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United States House of Representatives
Committee on Financial Services, Subcommittee on Consumer Protection and Financial Institutions
2129 Rayburn House Office Building
Washington, DC 20515

Delivered electronically

April 29, 2019

RE: "Ending Debt Traps in the Payday and Small Dollar Credit Industry" (Hearing April 30, 2019)

Chairman Meeks, Ranking Member Luetkemeyer, and Members of the Committee:

Millions of the most financially fragile individuals in this country are experiencing harm because payday loans and other small-dollar loans that they seek to get help paying bills actually have the reverse effect of making it harder to make ends meet. This problem is compounded when lenders abuse "leveraged payment mechanisms" such as post-dated checks or electronic payment plans to collect on loans even when it undermines borrowers' ability to meet basic needs or other financial obligations. The case for reform is overwhelmingly supported by research, as summarized below (see "Conclusions Based on Research Findings" section, below).

I oversee the consumer finance project at The Pew Charitable Trusts, where since 2011 our team of professionals has conducted rigorous, non-partisan, in-depth analysis on the market for payday, vehicle title, and similar loans. We have published the most extensive body of research on this topic available, including detailed policy recommendations for federal and state lawmakers (see "Pew's Qualifications for Commenting on Payday and Small-Dollar Credit Policy" section, below).

I write to express strong support for the Consumer Financial Protection Bureau's 2017 payday loan rule, which is narrowly tailored to address the most harmful balloon-payment loans, and strong opposition to the CFPB's current proposal to rescind or delay it. Secondly, if legislative bodies such as Congress want to address the payday loan problem, they should not attempt to replicate the CFPB's "ability to pay" rule but instead should use the full scope of their legislative powers to regulate loan terms directly. The CFPB's 2017 rule would help millions of borrowers, but because of the Bureau's limited authority, it did not regulate loan prices, durations, total costs, the size of payments, or other factors that are important to balance the interests of lenders and borrowers. Congress and state legislatures can, and should, regulate these terms.

The 2017 CFPB Rule for Payday and Similar Loans Is Working, and the Agency Should Not Undo It

The CFPB recently issued a Notice of Proposed Rulemaking stating its preliminary intention to eliminate the core component of its 2017 rule on payday, vehicle title, and certain high-cost

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Attachment: Pew comment letter to the CFPB dated March 18, 2019

(continued from page 1) installment loans. The agency has also proposed to delay implementation of the rule while it completes its evaluation. In recent comments to the agency, Pew expressed support for the 2017 rule and opposition to the agency's plans to change or delay it. Our comment letter dated March 18 of this year, which is attached here, noted that "the final rule set strong consumer protections for loans that consistently harm consumers—single payment and balloon-payment loans—without eliminating them, and it gave lenders complete leeway in offering both affordable and high-cost loans repayable in equal installments over terms longer than 45 days."

The CFPB's 2017 payday loan rule is narrowly targeted to regulate the most harmful types of loans in this market: balloon-payment loans and loans that last 45 days or less. Under the rule, if a loan lasts 45 days or less, lenders must undergo a prescribed process of determining a loan applicant's ability to repay the loan or follow an alternative process that includes several consumer safeguards; but if the loan lasts longer than 45 days, lenders do not need to follow the ability-to-repay guidelines. The net effect of this rule has been to encourage lenders to give borrowers more than 45 days to repay their loans in equal installments—which our research demonstrates is the right outcome.

As we explained in our March 18th letter to the CFPB, bank and credit union regulators took important steps in the wake of the CFPB rule that help demonstrate its success. For example, the Office of the Comptroller of the Currency published a bulletin in May of 2018 giving banks guidelines for issuing small installment loans with terms lasting longer than 45 days. In September of 2018, U.S. Bank began offering a new small installment loan repayable over three months with strong consumer protections and dramatically lower costs than existing options for people with low credit scores (whereas borrowing $400 from a payday lender for three months typically costs $360, U.S. Bank is offering that same credit for $48 to $60).[1]

The CFPB now claims that credit will be constrained under the 2017 payday loan rule, but this is not substantiated. While there is likely to be a reduction in the number of loans with terms lasting less than 45 days, there is and will continue to be ample access to credit that is repayable in more than 45 days. This is shown not only in the launch of new small installment loan products from banks, but also in the expansion of installment lending from payday lenders and other nonbank lenders. In sum, the CFPB's payday loan rule will not result in the drop in access to credit that the 2019 proposal alleges, because it discourages lenders from making short-term loans with balloon payments, which most borrowers cannot afford, but places virtually no impediments to allowing credit to flow in the form of amortizing installment loans.

Under the final 2017 rule, credit would be widely available. Lenders could issue single-payment loans by assessing applicants' ability to repay or using a principal payoff option. Or lenders could easily offer payday installment loans, payday lines of credit, or vehicle title-secured versions of these loans. The rule would benefit consumers by ending long sequences of single-payment loans, and it would benefit transparent lenders who acknowledge, disclose, and structure loans with sufficient time to repay in installments.

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[1] For commentary about the U.S. Bank Simple Loan, see The St. Louis Post-Dispatch, "Editorial: Finally, Banks and Others Challenging Payday Lenders" (September 13, 2018), https://www.stltoday.com/opinion/editorial/editorial-finally-banks-and-others-are-challenging-payday-lenders/article_fa29143b-8d73-57b3-af47-723fa7871bb7.html. See also The Albuquerque Journal, "Editorial: Technology Leads Way to Fair Small-Dollar, Short-Term Loans" (September 29, 2018), https://www.abqjournal.com/1227262/technology-leads-way-to-fair-smalldollar-shortterm-loans.html.

The 2019 proposal cites as its rationale that access to credit will be severely curtailed under the 2017 rule and competition[2] will be harmed. The Bureau's claim is that the 2017 provisions "would have the effect of restricting access to credit and reducing competition for these products." The Bureau now argues the 2017 rule would have "dramatic impacts in restricting consumer access to payday loans" and "eliminating over 90 percent of all payday and vehicle title loans would adversely affect the interests of all borrowers." The Bureau's 2019 proposal describes the 2017 final rule as saying that "…the Bureau estimated that, absent the conditional exemption in 1041.6, the Mandatory Underwriting Provisions of the Rule would reduce payday loan volume and lender revenue by approximately 92 to 93 percent relative to lending volumes in 2017 and vehicle title volume and lender revenue by between 89 and 93 percent."

This paraphrasing makes it sound like the 2017 rule estimates there will be large drops in access to credit. But the 2017 rule does not reach that conclusion. Instead, the 2017 rule says "…the Bureau estimates that the restrictions on short-term vehicle title lending will prevent between 89 and 93 percent of *short-term vehicle title loans that are currently made*" (emphasis added). That conclusion is substantially different than the agency's current paraphrasing of it, because lenders are not limited to only offering short-term loans with terms up to 45 days. Instead, many lenders have shifted, and others will shift, to offering loans that are not covered because they have terms beyond 45 days. The 2017 rule acknowledges this, explaining "The primary impact of this rule, *prior to any reforms it may prompt in market practices*, will be a substantial reduction in the volume of *short-term* payday and vehicle title loans…" (emphasis added).[3]

A borrower who uses a single-payment vehicle title loan before the law change and would not pass the ability-to-repay test will generally still have access to credit. The borrower can obtain 1) a longer-term auto title loan, 2) a subprime consumer loan from a traditional installment lender, or if the borrower is among the large majority of auto title loan customers that have a checking account, 3) a payday installment loan or payday line of credit, or 4) a small installment loan or line of credit from their bank or credit union. None of these loans are required to adopt the 2017 safeguards because they all have terms of more than 45 days and do not carry balloon payments. The 2017 rule correctly recognizes that the borrower will only have reduced access to single-payment and balloon-payment loans, not to all forms of credit available to them.

The 2019 proposal appears to be motivated primarily by a misunderstanding of the availability of credit under the 2017 rule. The writers of the 2019 proposal are not the first ones to make such a fundamental error. Several analysts and industry consultants have made similar errors in attempting to evaluate the impact of policy changes. At this point there is enough evidence to be certain that their assumptions (that lenders will not extend the terms of loans beyond 45 days or comply with new laws under which they can operate profitably) are incorrect.

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[2] Payday lenders do not primarily compete on price, instead pricing at the state rate ceiling no matter where it is set, as the Bureau tentatively acknowledged in its 2019 proposal. It is unclear how consumers would suffer even if the ostensible lack of competition materialized under the 2017 rule; see The Pew Charitable Trusts, "How State Rate Limits Affect Payday Loan Prices" (2014), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

[3] Pew published research in 2016 documenting that payday lenders were already moving away from balloon-payment, or "lump sum" products and toward installment loans that last longer than 45 days. See note 4, below.

The Bureau's 2019 proposal argues that there is insufficient or inadequate research to support the findings of unfairness and abusiveness in the 2017 rule. The proposal especially focuses on two studies, one by Pew, which it believes the 2017 rule misinterprets. While we believe the two studies discussed were interpreted correctly in the 2017 rule, they are hardly the only basis for the 2017 rule. The CFPB studied payday lending for six years before finalizing a rule, and we count 153 separate studies that the Bureau cited in its 2017 rule, including 60 distinct academic studies. The 153 studies total more than 8,000 pages. The 2019 proposal's reinterpretation of three survey questions in two of the more than 20 Pew publications on small loans and fault with the scope of one study from a Columbia Law professor does not undercut the rest of the research basis for the rule.

If the 2017 final rule takes effect, high-rate lending will continue in most or all states where it exists today, and is even likely to thrive, though consumers will have more time to repay in most instances. Payday and auto title lenders have already started adapting to the 2017 rule by becoming makers of longer-term loans; in fact, our research shows that these lenders are already making high-cost installment loans and lines of credit in a majority of states and are likely to expand to others.[4] This is not necessarily a problem in and of itself, and it renders the bulk of the 2019 proposal's arguments moot because borrowers will maintain access to credit.[5] We have concluded, along with most industry experts who have spoken with us or published on this issue, that a majority of today's payday loan borrowers will continue to be approved for high-cost loans or lines of credit under the rule, though lenders will shift mostly to loans with terms of more than 45 days.

Please see our attached letter to the CFPB (March 18, 2019) for more information.

Legislative Solutions to the Payday Loan Problem Are Possible, But Legislators Should Not Replicate the CFPB's Ability-to-Repay Rule

After more than eight years of relevant research and analysis, we have concluded that credit can in fact help people cope with periodic shortfalls in their monthly budgets, but *only if that credit is structured to foster affordable repayment and has reasonable pricing*. In the case of small loans for people with low credit scores (like payday and auto title loans) any regulatory reform must come as

[4] The Pew Charitable Trusts, *From Payday to Small Installment Loans* (2016), 5, http://www.pewtrusts.org/~/media/assets/2016/08/from_payday_to_small_installment_loans.pdf#page=5. These states are the 26 identified in the cited brief, minus South Dakota, which has since enacted a 36 percent rate cap, plus Washington and Kentucky. In Washington, at least one lender has used the payday lending statute to issue multi-payment loans. In Kentucky, lenders can use the traditional installment loan statute to issue small loans with credit insurance, resulting in three-digit all-in APRs. Oklahoma passed a law in April 2019 to enable payday lenders to issue high-cost payday installment loans. In Iowa, lenders can issue high-cost lines of credit though we are not aware of lenders who have yet switched to doing so. Including Oklahoma and Iowa, that would mean that in at least 29 of the 38 states where payday and title lenders operate, they can issue high-cost installment loans or lines of credit.

[5] Our research has shown that liquidity credit can be helpful, even at high annual percentage rates, but only if it is structured in a way to ensure affordable payments, reasonable time to repay, and the other safeguards noted above.

close as possible to ensuring that several conditions are met. Pew published its original recommendations elaborating this concept in October of 2013, and they are summarized as follows:

- Limit payments to an affordable percentage of a borrower's periodic income.
- Spread costs evenly over the life of the loan.
- Guard against harmful repayment or collection practices and excessively long loan terms.
- Require concise disclosures that reveal both periodic and total costs.
- Set maximum allowable charges on loans for those with poor credit.[6]

In its 2017 payday loan rule, the CFPB did not set clear requirements for affordable payments, maximum allowable charges, or the other loan terms suggested above because of its limited authority. Instead, the CFPB used its powers under Dodd-Frank to require lenders to complete a prescribed process of determining a borrower's ability to repay the loans. While the net effect of the CFPB's rule governing short-term loans is positive, applying the ability-to-repay rule more broadly would likely prove harmful to consumers and to the marketplace in general. If legislative bodies such as Congress wish to address the problems with these longer-term loans, they should use their legislative powers to regulate loan terms directly rather than adopting this framework.

In 2016, Pew wrote to the CFPB to warn against applying its ability-to-repay requirements to loans lasting *longer* than 45 days, both because it would not provide sufficient consumer protections (monthly installment payments would routinely exceed research-based standards for affordable payments by hundreds of dollars) and it would tend to shut out mainstream lenders like banks from this market, essentially giving the most harmful or aggressive payday lenders control of it. The CFPB heeded this warning and only applied its ability-to-repay rule to loans lasting 45 days or less.

While the CFPB's ability-to-repay process works for short-term loans, it would break down for loans lasting longer than 45 days. We explain why in Pew's 2016 comment letter to the CFPB, at Section 5 starting on p.43. The following excerpt from the letter demonstrates, using the CFPB's own estimates of what would be possible under the ability-to-repay rule, that lenders would be able to take far too much of a borrower's income if that rule were applied to longer-term loans:

> If, for instance, the applicant makes $2,499 monthly and has actual total household expenditures at the 10th percentile level ($888), then remaining income would be $1,611 ($922—or 134 percent—higher than the average). Conversely, if this applicant's actual expenses were at the 90th percentile level ($2,281), then remaining income would be $218 ($471—or 68 percent—lower than the average). In this example alone, a lender would have the option of choosing to base its estimate of the appropriate monthly loan payment somewhere between $218 at the low end, $689 using published averages, or $1,611 at the high end—minus whatever other debt obligations may be revealed on the applicant's credit reports (such as credit card

[6] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

monthly minimum payments) and whatever the lender chooses to estimate for "other living expenses."[7]

The CFPB's ability-to-repay rule works well to combat the problem of short-term balloon payment loans, but it does not provide for a helpful regulatory or legislative tool for installment loans—in fact quite the opposite. By contrast, legislative bodies typically regulate loan terms directly, and there are several options for reforming the market for payday and similar small-dollar loans. For example, whenever a lender takes a leveraged payment mechanism such as a post-dated check or electronic access to a borrower's checking account, the legislature could require that 95% of the borrower's income is shielded (that is, the lender is prevented from taking more than 5% of the borrower's monthly income through required monthly loan payments); require reasonable time to repay (by limiting total loan revenue to 50% of the original loan amount or setting firm minimum and maximum loan terms); prohibit or strictly regulate origination fees or ancillary products like credit insurance; stipulate clear disclosures; and regulate pricing so that it is fair to borrowers and lenders (e.g. 28 to 36 percent interest plus a reasonable monthly maintenance fee). Pew has written about how state legislatures could pursue these reforms.[8] We have also published a review of market practices and state laws in the nonbank installment loan market (policy recommendations are included in this report).[9] Most recently, Ohio lawmakers dramatically reformed that state's payday loan market via the Fairness in Lending Act of 2018, setting clear requirements for loan terms resulting in widespread access to credit in the form of safe installment loans with prices that are three to four times lower than before the law changed.[10]

Pew's Qualifications for Commenting on Payday and Small-Dollar Credit Policy

The Pew Charitable Trusts is a global, non-governmental research and public policy organization dedicated to serving the public. We strive to improve public policy by conducting rigorous analysis, linking diverse interests to pursue common cause, and focusing on tangible results. Consumer finance is an area to which Pew has dedicated significant resources in recent years.

Pew's consumer finance project works to provide thorough, objective analysis to help inform the efforts of policy makers including the CFPB. In choosing in 2010 to begin working on small-dollar

[7] The Pew Charitable Trusts, comment letter to the Consumer Financial Protection Bureau, "Payday, Vehicle Title, and Certain High-Cost Loans (Proposed Rule); Docket No. CFPB-2016-0025 (RIN 3170-AA40)" (October 7, 2016), at p. 50-51, https://www.regulations.gov/document?D=CFPB-2016-0025-142716.

[8] The Pew Charitable Trusts, "State Payday Loan Reform," https://www.pewtrusts.org/en/research-and-analysis/articles/2019/01/11/state-payday-loan-reform.

[9] The Pew Charitable Trusts, "State Laws Put Installment Loan Borrowers at Risk: How Outdated Policies Discourage Safer Lending" (October 17, 2018), https://www.pewtrusts.org/en/research-and-analysis/reports/2018/10/17/state-laws-put-installment-loan-borrowers-at-risk.

[10] See Nick Bourke, Olga Karpekina, and Gabriel Kravitz, "As Payday Loan Market Changes, States Need to Respond" (August 22, 2018), https://www.pewtrusts.org/en/research-and-analysis/articles/2018/08/22/as-payday-loan-market-changes-states-need-to-respond. See also The Pew Charitable Trusts, "Ohio a National Model for Payday Loan Reform: New Policies Support Borrower Protections, Lender Profitability, and Credit Availability" (November 9, 2018), https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2018/ohio-a-national-model-for-payday-loan-reform; Bourke, Nick ,"The Ohio Legislature Got Payday Loan Reform Right" (October 29, 2018), https://www.pewtrusts.org/en/about/news-room/opinion/2018/10/29/the-ohio-legislature-got-payday-loan-reform-right.

lending, we realized that there were significant gaps in available research about the market for payday, auto title, and similar forms of small-dollar loans, particularly with respect to understanding the needs and experiences of borrowers and identifying and evaluating policy responses to perceived consumer harms.

Now, more than eight years later, Pew's consumer finance project has produced a comprehensive body of research and developed a group of highly qualified experts on this subject. The team's director has been with the project since its inception in 2010, and the two lead researchers have been with the project since 2011. Altogether, the staff on this project collectively has had more than thirty years of experience working together to conduct research and analysis on the market for payday and similar small-dollar loans. Their prior training and experience includes advanced degrees in law and public policy (including training in statistical research methods), professional public opinion research at the highest levels, product management and consulting work in the consumer finance industry and elsewhere, federal regulatory experience, and backgrounds in banking, community organizing, and policy analysis and advocacy.

In July of 2012, we published our first report, entitled "Payday Lending in America: Who Borrows, Where They Borrow, and Why." This report included findings from a first-ever nationally representative telephone poll of payday loan borrowers about their experiences using the loans.[11] The *Payday Lending in America* series of reports grew to include a total of five reports about payday lending, online payday lending, and auto title lending—essentially, all of the loans covered by the Bureau's 2017 final rule."[12]

As of this writing, Pew's research and contributions to the literature include the following:

- Unique, nationally representative surveys consisting of in-depth telephone interviews with borrowers of payday and similar loans (as well as the general public) conducted according to the highest standards of survey research.

- Conversations with hundreds of borrowers in more than 20 focus groups throughout the country.

- Scores of meetings, interviews, and store visits with lenders and consumer finance professionals of all types.

- More than 100 one-on-one conversations with bank and credit union officials about small-dollar lending. We convened a group of executives from more than ten banks (which collectively operate approximately one-fifth of all bank branches in the United States) to discuss federal regulation of small-dollar loans.

[11] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf. Methodology for the report is available at page 31.
[12] The reports are available as a collection online at http://www.pewtrusts.org/en/research-and-analysis/collections/2014/12/payday-lending-in-america.

- Extensive consultation with community groups in a majority of states, including representatives of consumer advocacy groups, civil rights and faith-based organizations, consumer credit counselors, legal advocates, and others.

- Analysis of academic literature and regulatory data. We have read all published academic papers about payday and auto title loans and reviewed all publicly available data about this market from state and federal government agencies as well as additional non-publicly available data obtained through special requests to various regulators and private companies.

- Including the five *Payday Lending in America* reports, Pew's small-dollar loans project has released more than two dozen carefully researched and reviewed issue briefs, fact sheets, and multi-media publications. See our website for links (www.pewtrusts.org/small-loans).

- In recent years, we have submitted comment letters, testimony, technical assistance, and informal input to federal regulators and state government officials throughout the country and spoken about this topic at dozens of conferences and other professional gatherings. Our work has been cited or quoted in a wide variety of publications from federal, state, and local government officials including the Bureau.

- Pew's publications on small-dollar loans have been cited in scholarly articles by academics and other researchers more than 140 times.

- Pew's work on small-dollar loans has been cited in more than 1,000 media stories.

- The CFPB's 2016 Notice of Proposed Rulemaking cited our work more than 40 times; the 2017 final rule cited our work more than 50 times; and the 2019 proposed rescission cited our work 19 times.

Pew spent nearly three years researching the markets for payday and similar forms of small-dollar credit before developing initial policy recommendations, in October of 2013.[13] The report included a case study of Colorado's 2010 payday loan reform law (which converted payday loans in that state from conventional short-term loans to those that last about six months); survey data finding that borrowers favor having more time to repay loans in smaller installment payments; and discussion of various potential benefits and harms associated with installment lending and how policy could help ensure that the migration to installment lending is safe and effective.[14] In the years since, we have revisited the data underlying that report and supplemented our recommendations with additional research and analysis, making revisions where appropriate.

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[13] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

[14] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf.

Pew is deeply committed to unbiased research and dedicated to improving public policy through pragmatic measures that would accommodate legitimate interests of both borrowers and lenders, as well as the public generally. Stakeholder outreach has been a constant feature of our work since it started.

In sum, Pew is highly qualified to comment on small-dollar lending to The House Financial Services Subcommittee on Consumer Protection and Financial Institutions.

Conclusions Based on Research Findings

The following section summarizes some key research findings about the market for payday, vehicle title, and similar loans.

(a) Borrower profile

Individuals who use high-cost payday loans are struggling financially, and 58 percent report trouble covering ordinary living expenses from month to month.[15] A majority (52 percent) report paying bank overdraft fees, and most carry credit cards but with little available credit.[16] Almost all have a damaged credit history that makes them ineligible for mainstream consumer credit, with credit scores that are at the lowest end of the scale (typical FICO scores in the low 500s[17] and similarly low VantageScores in the mid-to-high 500s[18]). These consumers are not the unbanked–they have an income and checking account, which are requirements for getting a payday loan–but they are dealing with periodic cash shortfalls rather than rare and unexpected emergency expenses.[19]

The average payday loan borrower earns about $30,000 per year,[20] although borrowers within every income group have used a payday loan.[21] Regardless of income, most borrowers find it

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[15] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 10, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=10.

[16] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loan Choices and Consequences*, Oct. 11, 2012, Vanderbilt Law and Economics Research Paper No. 12-30, 13, http://dx.doi.org/10.2139/ssrn.2160947. Fifty-nine percent of borrowers in the dataset have a credit card.

[17] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loan Choices and Consequences*, Oct. 11, 2012, Vanderbilt Law and Economics Research Paper No. 12-30, http://dx.doi.org/10.2139/ssrn.2160947.

[18] Jennifer Priestley, *Payday Loan Rollovers and Consumer Welfare*, Table 5, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2534628.

[19] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2013), 14, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=16.

[20] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 53, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=59

[21] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 10, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=12.

difficult to repay the average lump-sum payment of $430 that is required on their next payday, which represents 36 percent of the average borrower's paycheck. Only 14 percent of borrowers say they can actually afford this amount.[22]

Instead, the average payday loan borrower can afford to pay $50 per two weeks (or $100 per month)—similar to the fee for renewing a typical payday loan today. These data help explain why most borrowers renew or reborrow rather than repay their loans in full, and why the CFPB has found that 82 percent of loans are renewals or quick reborrows[23] while lenders report that loan loss rates are only 3 percent.[24]

Auto title loans are a similar form of high-cost lending and mirror payday loans in both structure and borrower experience. These borrowers are also unable to qualify for traditional financing, and they struggle to make ends meet. Three-quarters of auto title loan borrowers report having a checking account,[25] though they do not necessarily need an income to obtain the loan, as the lender can repossess the borrower's vehicle if they fail to repay. Further, loan payments are even larger and consume half of the average borrower's monthly income.

Borrowers are not shopping for credit in the conventional sense, but rather trying to cover regular recurring expenses: 69 percent of first-time payday borrowers used the loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food, while 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.[26] Yet research has found that use of payday loans has a negative effect on the ability of lower-income households to meet other expenses.[27] Borrowers are torn about the experience–a majority says payday loans take advantage of them, and a majority also says they provide relief. The appreciation for urgently needed cash and friendly service conflicts with borrowers' feelings

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[22] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 14, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=14.

[23] Consumer Financial Protection Bureau, *CFPB Data Point: Payday Lending* (2014), 9, http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf#page=9.

[24] Advance America, Cash Advance Centers Inc., *Form 10-K Annual Report* (Period Ending 12/31/11), 5 and 41, http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=XNYS:AEA&ft=&d=c12cd1f791e34bf03980d4825adc1730. Using 2011's Annual (10-K) Report from Advance America, the largest storefront lender, as an example, we can calculate an approximate loss rate by dividing the "provision for doubtful accounts" by the "aggregate principal amount of cash advances originated." This calculation of $107,911,000 divided by $3,965,225,000 yields an estimated loss rate of 2.72 percent. Borrowers may renew or reborrow a loan, or experience temporary defaults by bouncing checks and incurring nonsufficient funds fees while still paying back a loan eventually; Jamie Fulmer, "Advance America and Payday Lending: Who Borrows and Why," *Advance America*, presentation, Oct. 18, 2012, http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf#page=12. Advance America has made a similar point, stating, "97 percent of our customers pay us back;" David Burtzlaff and Brittny Groce, *Payday Loan Industry*, Stephens Inc. (2011).

[25] The Pew Charitable Trusts, *Auto Title Loans: Market Practices and Borrowers' Experiences* (2015), 7, http://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf#page=11.

[26] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2013), 14, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=16.

[27] Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, The Quarterly Journal of Economics (2011) 126: 517-555, http://qje.oxfordjournals.org/content/126/1/517.full.pdf+html.

of dismay about high costs and frustration with unaffordable payments and lengthy indebtedness.[28]

Repaying the loan in one lump sum is difficult for most borrowers. Previous research, as well as discussions with industry leaders, and state-level reports, all make clear that a typical borrower uses payday loans many times per year, and much of this borrowing comes in relatively quick succession once someone begins using payday loans.[29] To repay a loan, 41 percent have needed a cash infusion of some kind, including getting help from friends or family, selling or pawning personal possessions, or taking out another type of loan.[30] Frequently, these alternatives borrowers use to retire payday loan debt were available to them instead of using the loans in the first place. But desperation or unrealistic expectations, fueled by the product's unsustainable promise of debt lasting only weeks, often make comparisons with more transparent alternatives—and the fundamental decision about whether to borrow in the first place—difficult.[31] Long-term debt and high costs are the rule rather than the exception: Only 3 percent of lump-sum payday loans go to customers who use just one or two per year, and more borrowers use 17 or more loans in a year than use just one.[32] The single-payment loan, whether offered by a bank,[33] a storefront lender,[34] or an online lender,[35] simply does not work as advertised for the vast majority of borrowers.

(b) Borrowers of covered loans are unusually fragile consumers

Payday and auto title loan borrowers are unusually fragile financially compared to consumers who do not rely on high-cost credit to make ends meet. Just 49 percent of all payday loan borrowers are employed full-time, 14 percent are unemployed, and 13 percent are employed

[28] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 39, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=39.

[29] Consumer Financial Protection Bureau, *CFPB Data Point: Payday Lending* (2014), 12, http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf#page=12. Data show "that half of all loans are in sequences of 10 or more loans; 62% are in sequences of seven or more loans." Consumer Financial Protection Bureau, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* (2016), 111, http://www.consumerfinance.gov/data-research/research-reports/supplemental-findings-payday-payday-installment-and-vehicle-title-loans-and-deposit-advance-products/. Data show over 80 percent of loans are reborrowed within 14 days from the same lender.

[30] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 37, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=37.

[31] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 19-29, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=19.

[32] Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending* (2011), https://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

[33] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[34] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf. The median storefront payday loan customer uses 10 loans in a year.

[35] David Burtzlaff and Brittny Groce, *Payday Loan Industry* (Stephens Inc., 2011). This paper notes that online payday lenders are not profitable unless borrowers use multiple loans.

part-time. Further, borrowers who self-identified as disabled or unemployed in Pew's national survey were the most likely to have used a loan of any employment group, with usage rates of 12 percent and 10 percent respectively.[36] High-cost loan borrowers mostly do not qualify for traditional loans because they have damaged credit histories.

Like many low- and moderate-income households, they are at risk of seeing their incomes fluctuate. Since 1979, nearly half of households in the U.S. have experienced an income gain or drop of more than 25 percent in any given two-year span.[37] And in recent years, contract employment has continued to increase–a shift often referred to as the "gig" or "sharing" economy. Data show that since 2010, 1099s (the forms that some employers fill out when paying contract workers more than $600) have been gaining ground and even outpacing W-2 forms. As companies drop employees and add contract workers, W-2s decrease and 1099s increase. The Census Bureau's count of non-employment businesses (i.e. independent workers) has also increased.[38] Together, these data suggest an increasing shift to hourly jobs, which could exacerbate income volatility since wages fluctuate with varying work schedules.

Swings in income can destabilize a family's finances by making it difficult to budget and meet monthly expenses, including loan payments. Data from the U.S. Financial Diaries Project show that for households living below the poverty line, 26 percent of monthly income is unpredictable compared with only 9 percent for those earning 200 to 300 percent of the poverty line.[39]

This shift will likely have a greater impact on lower-income households. Research shows that poorer households experience higher rates of income volatility than their middle-income counterparts,[40] and low-income households with children and people with disabilities are among those more likely to experience sharp income declines.[41] Further, research on work schedules for young adults shows that part-time employees experience a higher level of work-

[36] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 11, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=13. It is possible that unemployed people were employed at the time of their last payday loan, or that they are receiving a loan based on some other form of income, such as a benefits check.

[37] The Pew Charitable Trusts, "The Precarious State of Family Balance Sheets" (2015), http://www.pewtrusts.org/en/research-and-analysis/reports/2015/01/the-precarious-state-of-family-balance-sheets

[38] Justin Fox, "The Rise of the 1099 Economy," *Bloomberg View*, Dec. 11, 2015, https://www.bloomberg.com/view/articles/2015-12-11/the-gig-economy-is-showing-up-in-irs-s-1099-forms.

[39] Anthony Hannagan and Jonathan Morduch, *Income Gains and Month-to-Month Income Volatility: Household evidence from the US Financial Diaries*, 2015, 1, https://static1.squarespace.com/static/53d008ede4b0833aa2ab2eb9/t/553521dae4b048e6faa46cdb/1429545456581/paper1.pdf#page=1. The authors summarized income volatility by an average coefficient of variation of monthly income, which was 55 percent for those below the poverty line and 34 percent for those from 100-300 percent of the poverty line.

[40] Gregory Mills and Joe Amick, "Can Savings Help Overcome Income Instability?" *The Urban Institute*, 6, http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412290-Can-Savings-Help-Overcome-Income-Instability-.PDF#page=6. Coefficient of variation for monthly household income in lowest quintile was 0.499 and 0.321 for middle quintile.

[41] Gregory Acs, Pamela Loprest, and Austin Nichols, "Risk and Recovery: Understanding the Changing Risks to Family Incomes" (2009), *The Urban Institute*, http://www.urban.org/sites/default/files/alfresco/publication-pdfs/411971-Risk-and-Recovery-Understanding-the-Changing-Risks-to-Family-Incomes.PDF.

hour instability and lower averages of work hours, and that fluctuations in work hours may result in financial insecurity.[42]

Recent research has also found that highly indebted households' consumption is more sensitive to income shocks. Because these households devote a greater share of their income to fixed monthly debt payments, they have less room to cut non-essential expenses when faced with an income loss. In short, the population of borrowers using covered loans is more fragile than nonborrowers, and are exposed to a great deal of risk, especially considering that most borrowers earn less than $40,000 annually, struggle to make ends meet, and seek the loans for consumption-smoothing rather than wealth-building purposes.

(c) Payday and title lenders have unusually strong leverage over consumers to ensure their ability to collect loan payments

As Pew has previously discussed,[43] payday lenders are unique in that they do not use traditional underwriting to determine whether applicants have the ability to repay loans while fulfilling other obligations.[44] They focus primarily on the ability to collect repayment, using leveraged payment mechanisms such as deferred presentment (holding the borrower's check or having electronic access to the borrower's checking account).[45] Many other types of lenders use electronic access as a way of ensuring and streamlining repayment, but conceptually, electronic repayment plans differ from deferred presentment arrangements for several reasons: 1) payday lenders condition credit on use of a leveraged payment mechanism; 2) the repayment is tied to a borrower's payday, meaning lenders are first in line to get paid before the borrower's other creditors; and 3) borrowers can cancel the plans with other lenders and retain control over the inflows and outflows of their checking accounts. Thus, payday lenders have unusually strong ability to collect unaffordable payments, which sets them apart from other creditors.

A leveraged payment mechanism becomes a dangerous tool when it lacks limits and is coupled with a high-cost loan to a financially fragile borrower. For storefront loans, borrowers are required to return to the store to repay the loan in cash, or if they cannot afford the full payment, to pay the fee to renew it and extend the due date; if the borrower does not return, the lender can deposit the check or use ACH to debit the full loan amount. For online loans,

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[42] Susan J. Lambert, Peter J. Fugiel, and Julia R. Henly, "Precarious Work Schedules among Early-Career Employees in the US: A National Snapshot," *University of Chicago*, 12, https://ssascholars.uchicago.edu/sites/default/files/work-scheduling-study/files/lambert.fugiel.henly_.precarious_work_schedules.august2014_0.pdf#page=14.

[43] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 27, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=33

[44] Some providers have begun to create automated underwriting models that assess more than just whether someone has a checking account and an income stream, but do not engage in an assessment of all of the borrower's expenditures and liabilities to assess their ability to pay the loan because they still retain the ability to collect via the leveraged payment mechanism.

[45] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), 44, http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf#page=44. "Lenders may instead rely on their relative priority position in the repayment hierarchy to extend credit without regard to whether the consumer can afford the loan. This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses."

electronic access is almost universal, as there is a strong disincentive for the borrower to choose an alternate method of applying for, receiving, and repaying the loans by mail.[46] Auto title lenders also retain strong leverage through the use of a car title, which can lead to repossession of a borrower's vehicle as a consequence of falling behind on loan payments. The threat of repossession alone is enough to make borrowers return to the lender to make a payment to extend the term for another pay period or month.

This mechanism allows the lender to compel payment on an unaffordable loan. This explains why defaults, charge-offs, and losses are all artificially low in this market even though borrowers often struggle to repay and repeatedly renew the loans. In short, lenders of covered loans hold unusually strong leverage over unusually fragile borrowers.

(d) What do borrowers want?

Borrower Survey

In 2017, Pew published a survey of payday loan borrowers to gauge their views on payday lending, the key elements of the Bureau's 2016 notice of proposed rulemaking, and possible outcomes of the rulemaking.[47] The survey found that:

- 70 percent of borrowers believe that payday loans should be more regulated. This finding is consistent with Pew's 2013 survey finding that 72 percent of payday loan borrowers said they wanted more regulation.[48]

- Borrowers support requiring installment payment structures: More than 3 in 4 borrowers say it will be a major improvement if they are given several months to repay a loan and if they can repay it in smaller installments. Pew's 2013 survey had similar results.[49]

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[46] "Frequently Asked Questions," CashNetUSA, accessed Sept. 28, 2016, https://www.cashnetusa.com/faq.html#. For example, see the following response regarding CashNetUSA loan terms in Alabama to the question: "What if I want to make payments without agreeing to the ACH authorization portion of the loan contract?" The response: "If you would like to make payments without agreeing to the ACH authorization portion of the contract, you can follow the procedures below: 1. Print out the loan contract, cross out the ACH authorization agreement and initial next to the section. 2. Provide us with a post-dated check (using the date of your next payday) for the amount of your total payment, including principal and fees, and a copy of the contract via mail, FedEx, or another delivery service. 3. We will confirm the issuing of your loan once we receive these documents."

[47] The Pew Charitable Trusts, "Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks: Results of a nationally representative survey of U.S. borrowers" (April 29, 2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/payday-loan-customers-want-more-protections-access-to-lower-cost-credit-from-banks.

[48] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 48, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=48.

[49] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 22, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=28

- Borrowers saw loans' prices, the affordability of payments, and whether they could obtain them from banks and credit unions as important, while most did not view additional underwriting as a major improvement for them.

- When deciding where to get a loan, borrowers ranked the top three factors as: 1) the fees charged, 2) how quickly they can get the money, and 3) certainty of approval.

- 8 in 10 borrowers would prefer to borrow from a bank or credit union if they were equally likely to be approved. And 93 percent of borrowers would view it as a good thing if banks and credit unions offered small loans at prices 6 times lower than payday lenders. (Pew has concluded that this is a likely outcome under the 2017 final rule, pending action from bank regulators along the lines of the bulleting the Office of the Comptroller of the Currency issued in May 2018 and modifications by the National Credit Union Administration to its Payday Alternative Loan program.)

In summary, borrowers want loans that cost less, have longer repayment terms with smaller payments, and where they have a reasonable certainty of approval. They would prefer to borrow from banks and credit unions if the loans are competitive in terms of price, speed of loan origination, and certainty of approval. All of these developments were beginning to occur, and are likely to accelerate if the 2017 final rule goes into effect.

(e) What does the public support?

Public Survey

In 2017, Pew also published a survey of the general public to gauge their opinions on some of the possible outcomes of the proposed rule and the types of loans that might result from it.[50] The survey found that:

- 70 percent of American adults believe that payday loans should be more regulated. Similar results were reported in Pew's 2015 survey.[51]

- 7 in 10 Americans want to see banks offer small loans to borrowers with low credit scores. 70 percent said that their view of a bank would be more favorable if the bank offered a $400, three-month loan for $60 (as has begun happening since the 2017 rule was finalized and as is likely to continue if it takes effect).

[50] The Pew Charitable Trusts, "Americans Want Payday Loan Reform, Support Lower-Cost Bank Loans: Results of a nationally representative survey of U.S. adults" (April 19, 2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/americans-want-payday-loan-reform-support-lower-cost-bank-loans.
[51] The Pew Charitable Trusts, "A Survey of Americans: CFPB Proposal for Payday and Other Small Loans" (2015), 3, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=5.

- 86 percent of respondents believe it would be a good outcome if most people who use payday loans could obtain lower-cost credit from their banks and credit unions (as is likely to happen under the 2017 final rule).

- By almost 5 to 1, respondents believe it would be a good thing if banks began offering small loans at prices six times lower than payday lenders (as has begun since the 2017 rule was finalized), even when they are told the rates would be higher than those for credit cards.

These findings reveal that when evaluating effectiveness of regulation, Americans and payday loan borrowers view favorably the likely outcomes of the 2017 final rule: giving borrowers more time to repay in equal installments, and welcoming lower-cost installment loans and lines of credit from banks and credit unions. Even though the Bureau lacks the power to regulate prices, the 2017 rule created regulatory certainty for banks and credit unions and gave them a great deal of leeway as long as they give borrowers more than 45 days to repay in equal installments.

(f) Key problems in the market

Pew's research identified the following key problems in the market:

i. Unaffordable payments enforced by leveraged payment mechanisms (typical payments take more than one-third of borrower paychecks when most borrowers cannot afford to pay more than 5 percent)

A typical payday loan payment takes 36 percent of an average borrower's gross monthly income, and the average lump-sum auto title loan payment consumes 50 percent of the borrower's paycheck.[52] Most borrowers cannot afford to lose this much from their paycheck and still make ends meet, yet lenders use leveraged payment mechanisms to ensure their ability to collect anyway. This leads borrowers to renew or reborrow their loans repeatedly. As a result, a typical borrower, who takes out a $375 two-week loan, is indebted for five months of the year, and pays $520 in fees instead of the originally contracted fee amount of $55.[53]

ii. Deceptive business model

Although conventional two-week payday loans are advertised as a quick short-term solution for unexpected expenses, the average borrower is in debt for five months during the year. Data from lenders' filings and industry officials' testimonies reveal that renewals are an

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[52] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 31, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=37 The Pew Charitable Trusts, *Auto Title Loans: Market Practices and Borrowers' Experiences* (2015), 1, http://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf#page=5.

[53] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 9, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf#page=11.

essential part of the payday lending business model: If borrowers were using single-payment loans as advertised, the lenders would go out of business.[54] As the CFPB has noted, four in five loans are taken within two weeks of a previous loan. Data from Florida show that approximately 97 percent of loans go to those who use three or more annually, and about 3 in 5 go to those who use 12 or more loans.[55] Data from Oklahoma show that more borrowers use 17-plus loans in a year than just one.[56] To ensure that loans work as advertised, they should have affordable installment payments that fit into a borrower's budget and pay down principal. In addition, all fees and charges should be clearly disclosed and be pro rata refundable to reduce the incentive for lender-driven refinancing. Colorado's 2010 payday loan reform shifted the market from single-payment loans lasting an average of 18 days to installment loans lasting an average of 3 months (there is a 6-month minimum term but most loans are repaid early). Before that law change, a loan's advertised price represented 13 percent of finance charges actually paid in a year, whereas after the 2010 reform, the advertised price represented 87 percent of actual annual spending.[57] Much like the CFPB's 2017 final rule that would steer the market toward installment lending, this change gave borrowers more time to repay in equal installments and improved transparency.

iii. Origination fees and other lender incentives to refinance

When small loans carry an origination fee, lenders can earn a substantial portion of revenue at the outset of the loan. This creates a strong incentive to encourage borrowers to refinance so that the lender earns another origination fee. Similarly, when interest front-loading applies, lenders earn a disproportionate amount of income in the early months of the loan, creating an incentive to encourage refinancing.[58]

Frequent lender-driven refinancing places borrowers at risk of financial harm because of the additional fees, interest payments, and months of debt. They can also mask defaults by renewing unaffordable loans to avoid borrowers defaulting when they cannot afford a loan payment. However, the solution to this problem lies not with rationing the number of loans a borrower can take out, but with eliminating lender incentives to refinance loans. If the loan is structured in a way that makes every month of the loan equally profitable, then the lender does not have an incentive to encourage refinancing (and a refinance does not include a *de facto* prepayment penalty for borrowers). If borrowing is not limited (for example, at to two times per six months or year), the customer will borrow only what they

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[54] John Robinson, president of TitleMax Holdings LLC, "Affidavit of John Robinson, President of the Debtors, in Support of First Day Motions and Applications," 11, April 21, 2009, U.S. Bankruptcy Court for the Southern District of Georgia, Savannah Division, http://s3.documentcloud.org/documents/1227212/tmx-exec-delcaration-in-bk-case.pdf; Robert DeYoung and Ronnie J. Phillips, *Payday Loan Pricing* (Federal Reserve Bank of Kansas City Economic Research Department, 2009), https://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.
[55] Veritec Solutions LLC, *Florida Trends in Deferred Presentment* (2010). On file with The Pew Charitable Trusts.
[56] Veritec Solutions LLC, *Oklahoma Trends in Deferred Deposit Lending* (2011), https://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.
[57] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 12, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf#page=18
[58] National Consumer Law Center, *Installment Loans: Will States Protect Borrowers From A New Wave Of Predatory Lending?* (2015), 22, http://www.nclc.org/images/pdf/pr-reports/report-installment-loans.pdf#page=32.

need and prepay when possible.[59] Eliminating lender incentives to refinance without placing limits on borrowers' ability to access safer credit will lead to less indebtedness and lower consumer cost.

iv. Defaults

Payday loan borrowers' low credit scores mean they are at higher risk of defaulting on any loan. And yet defaults for these and other covered loans are much lower than they could be because of the lender's use of a leveraged payment mechanism. This creates artificially low default rates because it allows lenders to compel repayment (either the full amount or a fee to renew the loan, effectively masking a default), even though the borrower may be struggling to meet other obligations. When lenders do not have a leveraged payment mechanism, such as in the credit card market or traditional installment loan market for example, default rates are generally less than 10 percent even on subprime loans to borrowers who do not have prime credit scores.[60]

v. Unnecessarily long repayment terms

Ensuring that borrowers have more time to repay and requiring installment payments is imperative but not sufficient to protecting consumers. In some cases, lenders have set up terms that are unnecessarily long to derive more revenue from borrowers without incurring more risk. For example, a $500 auto title loan that has been offered in Arizona has a repayment period of 18 months and carries $1,126 in fees.[61] Pew's survey found that respondents believe that four to six months is a reasonable term for a $500 loan.[62]

vi. Abuse of leveraged payment mechanisms

Online payday loan borrowers are at especially high risk of unauthorized withdrawals because their bank accounts are exposed to lenders and sometimes others who buy their information from lenders or lead generators. Research shows that lenders have repeatedly accessed borrowers' accounts when debits fail, causing multiple overdraft fees. In Pew's national survey, 46 percent of online borrowers reported that their bank accounts were overdrawn by payday lenders' withdrawals, twice the rate among storefront borrowers.[63]

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[59] In general, it is unnecessary to ration safe loans; however, when it is not possible to make the underlying loan safe—as in the 2017 final rule's short-term conditional exemption—Pew supports loan limits.
[60] World Acceptance Corporation, *2015 Annual Report*, http://www.worldacceptance.com/wp-content/uploads/2015/07/2015-ANNUAL-REPORT_6-25-15.compressed.pdf; Regional Management, *2015 Annual Report*, http://www.regionalmanagement.com/phoenix.zhtml?c=246622&p=irol-sec#14225200; Springleaf Financial, *2014 Annual Report,* http://files.shareholder.com/downloads/AMDA-28PMI5/1248530341x0x823670/5A26396A-A4D8-4870-B693-B8F6B87F954A/Springleaf_2014_AR10K.pdf.
[61] "Arizona Rates and Terms," Speedy Cash, accessed Oct. 3, 2016, https://www.speedycash.com/rates-and-terms/arizona. The referenced Speedy Cash loan is available in Arizona as an auto title installment loan.
[62] The Pew Charitable Trusts, "A Survey of Americans: CFPB Proposal for Payday and Other Small Loans" (2015), 5, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=7.
[63] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 32–35,

Further, 22 percent of borrowers reported closing their checking accounts or having them closed by their bank in connection with an online payday loan.[64] Unscrupulous lenders have also been shown not to honor borrowers' requests to cancel the loans,[65] and there can be lag time between the request and when it takes effect,[66] demonstrating that safeguards are needed to protect against aggressive or fraudulent practices. Many unscrupulous lenders have been targets of judicial[67] and regulatory[68] actions because of the propensity for abuse via the ACH system, which is atypical of depository institutions that are subject to prudential regulatory oversight, underwrite their customers, and offer lower-cost loans.

Auto title loan borrowers are also at risk of harm due to lenders' ability to repossess their cars. Lenders often charge repossession-related fees to reduce or avoid losses on defaulted loans and to earn additional revenue. This drives up the cost for borrowers who repay and retrieve their cars and reduces any potential surplus refund for those whose cars are sold at auction. Because lenders add these fees to the outstanding debt, borrowers rarely receive any net profits from the car sale though it is typically mandated by state law. It should be noted that these fees are not a core part of the title loan business model.[69]

vii. Negligible price competition

Borrowers of high-cost loans show little sensitivity to price because they are not shopping for credit, but rather looking for quick cash to meet an urgent need, usually paying a bill. Lenders recognize this behavior and therefore do not compete on price, and instead, compete on non-price elements, such as location, certainty of approval, and customer

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http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf#page=32.

[64] The Pew Charitable Trusts, *Fraud and Abuse Online: Harmful Practices in Internet Payday Lending* (2014), 16, http://www.pewtrusts.org/~/media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf#page=20.

[65] Federal Trade Commission, "Online Payday Loans," accessed Sept. 28, 2016, https://www.consumer.ftc.gov/articles/0249-online-payday-loans. The FTC discusses lawsuits against online payday lenders for alleged violations of federal laws.

[66] Baptiste and Brodsky v. JP Morgan Chase Bank, filed Oct. 1, 2012, http://www.neweconomynyc.org/wp-content/uploads/2014/08/Baptiste-v.-Chase-complaint-FINAL.pdf. This is a complaint in a high-profile case of withdrawals by online payday lenders resulting in large bank fees for borrowers.

[67] Nick Bourke, Fintech Law Report, *Online Lending and the Integrity of the Banking System: Behind the Heated Rhetoric Over "Operation Choke Point,"* Mar/Apr 2015, Volume 18, Issue 2, pp. 5-6, http://www.pewtrusts.org/~/media/assets/2015/05/fintech1802_aa_bourke_proofed.pdf?la=en#page=5.

[68] NACHA, "ACH Network Risk and Enforcement Topics," Aug. 26, 2014, https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics.

[69] Tennessee Department of Financial Institutions, *2016 Report on the Title Pledge Industry* (2016), 11, http://www.tennessee.gov/assets/entities/tdfi/attachments/Title_Pledge_Report_2016_Final_Draft_Apr_6_2016.pdf#page=14 In Tennessee, lenders report spending 3 percent of revenue on repossession expenses; Jim Hawkins, "Credit on Wheels: The Law and Business of Auto-Title Lending," *Washington and Lee Law Review* 69, no. 2 (2012), accessed Oct. 4, 2016, 551–52, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1952084. "The notion that lenders repossess vehicles to generate significant profits is almost certainly wrong. Repossessing, storing, and selling vehicles are expensive relative to the value of most pledged vehicles. One operator estimated the costs at around $500 for his company—$250 to pay a company to repossess the vehicle and $250 to pay for the sale; another confirmed that '[r]epossessions, at best, are a breakeven process and most often simply mitigate our loss.'"

service.[70] The same lenders charge different prices to similarly situated borrowers across states. For states with usury caps, lenders typically charge the ceiling, and in states with no rate caps, lenders charge even higher prices.[71] For example, on a $500 loan, the same lender charges 664 percent APR to borrowers in Texas, but 391 percent APR to borrowers in Kansas.[72] Yet, in states with lower rate limits, payday credit is not significantly constrained; instead, fewer stores simply serve more customers each.[73] For example, in the five years after Colorado's 2010 reform lowered permissible interest rates for payday loans, more than half of stores closed; but each remaining store doubled its average customer count. Borrowers' access to credit in the state was virtually unchanged.[74]

The Bureau cannot set prices for loans and did not do so in its 2017 final rule. However, the Bureau's 2019 proposal alleges that the 2017 final rule would have the effect of "reducing competition" and that the purported reduction in supply "would have a dramatic effect on competition." The 2019 proposal acknowledges that "because of State-law regulation of interest rates, the effect of reduced competition may not manifest itself in higher prices." The proposal then argues that "lenders compete on non-price dimensions" but does not enumerate them or offer evidence that the 2017 rule would hurt competition on these unspecified dimensions. It proceeds to note that some new products have come to market in recent years enabling employees to access earned wages prior to payday and that the "2017 Final Rule included exclusions to accommodate these emerging products." Despite the fact that these products are not covered by the 2017 rule, the 2019 proposal claims without substantiation or example that the 2017 rule "would constrain innovation in this market."

To summarize, the 2019 proposal acknowledges that the 2017 rule is unlikely to result in higher prices, it acknowledges the 2017 rule does not cover emerging products that let consumers access their wages early, and it surmises that the 2017 rule could hurt nonprice competition, but does not specify any forms of nonprice competition and does not provide evidence that the 2017 rule would hurt nonprice competition. Therefore, the 2019

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[70] There is strong evidence that borrowers would choose lower-cost options if they were aware of them and these options were competitive on these factors; see The Pew Charitable Trusts, "Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks," (2017), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/payday-loan-customers-want-more-protections-access-to-lower-cost-credit-from-banks.

[71] The Pew Charitable Trusts, "How State Rate Limits Affect Payday Loan Prices" (2014), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

[72] "Find Your Closest Store," Advance America, accessed Sept. 30, 2016, https://www.advanceamerica.net/locations.

[73] Robert B. Avery and Katherine A. Samolyk, "Payday Loans Versus Pawn Shops: The Effects of Loan Fee Limits on Household Use" (2011), http://www.frbsf.org/community-development/files/2-avery-paper.pdf; and Mark J. Flannery and Katherine A. Samolyk, "Scale Economies at Payday Loan Stores" (2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2360233. Both papers have detailed this tendency.

[74] Colorado Office of the Attorney General, *2009 Deferred Deposit Lenders Annual Report* (2010), http://coag.gov/sites/default/files/contentuploads/cp/ConsumerCreditUnit/UCCC/AnnualReportComposites/2009_ddl_composite.pdf; Colorado Office of the Attorney General, *2015 Deferred Deposit Lenders Annual Report* (2016), http://coag.gov/sites/default/files/contentuploads/cp/ConsumerCreditUnit/UCCC/AnnualReportComposites/2015_ddl_composite.pdf.

proposal's claim is unfounded that the 2017 rule would hurt competition or that the alleged harm to competition would harm consumers.

Thank you for the opportunity to provide commentary for the committee's consideration. Please do not hesitate to get in touch if we can provide additional information.

Regards,

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Attachment: Pew comment letter to the CFPB dated March 18, 2019

ATTACHMENT

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March 18, 2019

Comment Intake
Consumer Financial Protection Bureau
1700 G St. NW
Washington, DC 20552
Via Electronic Submission

RE: Payday, Vehicle Title, and Certain High-Cost Installment Loans; Delay of Compliance—Docket No. CFPB-2019-0007 (RIN 3170-AA95)

Director Kraninger:

The Pew Charitable Trusts is a global, nongovernmental, nonpartisan research and public policy organization dedicated to serving the public. We strive to improve public policy by conducting rigorous analysis, linking diverse interests to pursue common cause, and focusing on tangible results. Ensuring that consumer financial markets are safe and transparent is a goal to which Pew has dedicated significant effort, time, and resources. As explained below, we urge you not to delay implementation of any part of the 2017 final rule on payday, vehicle title, and certain high-cost installment loans.

Based on extensive research conducted over eight years on payday and vehicle title lending, there is clear evidence of both a market failure and significant consumer harm. Through analyses of other subprime consumer credit markets; lenders' and borrowers' outcomes in states with different payday and auto title loan regulations; and bank and credit union small-dollar loan experiences, we have developed a strong research base and found overwhelming evidence that well-designed regulatory structures can promote access to useful small-dollar credit and improve consumers' well-being. Drawing on this deep research, we will offer detailed feedback about the CFPB's rescission proposal in a future comment letter. Here, we provide just brief commentary about the proposed rescission because it is the primary rationale offered in the proposal to delay compliance by 15 months from August 19, 2019 to November 19, 2020.

The Bureau preliminarily plans to eliminate the 2017 final rule's affordability safeguards ("mandatory underwriting provisions"). At a high level, we observe that the final rule set strong consumer protections for loans that consistently harm customers—single-payment and balloon-payment loans—without eliminating them, and it gave lenders complete leeway in offering both affordable and high-cost loans repayable in equal installments over terms longer than 45 days. There would be widespread access to credit from payday, auto title, installment, depository, and other lenders under the final rule.

Since the CFPB finalized its 2017 payday lending regulation, bank regulators and credit union regulators have taken important steps that were consistent with, and demonstrate the success of, the final rule. As an example, in May of 2018 the Office of the Comptroller of the Currency

issued a bulletin giving banks guidelines for issuing small installment loans with terms longer than 45 days.[1] In September of 2018, U.S. Bank began offering a new small installment loan, repaid over three months, with monthly payments set at 5 percent of a customer's monthly income. Whereas borrowing $400 from a payday lender for three months costs an average of $360, U.S. Bank is offering that same credit for $48 to $60, while serving many of the same customers who have very low credit scores.[2] The FDIC and National Credit Union Administration have also taken initial steps to provide guidelines for how banks and credit unions can offer small loans safely and sustainably to their customers who currently use payday and other high-cost loans.[3] These developments are a major benefit of the CFPB's 2017 regulation, because that regulation established minimum protections for balloon payment loans but placed virtually no restrictions on small installment loans lasting longer than 45 days.

The CFPB also explains in its 2019 notice of proposed rulemaking that it intends to rescind the 2017 safeguards because they would dramatically reduce access to credit, but this assertion is unsubstantiated. The estimates cited in the notice only reference *short-term* loan volume but do not recognize that a large majority of consumers would still be able to access small loans that last longer than 45 days under the 2017 regulation. Many consumers can or will soon be able to access small installment loans from banks and credit unions (U.S. Bank's three-month Simple Loan described in the previous paragraph is an example of a new, more affordable product that entered the market *after* the CFPB finalized its original rule, arguably because the rule helped provide regulatory certainty and open the market to new forms of competition). Further, small loans would continue to be available from payday and auto title lenders under the 2017 rule. In two-thirds of the states where payday or auto title lenders operate, they can comply with the 2017 regulation simply by giving consumers adequate time to repay with terms beyond 45 days—and in fact, they are already issuing some high-cost installment loans or lines of credit in these states. For example, in 2012 in Texas, only 27 percent of payday loan revenue came from payday installment loans. But in the most recent report from Texas, 85 percent of payday loan revenue came from payday installment loans.[4] When Colorado outlawed two-week loans in 2010, requiring that customers be allowed six months to repay, lenders simply shifted to making six-month loans. Credit remained available to the same type of customer and state regulatory data show that borrowers fared much better.[5] In short, decreased availability of loans with terms of shorter than 45 days does not signal a reduction in access to credit, because small loans that last longer than 45 days are often readily available or will quickly become readily available. The

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[1] Office of the Comptroller of the Currency, "Core Lending Principles for Short-Term, Small-Dollar Installment Lending," OCC Bulletin 2018-14 (May 23, 2018), https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html.

[2] Nick Bourke, *American Banker*, "Momentum is Building for Small-Dollar Loans," Sept. 12, 2018, https://www.americanbanker.com/opinion/momentum-is-building-for-small-dollar-loans.

[3] FDIC, "Request for Information on Small-Dollar Lending," FIL-71-2018 (November 14, 2018), https://www.fdic.gov/news/news/financial/2018/fil18071.html. National Credit Union Administration, Notice of Proposed Rulemaking on "Payday Alternative Loans," 83 FR 25583 (June 4, 2018).

[4] Texas Office of the Consumer Credit Commissioner, Financial Services Activity Reports: Credit Access Businesses, https://occc.texas.gov/publications/activity-reports#cab.

[5] The Pew Charitable Trusts, *Trial, Error, and Success in Colorado's Payday Lending Reforms* (2014), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2014/12/trial-error-and-success-in-colorados-payday-lending-reforms.

Bureau's fundamental premise—that there would be little access to credit under the 2017 regulation—is not borne out by experience.

On the time frame for compliance itself, there is not adequate justification for a delay in implementation. In the CFPB's 2016 notice of proposed rulemaking for these loans, it set an initial implementation period of 15 months. This was an unusually long period of time to allow for compliance relative to state payday loan law changes, which have typically allotted three to nine months for full implementation (see chart below). Even the Credit CARD Act of 2009—a major act of Congress that required fundamental changes to a part of the consumer finance industry serving more than 100 million customers who carry hundreds of billions of dollars in debt—gave credit card issuers just nine months to comply with major new consumer protections including an ability-to-repay requirement.[6] In its 2017 final regulation, the CFPB increased the initial implementation period of the payday loan rule to 21 months. In this new proposal, the CFPB suggests increasing that to 36 months.

Chart: Implementation Period for Payday Loan Law Changes
Number of months

	3	6	9	12	15	18	21	24	27	30	33	36
Arkansas 2008												
Colorado 2010												
Colorado 2018												
Florida 2018												
Georgia 2004												
Montana 2010												
New Mexico 2017												
Ohio 2018												
Oregon 2007												
South Dakota 2016												
Virginia 2008												
Washington 2009												
CFPB 2016 Proposal												
CFPB 2017 Final Rule												
CFPB 2019 Proposal												

Notes: All implementation periods are rounded to the nearest 3 months. Because the CFPB's 2017 final rule was not printed in the federal register for 1.5 months following publication, the actual time periods for both the 2017 final rule and 2019 proposal are 1.5 months longer than shown. All time periods shorter than three months are listed in the category of three months. The chart excludes temporary payday loan laws that had sunset provisions and no implementation periods, such as in Arizona and North Carolina.

[6] Public Law No: 111-24 (May 22, 2009), at Section 3.

The changes to payday lending laws made by states generally had a more substantial impact on the payday and auto title lending industries than the 2017 CFPB regulation would, because the state laws included regulations of loan terms including prices and durations. The 2017 final CFPB regulation did not set prices or terms, and it provided industry with four compliance options including a) assessing ability to repay, b) using a principal payoff option, c) giving consumers more than 45 days to repay high-cost loans in installments, or d) giving consumers more than 45 days to repay high-cost lines of credit. In two-thirds of the states where payday or auto title lenders operate, they already issue at least some longer-term high-cost installment loans or lines of credit, and these products were not covered by the 2017 regulation's ability-to-repay requirements.[7]

The proposed delay also cites as a rationale that it has identified:

> *"…[C]ertain potential obstacles to compliance that were not anticipated when the original compliance date was set. For example, several State laws applicable to payday or similar loans have been enacted subsequent to the 2017 Final Rule that have more immediate compliance dates. Some industry participants have indicated that, given time and resource constraints, their need to comply with these intervening State laws may impede their ability to comply with the 2017 Final Rule's Mandatory Underwriting Provisions by the August 19, 2019 compliance date."*

States make changes to payday loan laws periodically, and there was no reason to believe that when the CFPB set a 21-month implementation period in 2017 that state law changes would cease. For example, in 2016 and 2017, when the CFPB was in its rulemaking phase and considering the compliance time period, Mississippi expanded auto title installment loans, South Dakota effectively eliminated payday and auto title loans, and New Mexico limited rates to 175 percent APR and set a four-month minimum loan term. The fact that three states—Colorado, Florida, and Ohio—have made changes to their payday loan laws since then is not unusual.[8] Further evidence that the industry can comply with state law changes as well as the federal regulation is that payday lenders offered vocal support for the Florida law change and have also supported law changes in several other states since the regulation was finalized in the fall of 2017.

The Bureau also wrote: "Similarly, industry participants have indicated that they need additional time to finish building out, or otherwise making investments in, technology and critical systems necessary to comply with the Mandatory Underwriting Provisions of the 2017 Final Rule." The two main systems needed for compliance would be a way to check a database and a way to assess ability to repay. Lenders have routinely checked databases like Teletrack for more than a

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[7] The Pew Charitable Trusts, *From Payday to Small Installment Loans* (2016), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2016/08/from-payday-to-small-installment-loans. Since publication, both Colorado and South Dakota have passed ballot initiatives capping rates for deferred deposit loans at 36 percent, so lenders are not issuing payday or auto title loans in those states.

[8] Colorado's loans had terms of more than 45 days so fell outside the scope of the 2017 rule. Florida's new loans authorized by the 2018 law have terms of more than 45 days so fall outside the scope of the 2017 rule. Ohio, both before and after the law change, enabled lenders to offer loans with terms longer than 45 days which fall outside the scope of the 2017 law change.

decade. And vendors to the payday and auto title loan industries were advertising in 2017, before the regulation was even finalized, that they had created turnkey solutions to comply with the CFPB's ability-to-repay requirements.[9]

As demonstrated by lenders' experiences in states, the ready availability of payday loan databases, and the turnkey products marketed by vendors to facilitate compliance with the 2017 regulation, there is no need for additional time to comply. The 21-month implementation period set out in the 2017 regulation is an unusually long one, and no further time is necessary. The additional 15-month compliance delay would subject consumers to continued harm without federal protections. The 2017 regulation also offers lenders several options for compliance, the easiest of which is simply to give borrowers at least 46 days to repay a loan or line of credit. For these reasons, we recommend that the Bureau not delay the compliance date of the 2017 final regulation. We are available to discuss our extensive research on the topic of small-dollar credit that can help inform the Bureau as it undertakes this rulemaking.

Regards,

Nick Bourke
Director, Consumer Finance
The Pew Charitable Trusts

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[9] For example, Clarity Services, Inc. was one of several companies offering such products, https://www.clarityservices.com/insights/weve-got-covered/.