. Overview of refinancing.

There are certain suppositions embedded in the Proposed Rule that bear very careful scrutiny. One such supposition that is false, results in the confusion between "repeat re-borrowing" – a concept associated with non-amortizing debt (e.g., payday and title loans) and "re-borrowing," better referred to as refinancing – associated with installment lending. The Proposed Rule does not make a distinction between the two, treating them both interchangeably and viewing both as potentially being an indicator of predatory lending. The CFPB does this without any supporting data or analysis, and does not seem not to appreciate the fact that these are different. This failure explains in part the CFPB's lumping TILs into a payday and title rule.

Repeat re-borrowing based on the borrower's anticipated inability to repay the original payday or title loan is problematic and a sign of a predatory loan. That is, a sign of a predatory loan is when credit is advanced without the reasonable expectation that it will be repaid on its due date(s). Repeat re-borrowing then becomes an imbedded feature of such a loan product. And, this type of product should certainly be the subject of the Proposed Rule.

TILs – underwritten for repayment in accordance with its terms, fully-amortizing with equal payments, made with no prepayment penalty nor balloon payment, made without required leveraged payment mechanisms and reported to CRAs – do not anticipate such a repeat re-borrowing concept for yield to the lender. TILs are written to be repaid in accordance with their affordable terms.

The fact that a customer may return to a traditional installment lender from time to time, even repeatedly, for her borrowing needs, is not an indicator that the lender makes predatory loans. Rather, it is an indicator that the customer trusts the lender for her credit needs. Customers may use the same collateral for additional loans for different purposes. The initial loan could be for auto repair. The customer may refinance the loan later to get additional funds for a seasonal need (such as back-to-school expenses), and then refinance again later for additional funds to buy an appliance.

Most consumers have repeat credit needs – for both unexpected expenses and anticipated expenses. It is inappropriate to penalize a lender for serving a consumer's repeated borrowing needs. Just as the government would not treat a consumer's physician, dentist, clothier, grocer, mechanic, retailer, or any other service provider "negatively," for seeking repeat business with the consumer, the provider of liquidity – i.e., credit – should be treated no differently than any other provider of goods or services.

To our knowledge, the CFPB does not cite any study that offers or even suggests proof that refinancing, as opposed to repeat re-borrowing, is problematic for consumers. The failure of the CFPB to draw the distinction

between these two concepts is a fundamental flaw in the Proposed Rule. If left unchecked, this failure will result in clogging the pipeline for credit – the fuel that drives the American economy.

2. *Delinquency should be 30, not seven days.*

The Proposed Rule defines “recent delinquency” as when the customer has been delinquent more than seven days in the past 30 days. Only payday and title lenders define a loan as being delinquent when a payment is seven days late. This restriction may be appropriate for a payday or title loan with a 14-day term, but it is not appropriate for a TIL with a 12-month term. Even the major CRAs typically define “Amount Past Due” when the account is 30 days or more past due. The Proposed Rule should direct lenders to count a loan as delinquent when it is more than 30 days past due.

F. The payment requirement should rely on NACHA and Regulation E and be must revised for clarity.

AFSA has several concerns with this section.

- (1) The CFPB should rely on NACHA and Regulation E requirements, not make new rules for non-sufficient funds (“NSF”) fees.
- (2) Prior to initiating a payment transfer from a consumer’s account, a lender must provide the consumer with a payment notice. The transfer terms include a check number, if the transfer will be by check, remotely created check, payment order, internal transfer, or debit card order. This could effectively prohibit remotely created checks and payment orders. AFSA does not see why the check number matters or how the customer benefits from this requirement.
- (3) The CFPB does not discuss testing the model withdrawal notice forms with consumers. AFSA strongly suggests that the CFPB do so before finalizing the rule.
- (4) The Proposed Rule should be clarified so that the payment notice is not required if the lender obtains authorization for each payment.
- (5) The CFPB web address at the bottom of the form is “CFPB.gov/payday.” The use of the term “payday” is not accurate and only furthers the erroneous perceptions of the TIL industry.

Some of the requirements for obtaining consent to provide the notice electronically are more onerous than the requirements set forth by the CFPB in its guidance on recurring ACH issued in November, 2015 (the “November 2015 Guidance”), which allows oral consent if it meets the ESIGN Act⁶³ requirements. The CFPB should either allow oral consent to receive notices electronically, or alternatively follow its same standards as set for in the November 2015 Guidance.⁶⁴

⁶³ ESIGN, Pub. L. 106–229, 114 Stat. 464.

⁶⁴ CFPB Compliance Bulletin 2015-06, *Requirements for Consumer Authorizations for Preauthorized Electronic Fund Transfers*. Nov. 23, 2015. Available at http://files.consumerfinance.gov/f/201511_cfpb_compliance-bulletin-2015-06-requirements-for-consumer-authorizations-for-preauthorized-electronic-fund-transfers.pdf.

G. The “Information Furnishing and Registered Information Systems” should be eliminated.

This section makes a major change to the credit reporting system in America. The credit reporting system is voluntary. This provision changes that and makes credit reporting on certain loans mandatory. The CFPB offers little justification for this huge change. The CFPB offers no studies to show that this change will not adversely affect the credit reporting system. In fact, the CFPB does not even address the fact that this is a major change with significant cost implications.

Traditional installment lenders generally report to at least one CRA and they obtain credit reports on loan applications. The requirement in this section to integrate with all Registered Information Systems would impose a significant burden on all entities, but especially on small ones. It provides a significant competitive advantage to larger entities which are able to spread the cost of integration over a larger number of transactions.

In order to report to a CRA or obtain credit reports from a CRA, a lender must have a contractual relationship with the CRA. Those contracts may be expensive and time-consuming to execute and expose the lender to additional liability. A requirement to integrate with all Registered Information Systems could be prohibitively expensive. It is also an example of a federal agency mandating that a lender enter into multiple contracts, which is beyond the CFPB’s authority.

H. The effective date of the Proposed Rule should be delayed with respect to the use of the Registered Information Systems.

The CFPB is proposing that, in general, the final rule would become effective 15 months after publication in the Federal Register. Due to the complexities of the Proposed Rule, we urge the CFPB to consider an implementation date of at least 18 months. In addition, the final rule should be effective for applications on or after the effective date, not loans made or disbursed after the effective date.

The CFPB is proposing that certain provisions necessary to implement the consumer reporting components of the Proposed Rule would become effective 60 days after publication of the final rule in the Federal Register. The CFPB should allow for a much longer implementation period with respect to the Registered Information Systems. It will take much longer than 60 days to implement the consumer reporting requirements. It would take at least 18 months, if not two years. The CFPB should delay the requirement to check the Registered Information Systems until there is adequate data in such systems and the systems have been tested.

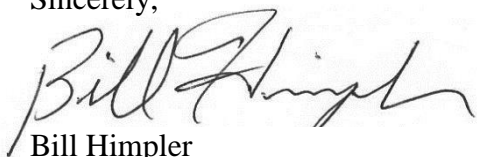
XI. Conclusion

In conclusion, we urge the CFPB to preserve consumer's access to safe and affordable TILs by modifying the Proposed Rule. The breadth of the Proposed Rule exceeds the CFPB's statutory authority and the over-inclusive nature of the Proposed Rule is arbitrary and capricious. The Proposed Rule should be limited to payday, title, and high-cost installment loans. TILs, which have been around for a hundred years, should be exempted. If they are not, consumers will turn to unlicensed and unregulated online lenders, trapping them in hopeless financial quagmires.

If the CFPB does not exempt TILs, AFSA urges the CFPB to consider specific changes to the Proposed Rule including: (1) eliminating the prohibition against evasion, voluntary leveraged payment mechanisms as a trigger for coverage, and the mandatory credit reporting requirement; (2) revising the definition of total cost of credit and the payment procedures; (3) modifying the ability-to-repay requirements to allow lenders more flexibility and the restrictions on refinancing; and lastly (4) extending the effective dates.

If you have any questions, please do not hesitate to contact me by phone at 202-466-8616 or e-mail at bhimpler@afsamail.org

Sincerely,

A handwritten signature in black ink, appearing to read "Bill Himpler", with a stylized, cursive script.

Bill Himpler
Executive Vice President
American Financial Services Association

APPENDIX I

BUSINESS AND ECONOMIC DEVELOPMENT

Resolution BED-16-21

A RESOLUTION PROMOTING SAFE AND AFFORDABLE LENDING PRACTICES

WHEREAS, the National Black Caucus of State Legislators (NBCSL) has always been committed to financial empowerment through improved access to capital as well as a marketplace that offers safe and affordable lending products and services;

WHEREAS, in 1998, the United Nations defined poverty as the lack of access to certain essential goods and services, including access to credit;

WHEREAS, the need for small-dollar closed end credit exists in every community throughout the country;

WHEREAS, not all loan types are equally safe and affordable, and the structure of certain loans significantly increases the likelihood of borrowers falling into a cycle of debt;

WHEREAS, responsibly structured credit is essential to support a household's ability to save, build a sound credit history, and facilitate crucial investments that can provide a foundation for other wealth-building activities;

WHEREAS, the key structural qualities of closed end loans that are safe and affordable are that the lender makes a good faith effort to assess the borrower's ability to repay the loan and that the loan is repayable in substantially equal installments, with no balloon payments;

WHEREAS, it is the intention of this body to ensure access to loans that are low cost rather than low rate, since consumers buy goods with dollars and cents and not with annual percentage rates;

WHEREAS, NBCSL passed Resolution BFI-13-14, "PROMOTING SAFE AND AFFORDABLE LENDING PRACTICES," among the 2013 Ratified Resolutions and that resolution promotes adequate safeguards to protect the general community from abusive financial services;

WHEREAS, this resolution maintains that responsibly structured credit is an essential part of the wealth-building ecosystem, that includes building a sound credit history, as well as saving and wise investment;

BUSINESS AND ECONOMIC DEVELOPMENT

Resolution BED-16-21

WHEREAS, all small-dollar closed end credit should be “fully amortized,” meaning that the Total of Payments defined under the Federal Truth in Lending Act, is repaid in substantially equal multiple installments at fixed intervals to fulfill the consumer’s obligation;

WHEREAS, small-dollar closed end credit, when used prudently by consumers, may help establish, re-establish or improve credit scores;

WHEREAS, all small-dollar closed end credit should be reported to at least one of the three major credit agencies: Equifax, Experian and TransUnion;

WHEREAS, all small-dollar closed end credit should provide that the Total of Payments as defined in the Truth in Lending Act be repaid over at least a 120 day period in substantially equal payments; and

WHEREAS, Traditional Installment Loan Lenders offering amortizing small-dollar closed end credit, may prevent cycle of debt issues inherent with non-amortizing balloon payment loans.

THEREFORE, BE IT RESOLVED, that the NBCSL supports small-dollar closed end credit in the form of traditional installment loans;

BE IT FURTHER RESOLVED, that Traditional Installment Loan Lenders should be reasonably protected;

BE IT FURTHER RESOLVED, that the NBCSL supports the expansion of Traditional Installment Loans as an affordable means for borrowers to establish and _secure small dollar closed end credit while preventing cycle of debt issues inherent with non-amortizing balloon payment loans; and

BE IT FINALLY RESOLVED, that a copy of this resolution be transmitted to the President of the United States, Vice President of the United States, members of the United States House of Representatives and the United States Senate, and other federal and state government officials as appropriate.

SPONSOR: Representative Karla May (MO)

Committee of Jurisdiction: Business and Economic Development Policy Committee

Certified by Committee Co-Chairs: Senator Jeffery Hayden (MN) and Representative Angela Williams (CO)

Ratified in Plenary Session: Ratification Date is December 4, 2015

Ratification is certified by: Senator Catherine Pugh (MD), President

NHCSL RESOLUTIONS 2013

2

SENATOR LETICIA VAN DE PUTTE (TX) LAW & CRIMINAL JUSTICE TASK I

PROMOTING SAFE AND AFFORDABLE LENDING PRACTICES

WHEREAS, the National Hispanic Caucus of State Legislators (NHCSL) has always been committed to financial empowerment through improved access to capital as marketplace that offers safe and affordable lending products and services;

WHEREAS, in 1998, the United Nations defined poverty as the lack of access to certain essential goods and services, including access to credit;

WHEREAS, the need for small-dollar credit exists in every community throughout the country;

WHEREAS, not all loan types are equally safe and affordable, and the structure of certain loans significantly increases the likelihood of borrowers falling into a cycle of debt;
WHEREAS, responsibly structured credit is essential to support a household's ability to save, build a sound credit history, and facilitate crucial investments that can lay foundation for other wealth-building activities;

WHEREAS, the key structural qualities of loans that are safe and affordable are that the lender makes a good faith efforts to assess the borrower's ability to repay the loan that the loan is repayable in substantially equal installments of principal and interest, with no balloon payments;

WHEREAS, it is the intention of this body to ensure access to loans that are low cost rather than low rate, since consumers buy goods with dollars and cents and not with percentage rates;

WHEREAS, government subsidized loans do not exist in meaningful numbers and whenever they do exist, their availability is only temporary, and so loan products are not available at commercially sustainable rates;

WHEREAS, it is important that safe and affordable small-dollar loans be made from offices located within communities and licensed and audited by state authorities to protect borrowers from predatory lenders and lending practices.

THEREFORE BE IT RESOLVED, that the National Hispanic Caucus of State Legislators (NHCSL) supports the development of lending products that encourage responsible underwriting, and attempts to assess a borrower's stability, ability, and willingness to repay the loan;

BE IT FURTHER RESOLVED, that NHCSL encourages policymakers to take the following into account:

That lenders should support and observe all applicable state laws regarding collection practices and that they should make good faith attempts with borrowers to resolve delinquent accounts;

That any loan should be structured in such a way as to minimize the danger of that a borrower might fall into the cycle of debt;

That lenders take care to explain to borrowers, the terms of a possible loan transaction in as clear and transparent a manner as possible;

That lenders should be a vital part of the communities in which they operate and actively participate in community activities and charitable endeavors;

That lenders should support and participate in financial literacy programs by contributing financially to organizations that offer these services to borrowers; and

That lenders, non-profit organizations, and government entities should work together to improve financial literacy;

BE IT FURTHER RESOLVED, that the NHCSL supports efforts to protect consumers who need short-term loans; and

BE IT FINALLY RESOLVED, that a copy of this resolution be transmitted to the President of the United States, Vice President of the United States, members of the United States House of Representatives and the United States Senate, and other federal and state government officials as appropriate.

THIS RESOLUTION WAS ADOPTED ON JULY 13, 2013, AT THE NHCSL EXECUTIVE COMMITTEE MEETING HELD IN MASHANTUCKET, CONNECTICUT AND RATIFIED ON NOVEMBER 16, 2013 AT THE NHCSL ANNUAL MEETING HELD IN ORLANDO, FLORIDA.

SPONSORED BY: Senator Leticia Van De Putte (TX)

CO-SPONSOR: Senator Juan Pichardo (RI)

CO-SPONSOR: Iris Y. Martinez (IL)

APPENDIX

II

By Electronic Filing

October 6, 2016

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: Proposed Rule: Payday, Vehicle Title, and Certain High-Cost Installment Loans (No. CFPB-2016-0025)

Dear Ms. Jackson:

This letter provides comments from trade associations representing a broad cross-section of the United States financial services industry on the Consumer Financial Protection Bureau's proposed rule, "Payday, Vehicle Title, and Certain High-Cost Installment Loans," 81 Fed. Reg. 47,864 (July 22, 2016) ("Proposed Rule"). Specifically, the American Bankers Association ("ABA"), American Financial Services Association ("AFSA"), and Consumer Bankers Association ("CBA")—collectively, the "Trade Associations"—are concerned that the Proposed Rule exceeds the Bureau's statutory authority, is unsupported by adequate evidence, does not undertake a sufficient cost-benefit analysis, fails to consider less intrusive alternatives, and is arbitrary and capricious in other respects. We urge the Bureau to remedy these problems when it finalizes the Proposed Rule.

I. The Proposed Rule Exceeds the Bureau's Statutory Authority.

Federal agencies are creatures of statute and may exercise only those powers delegated to them by statute. *See, e.g., La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986) ("[A]n agency literally has no power to act ... unless and until Congress confers power upon it."); *FTC v. Dean Foods Co.*, 384 U.S. 597, 605 (1966); *see also W. Minnesota Mun. Power Agency v. FERC*, 806 F.3d 588, 593 (D.C. Cir. 2015). The Proposed Rule violates that principle—and therefore violates the Administrative Procedure Act—because it fails to observe the limitations Congress placed on the Bureau's authority.

A. The Proposed Rule Imposes An Unlawful Usury Limit.

Section 1027(o) of the Dodd-Frank Act provides that the Bureau may not "establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless authorized by law." 12 U.S.C. § 5517(o). No statute authorizes the Bureau to impose usury limits on traditional installment loans ("TILs") or lines of credit ("LOCs") (collectively, "Traditional Loan Products"). Thus, the Bureau lacks legal authority to impose a usury limit on Traditional Loan Products.

The Proposed Rule exceeds the Bureau's statutory authority by imposing just such a usury limit. In particular, the Proposed Rule imposes substantial and burdensome underwriting requirements on covered long-term loans with a "total cost of credit that exceeds 36 percent." 81 Fed. Reg. at 47,904. Because these additional underwriting requirements are so costly, many lenders will not make such loans and charge such interest rates. It is irrelevant that the Proposed Rule does not categorically prohibit covered loans with a total cost of credit in excess of 36 percent. The Proposed Rule imposes a *de facto* usury limit by making it uneconomical for many lenders to comply with the new underwriting requirements.

Moreover, lenders would (absent evidence to overcome a presumption that the borrower is unable to repay) be prohibited from issuing covered TILs and LOCs to several classes of borrowers, including borrowers who have an outstanding covered short-term loan or a covered longer-term loan with a balloon payment (or who closed such a loan within the preceding 30 days). *Id.* at 47,865. As to these classes of borrowers, lenders could only make loans with a “total cost of credit” of 36 percent or less. Accordingly, the Proposed Rule imposes a prohibited usury limit. *See* 5 U.S.C. § 706(2)(C) (court must “hold unlawful and set aside agency action . . . found to be in excess of statutory jurisdiction, authority, or limitations, or short of statutory right”).

The two alternative loan structures included in the Proposed Rule are similarly flawed because both include express usury limits. The NCUA “Payday Alternative Loan” option imposes a maximum interest rate of 28 percent, *see* 81 Fed. Reg. at 47,892, while loans made under the remaining option “must carry a modified total cost of credit of less than or equal to an annual rate of 36 percent,” *id.* at 47,865.

B. The Bureau Lacks Authority To Enforce An Ability-To-Repay Requirement With Respect To Traditional Loan Products.

Congress instructed the Bureau to implement an ability-to-repay standard only with respect to two types of consumer financial products: mortgages and credit card loans. *See* 15 U.S.C. §§ 1639c(a)(1) (“[N]o creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms.”); 1665e (“A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.”).

In contrast to mortgages and credit cards, Congress has not granted the Bureau authority to impose an ability-to-repay requirement with respect to Traditional Loan Products. Under the *expressio unius* canon of construction, courts will presume that Congress intended not to adopt an ability-to-repay requirement for these products. *See Leatherman v. Tarrant Cty. Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993).

The *expressio unius* inference is particularly warranted with respect to the Proposed Rule because Congress adopted the ability-to-repay requirement for mortgages, 15 U.S.C. § 1639c(a)(1), in the Dodd-Frank Act—the same statute that created the Bureau. *See* Pub. L. 111-203, § 1411 (mortgage provision); *id.* §§ 1011 et seq. (establishing Bureau and enumerating its powers). As the Supreme Court has observed, “[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.” *Russello v. United States*, 464 U.S. 16, 23 (1983) (citation and quotation marks omitted).

Accordingly, the Proposed Rule’s application of an ability-to-repay requirement to Traditional Loan Products exceeds the Bureau’s statutory authority. *See* 5 U.S.C. § 706(2).

C. The Proposed Rule Would Regulate Insurance In Violation Of The Dodd-Frank Act.

Congress expressly limited the Bureau's authority over insurance products, providing that "[t]he Bureau may not define" "the business of insurance" "as a financial product or service, by regulation or otherwise." 12 U.S.C. § 5517(m). The Act defines the "[b]usiness of insurance" expansively as "the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons." 12 U.S.C. § 5481(3). Section 5517(f) further restricts the Bureau's authority by (i) preserving the authority of state insurance regulators and (ii) directing that (with limited exceptions) "the Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by a State insurance regulator."

Despite these restrictions, the Proposed Rule includes provisions that would in fact regulate the sale of optional ancillary insurance products, including credit life insurance, disability insurance, involuntary unemployment insurance, and similar policies. Specifically, the Proposed Rule would include the cost of such insurance products in the "total cost of credit" for purposes of determining whether a TIL or LOC is a long-term covered loan. *See* 81 Fed. Reg. at 47,909. Because the Proposed Rule restricts lenders' ability to offer covered Traditional Loan Products with a "total cost of credit" in excess of 36 percent of the loan value, the Proposed Rule directly limits the price and availability of optional (and beneficial) insurance products.

The Proposed Rule asserts that such regulation is necessary because "lenders might otherwise shift their fee structures to fall outside traditional Regulation Z concepts and thus outside the coverage of proposed part 1041" of the Bureau's rules—for instance "by shifting the costs of a loan by lowering the interest rate and imposing (or increasing) one or more fees that are not included in the calculation of APR under Regulation Z." *Id.* (emphasis added). This argument fails for two principal reasons.

First, and most fundamentally, regulations on the price and availability of optional ancillary insurance products contravene sections 5517(f) and 5517(m) to the extent that they seek to regulate "the business of insurance." If there is a valid concern regarding the cost of optional ancillary insurance products, that concern should be addressed by state insurance laws. Lenders that provide Traditional Loan Products are licensed and regulated by state departments of insurance, thus providing consumers with ample safeguards. In particular, lenders must charge and remit the premium rates filed with and approved by state regulators and have no authority unilaterally to increase those rates. All actions taken by lenders in their capacities as insurance agents—including the collection of premiums and policy fulfillment—are expressly outside the Bureau's statutory authority. *See* 12 U.S.C. §§ 5517(f), 5517(m).

This limitation applies regardless of whether a lender sells optional ancillary insurance products at the time it issues a TIL or LOC, or shortly after consummation of the loan. Thus, the Proposed Rule's assertion of regulatory authority over voluntary insurance products purchased by a consumer within 72 hours of loan consummation, *see* 81 Fed. Reg. at 47,909, is also *ultra vires* under section 5517(m).

Second, credit life insurance and similar products are optional ancillary forms of insurance that consumers purchase to protect their credit scores, those of their co-borrowers, and ensure that unexpected calamities, such as job loss, do not prevent repayment of a loan. Regulation Z provides that if a lender requires borrowers to purchase such insurance, the associated cost must be included in the APR under existing law. *See* 12 C.F.R. § 1026.4(b)(7)–(8). The cost of “voluntary credit insurance premiums,” in contrast, does not count toward a loan’s APR if the lender makes certain required disclosures and obtains any required affirmative written request to purchase such insurance. *Id.* § 1026.4(d)(1)–(2). Hence, even if the Bureau had authority to regulate the cost and availability of optional ancillary insurance products (which it does not), the concern expressed in the Proposed Rule is already addressed by Regulation Z and cannot justify a further extension of regulatory authority over Traditional Loan Products.

In this regard, the process of issuing a TIL or LOC is properly understood as involving two distinct phases. The first phase involves the lending transaction up to and including the disclosures mandated by Regulation Z. This aspect of the transaction may be subject to the Bureau’s authority. *See* 12 U.S.C. § 5517(f)(2). However, once the lender makes the Regulation Z disclosures, a second phase begins in which the lender markets, sells, fulfills or performs activities as the agent of the insurance company, under the oversight of state insurance regulators. Those activities lie outside the Bureau’s statutory authority, *see id.* §§ 5517(f)(1), 5517(m), and the Proposed Rule is contrary law to the extent it purports to regulate them, *see* 5 U.S.C. § 706(2).

D. The Proposed Rule Exceeds The Bureau’s Authority To Regulate “Unfair, Deceptive, or Abusive” Practices.

Although the Dodd-Frank Act grants the Bureau authority to prevent “unfair, deceptive, or abusive act[s] or practices,” 12 U.S.C. § 5531(a), lenders issuing Traditional Loan Products do not engage in any of these forbidden practices. Far from being unfair, deceptive, or abusive, Traditional Loan Products are reasonably underwritten, fully amortized, transparent, beneficial to consumers, and issued with the expectation that they will be repaid in full according to their terms. The Bureau has no findings of which we are aware, and certainly no substantial basis in data, to conclude that Traditional Loan Products are unfair, deceptive, or abusive. While we understand the Bureau’s desire to ensure that payday and title lenders do not sidestep the Bureau’s rule, the fear of side-stepping cannot and does not justify the substantial and unwarranted burden on such a large segment of the consumer lending industry. Moreover, the Bureau may not rely on findings regarding other types of small-dollar loans, such as payday loans, to justify regulation of Traditional Loan Products under the Bureau’s UDAAP authority.

1. The Record Evidence Does Not Justify Regulation Of Traditional Loan Products.

The Proposed Rule largely treats Traditional Loan Products as collateral damage. Although the Proposed Rule goes on at length regarding unfair, deceptive, and abusive practices associated with other forms of loans (such as payday-lending products), nowhere does the Bureau make a similar showing with respect to Traditional Loan Products. It is axiomatic that the Bureau cannot extend the Proposed Rule to cover Traditional Loan Products unless the record evidence demonstrates that Traditional Loan Products are unfair, deceptive, or abusive. The Bureau has not even attempted to make this showing.

The Proposed Rule attempts to justify its overreach by asserting that only a “fraction” of Traditional Loan Products will be regulated, and that “the rule would have a minimal effect on [installment] lenders because they already engage in substantial underwriting.” 81 Fed. Reg. at 47,987 n.655. The Bureau is wrong to suggest that an insignificant number of Traditional Loan Products will be regulated. *See* ABA Comments at Section III.B.1; AFSA Comments at Section II; CBA Comments at Section II.

In any event, the Bureau’s unfounded conclusions cannot substitute for data showing that traditional installment loans meet the UDAP criteria set forth in 12 U.S.C. § 5531. Among other things, the Proposed Rule does not cite any research on Traditional Loan Products or the purported injuries that result when a TIL or LOC borrower grants a lender access to his or her bank account (or other collateral). These omissions render the Proposed Rule unlawful in each of its applications to Traditional Loan Products. *See* 5 U.S.C. § 706(2); *see also Motor Veh. Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (agency action arbitrary and capricious if agency fails to “examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made,” or if the agency “offer[s] an explanation for its decision that runs counter to the evidence before the agency” (alteration added, quotation marks omitted)); *Ass’n of Data Processing Serv. Organizations, Inc. v. Bd. of Governors of Fed. Reserve Sys.*, 745 F.2d 677, 683–84 (D.C. Cir. 1984) (ADPSO) (courts will “strike down, as arbitrary, agency action that is devoid of needed factual support”).

Moreover, as discussed below, Traditional Loan Products are not unfair, deceptive, or abusive because they are underwritten, contain simple and clear terms, and are allegedly designed to be repaid according to their terms. So far as the Trade Associations are aware, the record contains no evidence whatsoever that Traditional Loan Products trap borrowers in a cycle of debt or have the other adverse consequences the Proposed Rule is designed to address. To the contrary, the Bureau expressly recognized that installment lenders already engage in substantial underwriting. Accordingly, there is no need or basis for imposing the ability-to-repay and other requirements of the Proposed Rule on Traditional Loan Products.

The Proposed Rule focuses nearly all of its findings on payday loans and other short-term forms of credit that often have APRs of 180 percent or more, are not underwritten, and are not designed to be repaid according to their terms. *See, e.g.*, 81 Fed. Reg. at 47,868–71. These findings cannot justify regulation of Traditional Loan Products given the substantial differences between the two classes of loans. *Cf. Adams Fruit Co. v. Barrett*, 494 U.S. 638, 650 (1990) (“it is fundamental that an agency may not bootstrap itself into an area in which it has no jurisdiction” (citation and quotation marks omitted)); *see also, e.g.*, AFSA Comments at Section I, III, & V (documenting ways in which TILs differ from payday-lending products); ABA Comments at Section III.B.1 (describing how Traditional Loan Products offered by banks are underwritten and have low default and rollover rates); CBA Comments at Section III.

2. The Bureau Has Not Established That Traditional Loan Products Are “Unfair.”

The Bureau’s authority over “unfair” practices is limited to practices that (i) cause “substantial injury to consumers” (ii) that “is not reasonably avoidable by consumers,” and (iii)

where the “substantial injury is not outweighed by countervailing benefits to consumers or competition.” 12 U.S.C. § 5531(c)(1). The Proposed Rule is *ultra vires* because the Bureau has not established that any of those criteria are met with respect to Traditional Loan Products.

To begin with, the Proposed Rule does not demonstrate that Traditional Loan Products (or acts and practices taken in conjunction with the offering and issuance of such loans) cause substantial injury to consumers. Indeed, the Proposed Rule does not cite any evidence to suggest that Traditional Loan Products (or the steps lenders taken in issuing them) cause harm to consumers, much less “substantial injury.” On the contrary, Traditional Loan Products have long provided consumers with important benefits. *See, e.g.*, CBA Comments at Section I(1); AFSA Comments at Section I; ABA Comments at III.B.3. Given the lack of data showing substantial injury to consumers, and the wealth of record evidence showing consumer benefits, the Proposed Rule is arbitrary and capricious to the extent it relies on the Bureau’s authority to regulate “unfair” practices. *See* 5 U.S.C. § 706(2); *State Farm*, 463 U.S. at 43.

Moreover, any harm caused by Traditional Loan Products is reasonably avoidable by consumers. Consumers voluntarily obtain TILs and LOCs, and so could avoid any perceived harm by simply choosing not to borrow, or by borrowing from other lenders. The terms of these loans are also transparent and easily understood—meaning that borrowers take them out with full knowledge of the parties’ respective rights and obligations. The Proposed Rule does not provide any evidence suggesting that consumers do not understand the terms of Traditional Loan Products.

Furthermore, any injury resulting from Traditional Loan Products would be substantially outweighed by the significant benefits such loans provide to consumers. Traditional Loan Products have long helped borrowers with few other options meet their financial obligations such as making a rent or mortgage payment, paying utility bills, and so on. The flexibility provided by Traditional Loan Products is important for consumers who are unbanked or under-banked, as these loans are often the only legal source of access to credit for such customers.¹ But Traditional Loan Products are also an important tool for well-banked consumers with prime credit scores, who often rely on the flexibility offered by those products. The Proposed Rule does not establish—nor could it establish—that these benefits to consumers and competition are outweighed by other considerations. Thus, the Proposed Rule is unlawful insofar as it regulates Traditional Loan Products under the Bureau’s section 5531(c) authority to prevent “unfair” acts or practices. *See* 5 U.S.C. § 706(2); *State Farm*, 463 U.S. at 43.

More generally, the Proposed Rule exceeds the Bureau’s authority because it is impermissibly based on policy considerations rather than hard evidence. The Dodd-Frank Act prohibits the Bureau from relying on its established public policy positions “as a primary basis for” determining that a given practice is “unfair.” 12 U.S.C. § 5531(c)(2). The Proposed Rule makes clear that it is premised on the Bureau’s policy preferences concerning the social utility of covered loan products, and of certain contract provisions (such as annual percentage rates)

¹ Lenders report consumers’ payments on Traditional Loan Products to credit bureaus, which provides consumers with the opportunity to demonstrate good credit and improve their credit scores. This is a significant benefit to credit-impaired consumers.

associated with those products. *See, e.g.*, 81 Fed. Reg. at 47,909–10. The Bureau cannot substitute its preferences for record evidence showing that Traditional Loan Products in particular (rather than other types of loans with substantially different terms, offered by lenders with substantially different track records) meet the statutory criteria for “unfair” practices. *See, e.g., ADPSO*, 745 F.2d at 683–84.

3. The Bureau Has Not Established That Traditional Loan Products Are “Abusive.”

The Bureau’s authority over “abusive” practices likewise does not provide a basis for regulating Traditional Loan Products. This authority is limited to practices that: (i) materially interfere with the ability of a consumer to understand a term or condition of a consumer financial product or service, or (ii) take unreasonable advantage of (a) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service, (b) the inability of the consumer to protect his or her interests in selecting or using a consumer financial product or service, or (c) the reasonable reliance by the consumer on the financial service provider to act in the interests of the consumer. 12 U.S.C. § 5531(d). Traditional Loan Products (and lenders’ practices in issuing such loans) cannot be regulated as “abusive” because they do not meet any of those statutory requirements.

As an initial matter, the Proposed Rule does not identify any *practice* that materially interferes with the ability of consumers to understand terms or conditions of Traditional Loan Products. The Bureau may not regulate Traditional Loan Products without making such a finding. Because the Proposed Rule fails to do so, it exceeds the Bureau’s statutory authority.

Nor, in any event, has the Bureau shown that consumers do not understand the terms and conditions, or material risks or costs of Traditional Loan Products. *See* 12 U.S.C. § 5531(d)(2)(A). This is hardly surprising: Traditional Loan Products are “plain vanilla” loans with transparent, easy-to-understand terms, due dates, and payment amounts.

Indeed, Director Cordray himself has raised doubts about whether the “lack of understanding” prong could even be the basis for a broad rulemaking such as that envisioned by the Proposed Rule. He has stated that a lack of understanding sufficient to support an abusive claim is “unavoidably situational” and that the Bureau would need to investigate the facts “consumer by consumer.” Transcript, House Committee on Financial Services, “The Semi-Annual Report of the Consumer Financial Protection Bureau,” 112th Cong. (March 29, 2012), at 18. He has also stated that “what is abusive and takes unreasonable advantage can differ from circumstance to circumstance.” *Id.* Accordingly, to justify regulation of Traditional Loan Products under section 5531(d)(2), the Bureau would need to show that such loans are not understood by all or nearly all consumers. Once again, the Bureau has not done so.

Any lack of understanding would, in the first instance, compel the Bureau to explore enhanced disclosures as a remedy, which the Bureau has not done. For example, if the Bureau believes that particular terms of Traditional Loan Products are insufficiently clear or are not provided in a manner likely to foster consumer understanding, the Bureau could mandate improved disclosure practices. The Proposed Rule skips over this commonsense step and instead opts for far more invasive forms of regulation. In doing so, the Proposed Rule violates the

Administrative Procedure Act. *See, e.g., State Farm*, 463 U.S. at 48 (“At the very least this alternative way of achieving the objectives of the Act should have been addressed and adequate reasons given for its abandonment.”); *Allied Local & Reg’l Mfrs. Caucus v. EPA*, 215 F.3d 61, 80 (D.C. Cir. 2000) (“To be regarded as rational, an agency must . . . consider significant alternatives to the course it ultimately chooses.”).

The Bureau likewise has not shown that borrowers are unable to protect their own interests in selecting or using Traditional Loan Products. In fact, such loans are mainstream products that have long been used by mainstream consumers who are experienced in making educated product choices and looking out for their own interests.

Finally, the Proposed Rule does not show that borrowers are reasonably relying on non-bank lenders to act in their interests with respect to Traditional Loan Products. On the contrary, the record shows that Traditional Loan Products are issued in arms-length transactions with no expectation of a fiduciary or similar relationship between lender or borrower. *See, e.g., AFSA Comments at Sections VIII & X*. Thus, to the extent the Proposed Rule relies on the Bureau’s authority under section 5531(d)(2)(C), it is arbitrary and capricious. *See State Farm*, 463 U.S. at 43; *ADPSO*, 745 F.2d at 683–84. Similarly, if the Bureau believes consumers are relying on Traditional Loan Product providers to act in their interests (despite the Bureau’s failure to furnish data documenting such reliance), the proper course is to mandate clear disclosures disabusing consumers of that assumption. *See Allied Local*, 215 F.3d at 80.

4. The Bureau Lacks Authority To Require Lenders To Underwrite Traditional Loan Products in the Bureau’s Preferred Manner.

For the same reasons as given in Sections I.D.1 to I.D.3 above, the Bureau lacks statutory authority to require lenders to underwrite (or underwrite in any particular manner) when issuing TILs and LOCs. The Bureau has no general rulemaking authority that allows it to determine how all lenders should underwrite loans. To the contrary, the Bureau’s authority is limited to “prevent[ing] a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.” 12 U.S.C. § 5531(a) (emphasis added).

Thus, where the Bureau has properly determined that an act or practice is unfair or abusive, *see id.* § 5531(c)–(d), the Bureau may prevent lenders from engaging in that practice. The Bureau has not made or supported such a finding with respect to Traditional Loan Products themselves, or with respect to any acts or practices made in connection with the offering and issuance of such loans.

The Bureau has clearly exceeded its statutory authority in mandating that lenders determine ability to repay using its preferred “residual income” test. The Bureau has no basis for using its UDAAP authority to mandate this extremely burdensome and restrictive method of underwriting. The Bureau has not—and cannot—demonstrate that all other underwriting approaches are necessarily unfair or abusive. For example, the Bureau does not require credit card issuers and mortgage lenders to make an ability to repay determination based on “residual income”; those lenders can instead consider, among other things, the consumer’s debt-to-income

ratio. Similarly, the Proposed Rule prohibits a lender from relying solely on a consumer's statement regarding her income, and instead requires the lender to verify that the stated income is correct. The Bureau has not—and cannot—demonstrate that all underwriting approaches that rely on a consumer's statement of income are necessarily unfair or abusive. Once again, the Bureau permits credit card issuers to rely on the consumer's statement of income and does not require verification of those statements.

The Proposed Rule acknowledges that many lenders engage in “substantial underwriting” in issuing Traditional Loan Products. 81 Fed. Reg. 47987 n.655. The Bureau does not explain why these underwriting methods are unfair or abusive, and yet nevertheless would require these lenders to change their underwriting practices to conform to the Bureau's preferred “residual income” approach. This failure to consider other less restrictive underwriting methods is arbitrary and capricious.

E. The Proposed Rule Is Contrary To The Bureau's Statutory Purpose.

In addition to the specific deficiencies noted above, the Proposed Rule is also contrary to law because it would undermine one of the Bureau's core purposes: to “ensur[e] that all consumers have access to markets for consumer financial products and services.” 12 U.S.C. § 5511(a). The Proposed Rule directly and substantially frustrates that purpose because it will restrict—or in many cases eliminate altogether—access to two sources of credit that consumers have long relied upon: TILs and LOCs. *See, e.g.*, AFSA Comments at Sections II–V & X (explaining that the Proposed Rule's underwriting, reporting, and other requirements will be “almost impossible to meet” and will cause many lenders to exit the market); ABA Comments at Section V (explaining how the Proposed Rule will force most banks to stop offering Traditional Loan Products and discourage banks from designing new small dollar loan products). A regulation so at odds with Congress's stated purposes cannot withstand APA review. *See, e.g., Envtl. Def. Fund v. EPA*, 852 F.2d 1316, 1328–29 (D.C. Cir. 1988); *see also New York State Dept. of Social Servs. v. Dublino*, 413 U.S. 405, 419–420, (1973) (“We cannot interpret federal statutes to negate their own stated purposes.”).

It is true that the Dodd-Frank Act also charges the Bureau with ensuring that “markets for consumer financial products and services are fair, transparent, and competitive.” 12 U.S.C. § 5511(a).² But “no legislation pursues its purposes at all costs,” *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2185 (2014) (quotation marks and citation omitted), and the Act's transparency and fairness goals must be balanced against the additional credit-access goals described above, *see King v. Burwell*, 135 S.Ct. 2480, 2489 (2015) (courts and agencies “must read the words” of a statute “in their context and with a view to their place in the overall statutory scheme”). The Bureau therefore may not adopt regulations that focus exclusively on perceived fairness and transparency concerns. The Proposed Rule is invalid because it does just that, without effectuating Congress's goal of ensuring that all consumers also have adequate access to consumer financial products and services. *See Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2446 (2014)

² The Proposed Rule is devoid of any indication that the market for Traditional Loan Products is not fair, transparent, or competitive.

(reaffirming “the core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate”).

II. The Proposed Rule Is Arbitrary, Capricious, And Contrary To Law.

In addition to respecting the limitations on their statutory authority, agencies must also engage in reasoned decisionmaking. *See, e.g., Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016) (“One of the basic procedural requirements of administrative rulemaking is that an agency must give adequate reasons for its decisions.”); *State Farm*, 463 U.S. at 43, 52. The Proposed Rule fails this fundamental requirement in multiple respects. Publishing a 1300 page Proposed Rule does not *ipso facto* equate to reasoned decisionmaking.

A. The Proposed Rule Is Not Supported By An Adequate Cost/Benefit Analysis.

The Dodd-Frank Act permits the Bureau to issue regulations “as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial protection laws, and to prevent evasions thereof.” 12 U.S.C. § 5512(b)(1) (emphasis added). As the Supreme Court recently held in *Michigan v. EPA*, 135 S.Ct. 2699, 2706–07 (2015), statutes that use the term “appropriate” impose an implicit requirement to assess a rule’s costs and benefits.³

The Dodd-Frank Act provides specific guidance regarding the kind of cost-benefit analysis that the Bureau must undertake. In particular, the Bureau “shall consider (i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; and (ii) the impact of proposed rules on covered persons . . . and the impact on consumers in rural areas.” 12 U.S.C. § 5512(b)(2)(A).

The Proposed Rule is arbitrary and capricious because it fails to conduct such an analysis with respect to Traditional Loan Products. Missing entirely from the Proposed Rule is evidence to suggest that Traditional Loan Products harm consumers. Even if there were evidence of harm, the Bureau never explains how the Proposed Rule would address the purported harm, or whether the Proposed Rule’s perceived benefits outweigh its substantial (and presently unacknowledged) costs in terms of consumer access to safe, legal means of small-dollar credit. Unless the Bureau quantifies and seriously evaluates the Proposed Rule’s effect on credit availability for consumers (particularly those who are unbanked and under-banked), it cannot ensure that the Rule’s benefits

³ Specifically, the Court held in *Michigan* that “‘appropriate’ is the classic broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors”—including whether a rule’s costs are justified by its benefits. 135 S. Ct. at 2707 (quotation marks omitted). “Agencies have long treated cost as a centrally relevant factor when deciding whether to regulate,” because “[c]onsideration of cost reflects the understanding that reasonable regulation ordinarily requires paying attention to the advantages and the disadvantages of agency decisions.” *Id.*; *see also State Farm*, 463 U.S. at 54 (“The agency was correct to look at the costs as well as the benefits” of its rule.).

justify its costs. The Bureau's failure to conduct these statutorily mandated aspects of the cost-benefit analysis renders the Proposed Rule arbitrary and capricious. *See, e.g., Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011).

The Proposed Rule's consideration of costs and benefits also fails in several other respects. First, the Proposed Rule inadequately considers the benefits that Traditional Loan Products offer in terms of consumer welfare. Second, the purported benefits of rule—elimination of harms caused by payday and title pawn re-borrowing—are entirely speculative. This is particularly so given the Bureau's failure to distinguish “repeat re-borrowing” that results in a “cycle of debt” from “refinancing” associated with Traditional Loan Products, which does not present the same consequences for consumers. *See* AFSA Comments at Section X. Third, the Proposed Rule fails to consider the consequences that will result when consumers are forced to turn to riskier and more costly forms of credit—including nonpayment of bills or illegal loan sharks. Fourth, the Proposed Rule fails to comprehend that its burdensome underwriting, reporting, and other requirements will make it uneconomical for lenders to continue to provide small-dollar, covered TILs and LOCs—thus substantially reducing consumers' access to safe, smaller-dollar loan products. For example, the Proposed Rule has significantly understated the costs to lenders to modify their computer systems to make small dollar loans and to comply with the verification and other requirements to make an individual loan. *See* ABA Comments at Section VI (contrasting Proposed Rule's unsupported cost figures with cost data ABA obtained from its member banks). The Proposed Rule also fails to explain why the cost associated with requiring lenders to integrate with all registered information systems is justified by the benefits of that practice. *See, e.g.,* AFSA Comments at Section X. Fifth, the Proposed Rule does not adequately consider the effect that it will have on rural consumers, who often have less overall access to small-dollar credit, as well as access to fewer types of small-dollar credit.⁴

B. The Proposed Rule Violates The Regulatory Flexibility Act.

The Bureau must prepare a regulatory flexibility analysis because the Proposed Rule will have a significant economic impact on “small entities”—i.e., businesses that are “independently owned and operated and which [are] not dominant in [their] field of operation.” *See* 5 U.S.C. §§ 601(3), (6), 603(a), 604(a)(4)–(6), 15 U.S.C. § 632(a)(1).

The initial regulatory flexibility analysis must describe “any projected increase in the cost of credit for small entities,” as well as “any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities.” 5 U.S.C. § 603(d)(1); *see also id.* § 603(b), (c) (setting forth further requirements). And the final regulatory flexibility analysis must contain “a description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a

⁴ The Proposed Rule concludes that rural consumers will experience a “greater reduction in the physical availability of covered short-term loans made through storefronts” than consumers in urban areas, 81 Fed. Reg. at 48,150, but does not determine whether rural consumers will continue to have adequate access to safe and legal small-dollar loans once the Proposed Rule's provisions are in effect.

statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.” *Id.* § 604(a)(6); *see also id.* § 604(a)(1)–(6) (imposing additional requirements).

Although the Proposed Rule contains an initial regulatory flexibility analysis, *see* 81 Fed. Reg. at 48,150–48,166, that analysis fails to meet several of the Regulatory Flexibility Act’s requirements. In particular, the Bureau’s initial analysis falls short in the following respects:

- Reporting Requirements. The Proposed Rule would force lenders to make a substantial investment in automated systems to report consumer information. Although the Bureau acknowledges that small businesses will have to develop procedures to comply with the proposed rule, it does not “describe” these procedures or outline what small businesses must do to develop these procedures, including consulting with lawyers, vendors, and navigating through the complexity of the rule—as required by the Regulatory Flexibility Act. Further, the Proposed Rule severely underestimates the amount of time it will take employees to comply with its reporting procedures.
- Recordkeeping Requirements. The Proposed Rule does not identify any costs associated with the 36-month retention period. *See* 81 Fed. Reg. at 48,105–48,106. Those costs are significant. Even if a lender maintains records electronically, it will incur substantial additional costs in developing a document retention policy, obtaining additional computer storage space to maintain the documents, programming the computer system to keep the documents for 36 months and then delete them, training employees to comply with the recordkeeping requirements, and monitoring the implementation of these new procedures. Despite these significant costs, the Bureau’s initial regulatory flexibility analysis fails to account for the cost of the new recordkeeping requirements.
- Time to Review Verification Evidence. The Proposed Rule estimates that it will take three to five minutes for an employee to review loan-verification evidence to ensure that it is complete and complies with the ability-to-repay requirements. That estimate is grossly understated; the Proposed Rule is complex and would require a substantial amount of documentation from loan applicants. Employees who are charged with reviewing verification materials will need adequate time to ensure that all required information is in the consumer’s file, and that review process will take well in excess of the three to five minutes estimated by the Bureau.
- Time to Make Ability-To-Repay Decisions. The Proposed Rule’s estimates that it will only take 10 minutes for manual decisions and no time at all for automated ability-to-repay determinations are unreasonable. In reality, it will take an employee much longer than 10 minutes to comply with the Proposed Rule’s ability-to-repay requirements. For lenders who have a subjective or partially-subjective decisionmaking process, the employee must discuss what is required with the applicant, answer the applicant’s questions, assist the applicant in obtaining

documentation from employers and others, compile the information, ensure the information is complete, and then review the completed information to determine ability to repay. Even for those small businesses that use an automated underwriting system, employees would still be required to monitor the system and ensure that it is functioning appropriately. The Proposed Rule fails to consider these monitoring costs, as well as other costs necessary to create, maintain, and monitor a properly functioning ability-to-repay decisionmaking system.⁵

- Reliance on Attorneys and Vendors as Cost-Savers. In acknowledging that making ability-to-repay determinations will be a challenge for small entities, the Proposed Rule emphasizes that vendors and law firms can offer “products and guidance,” 81 Fed. Reg. at 48,120, which may reduce the cost of compliance. This description of costs is unreasonable: attorneys and vendors will cost small businesses money. It is unclear why the Bureau refers to attorneys and vendors as cost-savers when they are really additional costs that should be described in the regulatory flexibility analysis.
- Other Cost Determinations. Although the Proposed Rule estimates that employees will require only 4.5 hours of initial training and 2.25 hours of periodic ongoing training per year to comply with the ability-to-repay requirements, *see* 81 Fed. Reg. at 48,157, those estimates are far too low given the Proposed Rule’s complexity.
- Limitations on Refinancing. The Proposed Rule does not describe the costs associated with developing a system with the capacity to detect when the applicant has taken out recent covered loans, nor does it describe the costs associated with employee wages needed to create, operate, and monitor such a system.
- Limitation on Payment Withdrawal Attempts. Small businesses collect payments directly from borrower accounts for security reasons, and for the borrower’s convenience. Account access also enables small businesses to lend to borrowers who might not otherwise have access to credit. Contrary to the Bureau’s assumptions, small businesses do not currently have the capability to track two failed withdrawal attempts from consumer accounts. *See* 81 Fed. Reg. at 47,866. Small businesses will have to develop, monitor, and maintain such systems. The Bureau’s initial regulatory flexibility analysis is deficient because it fails to describe or account for those costs.
- Differing Compliance or Reporting Requirements or Timetables for Small Entities and Similar Matters. Although the Regulatory Flexibility Act requires agencies to consider “the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities,” 5 U.S.C. 603(c)(1), the Bureau’s initial regulatory flexibility analysis fails to do so. The Bureau committed the

⁵ The same is true for systems designed to ensure compliance with alternatives to the Proposed Rule’s ability-to-repay requirement.

same error with respect to similar requirements set forth in 5 U.S.C. §§ 603(c)(2)–(3), 603(d)(1)(A).

- The Bureau Identifies, But Does Not Describe Several of the Proposed Rule’s Costs. Although the initial regulatory flexibility analysis pays lip service to the Bureau’s obligations under the Regulatory Flexibility Act by “identifying” several classes of costs and burdens, the analysis is deficient because identification is not enough. The Regulatory Flexibility Act requires agencies to describe the impact of these costs and burdens as a means of showing that the agency has taken them into account in fashioning the rule. *See, e.g.*, 5 U.S.C. §§ 603(a) (agency “shall describe the impact of the proposed rule on small entities” (emphasis added)). The Proposed Rule has not done so.
- Business Risks and Lost Revenue. The initial regulatory flexibility analysis fails adequately to consider the practical effect the Proposed Rule will have on small lenders on a day-to-day basis. Among other things, the analysis omits any discussion of revenue losses that will result from prohibitions on issuing certain covered small-dollar loans (e.g., because a consumer fails the ability-to-repay criteria, is unable to furnish documentation sufficient to satisfy those criteria, or has an outstanding covered loan).
- Required Notices. The Proposed Rule underestimates the amount of employee and training time that will be required to ensure that lenders send appropriate notices to consumers, as well as the cost associated with developing procedures to ensure that such notices are sent in a timely, accurate fashion. For lenders without complex automated systems, several hours of employee time will be required. For lenders with more sophisticated systems, the Proposed Rule fails to address the substantial programming time, testing time, training time, monitoring time, and stationary and postage costs that will be incurred.
- Duplicate and Overlapping Regulations. Although the Regulatory Flexibility Act requires agencies to identify federal rules “which may duplicate, overlap or conflict with the proposed rule,” 5 U.S.C. § 603(b)(5), the Proposed Rule fails to identify E-SIGN and ECOA/Regulation B as duplicate or overlapping rules. This omission is improper. The Proposed Rule conflicts with E-SIGN and Regulation E because it adopts a different and new definition for consumer consent to receive electronic disclosures. Likewise, the Proposed Rule conflicts with ECOA because it does not permit lenders to consider household income or expenses in making an ability-to-repay determination

The Proposed Rule also violates the requirements of the Small Business Regulatory Enforcement Fairness Act (“SBREFA”). Prior to publishing the initial regulatory flexibility analysis, the Bureau was required to consult with small business owners, convene a panel with the Small Business Administration and Office of Management and Budget (OMB) and produce a report. *See, e.g.*, 5 U.S.C. §§ 609(b)(2), (b)(4)–(6). The Bureau did not properly conduct this mandatory consultation process.

In particular, the Bureau did not heed the detailed feedback provided by small entity representatives (“SERs”) regarding the Proposed Rule’s negative effects. SERs explained that the Proposed Rule would affect small businesses by increasing operating costs, reducing the ability to provide credit to consumers, and even forcing businesses to close—ultimately harming customers, employees, and communities. For example, based on experience complying with state laws in Virginia, North Carolina, South Carolina, Georgia, Florida, Kentucky, Ohio, Michigan, Colorado, Oregon, Utah, and Washington, SERs noted that:

- The Proposed Rule’s requirements to (i) collect and verify documents as part of an ability-to-repay analysis (including for loan applications ultimately rejected), (ii) train employees in the Rule’s complexities, and (iii) implement new hardware and software for underwriting and loan reporting, would dramatically increase the costs associated with issuing TILs and LOCs.
- The Proposed Rule’s prescriptive ability-to-repay requirements would confuse and frustrate customers and significantly increase transaction times, driving customers to less scrupulous lenders.
- NCUA-type loans have proven to be unprofitable for small businesses that have made them in the past, and therefore are not a serious “alternative” to an ability-to-repay determination.

The Proposed Rule similarly overlooked substantial alternatives offered by SERs during the SBREFA process.⁶ These alternatives included:

- Allowing lenders to consider a borrower’s ability to repay using less prescriptive means. Returning customers that have borrowed and repaid loans in the past, for example, have already demonstrated their ability to repay several times over. Customers that need money for emergencies should also not be shut out from obtaining credit due to rigid underwriting requirements. The Bureau could adopt an alternative to the ability-to-repay requirements based, for example, on a payment-to-income standard.
- Recognizing other consumer safeguards. State law, NACHA requirements, and trade association best practices have transformed loan underwriting for the better in recent years, without any need for a prescriptive ability-to-repay requirement. The Bureau must take these improvements into account when fashioning the final rule.
- Streamlining the requirements for reporting the use of covered loans to consumer reporting agencies. Although Traditional Loan Product providers have relationships with credit-reporting bureaus, the Proposed Rule would take the unprecedented step of requiring lenders to integrate with all registered information systems. This mandate will

⁶ See Final Report of the Small Business Review Panel on CFPB Rulemaking on Payday, Vehicle Title, and Similar Loans (June 25, 2015), *available at* <http://www.consumerfinance.gov/policy-compliance/rulemaking/small-business-review-panels/payday-vehicle-title-and-similar-loans/>.

necessitate significant expenditures of time and money by lenders without producing any apparent benefit, and will lead many lenders to exit the market for covered Traditional Loan Products entirely.

C. The Proposed Rule Violates The Paperwork Reduction Act.

The Paperwork Reduction Act requires agencies to obtain OMB approval before conducting a “collection of information”—i.e., “obtaining, causing to be obtained, soliciting, or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency.” 44 U.S.C. § 3502(3); 5 C.F.R. § 1320.3(c). The Proposed Rule is subject to such approval because it would require lenders to obtain and retain significant volumes of personal financial information from borrowers, and to report loan information to third-party credit bureaus.

To obtain OMB approval, the Bureau first must publish a notice in the Federal Register describing the “collection of information” and allow the public 60 days to comment. 5 C.F.R. § 1320.8(d). After reviewing and incorporating the comments from the first notice, the agency must publish a second Federal Register notice and provide a 30-day comment period, after which OMB has 60 days to approve or deny the collection of information. 5 C.F.R. § 1320.11.

The purpose of the Paperwork Reduction Act is to ensure that collections of information to fill a legitimate regulatory purpose, so as not to burden commercial enterprises with unnecessary “red tape.” In this case, much of the paperwork burden—in particular, the collection and verification of income and debt information—serves no legitimate purpose, and will not advance the stated goal of ensuring ability to repay. Accordingly, the Proposed Rule’s data collection and retention mandates are unlawful and must not be approved.

Sincerely,

American Bankers Association

American Financial Services Association

Consumer Bankers Association