October 7, 2016

VIA ELECTRONIC SUBMISSION

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1275 First Street NE
Washington, DC 20552

Dear Director Cordray:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits these comments on the proposed rule on the Consumer Financial Protection Bureau (CFPB or the Bureau) Payday, Vehicle Title, and Certain High-Cost Installment Loans.[1] Advocacy is concerned that the economic impact of the proposed rule on small entities and consumers may be greater than what is indicated in the CFPB's Regulatory Flexibility Act (RFA) analysis. Advocacy encourages the CFPB to reevaluate the economic impact in RFA section of the proposed rule and consider less burdensome alternatives for small entities.

Advocacy Background

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,[2] as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),[3] gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.[4] The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to

[1] 81 Fed. Reg. 47,864 (July 22, 2016)
[2] 5 U.S.C. § 601 et seq.
[3] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).
[4] Small Business Jobs Act of 2010 (PL 111-240) § 1601.

written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.[5]

In July 2010, the United States Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act or Dodd-Frank).[6] Section 1011 of the Act establishes the CFPB to supervise certain activities of financial institutions. Section 1100G, entitled "Small Business Fairness and Regulatory Transparency," amends 5 U.S.C. § 609(d), to require the CFPB to comply with the SBREFA panel process.

The SBREFA panel process requires the CFPB to conduct special outreach efforts to ensure that small entity views are carefully considered prior to the issuance of a proposed rule, if the rule is expected to have a significant economic impact on a substantial number of small entities. This outreach is accomplished through the work of small business advocacy review panels consisting of a representative or representatives from the rulemaking agency, the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) and the Chief Counsel for the Office of Advocacy. The panel solicits information and advice from small entity representatives (SERs), who are individuals who represent small entities affected by the proposal. SERs help the panel better understand the ramifications of the proposed rule. The product of a SBREFA panel's work is its panel report on the regulatory proposal under review.

On April 27, 2015, the CFPB convened a SBREFA panel to consider proposals to prevent consumer injuries that result from lenders extending payday, vehicle title, and similar loans that a consumer cannot afford to repay. It also considered proposals to address harms that may arise from certain lender practices in collecting repayment from a consumer's account.[7]

The Rulemaking

Dodd-Frank authorizes the CFPB to issue rules to identify and prevent unfair, deceptive, or abusive acts or practices in the consumer financial markets.[8] Pursuant to § 1031, an act or practice is unfair if it causes or is likely to cause substantial injury to consumers; the injury is not reasonably avoidable by consumers; and the injury is not outweighed by any countervailing benefits to consumers or competition.[9]

On July 22, 2016, the CFPB published in the Federal Register a proposed rule to establish 12 CFR 1041, which would contain regulations creating consumer protections for certain consumer credit products. The proposed regulations would cover payday, vehicle title, and certain high-cost installment loans. The CFPB's proposal would apply to two types of covered loans. First, it would apply to short-term loans that have terms of 45 days or less, including typical 14-day and 30-day payday loans, as well as short-term vehicle title loans that are usually made for 30-day terms. Second, the proposal would apply to longer-term loans with terms of more than 45 days that have (1) a total cost of credit that exceeds 36 percent; and (2) either a lien or other security

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[5] Id.

[6] Pub. L. 111-203.

[7] *The Final Report of the Small Business Review Panel on CFPB's Rulemaking on Payday, Vehicle Title, and Similar Loans* (hereinafter Panel Report), June 25, 2016.

[8] 12 U.S.C. 5531(b).

[9] 12 U.S.C. 5531(c).

interest in a ‘‘leveraged payment mechanism’’ that gives the lender a right to initiate transfers from the consumer’s account or to obtain payment through a payroll deduction or other direct access to the consumer’s paycheck. Included among covered longer-term loans is a subcategory of loans with a balloon payment, which require the consumer to pay all of the principal in a single payment or make at least one payment that is more than twice as large as any other payment. The CFPB is proposing to exclude several types of consumer credit from the scope of the proposal, including: (1) loans extended solely to finance the purchase of a car or other consumer good in which the good secures the loan; (2) home mortgages and other loans secured by real property or a dwelling if recorded or perfected; (3) credit cards; (4) student loans; (5) nonrecourse pawn loans; and (6) overdraft services and lines of credit.[10]

For both categories of covered loans, the proposal would identify it as an abusive and unfair practice for a lender to make a covered loan without reasonably determining that the consumer has the ability to repay the loan. The proposal also would impose certain restrictions on making covered loans when a consumer has or recently had certain outstanding loans. The proposal would provide lenders with options to make covered loans without satisfying the ability-to-repay requirements, if those loans meet certain conditions.[11]

The proposal also would identify it as an unfair and abusive practice to attempt to withdraw payment from a consumer’s account for a covered loan after two consecutive payment attempts have failed, unless the lender obtains the consumer’s new and specific authorization to make further withdrawals from the account. The proposal would require lenders to provide certain notices to the consumer before attempting to withdraw payment for a covered loan from the consumer’s account. The proposal would also prescribe processes and criteria for registration of information systems, and requirements for furnishing loan information to and obtaining consumer reports from those registered information systems.[12]

Advocacy Performed Small Entity Outreach for the Proposed Rule

The Office of Advocacy performs outreach through roundtables, conference calls and other means to develop its position on important issues such as this one. Advocacy held three roundtables with small entities on this issue in September 2016. One roundtable was held in Kentucky and another in Wisconsin in response to the SBREFA panel recommendation to perform outreach in rural communities.[13] The third roundtable was held in Washington, DC. The attendees included storefront payday lenders, online lenders, banks, credit unions, tribal representatives, trade associations representing small businesses, and government representatives. Some of the attendees had served as SERs for the SBREFA panel. The CFPB attended all three roundtables.

[10] Fed. Reg. at 47864.
[11] Id at 47864-47865.
[12] Id at 47866.
[13] *The Final Report of the Small Business Review Panel on CFPB’s Rulemaking on Payday, Vehicle Title, and Similar Loans* (hereinafter Panel Report), June 25, 2016page 34.

The Proposed Rule Will Have a Significant Economic Impact on Small Entities

One of the main concerns the SERs expressed to the SBREFA panel pre-proposal, and which many of the roundtable participants re-emphasized post-proposal, was the significant economic impact that the proposed rule would have on their businesses, communities and customers. The SERs stated that the proposals under consideration to require that lenders determine whether a consumer has the ability to repay a covered short-term loan would prevent them from making covered short-term loans. The SERs indicated that the proposals under consideration would result in substantial changes to their business models, making it difficult, if not impossible, for small entities to remain in business. The SERs asserted that the general framework of the requirement would result in a dramatic revenue reduction and also that compliance with some of the specific operational features would be costly and burdensome relative to the CFPB's stated objective for the regulation.[14]

The SERs were particularly concerned about the ability to repay (ATR) requirements. The issues were not resolved in the proposed rule. At the roundtables, some of the attendees reiterated the concerns of the SERs. They stated that their customers will not be able to withstand the scrutiny of the ATR requirements and the revenue stream will be too low for their businesses to survive. Some roundtable participants stated that they may experience revenue reductions of greater than 70 percent and be forced to exit the market.

Advocacy believes that the CFPB has underestimated the potential economic impact of this rulemaking on small entities. In determining the economic impact of the ATR requirements, the CFPB's RFA analysis appears to be limited to the costs of the new recordkeeping system, the costs of obtaining verification evidence and the costs of making an ATR determination consistent with that evidence.[15] The CFPB has not provided an adequate estimate of the aggregate impact that the ATR requirements may have on the revenue stream of small entities, if their customers no longer qualify for loans. Advocacy encourages the CFPB to include these additional costs in the analysis of the economic impact of the loss of revenue.

The Ability to Repay Requirements in the Proposed Rule Will Be Burdensome

Overall, the proposed rule prescribes the steps that a lender must take before making a covered short-term loan. The lender would have to make a reasonable determination that the consumer would be able to make the payments on the loan and be able to meet the consumer's other major financial obligations and basic living expenses without needing to reborrow over the ensuing 30 days. It requires the lender to verify the consumer's net income; verify the consumer's debt obligations using a national consumer report and a consumer report from a "registered information system"; verify the consumer's housing costs or use a reliable method of estimating a consumer's housing expense based on the housing expenses of similarly situated consumers; forecast a reasonable amount of basic living expenses for the consumer—expenditures (other than debt obligations and housing costs) necessary for a consumer to maintain the consumer's health, welfare, and ability to produce income; project the consumer's net income, debt obligations, and housing costs for a period of time based on the term of the loan; and determine

[14] Id. at page 29.
[15] Fed. Reg. at 48155-48156.

the consumer's ability to repay the loan based on the lender's projections of the consumer's income, debt obligations, and housing costs and forecast of basic living expenses for the consumer.

The ATR requirements are complicated and extensive. Payday lenders assume the high-risk of offering the product for people who do not qualify for other sources of credit. The roundtable participants expressed concern that through the ATR requirements, the CFPB was turning an uncomplicated product into a complex product.

The roundtable participants were also concerned that their customers may not qualify for a loan under the ATR requirements. The lack of flexibility may interfere with a business' ability to provide critical funds to consumers who do not have other credit options. This is especially problematic in small rural communities where the lenders contend that they know their customers and the lending is relationship based.

The CFPB's proposed rule applies to loans that are less than $500. One of the roundtable participants opined that the proposed requirements are greater than what is required for other credit products like credit cards or a home mortgage. The roundtable participants questioned whether a consumer should have to undergo such extensive scrutiny for such a small loan.

Advocacy encourages the CFPB to eliminate some of the ATR requirements. For example, the CFPB may want to eliminate the credit check requirement. As stated by the roundtable participants, a credit check is an unnecessary hurdle. Many of the people who use payday lenders do not have credit cards or loans in their name so there is no credit history. The CFPB estimates that the reports will cost approximately two dollars for small lenders versus fifty-five cents for larger lenders.[16] Small business representatives have stated that the actual cost of a credit report may be as high as twelve dollars per report. Small entities will incur this cost even if the loans are not approved. Small lenders in states with rate caps will not be able to pass the additional costs to consumers.[17] By eliminating the credit check requirement, the CFPB will reduce some of the costs that may result from this rulemaking.

The 30-Day Cooling Off Period Will Harm Small Businesses

At the time of the SBREFA panel SERs meeting, the proposals under consideration contained a 60-day cooling off period for reborrowing. By the CFPB's own estimation, the 60- day cooling off period would have resulted in an 84 percent reduction in revenue.[18] The SERs stated that the restrictions on reborrowing for covered short-term loans would significantly decrease their revenue and profit, making it difficult, if not impossible, for small entities to remain in business. The Panel recommended that the Bureau request comment on whether a loan sequence could be defined with

[16] Id. at 48119.
[17] Id. at 48126.
[18] *Small Business Advisory Review Panel For Potential Rulemakings For Payday, Vehicle Title, And Similar Loans Outline Of Proposals Under Consideration And Alternatives Considered*, March 2015, page 43.

reference to a period shorter than 60 days in order to reduce the impact of the proposals on small entities while addressing concerns about reborrowing from unaffordable loans.[19]

As a result of the SBREFA panel, the 60-day cooling off period has been reduced to a 30-day cooling off period in the proposed rule.[20] It provides that if a consumer seeks a covered short-term loan within 30 days of obtaining another covered short-term loan, the lender would have to presume that the consumer cannot afford the loan. A lender would be able to overcome the presumption of unaffordability if the lender is able to document an improvement in the consumer's financial capacity.

Advocacy appreciates the CFPB reducing the term of the cooling off period. Although the impact will not be an 84 percent reduction in revenue, the CFPB projects that there may be a 55-62 percent reduction in loan volume and a 71 to 76 percent reduction in revenue due to the 30-day cooling off period.[21] Advocacy asserts that a 71 to 76 percent decrease in revenue may be detrimental to small entities and encourages the CFPB to consider a shorter period to reduce the economic impact on small entities.

In addition, some of the small businesses stated that the 30-day cooling off period may be detrimental to their customers as well. The underlying assumption of the 30-day cooling off period is that consumers who use payday loans operate on a 30-day billing cycle. According to the roundtable participants, some of their clients do not operate on a 30- day billing cycle. For example, some may pay their rent on a weekly basis. In such an instance, the 30-day cooling off period may prevent a consumer from obtaining funds that may be needed to meet essential needs.

Advocacy encourages the CFPB to reconsider the cooling off period. If one is necessary, Advocacy encourages the CFPB to implement a shorter cooling off period.

An Exception for Loans to Address an Emergency Is Necessary

The CFPB solicited comment on whether to permit lenders to overcome a presumption of unaffordability by finding that the consumer had experienced an unusual and nonrecurring expense and, if so, on measures to address the challenges described above.[22] The roundtable participants and the SERs for the SBREFA panel expressed concerns about not being able to address the needs of their customers in the event of an emergency. Advocacy encourages the CFPB to provide an exception for an emergency. Advocacy further encourages the CFPB to provide clear guidance on what qualifies as an emergency.

Some States Have Addressed the Issue of Payday Lending

As noted in the preamble, many states have addressed the issue of payday loans. Some states have banned payday loans or have fee or interest rate caps that payday lenders apparently find too low to sustain their business models.[23] Following the SBREFA panel, several state legislators wrote to the CFPB. The letters referred to the steps that had been taken to protect the consumer

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[19] Panel Report at page 30.
[20] Fed. Reg. at 47959.
[21] Id. at 41822.
[22] Id. at 48021.
[23] Id. at 47868-47869.

while maintaining access to short term credit. The letters also voiced concerns about the impact that the CFPB's proposals would have on small rural communities. The states urged the CFPB to reconsider the proposals.

Likewise, the roundtable participants and the SBREFA panel SERs expressed concerns about the impact of the regulations in states with payday lending laws. Some spoke of the changes that they made to comply with the state laws and concern about having to incur additional expenses to change their systems and train their employees to implement the CFPB's rules. They indicated that the laws are working in their states.

In implementing laws, states take into consideration the needs of their citizens. Advocacy encourages the CFPB to recognize the states' ability to make the appropriate choices for their citizens and exempt from the rule small businesses that operate in states that currently have payday lending laws.

The CFPB Underestimated the Impact that the Proposed Rule May Have on Credit Unions

In the proposed rule, the CFPB states that depository institutions and credit unions with less than ten billion dollars in assets rarely originate loans that would be covered short-term loans. It further states that some of these institutions do originate loans that would be covered longer-term loans. The CFPB asserts that small credit unions that make available Payday Alternative Loan (PAL) loans would continue to do so, using the PAL approach.[24]

According to the Credit Union National Association (CUNA) representatives at Advocacy's roundtables, the minimum length of a PAL loan is 30 days. As such, some credit unions do make loans that are under 46 days. Small credit unions are very concerned with the lack of sufficient analysis about the impact of this rule on credit union loans under 46 days.

In addition, according to CUNA, the all-in APR is problematic for loans longer than 45 days. It may require credit unions to perform three different APR calculations for consumer loans, in addition to having new forms and disclosures, compliance training, and other resources. The proposed rule adds unnecessary complexity and new compliance burdens to consumer friendly credit union small dollar loans.

The National Credit Union Administration (NCUA) has addressed the issue of payday type loans for credit unions with the PAL program. NCUA is the independent federal agency within the executive branch. It is the chartering authority for federal credit unions and provides federal account insurance to all federal credit unions. NCUA works to ensure safety and soundness as well as compliance with applicable federal regulations in the credit union system. It also works to protect consumer rights and member deposits. Advocacy encourages the CFPB to recognize the NCUA's expertise in the area of credit unions and exempt small credit unions from the proposed rule.

[24] Fed. Reg. at 48150.

The Proposed Rule May Impact Small Communities

The proposed rule may have a significant economic impact on small rural communities. The SERs stated that they are known to their customers in rural communities and that they know whether their consumers will be able to repay their loans. The SERs also stated that consumers in rural communities may have few options for accessing credit other than the covered loans offered by these lenders.[25]

Although the CFPB implies that the providers of short-term loans will be able to consolidate, it is unlikely in the rural areas. In rural areas, the stores may be miles apart. The likelihood of someone driving a long distance for a payday loan may be slim. Section 1031 of Dodd-Frank requires the CFPB to consider whether the injury is outweighed by the countervailing benefits to consumers or competition. Removing this form of financing from rural communities may be detrimental to consumers, the economy and competition.

Advocacy encourages the CFPB to consider the detrimental effects that the proposal may have on small rural communities.

The Proposal Will Impact Tribes

Several tribal representatives attended Advocacy's roundtables. At the roundtables, the representatives expressed concerns about the economic impact that the proposed rule could have on tribal businesses and tribal communities. For example, at the roundtable in Washington, DC, a tribal representative from the Fort Belknap Indian Community[26] stated that the median income of tribe members is $12,000 per year. Many tribal communities are economically disadvantaged.

The tribal representatives stated that the goal of their tribal payday lending businesses is economic development. According to the tribal representatives, the proposed rule will directly impact the economic vitality of the tribal community. The tribal representatives were particularly concerned about the lack of full tribal consultation and the infringement on tribal sovereignty. In the preamble, the CFPB states that it consulted with the tribes.[27] Advocacy encourages the CFPB to work with the tribes to resolve the issue of tribal consultation and tribal sovereignty.

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[25] Panel Report at page 34.

[26] In 2010, the population of the Fort Belknap Indian community was 2,851. *See* http://www.ceic.mt.gov/Documents/PopulationProjections/Census2010Profiles/Reservation%20Profiles/Census2010_DP1_FortBelknapReservation.pdf. A small governmental jurisdiction is defined by the 601(5) RFA as a community with a population of less than 50,000. Although the Native American tribes are not covered by the RFA, section 2(d) of Senate Bill S 1536 would amend the RFA to include tribes as small governmental jurisdictions.

[27] Fed. Reg. at 47,897.

The Proposed Rule May Impact the Cost of Credit for Small Entities

Business Loans

Preliminarily, Advocacy would like to thank the CFPB for clarifying that the proposed rule will not apply to business loans. As indicated in the comments from the SERs some small businesses use payday loan products to finance their businesses.[28] It is important for it to be clear that this source of financing is available to them. At the roundtable, some participants indicated that the line between consumer loans and small business loans may be ambiguous and blurry. Advocacy encourages the CFPB to provide clear guidance on what qualifies as a small business loan.

However, clear guidance alone may not be enough to assure that this source of funding is available to small businesses. If the rule puts a large percentage of payday lenders out of business (or convince many others to stop offering these products), that source of credit may no longer be available to the small businesses that need it. As such, they will have to obtain financing elsewhere, if they can obtain it at all.

Impact on the Cost of Credit

In addition, some of the payday lenders themselves may use a line of credit to support their own businesses. If the proposed rule affects the revenue stream of payday lenders, those lenders who use a line of credit to finance their businesses may incur an increase in the cost of credit.[29] Advocacy encourages the CFPB to perform a full analysis of the impact that this rulemaking may have on the cost of credit for small entities as required by the RFA.

Implementation Date

The CFPB is proposing that the final rule be effective 15 months after publication of the final rule in the Federal Register.[30] Small entities have undergone a number of regulatory changes. Some small entities have had to make adjustments due to changes in state law. Small entities have also undergone a number of changes due to the requirements of the Military Lending Act. Small entities will need time to meet the requirements of a final rule that the CFPB may issue. Advocacy encourages the CFPB to allow at least 24 months for small entities to comply.

The Rule as Proposed May Harm Consumers and Small Businesses That Serve Them

As noted above, Dodd-Frank authorizes the CFPB to issue rules to identify and prevent unfair, deceptive, or abusive acts or practices in the consumer financial markets. In doing so, the CFPB must consider if the practice causes or is likely to cause substantial injury to consumers; if the injury is not reasonably avoidable by consumers; and if the injury is not outweighed by any countervailing benefits to consumers or competition.

The CFPB's proposed rule may force legitimate businesses to cease operation. Imposing such a regulation will not alleviate a consumer's financial situation. The consumer will still need to pay his/her bills and other expenses. Imposing these strict regulations may deprive consumers of a means of addressing their financial situation.

[28] Panel Report at page 25.
[29] Payday Lending Panel Report, p. 25
[30] Fed. Reg. at 47866.

Therefore, in addition to the other recommendations in this letter, Advocacy encourages the CFPB to reconsider its proposal and develop requirements that protect the consumers without jeopardizing their access to legitimate credit in states that do not currently regulate payday lending. If the CFPB believes that it is necessary to go forward at this juncture, Advocacy further encourages the CFPB to perform additional research to determine the impact of the changes on small entities and consumers in those states prior to implementing permanent regulations.

Conclusion

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact me or Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

The Honorable Darryl L. DePriest
Chief Counsel
Office of Advocacy
U.S. Small Business Administration

/s/

Jennifer A. Smith
Assistant Chief Counsel
For Economic Regulation & Banking
Office of Advocacy
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Copy to: The Honorable Howard Shelanski
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