WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

October 7, 2016

Director Richard Cordray
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: Docket No. CFPB-2016-0025 or RIN 3170-AA40

Dear Director Cordray:

The Egan Campaign for Payday Loan Reform (the "Egan Campaign"), Woodstock Institute, and Citizen Action/Illinois offer this comment in response to the Consumer Financial Protection Bureau's (CFPB's) proposed rule on payday, vehicle title, and certain high cost installment loans (the "Proposed Rules"). Thank you for the opportunity to submit comments on this important subject. The Proposed Rules are a critical step in stopping the harms of unaffordable loans, but they must be strengthened to ensure that they stop the debt trap once and for all.

About the Egan Campaign

The Campaign for Payday Loan Reform began in 1999, shortly after a poor woman came to confession at Holy Name Cathedral and spoke tearfully of her experience with payday loans. Monsignor John Egan assisted the woman in paying off both the loans and the interest, but his outrage towards the unscrupulous lenders had only begun. He immediately began calling friends, organizations, and associates to try to challenge this contemporary usury. Shortly after his death in 2001, the coalition he helped to create was renamed the Monsignor John Egan Campaign for Payday Loan Reform.

Early leaders of the Egan Campaign included Woodstock, Citizen Action/Illinois, AFSCME Council 31, and Metropolitan Family Services. Over the years, many more groups joined the campaign, including AARP, Illinois People's Action, Illinois AFL-CIO, United Auto Workers, Chicago Federation of Labor, Illinois PIRG, SEIU Local 73, Heartland Alliance, Center for Economic Progress, Sargent Shriver National Center on Poverty Law, Westside NAACP, Access Living, and Lutheran Social Services of Illinois.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of equitable lending and investments; wealth creation and preservation; and safe and affordable financial products, services, and systems. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Our key tools include: applied research; policy development; coalition building; and technical assistance. Woodstock Institute has been a recognized economic justice leader and bridge-builder between communities and policymakers in this field since it was founded in 1973 near Woodstock, Illinois.

Historical Context

The effort to protect Illinois consumers from predatory payday, title, and installment loans spans many years. Before 2005, Illinois was the Wild West of payday lending. In 2001-2002, there were 765 payday loan stores in Illinois – far outnumbering the State's 655 McDonald's. Payday lenders were largely unregulated, and there were no consumer protections. Illinois rules intended to govern payday loans were promulgated in 2001, but the rules applied only to loans with terms of 30 days or less, so lenders got around the rules by making 31-day payday loans. In June 2003, a draft of a survey of payday lenders by the Department of Financial Institutions (DFI) was released to the Egan Campaign. According to the draft, less than three percent of the loans that were reviewed by DFI were subject to the rules.

Even though the industry was side-stepping the rules with ease, they filed a lawsuit challenging the rules. That lawsuit eventually made its way to the Illinois Supreme Court where the Court in a 3-3 vote affirmed the dismissal of the case.

The Payday Loan Reform Act (the "PLRA") became law in 2005. In the course of the legislative process, the bill was amended so that it applied only to loans of 120 days or less. For covered loans, the PLRA limited the finance charge to $15.50 per $100, capped the loan amount at 25 percent of a consumer's gross monthly income, set a maximum days of indebtedness of 45 days, and required lenders to use a statewide database to determine eligibility for a loan.

Because the PLRA applied only to loans of 120 days or less, the 120-day provision in the definition of payday loan was a loophole that the lenders exploited by making 121-day loans. In April 2008, Woodstock and the Public Action Foundation released a report called "The Illinois Payday Loan Loophole."[i] The report found that after the PLRA went into effect, lenders switched to longer-term installment loans not subject to the PLRA's consumer protections.

In an attempt to address the industry's maneuver, the Illinois Department of Financial and Professional Regulation (IDFPR) issued a set of "directives" intended to provide protections for consumers who entered into the new installment loan product. The industry filed another lawsuit against IDFPR seeking a temporary restraining order blocking the directives. The court granted the industry's motion.

On June 21, 2010, Governor Pat Quinn signed into law HB 537, which, among other things, closed the 120-day loophole. The law, which took effect in March of 2011, codified and placed restrictions on "payday installment loans" and "small consumer loans." In Illinois, a payday installment loan is a loan with a term of 112-180 days. The law sets a finance charge cap on payday installment loans of $15.50 per $100 per installment period. The law further caps a consumer's days of indebtedness at 180 days.

Under HB 537, a small consumer loan is a loan of $4,000 or less with a term longer than 180 days. The law caps the APR on small consumer loans at 99 percent, and limits monthly payments on small consumer loans to 22.5 percent of a borrower's gross monthly income. Additionally, HB 537 prohibits "dual licensure," meaning that a lender cannot have both a PLRA license and a CILA license,[ii] and HB 537 requires lenders to enter loan data into a statewide database. The statewide database has been an extremely effective tool for both determining loan eligibility in the case of payday loans and for compiling data about the products. Illinois may have the most comprehensive set of data about the industry. We believe it would benefit policymakers, regulators, and consumers to have a nationwide databased that is based on the Illinois model.

The industry filed yet another lawsuit against IDFPR – this time challenging the dual-licensure prohibition. The lawsuit was eventually dismissed, but the industry's litigiousness underscores the degree to which lenders will resist regulatory constraints.

Data published this year by IDFPR strongly suggest that Illinois consumers need additional protections.[iii] Our position is based, in part, on two significant conclusions that we derive from the IDFPR Report:

1. **<u>Payday/Installment/Title Loan customers tend to be lower income.</u>** According to the IDFPR Report, the average borrower earns less than $31,000 per year,[iv] which is less than 60 percent of Chicago's median income.[v] We have always thought that lower-income people constituted the bulk of the industry's customer base, but the IDFPR Report confirms that. As a general matter, lower-income people are at a higher risk of economic insecurity, and thus, need enhanced consumer protections.

2. **<u>Payday/Installment/Title Loan customers are too reliant on high-cost loan products</u>**. Most of the loans reported to the statewide database have triple-digit interest rates,[vi] and the average borrower obtained over six reportable loans.[vii] Many borrowers would have obtained even more loans but were declined due to statutory limits on days of indebtedness and numbers of loans.[viii] Repeat borrowing of these high-cost loans means that many borrowers are struggling to pay back their loans and/or are paying back their loans but are experiencing economic shortfalls. Remember that the ostensible purpose of these high-cost products is to assist with unexpected cash flow shortages. Because of their high interest rates, these products are not suited for longer-term financing.

In Illinois, on a $300, two-week payday loan, payday lenders typically charge 404 percent.[ix] Annually, these high cost lenders drain $270,204,194 in payday fees and $233,259,868 in car title fees, a significant loss both to borrowers and to the overall state economy.[x] This is particularly detrimental to Illinois' 699,522 veterans and to communities of color, populations which the payday and car title loan industries target and exploit. Payday lenders' ability to seize money directly out of borrowers' bank accounts means that people are left with little choice but to re-borrow, becoming more deeply mired in a cycle of debt.

The need for a strong rule is further demonstrated by the CFPB's research, which shows that 75 percent of all payday loan fees are due to borrowers trapped in more than 10 loans a year and that 80 percent of all car title loans are due to borrowers trapped in more than seven loans a year.[xi] In all likelihood, borrowers who take out seven or more of these high-cost loans in a year are in a state of dire financial insecurity or even financial chaos. Regulatory reform is needed to protect these consumers.

The Egan Campaign and Woodstock strongly support the Proposed Rules' ability-to-repay standard.

The Proposed Rules would provide Illinois consumers with additional protections by requiring lenders to determine that borrowers can afford to pay them back. We consider this to be a common-sense protection. After all, does it make sense to permit lenders to make loans that consumers *cannot* repay? (That's what caused the mortgage and foreclosure crisis that we are still recovering from.) The ability-to-repay standard will help consumers avoid the debt trap.

The ability-to-repay standard should apply to *all* loans.

The Proposed Rules should be modified to apply the ability-to-repay standard to *all* consumer loans. The Proposed Rules would permit lenders to make up to six short-term loans of $500 or less per year that do not comply with the ability-to-repay standard. The Proposed Rules would also permit a variety of types of longer-term installment loans to be made that do not comply with the ability-to-repay standard. For example, an ability-to-repay standard applies to a longer-term installment loan only if the loan is secured by a "leveraged payment mechanism," such as direct access to the borrower's paycheck, within 72 hours of the loan being made. If a lender secures the leveraged payment mechanism after 72 hours or if the loan is unsecured, the ability-to-repay standard would not apply. Other types of loans not covered by the ability-to-repay standard include installment loans secured by a wage assignment and installments loans secured by personal property. For us, permitting loans to be made that do not comport with the ability-to-repay standard is a loophole, and our experience in Illinois teaches us that lenders will take advantage of this loophole. An August 2016 article in *Vice* magazine provides additional evidence of the industry's intention to skirt the rules.[xii] In March, industry leaders met at a posh resort in the Bahamas. Among the topics discussed was "Federal Rulemaking in 2016: What to Expect and What Alternative Products to Consider." This particular panel was described as "a master class in how to exploit and manipulate regulatory loopholes."

Permitting lenders to make certain types of loans that are not covered by the ability-to-repay standard is an invitation for them to make those types of loans. This means that consumers will be given loans that they cannot pay back without re-borrowing or skimping on other expenses. This is precisely what the Proposed Rules should be aiming to prevent. No consumer should be given a loan that they cannot pay back. Therefore, we urge you to close the loopholes in the Proposed Rules and apply the ability-to-repay standard to all loans.

Title Loans

Title loan reform is long overdue in Illinois. Title lenders were not part of the negotiating process for either the Payday Loan Reform Act (PLRA) or for the 2010 reforms to the PLRA and the Consumer Installment Loan Act (CILA). Rules governing title loans had been promulgated in 2001, but they contained a fatal loophole in that they covered only loans with terms under 60 days. In 2009, the title loan industry and IDFPR enter into negotiations on the rules, and, that year, the loophole in the rules was closed.

The data, however, show that major reforms are still needed. According to the IDFPR Report, the default rate on title loans in 2015 was 37.3 percent.[xiii] This is an unacceptably high level, and it is made more egregious when you consider that the consequence of defaulting on a title loan is that the consumer's vehicle is repossessed. A recent report by Woodstock Institute and Illinois Asset Building Group discusses the impacts of repossession:

> Repossession of a vehicle can have ripple effects on borrowers' employment stability, health care access, and other parts of their lives. For example, in 76 of Illinois' 102 counties, 90 percent or more of workers rely on a car to get to work. In only five of Illinois' 102 counties does five percent or more of the workforce use public transit to get to work. For families who are dependent on a vehicle to commute to work, transport children, run errands, and travel to health appointments, the loss of a vehicle can be devastating.[xiv] (citations omitted)

Another development that the IDFPR Report reveals is that the term on title loans has become significantly longer. In 2009, only 7.1 percent of title loans were over 720 days. By 2015, that number had grown to 66.2 percent. This is a troubling development. Title loans are a high-cost product; the average APR is 189 percent. Carrying a balance on a loan with triple-digit interest for two years or more is bad for a consumer's financial well-being. The industry commonly justifies charging triple-digit interest by pointing to a relatively short loan term, and saying that an *annual* percentage rate is misleading for loans that mature in less than a year. In the case of title loans of 720+ days, however, the APR is as bad as it sounds. The ability-to-repay standard is necessary to protect consumers from this dangerous and expensive product.

Woodstock and the Egan Campaign strongly support the Proposed Rules' restriction on the number of times that a lender can debit a consumer's bank account.

Repeat debiting of a consumer's account when there are insufficient funds exacts significant harm on a consumer in the form of insufficient funds fees. Therefore, we support the Proposed Rules' limit of two consecutive, unsuccessful attempts to debit a borrower's checking account. We further propose that the Proposed Rules be modified to require reauthorization from the consumer for continued payments after three failed attempts in a 12-month period, even if those attempts are not consecutive.

Woodstock and the Egan Campaign oppose a five-percent payment-to-income ratio.

Obviously, a five-percent payment-to-income ratio has the beauty of simplicity, but the fact is that five percent of a borrower's income may be more than a borrower can spare. Assessing income alone is not sufficient to determine if a loan is affordable. Affordability can be determined only when considering both income and expenses. The CFPB's own research shows that there is still a high default rate (28-40 percent) on longer-term payday loans when the payments are five percent of income or less.[xv] A thorough ability-to-repay analysis is necessary to ensure that borrowers can repay their loans without re-borrowing or forgoing other expenses.

The cooling-off period between short-term loans should be 60 days.

A longer cooling-off period will increase the likelihood that a consumer's finances will recover from the destabilizing effects of a high-cost loan. We recommend that the CFPB extend the cooling-off period between short-term loans from 30 days to 60 days.

Establish a limit on the total days of indebtedness per year for short-term loans.

A limit on the total days of indebtedness is the best way to limit refinancings, renewals, rollovers, and loan flipping. Limiting the total days of indebtedness is more effective than trying to limit the number of refinancings, renewals, rollovers, loan flips, and loan modifications. A lender could, for example, evade a limit on refinancings by doing a loan modification: extending the loan term and charging additional fees. This is why the PLRA does not impose limits on refinancing a payday loan, rather, it establishes a limit of 45 consecutive days of indebtedness. The top reason for loan ineligibility in Illinois is "restricted by consecutive days in product."[xvi] This suggests that the limit on days of indebtedness is effective in helping to limit the cycle of debt. For short-term loans, we suggest that the Proposed Rules establish a limit of 90 days of indebtedness every 12 months, which is consistent with the FDIC's long-time standard for the banks it regulates.

Strengthen protections against repeat financing of longer-terms loans.

Refinancings are a strong indication that the consumer is unable to pay back a loan. The Proposed Rules' criteria to address flipping of longer-term loans is insufficient to prevent lenders from flipping borrowers from one unaffordable loan to the next. Refinancing of a longer-term loan should carry a presumption of unaffordability if the borrower is delinquent by even one day or if the borrower has not repaid at least 75 percent of the loan principal. Moreover, refinancing a covered longer-term loan a second time should be prohibited.

Close the "business as usual" loophole.

The Proposed Rules do not go far enough to ensure that people will have enough money to live on after making the loan payment. Rather than allowing lenders to forecast a borrower's living expenses, lenders should be required to look at objective assessments of a borrower's basic living expenses. The Proposed Rules require only that the lender not have unusually high default, delinquency, or re-borrowing rates. However, even low default or re-borrowing rates are not sufficient evidence of loan affordability because lenders have direct access to the borrower's bank account. A lender might be getting paid while the consumer is still struggling and forgoing critical expenses.

Lenders should not be permitted to compare their default rate to other lenders.

Permitting lenders to compare their default rates to other lenders' default rates invites a "race to the bottom." Instead, we urge the CFPB to set a default rate threshold of 10 percent on all loans except title loans and payroll deduction loans. For those loans, the CFPB should set a default rate threshold of five percent. Lenders who exceed the default rate should receive heightened regulatory scrutiny.

The Proposed Rules should provide that a loan made in violation of state law constitutes an unfair, deceptive, or abusive practice under the Dodd-Frank Act.

There are currently 14 states plus the District of Columbia that enforce rate caps that effectively prohibit payday loans.[xvii] The CFPB must not undermine these strong state laws and must go further to deem that making or offering a loan in violation of state law is an unfair, abusive, and deceptive practice.

Conclusion

We applaud the CFPB for proposing an ability-to-repay standard that, we believe, has the potential to protect millions of consumers. To ensure that the standard is applied as intended, it should apply to *all* loans. If the ability-to-repay standard does not apply to all loans, lenders will, to the greatest extent possible, make loans that are not covered by the standard. When and if that happens, CFPB may have to go back to the drawing board and go through the rule-making process all over again. We know this because that is what happened to us here in Illinois. To best protect consumers and to avoid having to do this all over again, the ability-to-repay standard should apply to *all* loans with *no* exceptions.

Thank you for your thoughtful consideration of our comments.

Very truly yours

EGAN CAMPAIGN FOR PAYDAY LOAN REFORM
WOODSTOCK INSTITUTE
CITIZEN ACTION/ILLINOIS

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[i] Woodstock Institution & Public Action Foundation, "The Illinois Payday Loan Loophole," (April 2008) http://www.woodstockinst.org/research/illinois-payday-loan-loophole.

[ii] There is an exception to the dual-licensure prohibition for title lenders. A title lender may obtain both a CILA license for the purpose of making title loans and a PLRA license.

[iii] "Illinois Trends Report Select Consumer Loan Products Through December 2015" (the "IDFPR Report") (Last Updated 4/4/2016) http://www.idfpr.com/DFI/CCD/pdfs/IL_Trends_Report%202015-%20FINAL.pdf?ActID=1204&ChapterID=20.

[iv] IDPFR Report at 6.

[v] *See* City of Chicago Area Median Income chart: https://www.cityofchicago.org/city/en/depts/dcd/supp_info/area_median_incomeamichart.html

[vi] IDFPR Report at 15, 23, 30, 33.

[vii] *Id.* at 5.

[viii] *Id* at 11.

[ix] Center for Responsible Lending, Map of U.S. Payday Loan Interest Rates, 2016, http://www.responsiblelending.org/research-publication/map-us-payday-interest-rates

[x] Center for Responsible Lending, "Payday and Car Title Lenders Drain $8 Billion in Fees Every Year", 2016, http://www.responsiblelending.org/research-publication/payday-and-car-title-lenders-drain-8-billion-fees-every-year

[xi] CFPB, 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

[xii] David Dayen, "How Predatory Payday Lenders Plot to Fight Government Regulation," *Vice*, August 18, 2016. http://www.vice.com/read/payday-lenders-consumer-protection-strategy-atlantis-bahamas

[xiii] IDFPR Report at 12.

[xiv] Spencer Cowan, Courtney Eccles, Jody Blaylock, & Lucy Mullany. "No Right Turn: Illinois Auto Title Loan Industry and its Impact on Consumers" (October 2015). http://www.woodstockinst.org/sites/default/files/attachments/No_Right_Turn.pdf.

[xv] CFPB Supplemental Data released June 2, 2016, Fig. 6-12. http://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf

[xvi] IDFPR Report at 11.

[xvii] *See* California Reinvestment Coalition, New Economy Project, Reinvestment Partners, & Woodstock Institute, "The Case for Banning Payday Lending" (2013). http://www.woodstockinst.org/sites/default/files/attachments/The%20Case%20for%20Banning%20Payday%20Lending%20-%20June%202013.pdf (report presents a snapshot of two states that do and two states that do not ban payday lending).