WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

May 15, 2019

Director Kathy Kraninger
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: Docket No. CFPB-2019-0006, RIN 3170-AA80

Dear Director Kraninger:

Woodstock Institute offers this comment in response to the Consumer Financial Protection Bureau's (CFPB's) Notice of Proposed Rulemaking (NPRM) on payday, vehicle title, and certain high cost installment loans (the "Proposed Rule"). Thank you for the opportunity to comment on this important subject. The Proposed Rule runs counter to reason and research, and it poses a significant threat to millions of American consumers. As explained below, the vast amount of evidence supporting the 2017 Rule establishes that making payday loans to consumers without regard to the consumers' ability to repay the loans is both "abusive" and "unfair" under Section 1031 of the Dodd-Frank Act.

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. Among the issues recently on Woodstock's policy agenda are payday and auto title lending, check-cashing fees, small business lending, abusive municipal fines & fees, and the Community Reinvestment Act.

About the Author

Woodstock Senior Vice President of Policy & Communication Brent Adams wrote the Illinois Payday Loan Reform Act of 2005 while serving as the Policy Director at Citizen Action/Illinois. In 2006, the Illinois Department of Financial & Professional Regulation (IDFPR) hired him as a deputy general counsel to help enforce the new law. In 2009, Governor Pat Quinn appointed Brent to serve as Secretary of IDFPR, making him the State's chief regulatory official overseeing the payday loan industry in addition to most of the State's financial institutions and licensed professions. Brent served in that role until 2012. In 2016, Brent began his current role at Woodstock, advocating for regulatory reform to protect consumers.

Woodstock's 2016 Comment

Woodstock submitted a comment in 2016 on the CFPB's proposed rule that the CFPB finalized in 2017 (the "2017 Rule"). That comment, which we are submitting as an attachment to this comment, supported the requirement that payday lenders assess a borrower's ability to repay the loan (the "ATR requirement"), and urged the CFPB to apply the ATR requirement to *all* consumer loans. The CFPB opted not to adopt that recommendation, choosing to apply the ATR requirement to only short-term payday and auto title loans. This fact is important because it demonstrates how the CFPB took a *measured approach*, applying the ATR requirement to only part of the market. The 2017 Rule took into account industry concerns and the uncertainty as to precisely how the ATR requirement would affect the availability of payday and auto title loans. The 2017 Rule was a compromise.

Payday Loans (and similar products) in Illinois

The storefront lending market is diverse and thriving in Illinois, and Illinois allows a variety of different products in this space: payday loans, installment payday loans, small consumer loans, auto title loans, and traditional installment loans.[1] Thanks to a statewide database (the "Database") that was first implemented in 2006 pursuant to statute,[2] we have nearly 15 years' worth of reliable data on a vast amount of lending activity. Of the five storefront loan products listed above, data about all of them, except traditional installment loans, are entered into the Database. [3]

The Database was statutorily established by the Payday Loan Reform Act of 2005 (PLRA).[4] As an enforcement tool, the Database is superior to the traditional method of regulatory enforcement which involves an examiner visiting a store, pulling a set of loan files, and determining whether the loans were made in accordance with the law. With "real-time enforcement" by the Database, no payday loan, installment payday loan, or auto title loan is made in Illinois without first getting a "green light" from the Database.[5] The Database cuts down on human error and saves resources by limiting the scope of examinations. The Database also protects consumers by stopping an unlawful loan *before* the loan is made.

The reliability of the Illinois data is especially important considering that the Proposed Rule is based, in part, on the CFPB's belief that the evidence cited in support of the 2017 Rule is unreliable.[6] The Illinois data is not a sample. The data is *all* loans. Presumably, some lenders – either mistakenly or intentionally – have made loans without entering data into the Database, but the number of such loans would be negligible. The cost of compliance is extremely low once the database is integrated into the lenders'

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[1] Short-term auto title loans do not exist in Illinois, so neither the 2017 rule nor the Proposed Rule will affect that market in this state. The average loan term for an auto title loan in Illinois is 515.8 days.

[2] 815 ILCS 122/2-15 (2015).

[3] Lenders are not required to enter data into the Database regarding traditional installment loans. This is largely due to the fact that traditional installment loans are subject to a 36 percent APR cap, and thus, are considered less dangerous than the other products.

[4] 815 ILCS 122 (2015).

[5] With respect to small consumer loans, lenders are required to enter data into the Database, but the Database does not play a role in the approval process. Small consumer loans are loans, other than title loans, that are $4,000 or less subject to an APR cap of 99 percent.

[6] 84 FR 4252, 4253 (Feb. 14, 2019).

systems and is certainly far less than the potential cost of a severe disciplinary action that would result from skirting the database requirement. As reported by the most recent *Illinois Trends Report*, the total number of loans entered into the Database is 9.7 million through the end of 2017 – an ample dataset by any measure.[7] The number of consumers who took out these loans is 1.4 million, equaling an average of seven loans per consumer. These data are consistent with the CFPB's research on repeat borrowing, which is discussed in the next section.

The interest rates on payday loans, payday installment loans, and auto title loans in Illinois are extremely high. On payday loans in Illinois, the average interest rate is 316 percent, and the average loan amount is $352.45. The average number of payday loans per borrower is 6.8, but, since 2006, 1,357,530 payday loan applications have been declined due to statutory limitations. For example, the PLRA imposes a 45-day limit on consecutive days of indebtedness.[8] Absent that requirement, the number of loans per borrower would be higher.

Making Payday Loans to Consumers Who Lack the Ability to Repay Them is Unfair and Abusive

Debt trap harms are severe, widespread, and well documented. Any consumer who has ever struggled to pay bills can appreciate the harms caused by being trapped in debt. It should not be necessary to belabor this point, but the Proposed Rule fails to fully appreciate the magnitude of the problem. Knowing the 2017 Rule would be subject to attack – from outside and/or from within – the CFPB compiled a mountain of evidence to establish its authority to take action with respect to "unfair" and "abusive" payday loan practices.[9]

Unfairness

The CFPB's research, as you well know, found that payday loans often lead to "significant consumer harm."[10] Section 1031 of the Dodd-Frank Act authorizes the CFPB to develop rules to address "unfair" acts or practices, which are acts or practices that cause substantial injury, which is not reasonably avoidable.[11] To highlight just one example, in the case of online payday loans, the CFPB found that half of online payday borrowers are charged an average of $185 in bank penalties, and 36 percent of accounts with a failed debit attempt from an online lender ended up being closed by the depository institution.[12] Put another way, online payday loans create a significant risk of the consumer being kicked out of the mainstream banking system. The negative consequences of becoming unbanked are multi-fold. One is that the consumer must rely on costly alternative financial services providers, such as check cashers, for day-to-day financial transactions. The added expenses associated with being unbanked

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[7] Ill. Dept. of Financial & Professional Regulation, *Illinois Trends Report* (June 19, 2018). https://www.idfpr.com/dfi/ccd/pdfs/IL_Trends_Report%202017.pdf

[8] 815 ILCS 122/2-5(b).

[9] 12 U.S.C. 5531.

[10] CFPB, *Payday Loans, Auto Title Loans, And High-Cost Installment Loans: Highlights From CFPB Research* ("Research Highlights") (June 2, 2016). https://files.consumerfinance.gov/f/documents/Payday_Loans_Highlights_From_CFPB_Research.pdf

[11] A finding of unfairness can negated by "countervailing benefits" that outweigh the injury. 12 U.S.C. 5531(c)(1)(B). Payday loan benefits are discussed in the next major (bolded) section beginning on the following page.

[12] CFPB, *Online Payday Loan Payments* (Apr. 2016). https://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf

create a downward spiral that makes it increasingly hard to re-enter the financial mainstream. This certainly qualifies as a substantial injury.

Substantial injuries from payday loans are not reasonably avoidable because payday loan borrowers are often in dire financial straits. Payday loan borrowers are predominantly lower-income. In Illinois, most payday loan borrowers earn less than $30,000 per year.[13] For low-income consumers, the consequences of a high-cost loan that becomes a never-ending cycle of debt can be more severe and immediate than for higher-income consumers because lower-income consumers have less of an economic cushion in terms of assets and less flexibility in terms of being able to decide when and how to pay creditors versus paying for basic needs such as food, diapers, and the like. Even a loan payment of less than $100 can mean that a consumer will skimp on or ration a basic need, such as a prescription medication.

The payday lenders acknowledge that their products are intended only for short-term use. It's why the product is called a *payday* loan; it is meant to be paid in full on the payday immediately following the day the loan was made. Payday lenders point to the short loan terms when attempting to justify the extremely high annual percentage rates (APRs). It is true: 400 percent APR on a 14-day loan is very different than 400 percent APR on a 12-month loan. A cycle of re-borrowing, however, effectively converts a short-term loan into a longer-term loan. Four out of five payday loans are re-borrowed,[14] and most short-term loans are borrowed by consumers who take out a least 10 loans in a row.[15] A narrative depiction of how this destructive cycle plays out can be found in *Caught In the Debt Trap: Stories of Payday and Car Title Loan Borrowers*.[16] Recurring, automatic payments on payday loans can mean having to skimp on non-automatic purchases such as food and medical care.

Abusiveness

Payday loans made to borrowers without regard to ability to pay are also "abusive" under the Dodd-Frank Act. The evidence is substantial that our country's most vulnerable consumers are in need of protection from the dangerous features of payday loans. The triple-digit interest rates, standing alone, make payday loans dangerous. To deny this strains credulity. Market competition fails to make payday loans affordable because many consumers who obtain payday loans have a desperate need for cash. They are over the proverbial barrel. Behavioral economics shows that consumers, in such circumstances, are more likely to prioritize short-term needs over longer-term consequences.[17] Consumers in these situations are unable to wield their purchasing power to protect their interests by demanding a better price or better terms. In this way, payday loans made without regard to the ability to repay are "abusive" because they take unreasonable advantage of a consumer's inability to protect their own interests. Requiring payday lenders to determine whether a borrower can repay a loan is a precisely targeted mechanism to prevent such abuse.

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[13] *Trends Report* at 15.
[14] *Research Highlights* at 1.
[15] CFPB, *CFPB finalizes rule to stop payday debt traps* (Oct. 5, 2017). https://files.consumerfinance.gov/f/documents/201710_cfpb_fact-sheet_payday-loans.pdf
[16] Allyson Fredericksen, People's Action Institute, *Caught In the Debt Trap: Stories of Payday and Car Title Loan Borrowers* (Oct. 7, 2016). https://mk0coniwirakqjfvhpgc.kinstacdn.com/wp-content/uploads/2016/10/Caught-in-the-Debt-Trap-final.pdf
[17] Sendhil Mullainathan and Eldar Shafir*, Scarcity: Why Having Too Little Means So Much* (2013).

The Benefits of Payday Lending Do Not Outweigh the Injuries

Section 1031(c)(1)(B) of the Dodd-Frank Act provides that an act or practice is not "unfair" if "countervailing benefits" outweigh the substantial injuries caused by the act or practice.[18] The NPRM fails to present evidence that payday loans, more often than not, provide sustained benefits to consumers that outweigh the known injuries. Managing to pay off a payday loan may, at best, suggest that a consumer escaped or minimized injury, which is not the same as establishing that they benefited.

Regardless of your opinion on the 2017 Rule, it is undisputed that the CFPB did a compelling amount of research to support it. Substantially less research was done in support of the Proposed Rule. In several places, the NPRM states that the CFPB does not believe such research to be "cost effective."[19] The concept of cost-effectiveness is unusual in a regulatory context – a regulatory agency's primary focus is not itself, but rather, the regulated entities and/or the consumers served by them. Millions of consumers annually are directly impacted by payday loans.[20] In terms of dollars, billions of dollars hinge on whether payday loans will be subject to an ATR requirement. How, then, could the CFPB's research on the subject *not* be "cost effective?"

Certainly, research done properly is time-consuming and would have significantly postponed issuance of the NPRM. The Bureau could, however, have proceeded with the proposal to delay the rule, conducted research, and then proposed a modification, if warranted. As it stands, the Proposed Rule is inadequately researched; the NPRM fails to build a compelling case as to benefits of payday lending. Critiquing the research backing the 2017 Rule and pointing to expected declines in the availability of payday loans is far from enough to outweigh the significant injuries caused by a cycle of high-cost debt. As such, the mountain of evidence of payday loan injuries that supports the 2017 Rule is not sufficiently "countervailed."

The bottom line is that folks sometimes run out of money due to insufficient income to meet expenses. The availability of payday loans does not preclude that. Obtaining a payday loan – or several payday loans – very easily can, and does, make running out of money worse because payday loan debt is extremely expensive. The debt is often in addition to other forms of debt. In such instances, a payday loan is like throwing gasoline onto a fire.

The NPRM lists a variety of so-called "impacts" from the inability to obtain a payday loan, e.g., defaulting on bills, overdrafts, etc.[21] These impacts, however, are not *caused* by the inability to obtain a payday loan. They are caused by running out of money! Running out of money is sustainably prevented or addressed only when (a) expenses are cut, and/or (b) income is increased. A payday loan is someone else's money, so it is not income. It becomes an expense as soon as it is received. Added to that expense, of course, is the triple-digit interest charged on most payday loans, not to mention their assorted penalties and fees.

There are stories about folks who have invested their payday loans into a small business or other enterprise and have increased their income. That would qualify as a benefit. These stories are the exception, however, not the norm. Insofar as the CFPB or the industry opts to rely on these "success

[18] 12 U.S.C. 5531(c)(1).
[19] 84 FR 4252, 4253, 4266, 4268.
[20] *Id.* at 4255.
[21] 84 FR 4252, 4259-4260.

stories," they need to be backed with data. In what percentage of payday loan transactions does the borrower successfully leverage the loan funds in such a way as to cause a sustained increase in the borrower's income? This is perhaps a research topic that the CFPB could have explored *before* making such a drastic change to the 2017 Rule.

Worst-case Scenario

I know you are concerned about the impact the ATR requirement will have on access to credit. First, there have always been limits on access to credit – "credit," of course, is the same as debt as soon as the bills become due – and when such limits have been ignored, such as during the sub-prime mortgage crisis, families and entire communities have been devastated. Some communities in Chicago, especially lower-income communities and communities of color, are still trying to recover from the cataclysmic effects of mortgage loans made without regard to borrowers' ability to repay. Those loans stripped families of wealth and left neighborhoods pockmarked with foreclosed homes. Woodstock's recently released *2018 Chicago Area Community Lending Fact Book* depicts the sluggish recovery that still exists in predominantly lower-income communities and communities of color.[22]

The regulatory experience in Illinois with respect to payday lending, which is discussed in the "Historical Context" section of our 2016 comment, is instructive as to how the market may react to increased regulation. For the most part, lenders who decline to make loans subject to a new regulation will first determine whether they can alter the terms of their products to fall outside the new regulation or offer different products. This is not a recent revelation. As described in an August 2016 article in *Vice* magazine, among the topics discussed at a payday lender meeting in the Bahamas in March 2016 was "Federal Rulemaking in 2016: What to Expect and What Alternative Products to Consider." [23]

In Illinois, after the PLRA took effect, some lenders opted to offer 121-day loans because the PLRA applied only to loans of 120 days or less. Woodstock and the Public Action Foundation released a report in 2008 calling this the payday loan loophole.[24] Thus, even assuming that the ATR requirement would cause lenders to stop making loans subject to the ATR requirement, lenders would (1) offer payday loans that are not subject to the ATR requirement, and/or (2) offer other types of loans not subject to the ATR requirement, e.g., longer-term payday installment loans. States that do not allow such a variety of products as Illinois allows would have the option to respond to a tightening in the market by developing laws and/or regulations to address that concern. This is the proper role of the states.

As you observe in the NPRM, 17 states and the District of Columbia ban payday loans or have interest rate caps that caused the payday lenders to stop making payday loans in those states. Those jurisdictions have voluntarily chosen the outcome the CFPB is going to extraordinary lengths in the Proposed Rule to prevent. Those states (and DC) have avoided a financial cataclysm. Even if a total ban of high-cost loans has negative consequences, the 2017 Rule falls far short of a total ban. It does not even impose the ATR requirement on all payday loans.

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[22] Woodstock Institute, *2018 Chicago Area Community Lending Fact Book* (Dec. 2018). https://woodstockinst.org/wp-content/uploads/2018/12/2018-Chicago-Area-Community-Lending-Fact-Book.pdf

[23] 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

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

Consumers' behavior in the payday-free states is the best evidence as to what would happen if payday lenders opted to stop making loans. The Center for Responsible Lending's *Shark-Free Waters* report is important literature in this field.[25] The report explains that, in states without payday lending, consumers employ a "host of strategies:" using another type of credit such as a credit card or cash advance; turning to family or friends; selling personal items; or cutting expenses. A mass migration to unlicensed online lending or to loan sharks does not occur.[26]

Conclusion

While deploring hackneyed expressions, it is hard not to describe the Proposed Rule as a classic example of throwing the baby out with the bath water. Any reasonably robust ATR requirement is complex, and it is certainly more burdensome on lenders to do it than not to do it. Tweaking it or modifying it to account for concerns about market impacts *might* be reasonable if supported by data and credible research, but rescinding the final rule entirely is manifestly contrary to the best interests of consumers.

We appreciate your time and consideration. Please let us know if we can be of any assistance.

Very truly yours,

Brent E. Adams
Senior Vice President of Policy & Communication

[25] Center for Responsible Lending, *Shark-Free Waters: States are Better Off without Payday Lending* (Aug. 2016; Updated Sept. 2017). https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-shark-free-waters-aug2016.pdf

[26] *Shark-Free Waters* at 3 (citing The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (July 2012)).