October 7, 2016

By electronic submission to www.regulations.gov

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

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

Online Lenders Alliance ("OLA") welcomes the opportunity to comment on the proposed rule covering payday, vehicle title, and certain high-cost installment loans (the "Proposal") issued by the Consumer Financial Protection Bureau (the "CFPB" or "Bureau").[1]

Online Lenders Alliance is the center for lending, technology and innovation, representing the growing industry of innovative companies offering online loans. OLA members abide by a set of Best Practices and a Code of Conduct to ensure their customers are fully informed and fairly treated. Our members provide a number of different loan products including unsecured installment loans to millions of American consumers, a much-needed credit product for consumers who may not have access to traditional forms of credit. These loans offer credit options for many consumer needs including unexpected or emergency expenses or just to make ends meet. These loans provide convenience that consumers value. Our products fill a critical need for over 17 million Americans who use the Internet to access short-term credit. Traditional sources of consumer credit are generally not an option for these consumers.

OLA supports efforts by the CFPB, Federal Trade Commission, federal banking agencies, and others to halt bad actors who engage in deceptive, unfair, or abusive lending practices. Besides complying with applicable federal consumer financial protection laws and NACHA requirements, OLA member companies have agreed to comply with additional requirements under OLA's Best Practices and Code of Conduct, which offer additional protections for consumers. Our members also agree that consumers should have the ability to repay their loans, and our members use proprietary and innovative underwriting methods to avoid making loans to consumers who cannot repay.

However, the OLA is concerned that CFPB's complex, rigid, and costly Proposal is not targeted to the specific harm identified by the Bureau and will uniquely and adversely impact the online lending market and the consumers our members serve. The Proposal's burdensome and

[1] Bureau of Consumer Fin. Prot., Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864 (July 22, 2016).

restrictive standards will increase costs to consumers and will reduce access to credit as lenders exit the market or are precluded from serving many consumers who use these products today.

The proposed regulation of covered longer-term loans would be triggered by the loan having a total cost of credit of 36 percent, and the borrower's choice of electronic payment. Online lenders often extend credit in excess of a 36 percent "all-in" APR due to the short time periods, small loan sizes, and underwriting costs involved. Online lenders also rely on electronic means both to fund and service the loans that they extend to consumers. Many other lenders regularly extend credit in excess of a 36 percent all-in APR, but because they are not repaid by preauthorized electronic fund transfers, the Proposal would not apply to them. In addition, the CFPB has noted that, like online lenders, some community banks, credit unions, and traditional finance companies will be swept within the rule because their rates exceed the 36 percent all-in APR and they obtain repayment through automated electronic debits.

As set forth in greater detail in this letter, our members have the following concerns with the current proposal:

- **The remedy is unconnected and disproportionate to the harm.** The CFPB's Proposal identifies one potential harm associated with the market for covered longer-term loans: repeated debits to a borrower's account by a lender seeking repayment and the associated insufficient funds ("NSF") or overdraft fees and the risk of account closure. But, the CFPB's conclusions are based on outdated information. Amendments to the rules of the National Automated Clearinghouse Association ("NACHA") setting return thresholds, including a 15 percent rate of total returns, a three percent rate of administrative returns, and a 0.5 percent rate of unauthorized transaction returns, and prohibiting payment splitting and re-presentments, have largely addressed the harm identified by the Bureau. In any event, the harm identified by the Bureau could be addressed by a rule far less sweeping than the Proposal. To address the specific harm identified, the Bureau could have simply declared the practice of initiating repeated debits to a consumer's account unfair or abusive and required additional authorization after a specific number of failed debit initiations.

    - Instead, the Bureau proposes to adopt complex, rigid, and costly underwriting requirements that are unrelated to the harm – and to declare all other methods of underwriting to be unfair and abusive.

    - The Proposal's prescriptive "residual income"-based ability-to-repay ("ATR") standard cannot possibly be the only way for a lender to make a reasonable determination of a consumer's ability to repay a loan and to avoid engaging in unfair or abusive practices. For one thing, OLA members do not currently use the "residual income" method set forth in the Proposal for determining consumers' repayment ability; yet, most borrowers repay their loans without defaulting – a clear indication that other methods of underwriting are and can be effective. The proposed "residual income" standard creates a distorted view of a consumer's repayment ability because the Bureau does not allow lenders to consider the principal amount of the covered longer-term loan as an offset to the consumer's major financial obligations or basic living expenses, even though the principal amount of the loan would be used to meet those obligations or pay those expenses. Moreover, residual income is rarely used by lenders or required by other federal consumer protection regulations.

- Similarly, the Proposal's loan limits, such as the requirement for a 30-day "cooling off" period after a consumer has paid off a covered short-term loan and the presumption of unaffordability if a consumer seeks to obtain a covered longer-term loan within 30 days after paying off a covered short-term loan or a covered longer-term balloon loan, are unconnected and disproportionate to the harm of repeated debits to borrowers' accounts.

- OLA questions whether the Fair Credit Reporting Act ("FCRA") is the appropriate model for the registered information systems contemplated by the Bureau because the Proposal would require the availability of complete, near-real-time data, but would simultaneously impose responsibilities and liability on furnishers and credit bureaus to ensure accuracy. A more appropriate model may be a database containing complete information, such as a database modeled after the Office of Foreign Assets Control ("OFAC") sanctions list or the Department of Defense's list of active duty servicemembers used to meet Military Lending Act and Servicemembers Civil Relief Act obligations.

- In sum, given the narrow harm identified, it is both bad policy and beyond the Bureau's authority to adopt rigid underwriting requirements for covered longer-term loans such that any approach to credit underwriting other than the particular "residual income" approach and information reporting requirements prescribed in the Proposal constitutes an unfair or abusive act or practice.

- **The Proposal creates an unlevel playing field in the market for "open use" credit and will have a disparate impact on women, African American, and Hispanic borrowers.** The Proposal would unfairly single out borrowers of covered loans to be subject to an untested ATR standard based on residual income and supported by verification evidence.

    - The CFPB's ATR rules for credit cards permit lenders to use debt-to-income ("DTI") or debt-to-asset ("DTA") ratios.

    - The CFPB's ATR rules for credit cards also permit card issuers to rely on self-reported information provided by the consumer about income and current obligations.

    - Covered small dollar loans are similar to credit cards; both types of products can be used for various purposes, including emergency funding and meeting temporary cash flow shortfalls, and limit the amount a consumer can borrow. In fact, covered small dollar loans often function as a credit card substitute for consumers who cannot qualify for a credit card, who choose not to use their existing credit cards, or who have insufficient purchasing capacity on their credit cards to meet immediate needs.

- The adoption of different ATR standards for covered small dollar loans and credit cards will put extra burdens on low- and moderate-income ("LMI") consumers, compared to more affluent credit card borrowers, and will have a disparate impact on women, African-American, and Hispanic borrowers, who tend to have lower incomes, on average, than the population as a whole, and who are more frequent users of small dollar loan products compared to the population at large.

- Several specialty consumer reporting agencies who are OLA members have evaluated the potential impact of the residual income test on consumer eligibility and estimated that Americans who earn $40,000 per year or less would be unlikely to qualify for a $500 small dollar loan. The consequences for LMI consumers are significant. According to the 2010 U.S. Census, more than 140 million adults in the United States earn less than $40,000 per year.[2] In addition, data from the U.S. Census Bureau shows that the 2014 median income for African-American households was $35,398 while the 2014 median income for households headed by women was $39,621. This data illustrates the likely impact the Proposal will have on LMI consumers and the disparate impact the Proposal will have on women and African-American borrowers.

- The Proposal's ATR rules are more similar to the CFPB's mortgage ATR rules. In other words, a consumer seeking a $500, six-month small dollar loan must go through an underwriting process comparable to that of a consumer seeking a $250,000, 30-year mortgage. But even the prescriptive mortgage ATR rules provide greater flexibility than the Proposal because they allow mortgage issuers to consider DTI or residual income.

- There is no reason for the CFPB to adopt a more rigid ATR standard for covered longer-term loans than it has adopted for credit cards and a standard that is comparable to the ATR standard for mortgages. We particularly note that: (1) mortgage loans are orders of magnitude larger than covered loans and of much longer duration; (2) a large percentage of the mortgage market operates on an originate-to-distribute model, which may reduce the incentive for some mortgage lenders to rigorously underwrite mortgage loans; (3) credit cards are close substitutes for small dollar loans, constitute alternate forms of "open use" credit, and limit the amount a consumer can borrow, and thus provide a better model for an ATR rule for small dollar loans, contain no limits on reuse and reborrowing, and must be underwritten to ensure the consumer's ability to repay the required minimum payment, not the full amount due. In this context, it is inappropriate for the CFPB to favor certain types of loan products and lenders and disfavor others.

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[2] *See* Bureau of Labor Statistics and the Census Bureau, Current Population Survey (CPS): Selected Characteristics of People 15 Years Old and Over by Total Money Income in 2010, Work Experience in 2010, Race, Hispanic Origin, and Sex, http://www.census.gov/hhes/www/cpstables/032011/perinc/new01_001.htm (last visited Oct. 5, 2016).

- **The Proposal will restrict access to credit by vulnerable people.** The Proposal's requirements for lenders to underwrite based on residual income, collect documents to establish a consumer's ability to repay, and obtain records from and furnish information to registered information systems would impose enormous costs and burdens on online lenders and the consumers they serve. The Proposal places a substantial burden on consumers to complete a detailed budget and to provide verification evidence for income and certain expenses. This mortgage-like approach to underwriting will deter many consumers and diminish the usefulness of small dollar loans as a source of quick, emergency credit. Some lenders, particularly smaller lenders, that cannot recoup their costs given the size of small dollar loans will drop out of the market, while other lenders will pass on these additional costs to consumers. It is counterintuitive for the CFPB to issue a Proposal that will further *increase* the cost of already high cost small dollar loans. OLA members strive to reduce the cost of credit by using technology and other innovations to streamline the credit granting process and reduce costs; the Proposal, if adopted, will substantially increase lender costs and make it impossible for lenders to reduce the cost of credit.

    - Likewise, the Proposal's alternatives to making an ability-to-repay determination are demonstrated money-losing products, unrealistic, or both. Without an ability to make covered loans profitably, lenders making covered loans would go out of business or dramatically scale back their lending, resulting in a decrease in credit to consumers.

    - The Proposal's lending limits would similarly prevent consumers from obtaining credit from legitimate, regulated lenders when they need it most – during emergencies or other exigent circumstances, or when cash flow and expenses temporarily do not match.

    - A customer of an OLA member recently wrote that she was grateful for the loan she obtained, because it was the only way she could get funds quickly to travel to her father's funeral. The Proposal, if adopted, would mean that many consumers just like her would not be able to get funds to travel to a parent's funeral, obtain a necessary car repair, pay for unexpected medical expenses, or manage temporary cash flow shortfalls.

    - Consumers unable to obtain covered loans because of the CFPB's rule would be driven to inferior (and costlier) alternatives. The Proposal would therefore hurt the very consumers it is intended to help.

- **The Proposal harms small businesses.** The Proposal would needlessly impose on lenders large fixed costs, including the costs of new systems and employees to comply with the rule's complex underwriting pathways, furnish information to each registered information system that the CFPB approves, and obtain, process and store verification evidence of a consumer's ability to repay. In addition, the proposal would add new marginal costs, such as the expense of obtaining written budgets, verification evidence, and multiple credit reports for each transaction.

  - OLA members estimate that the average cost of underwriting a covered longer-term loan in the manner required by the Proposal will increase from $58.00 to $88.30 per loan, representing an increase of $30.30 or 52 percent per loan. Small lenders cannot make up for these added costs with volume, like large lenders can, especially in an industry where profit margins are relatively low, generally in the single digits.

  - Larger lenders will be more able than small lenders to develop systems and obtain volume discounts to manage the per transaction costs. As a result, these costs would disproportionately harm small businesses, which is not what Congress intended when it subjected the CFPB to the Small Business Regulatory Enforcement Act ("SBREFA") process.

Despite our serious concerns with the Proposal, we emphasize that OLA believes that small dollar credit should be regulated. We support federal regulation of this market to protect not only consumers but also legitimate lenders that do things the right way and care about their customers. We believe the Bureau could craft a much more effective and reasonable rule by:

- Adopting the same ATR standards that the CFPB applies to credit card loans, which would be entirely appropriate given the similarities between the products; and

- Requiring lenders to provide reasonable payment reminders to consumers before an attempt to access funds in a consumer's account is made, including a reminder that the consumer can revoke account authorization under Regulation E.

Unlike the Proposal, such a rule would be simple and targeted directly at the harms identified by the CFPB. In addition, such a rule would not impose the Proposal's immense underwriting costs, and therefore would help preserve access to credit by vulnerable consumers, keep fees and interest rates lower than they would be under the Proposal, and allow small lenders to stay in business. Most importantly, such a rule would treat consumers fairly, rather than creating a two-tiered credit system in which more affluent credit card borrowers – the "haves" – are treated more favorably than consumers who rely on small-dollar loans – the "have nots."

The remainder of this letter describes in much greater detail our issues with the Proposal and our suggestions for how to formulate a more workable and fair rule.

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I. The Proposal Would Harm Consumers and Needlessly Put Lenders Out of Business

A. The Proposal Would Reduce Access to Credit by Consumers

As the CFPB acknowledges: "Covered loans are typically used by consumers who are living paycheck to paycheck, have little to no access to other credit products, and seek funds to meet recurring or one-time expenses."[3] For covered longer-term loans, the CFPB observed that "available information suggests that consumers who use hybrid payday, payday installment, and vehicle title installment loans also tend to come from lower or moderate income households, have little savings or available credit, and have been turned away from other credit products."[4] Such consumers tend to have "low-to-moderate incomes and poor credit histories."[5] In addition, the Bureau cited a study and survey indicating that 79 percent of online small dollar loan borrowers were denied traditional credit in the past year as a result of having a low or no credit score, and that 62 percent of online small dollar loan borrowers had already sought assistance from family and friends.[6]

OLA does not understand, and the CFPB does not explain, how the Proposal will make the lives of small dollar borrowers better. In fact, there are reasons to believe, as the CFPB implicitly concedes, the Proposal would make the lives of consumers worse.

First, the Proposal's ability-to-repay standards and limits on reborrowing will mean that many of the consumers described above will no longer have access to credit to meet recurring or one-time expenses. As the CFPB acknowledges, these consumers "have little to no access to other credit products," "have been turned away from other credit products," or have "poor credit histories." How will these consumers obtain funds to pay for a major car repair when living paycheck to paycheck and with little if any savings? The CFPB's Proposal does not provide an answer.[7] How will these consumers pay unexpected medical bills or cover living expenses during a layoff when the paycheck suddenly stops and the consumer has little if any savings? Again, the CFPB's Proposal does not provide an answer.[8]

The CFPB admits that the Proposal will reduce credit availability and that some borrowers unable to obtain covered longer-term loans "would bear some costs from this reduced access to credit."[9] The costs the Bureau itself identifies include foregoing certain purchases, paying some bills late (and potentially incurring late fees or the loss of utility service), or borrowing "from

3 81 Fed. Reg. at 47,864.

4 81 Fed. Reg. at 47,987.

5 81 Fed. Reg. at 47,987.

6 81 Fed. Reg. at 47,921. Later, citing another study, the Bureau suggests that borrowing from family or friends would be an option for some covered short-term loan borrowers, as would obtaining pawn loans, reducing expenses, and delaying bill payment. 81 Fed. Reg. at 48,130; *see also* 81 Fed. Reg. at 48,141.

7 *See* 81 Fed. Reg. at 47,864, 47,987-88.

8 *See* 81 Fed. Reg. at 47,988.

9 81 Fed. Reg. at 48,141.

sources that are more expensive or otherwise less desirable."[10] The Bureau also notes that "[s]ome borrowers may overdraft their checking account . . . [which] may be more expensive than taking out" a covered small dollar loan, or turn to lenders that do not comply with the Proposal.[11] It is not clear how pushing borrowers into "more expensive or otherwise less desirable" credit products or unlawful lending is a net positive for consumers.

It is unrealistic for the CFPB to expect lenders to provide the population of consumers described by the CFPB – those living paycheck to paycheck with little savings, low-to-moderate incomes, and poor credit histories – with unsecured credit at an annualized total cost of credit at or below than 36 percent or without an automated means of repayment. Despite the CFPB's Proposal, credit decisions and credit pricing are based on risk and this population consists of risky borrowers who cannot qualify for lower-cost loans because lenders would lose money if they made loans in small dollar amounts without an electronic repayment option or at a rate below the proposed 36 percent total cost of credit.

The CFPB's proposed ATR standard is too narrow because it focuses only on whether there is enough residual income to make the scheduled payments, and does not consider other means by which consumers successfully repay – such as by prioritizing other obligations. For example, a consumer may understand that a utility bill need not be paid immediately, but could be paid on the second or third notice without consequence. The residual income test also does not consider consumers who might anticipate and plan for renewal of their covered loan. (But, we note that the Bureau is quick to argue that those consumers who will lose access to credit under the Proposal can seek money from their friends and family, cut back on expenses, delay paying bills, or sell or pawn possessions – i.e., the same strategies which consumers could use to repay debts.[12])

It is the loss of access to credit resulting from adoption of the Proposal – not the continued provision of covered loans in the absence of "residual income"-based ATR underwriting – that will cause a substantial injury to consumers that will not be reasonably avoidable by those consumers.

Second, the CFPB appears to believe that prescriptively regulating small-dollar loans will either prompt lenders to offer lower-cost credit options to very high-risk borrowers or restrict the supply of high-cost credit to high-risk consumers. Neither assumption is consistent with economic reality:

- Lenders will not offer high-risk borrowers credit at or below a 36 percent annualized total cost of credit if they cannot earn a reasonable profit on those loans. The fact that some community banks, credit unions, and traditional finance companies will be subject to the rule based on the rates they charge speaks to the economic reality of lending to the high-risk population served by OLA members.

[10] 81 Fed. Reg. at 48,141.

[11] 81 Fed. Reg. at 48,141.

[12] 81 Fed. Reg. at 48,141.

- Similarly, consumers faced with financial emergencies will not simply accept that they cannot obtain credit from regulated lenders, but will seek to obtain the funds they need from alternative, and likely inferior sources, as the CFPB itself acknowledges.

Put another way, the Proposal is economically irrational because it focuses only on restricting the supply of higher-cost small dollar loans, but does nothing to reduce the demand for such credit by financially distressed consumers. It is one thing to tighten mortgage underwriting standards and reduce the percentage of consumers who qualify for a mortgage; consumers have alternatives to home ownership, specifically renting. However, reducing access to a type of credit that helps borrowers meet emergency needs, particularly consumers who cannot qualify for or access credit cards and other traditional forms of credit, will not eliminate those emergency needs but will simply make it more difficult, costlier, and in some cases impossible, for LMI consumers to get the credit they need.

B. The Proposal Would Increase the Cost of Credit to Consumers

The Proposal would impose exorbitant costs and burdens on lenders making covered loans that are disproportionate to the size and duration of the loans. For instance:

- Lenders would need to hire armies of lawyers and consultants to understand and operationalize hundreds of pages of rule text (including its associated enforcement traps, which we discuss below).

- Lenders would need to hire new employees in the compliance function, as well as customer service personnel who can resolve any consumer misunderstandings that will arise from the imposition of complex new requirements.

- Lenders would need to train new and existing employees in the rule's many complexities and underwriting decision pathways.

- Lenders would need to invest in systems capable of:

    - asking consumers the correct questions to satisfy the requirements of the rule based on each consumer's particular circumstances and previous answers;

    - obtaining and reviewing "verification evidence" of consumers' income and obligations, which would be set forth on non-standardized documents, or else hiring back office personnel to perform the task of reviewing those documents and inputting numbers into an underwriting form;

    - processing income and expense information to generate the consumer's "residual income";

    - evaluating the volatility of a consumer's income to establish an appropriate income "cushion";

- tracking ongoing loan-related information into categories for reporting to registered information systems;
- receiving information from the consumer that indicates that the consumer "expresses or has expressed within the past 30 days an inability to make one or more payments on the outstanding loan" and acting on that information;[13]
- furnishing information on a real-time basis to each registered information system that the CFPB accepts for registration, each of which may operate differently from the others;
- engaging in a detailed "presumption of inability to repay" analysis on renewal of the loan, including a review of borrower payment history, new loan terms, and any interaction with the borrower over the course of the loan term;
- receiving information from the same registered information systems, and taking account of that information in the ability-to-repay analysis;
- generating and sending payment reminders;
- recognizing that the consumer is unable to receive notices at the address or number that he or she provided the lender, seeking and updating consumers' contact information, and sending hard copy disclosures through the mail;
- tracking the number of unsuccessful consecutive debit attempts;
- classifying loans into categories such as covered short-term loans, covered short-term loan alternatives; covered longer-term loans, covered longer-term loans with balloon payments, National Credit Union Administration ("NCUA") Payday Alternative Loan ("PAL")-type loans, five-percent default rate loans, and non-covered loans; and
- retaining records for 36 months, including protecting very sensitive consumer data from data security breaches.

- Lenders would need to pay each registered information system to obtain reports for each consumer that the lender would otherwise approve. Lenders also would incur the cost of obtaining that information if the reports came back with information about the consumer that precluded them from making the loan, which would likely be passed on to those consumers who do obtain loans.
- Lenders would be subject to substantial enforcement and litigation risks that would not only hurt lenders' bottom lines if those risks materialized, but also would scare off investors and creditors, thereby increasing lenders' cost of capital.

[13] 81 Fed. Reg. at 48,170.

- Lenders would need to conduct data security audits to protect the very sensitive information the Proposal would require them to request and retain.

- With fewer covered loans in the market, service providers would increase prices for the remaining lenders making covered loans or cease providing services that allow lenders to remain profitable, such as lead generation.

OLA members estimate that the average cost of underwriting a covered longer-term loan as required by the Proposal will increase by from $58.00 to $88.30 per loan, representing an increase of $30.30 or 52 percent per loan. Lenders will not be able to absorb those costs since profit margins in the industry are relatively low, usually in the single digits,[14] and therefore will have no choice but to pass these costs on to consumers in the form of higher prices.

At the same time, the Proposal would decrease revenues for lenders making covered loans:

- Lenders would forego substantial revenues by losing the opportunity to make loans to:
    - consumers who cannot document their ability to repay in the manner required by the Proposal, or cannot transmit their documents to the lender, even if such consumers have sufficient residual income to support a covered loan;
    - consumers that have DTI or DTA ratios that would support a credit card loan, but do not have the residual income to support a covered loan;
    - stay-at-home consumers and consumers with part-time jobs that have access to the income of a spouse or partner, and therefore would have income for purposes of the CFPB's credit card ATR rules but not the Proposal;
    - consumers that have already taken out three consecutive loans and therefore would be subject to the Proposal's loan limits, even if those consumers have the actual ability to repay a new loan; and
    - consumers that become frustrated with the lengthy loan application process and abandon the lender's application webpage.

Lenders underwriting a $250,000 mortgage or $2,500 credit card line do not have to incur many of these costs or depressed revenues under the CFPB's qualified mortgage ("QM") and credit card ATR rules. Compared to mortgages, covered loans are substantially smaller in amount and duration; thus, mortgages generate more interest revenue to offset any increase in fixed costs. And the credit card ATR standards, which OLA believes the Bureau should follow as the appropriate ATR standard for covered small dollar loans, are far less prescriptive and burdensome and do not restrict reuse and reborrowing, thus giving card issuers the potential to earn more interest revenue as well.

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[14] *See* Enova Intl Profit Margin (Quarterly): 5.22 percent for June 30, 2016; Cash America Intl Profit Margin (Quarterly): 0.87 percent for June 30, 2016.

As a result, lenders would be required to increase fees and/or interest rates on covered loans to a much greater degree, relative to the size of each funded loan, to offset any increase in costs and loss of revenue. These costs are simply disproportionate to the size of covered loans. Moreover, lenders of covered longer-term loans reject a high percentage of the applications they receive and evaluate, which means that lenders of covered loans frequently incur variable underwriting costs that they cannot recoup from the applicant, but must instead recoup from other applicants whose loans they fund.

Thus, to the extent lenders remain in this market, any lender that continues to make covered longer-term loans will pass on its increased costs and loss of revenues to consumers to the extent permitted by law, thereby increasing the cost of credit to this population.

The CFPB does not explain how further increasing the cost of credit available to this population will improve the lives of consumers living paycheck to paycheck. If anything, these consumers will be worse off if the Proposal is adopted because “with little or no access to other credit products” and “poor credit histories,” these consumers will have no choice but to pay higher fees, assuming they can qualify for credit at all.

C. The Proposal Would Diminish Competition

All costs described in the previous section would create a significant barrier to entry in the consumer small dollar lending industry and would drive many, if not most, smaller lenders out of the market. The Proposal’s astonishing complexity clearly would favor larger players, which have a lower per unit cost of compliance. Companies that have the resources to develop systems to collect and verify borrower information will have a significant competitive advantage over smaller lenders.

Moreover, the Proposal would regulate products primarily provided by “upstart” and smaller lenders, rather than those provided by established large and midsized banks. Online lenders have been a source of innovation and competition in the consumer credit markets, particularly for consumers who have poor credit histories or no credit history, but many would shut down or be forced into a standardized underwriting model as a result of the costs of the Proposal.

D. The Proposal Would Cause a Migration to Inferior Alternatives

Clearly the CFPB understands that its regulatory choices can affect the mix of products that lenders will offer and consumers will use. The CFPB states that it is proposing to cover longer-term loans based, in part, on concerns that if it only regulated short-term loans, lenders would shift toward offering longer-term loans to avoid regulation.[15]

But, by the same reasoning, if the CFPB reduces access to longer-term, small-dollar loans and increases the cost of such lending that remains, consumers will simply find other sources of credit, including inferior alternatives.

[15] 81 Fed. Reg. at 47,986.

The most recent FDIC National Survey of Unbanked and Underbanked Households indicates that one in five households had bank accounts but also used alternative financial services, including small dollar loans.[16] As a result of reduced access to credit, some of these borrowers may migrate to alternatives that are inferior to covered loans to meet their needs. Alternatives can be more expensive and inconvenient, including defaults on other bills; incurring late fees that are usually higher than fees and interest rates on covered loans; bounced checks; overdrawn bank accounts; the cut-off and reconnection of utility services, which can be expensive, inconvenient, and dangerous (i.e., living in a house with no heating, cooling, water, electricity, or telephone line); and even the use of costly and illegal loan sharks.[17] Some of these alternatives can also damage the consumer's credit rating, or jeopardize the consumer's deposit account.

A study by the Federal Reserve Bank of New York found that "Georgians and North Carolinians do not seem better off since their states outlawed payday credit: they have bounced more checks, complained more about lenders and debt collectors, and have filed for Chapter 7 ("no asset") bankruptcy at a higher rate" and that "[f]orcing households to replace costly credit with even costlier credit is bound to make them worse off."[18]

Similarly, a study of survey data by Jonathan Zinman of Dartmouth College found that new binding restrictions on loan terms in Oregon caused a migration to "plausibly inferior substitutes," and caused Oregon respondents to be significantly more likely to experience an adverse change in financial condition.[19]

The CFPB candidly admits that the Proposal will lead some borrowers to borrow "from sources that are more expensive or otherwise less desirable."[20] For example, "[s]ome borrowers may overdraft their checking account . . . [which] may be more expensive than taking out" a covered small dollar loan, or turn to lenders that do not comply with the Proposal.[21] The Bureau does not explain how pushing borrowers into these "more expensive or otherwise less desirable" credit products or unlawful lending is a net positive for consumers. And many borrowers of covered loans may not have access even to such inferior alternatives, and the Bureau does not explain where these borrowers will be able to turn for help.

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16 *See* Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, Remarks to the FDIC 16th Annual Bank Research Conference, Arlington, VA (Sept. 8, 2016). The FDIC is not expected to release the full survey until late October 2016.

17 *See* Donald P. Morgan and Michael R. Strain, Fed. Reserve Bank of N.Y., Payday Holiday: How Households Fare After Payday Credit Bans, at 1 (Nov. 2007) (Payday credit is cheaper than overdraft credit for overdrafts below $180); G. Michael Flores, Bretton-Woods, Inc., Online Short-Term Lending: Statistical Analysis Report, at 8 (Feb. 28, 2014) (demonstrating that average overdraft fees are more expensive than small dollar loans in filling a consumer's credit need).

18 Donald P. Morgan and Michael R. Strain, Fed. Reserve Bank of N.Y., Payday Holiday: How Households Fare After Payday Credit Bans, at 26 (Nov. 2007).

19 Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap* (Oct. 2008).

20 81 Fed. Reg. at 48,141.

21 81 Fed. Reg. at 48,141.

E. The Proposal Would Put Small Businesses Out of Business

The Proposal's unproven and novel "residual income" underwriting standards, coupled with costly, unsafe, and antiquated documentation requirements, threaten to disrupt the viability of the entire small dollar lending market, but would disproportionately impact startups and small businesses, which likely could not remain in this market.

The CFPB estimated the impact of the Proposal on storefront payday loans (covered short-term loans) and vehicle title loans. For storefront payday loans, the CFPB estimated that revenues would decrease between 60 and 81 percent and loan volume would decrease between 60 and 82 percent.[22] However, the CFPB has not provided any estimate of the impact of the Proposal on covered longer-term loans, including online installment loans and lines of credit.

Whether the ability to repay determination and integration with registered information system are manual or automated, they are in addition to a lender's existing underwriting processes. Each lender will need to build a new platform to make ATR determinations that are consistent with the CFPB's expectations for the collection, verification, and retention of ATR information and to connect with all registered information systems. The costs of building these platforms will be much lower on a per unit basis for larger lenders than they will be for smaller lenders. Smaller lenders will not be able to compete and will go out of business at much higher rates than larger lenders.

This is not the result Congress intended when it subjected the CFPB's rules to the SBREFA process.

F. The Proposal Would Stifle Innovation

If all lenders in this market were required to underwrite according to the same rigid standard, it would limit innovation and the ability of smaller lenders to compete with bigger lenders.

In the business world, lenders work with constantly changing data in developing customer relationships for effective underwriting. Underwriting models are developed and constantly refined by individual lenders through their experience with their own portfolios and customer populations. Constraining underwriting to a specific formula – residual income – will prevent utilization of other useful data and will stifle innovation.

Innovators often cannot compete on cost, particularly when larger providers are able to spread compliance costs over a larger number of units sold. Innovators are able to compete on other elements of the transaction – such as speed, safety, and convenience – that may matter more than price to some consumers.[23] The Proposal triggers coverage based on price plus a leveraged

[22] 81 Fed. Reg., at 48,122; Consumer Financial Protection Bureau, Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products 146-49 (June 2, 2016) [hereafter "CFPB Supplemental Findings"].

[23] Alan Kline, *Five Reasons You Can't Ignore the Neobanks,* Am. Banker, Apr. 27, 2015.

payment mechanism, and fails to recognize other aspects of the transaction. In so doing, the Proposal would disadvantage innovators and stifle innovation.

II. The Proposal Is Contrary to Law

A. The Proposal Does Not Meet the Standards for Unfair or Abusive Acts or Practices

Under the Administrative Procedure Act, a court must set aside agency action that is "not in accordance with law, or that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[24] The Proposal exceeds the Bureau's authority under section 1031 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") to prevent a covered person or service provider from committing or engaging in unfair or abusive acts or practices, which is the CFPB's stated authority for the rulemaking.

1. The CFPB has not shown unfairness

Under section 1031(c) of the Dodd-Frank Act, an unfair practice involves (1) substantial injury to consumers, (2) that is not avoidable by consumers, and (3) that is not outweighed by countervailing benefits to consumers or to competition.[25] The Proposal fails on all these counts.

First, the CFPB has not shown that covered longer-term loans result in substantial injury to consumers. Instead, the CFPB has identified the following "market concerns" with respect to covered longer-term loans –

- ***Borrower characteristics.*** Based mostly on payday loan data, the CFPB believes that borrowers of covered longer-term loans are LMI individuals.[26] While these traits are generally (but not always) true for borrowers of longer-term loans, a borrower's preexisting economic status is not a harm.

- ***Failure to assess ability-to-repay.*** The CFPB concedes that lenders of covered loans collect income and other information about applicants, but asserts that the primary purpose of lenders' underwriting is to avoid fraud, not to ensure applicants' ability to repay. We take issue with the CFPB's inference about lender motivations. We find it

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[24] 5 U.S.C. § 706(2)(A), (C).

[25] The Federal Trade Commission Act has long provided the FTC with nearly identical statutory authority on unfairness. *See* 15 U.S.C. § 45. Per the December 17, 1980 FTC Policy Statement on Unfairness, under the parallel provision of the Federal Trade Commission Act, substantial injury cannot be trivial or speculative. However, "[a]n act or practice can cause 'substantial injury' by doing a 'small harm to a large number of people, or if it raises a significant risk of concrete harm." *FTC v. Neovi, Inc.*, 604 F.3d 1150, 1157-58 (9th Cir. 2010) (quoting *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 972 (D.C. Cir. 1985)). "In determining whether consumers' injuries were reasonably avoidable, courts look to whether the consumers had a free and informed choice." *Id.* at 1158. Under the countervailing benefits prong, courts have reviewed whether FTC properly examined "potential costs that the proposed remedy would impose on the parties and society in general." *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 975 (D.C. Cir. 1985).

[26] 81 Fed. Reg. at 47,988.

particularly inappropriate for the CFPB to insinuate, without any factual basis, that community banks, credit unions, traditional finance companies, and "some emerging companies" that offer covered loans engage in substantial underwriting, and thus have clean hands and pure motives, while other lenders making small dollar loans do not.[27] Online lenders that are members of OLA do underwrite their customers' ability to repay, and generally obtain information from specialty credit bureaus as part of their underwriting process. What online lenders do not do is follow the Proposal's novel residual income standard and antiquated document collection requirements.

- ***High delinquency and default rates.*** The CFPB concludes that borrowers of "payday installment" loans (i.e., longer-term covered loans) originated online experience especially high rates of delinquency and default.[28]
    - These findings are based on an extraordinarily limited data set – unspecified number (but fewer than seven) of lenders who originated loans both online and in store fronts, and apparently only one lender that originated loans exclusively online. Needless to say, the CFPB keeps the identity and business model of the individual lenders a secret. The CFPB also does not tell us how each lender defined "default."
    - The data relied upon by the CFPB purports to demonstrate a correlation between payment to income ratio ("PTI") and loan performance. (The analysis was performed only for those few lenders that also reported borrower income.) In most cases, the relationship between PTI and loan performance was as the CFPB expected – a lower PTI resulted in fewer defaults and refinancings. The anomaly, however, was for "payday installment" loans originated online. In that case, there was actually an inverse relationship between PTI ratio and default rates – for example loans with a PTI ratio of less than 10 percent actually defaulted at a *higher* rate than loans with a PTI ratio of 30 percent to 35 percent.[29] The CFPB does not explain this anomalous result, except to note that "we do not observe a relationship between PTI ratio and default rates," and to conclude that "the relationship between PTI ratio and repayment for loans by this group of payday installment lenders is likely dependent on factors beyond simply the PTI ratio and outcomes alone."[30] In fact, one explanation for an inverse relationship between PTI and default would be a high rate of fraud – i.e., the extensions of credit which the borrower has no intention of ever repaying. If this is the case, then no amount of credit underwriting will solve the problem. Moreover, if there is no relationship, or even a correlation, between PTI and default, then a residual income requirement for these types of loans seems especially futile.

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27 81 Fed. Reg. at 47,987 & n.655.

28 81 Fed. Reg. at 47,990 and 48,140.

29 *See* CFPB Supplemental Findings at 28-30.

30 *Id.* at 29.

- While we dispute that delinquency and default rates are as high as the CFPB's limited dataset indicates, assuming for the sake of argument that the CFPB's factual assertion is accurate, delinquencies and defaults in the small dollar market may not result in the same type, frequency or severity of consumer injury as in traditional credit markets. For example, the credit score changes of borrowers who default on payday loans do not differ materially from the score changes of borrowers who do not default on payday loans.[31] If the Bureau is concerned about the harms that result from default on small dollar loans, rather than trying to prevent default, the Bureau could more directly address the harms – such as it has done through its proposal to limit representments following a failed payment attempt. After reading the Proposal, a cynic might conclude that the Bureau believes that the best way to prevent credit defaults by certain consumers would simply be to prohibit the extension of credit to certain consumers.

- ***Repeat borrowing.*** Sustained use of a credit product is not itself an injury. The CFPB's studies overstate the degree of sustained use in short-term lending,[32] and the Bureau does not even offer evidence on longer-term lending. Nonetheless, even with respect to short-term loans, credit bureau data shows that borrowers who engage in protracted refinancing actually have better financial outcomes (measured by changes in credit scores) than consumers whose borrowing is limited to shorter periods.[33] And as noted above, the credit score changes of borrowers who default on payday loans differ immaterially from the score changes of borrowers who do not default on payday loans.[34] Reviewing this evidence, the CFPB states that "the evidence on the impacts of the availability of payday loans on consumer welfare is mixed. A reasonable synthesis appears to be that payday loans benefit consumers in certain circumstances, such as when they are hit by a transitory shock to income or expenses, but that in more general circumstances access to these loans makes consumer worse off."[35] **We do not believe "mixed" evidence can support a finding of unfairness nor a rule as sweeping as the Proposal.** If sustained use of a credit product is tantamount to injury, then any consumer who regularly carries a balance on a credit card over a period of months or years is similarly injured by credit card issuers and the products they offer. Such a conclusion is unsupportable and threatens the very foundation of credit markets.

- ***NSF and overdraft fees and account closures.*** Finally, the CFPB alleges an actual consumer harm: NSF and overdraft fees and account closures associated with lenders debiting borrowers' accounts repeatedly. The Bureau's supporting data for these

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31 *See* Ronald J. Mann, *Do Defaults on Payday Loans Matter?*, Soc. Sci. Research Network (Dec. 1, 2014).

32 *See* Letter from Hilary B. Miller, Attorney at Law, to Chief, Info. Office, Info. Quality Program, Bureau of Consumer Fin. Prot., re: Petition of Community Financial Services Association of America, Ltd. For Retraction Of "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings" (June 20, 2013).

33 *See* Jennifer Priestley, Payday Loan Rollovers and Consumer Welfare, (Dec. 5, 2014).

34 *See* Ronald Mann, Do Defaults on Payday Loans Matter?, Soc. Sci. Research Network (Dec. 1, 2014).

35 81 Fed. Reg. at 48,132.

> allegations, however, suffer from serious flaws. For instance, the Bureau's data on online payday loan payments pre-dates revisions to NACHA rules that have significantly reduced re-presentments. We discuss this and other flaws of the CFPB's payments data in greater detail in section V.A. of this letter. Nevertheless, if the CFPB's concern is about particular practices used by unscrupulous lenders, the solution is to outlaw those practices, not impose sweeping underwriting requirements that have, at best, a tenuous relationship to the harm that is asserted. There is simply no reason to impose underwriting requirements on the "front end" of the loan to stop lenders from initiating debits repeatedly on the "back end" of the loan.

The Proposal fails to explain how a small dollar loan with a total cost of credit of 36 percent and access to a leveraged payment mechanism *does not* create an injury or result in unfairness and abusiveness, but a small dollar loan with a total cost of credit of 37 percent – one percentage point higher – and access to a leveraged payment mechanism *does* create an injury and result in unfairness and abusiveness. It is arbitrary for the CFPB to define unfair and abusive conduct based on a rate differential of one percentage point in the total cost of credit.

Moreover, whether an "injury" has occurred needs to be assessed against the situation that would occur in the absence of this credit, i.e., the consumer defaulting on other financial obligations or being unable to afford basic living expenses. These outcomes are considerably worse on average than the use of covered loans. For instance, the Bureau states that the use of covered longer-term loans can result in cut-off of utilities.[36] However, this statement confuses correlation with causation: some borrowers take out covered loans precisely because they cannot afford their utility payments. The use of covered loans may help those borrowers afford utility payments for longer than they otherwise would have. Similarly, the Bureau concludes that the use of covered longer-term loans can result in NSF and overdraft fees and account closures.[37] However, consumers who take out covered longer-term loans may be just as likely to have experienced NSF and overdraft fees and account closures caused by *other* debits if they had not taken out those loans. Indeed, the use of covered longer-term loans is likely to postpone these negative events, if not reduce their incidence.

The authors of the CFPB report entitled "Online Payday Loan Payments," noted a *correlation* between account closures and use of online payday loans, but were very careful not to draw a causal relationship between the two events, noting that "[t]here is the potential for a number of confounding factors" which might explain the correlation.[38] In other words, there are any number of factors that might have contributed to the NSF for the closed account, including distress unrelated to (or even ameliorated by) the use of online loans. Unfortunately, others at the Bureau have not been so careful in their choice of words. In his prepared remarks announcing the online payday loan payments report, Director Cordray stated that "many online borrowers hit with an overdraft or NSF fee end up losing their checking or savings accounts

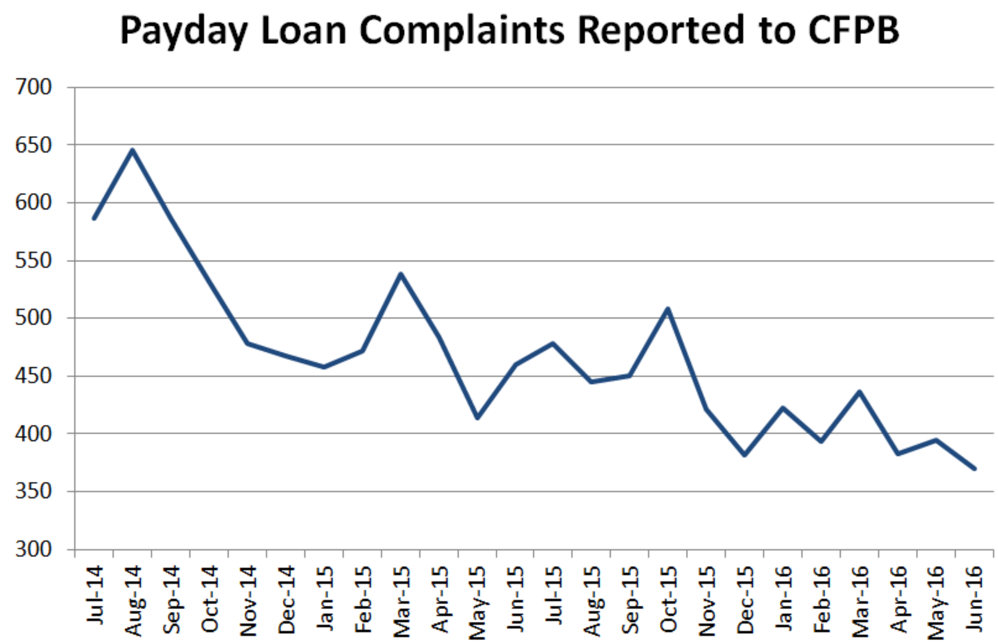
[36] 81 Fed. Reg. at 47,987, 47991-92.

[37] 81 Fed. Reg. at 47,990.

[38] CFPB, Online Payday Loan Payments, at 22-23 (Apr. 2016).

altogether," suggesting a causal link between the use of online loans and account closure.[39] Moreover, according to the study, there is frequently no way to determine whether an account closure was voluntary or involuntary.

If covered loans were causing consumers substantial harm, one would expect borrower complaints to be frequent and increasing. Yet, consumer complaints about payday loans represent less than 2 percent of all complaints to the CFPB,[40] and payday loan complaints have been persistently declining for some time according to the Bureau's own complaint data and reports. The Bureau's own data, summarized in the chart below, shows that payday loan complaints have declined 42 percent from August 2014 (645 complaints) to June 2016 (370 complaints):[41]



It is more difficult to evaluate trends in complaints about covered loans that consumers may not consider to be "payday loans" when submitting complaints to the CFPB, such as longer-term installment loans and title loans. The Bureau's complaint database potentially groups such loans with other loan types, including all vehicle loans and leases and personal lines of credit, into a "consumer loans" category. The CFPB's Monthly Complaint Report indicates that "consumer loans" represent only 4 percent of total complaints, vehicle loans and leases comprise 59 percent of "consumer loan" complaints, and title loans constitute a mere 2 percent of "consumer loan" complaints.[42] And although installment loans comprise 31 percent of "consumer loan"

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[39] *See* Richard Cordray, CFPB, *Prepared Remarks of CFPB Director Richard Cordray on Payday Lending Research Report Press Call* (April 20, 2016).

[40] CFPB, Monthly Complaint Report, Vol. 13, at 22 (July 2016).

[41] Chart constructed from data set forth in CFPB, Monthly Complaint Report, Vol. 13, at 21.

[42] CFPB, Monthly Complaint Report, Vol. 12, at 12 (June 2016).

complaints, installment loans is a broad category that includes both covered and non-covered loans.[43]

Second, even if there were a substantial injury, consumers could avoid the injury by choosing not to borrow. When attempting to make the case that the Proposal will not harm borrowers that will lose access to credit, for instance, the Bureau acknowledges that some consumers may turn to friends or family when they would rather borrow from a lender.[44] With respect to covered short-term loans, the Proposal relies upon a Pew Trusts study that found that without small dollar loans: 81 percent of borrowers would cut back on expenses; 62 percent would delay paying bills; 57 percent of borrowers would borrow from friends or family, 57 percent would sell or pawn possessions, 44 percent would get a loan from a bank or credit union, and 37 percent would use a credit card.[45]

In addition, consumers could avoid any injury from incurring overdrafts and NSF fees by not agreeing to repay by a leveraged payment mechanism, such as preauthorized electronic fund transfers. Consumers could also avoid any such injury by revoking authorization for the lender to obtain payment through a leveraged payment mechanism, for example, by revoking the lender's authorization to initiate preauthorized electronic fund transfers.

Third, covered loans have immediate countervailing benefits to consumers that outweigh any injury:

- Covered loans help borrowers with few other options meet their financial obligations.

- Covered loans present borrowers that do have other credit options with more choice in credit products. Covered loans – especially those made by online lenders – provide borrowers with convenience that competing products like bank loans do not offer. For instance, one borrower of an OLA member recently wrote that "When my father passed away, I needed some financial help so that I could travel to be there for his wake and his funeral. This was such a difficult time, and having the ability to go online and quickly get approval and funds was incredibly helpful. I couldn't go to a bank and wait for approval. This was time-sensitive, and I needed to be there. It was the online, small-dollar lending process that made it possible."

- Covered loans help borrowers with seasonal or temporary jobs "smooth" their income.

- Lenders' practice of *not* collecting sensitive documents from applicants has the benefits of increased privacy and data security.

- Lenders' practice of *not* necessarily underwriting to the Proposal's "residual income" standard has the effect of keeping underwriting costs low, which permits lenders to pass

43 *Id.*

44 81 Fed. Reg. at 48,141.

45 81 Fed. Reg. at 48,130.

along lower prices to borrowers and therefore benefits both “repayers” and “defaulters” – *including* those who would still qualify for a loan under a residual income standard.

Covered loans also make for better financial markets, which ultimately provide benefits to consumers in the long-term. Covered loans promote competition by providing alternatives to traditional bank products. And, providers of covered loans are a source of significant innovation in the consumer finance industry.[46] In sum, covered loans improve consumer well-being, particularly compared to the alternatives.

2. The CFPB has not shown abusiveness

An abusive practice is one that materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service, or takes unreasonable advantage of:

- a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
- the inability of the consumer to protect his or her interests in selecting or using a consumer financial product or service; or
- the reasonable reliance by the consumer on the financial service provider to act in the interests of the consumer.

The CFPB relies on two of the four grounds of abusiveness to support the Proposal with respect to covered longer-term loans:

- Any act or practice other than that required by the Proposal takes unreasonable advantage of a consumer’s lack of understanding of the material risks, costs, or conditions of the consumer financial product or service (the lack of understanding prong);[47] and
- Any act or practice other than that required by the Proposal takes unreasonable advantage of the inability of the consumer to protect the interest of the consumer in selecting or using a consumer financial product or service (the inability to protect prong).[48]

The CFPB’s abusiveness analysis relies on assumptions, suppositions, and theory drawn from behavioral economics, but not on actual data, studies, or facts. As a result, the CFPB lacks authority on each prong:

[46] *See* Alan Kline, Five Reasons You Can’t Ignore the Neobanks, Am. Banker (Apr. 27, 2015).

[47] 81 Fed. Reg. at 47,993-95.

[48] 81 Fed. Reg. at 47,995-96.

a) **Lack of understanding**

The CFPB assumes consumers do not understand the risks of small-dollar loans, lender decision-making practices, or the effects of leveraged payment mechanisms, but provides no valid evidence to back up those assumptions. Instead, the CFPB relies on a behavioral economic theory called "optimism bias" and cites to articles on consumer behavior that have no connection to credit, published in experimental social psychology journals.[49] The Bureau has no research that shows this theory has any force when it comes to a consumer's decision to take out a covered longer-term loan. The CFPB also asserts without any citation whatsoever that "consumers confronting time pressure and financial distress are especially likely to be affected by optimism bias."[50]

Of course, the CFPB could have just as easily adopted the equally compelling theory of *pessimism* bias had it wanted to support the opposite conclusion.[51]

The CFPB's "optimism bias" theory is undermined by consumer surveys cited by the Bureau showing that consumers take out small-dollar loans primarily to pay for unexpected expenses, such as medical emergencies and car repairs (approximately 36 percent of respondents), to meet payments due prior to the next paycheck (approximately 23 percent of respondents), and to meet general living expenses that are consistently more than income (approximately 23 percent of respondents).[52] These are not the borrowing habits of people who are optimistically gambling on their own ability to repay their debts. Consumers tend to borrow covered loans because it is rational for them to do so in order to avoid or postpone a greater harm. Or, in the Bureau's own words, "they may make a reasoned decision to accept covered longer-term loans even when suspecting they may have difficulty affording the payments."[53]

In any case, a lack of understanding would not support a sweeping underwriting rule based on abusiveness. A lack of understanding would, in the first instance, compel the CFPB to explore enhanced disclosures as a remedy, something the CFPB has not done in its Proposal. Interestingly, CFPB's own research appears to indicate that disclosures work. In its "Supplemental Findings" research, the CFPB found that those borrowers who are more likely to be indebted are also more responsive to disclosures and informational remedies.[54] The Proposal's requirements do not address any lack of understanding, or prevent any injury that may flow from it. Instead, the Proposal would impose a residual income test that dictates whether

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49 81 Fed. Reg. at 47,992.

50 81 Fed. Reg. at 47,998-99.

51 *See, e.g.*, Camelia M. Kuhnen and Andrei C. Miu, *Socioeconomic Status and Learning from Financial Information*, Soc. Sci. Research Network (May 2015) (NBER Working Paper No. w21214); Selima Ben Mansour, Elyes Jouini, and Clotilde Napp, *Is There a Pessimistic Bias in Individual Beliefs? Evidence from a Simple Survey* (July 7, 2006); Joachim Vosgerau, *How Prevalent is Wishful Thinking? Misattribution of Arousal Causes Optimism and Pessimism in Subjective Probabilities*, 139 J. Experimental Psychol. 32 (Feb. 2010).

52 81 Fed. Reg. at 47,988.

53 81 Fed. Reg. at 47,999.

54 *See* CFPB Supplemental Findings at 66.

consumers are able to take out a loan based on their financial circumstances without regard to the consumer's level of understanding.

If the Proposal really were aimed at addressing consumers' lack of understanding, it would not impose the same residual income test for consumers who have already taken out and repaid covered longer-term loans. Those consumers have experienced the effects of covered longer-term loans on their personal finances, understand the implications of a "leveraged payment mechanism," and should not be taken by surprise by any feature of covered longer-term loans when re-borrowing. Those consumers plainly do not lack understanding.

In addition, Director Cordray himself has raised doubts about whether the "lack of understanding" prong could even be the basis for a broad rulemaking such as the Proposal. He has stated that a lack of understanding sufficient to support an abusive claim is "unavoidably situational," and that the CFPB would need to investigate the facts "consumer by consumer."[55] Director Cordray stated further that "I think it is the case that what is abusive and takes unreasonable advantage can differ from circumstance to circumstance,"[56] raising the question of whether abusiveness could even be addressed by a sweeping, general rule.

b) **Inability of consumer to protect his or her interests**

The statutory language that an abusive "practice [takes] unreasonable advantage of the inability of the consumer to protect his or her interests" is similar to the Uniform Consumer Sales Practices Act's prohibition against unconscionable contracts that take "advantage of the inability of the consumer reasonably to protect his interests because of his physical infirmity, ignorance, illiteracy, inability to understand the language of an agreement."[57] In this case, however, there is no reason to think that borrowers of covered loans generally suffer from infirmity, illiteracy or ignorance. In fact, recent research shows that borrowers of covered loans are increasingly well-educated and sophisticated with respect to their use of financial services, and that there is no reason to believe that these borrowers are vulnerable or otherwise unable to protect themselves:

- A study by the Urban Institute, a non-profit, non-partisan think tank, found that households that use alternative financial services are increasingly likely to have completed some higher education, and are better able to understand the terms and consequences of credit products. [58]

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55 *The Semi-Annual Report of the Consumer Financial Protection Bureau, Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. at p. 18 (Mar. 29, 2012).

56 *Id.*

57 Uniform Consumer Sales Practices Act § 4 (1970).

58 *See* Gregory B. Mills, Urban Inst., *As the Recovery Progresses, Use of Nonbank Credit Rises* (Mar. 9, 2015).

- In addition, the median age of borrowers of small dollar single pay loans and installment loans is 41 and 43, respectively.[59] Most borrowers are not young or elderly.

- The CFPB's own study found that nearly half of new borrowers have only one loan sequence during the year, and a majority of short term borrowers use two or fewer loans in a sequence.[60]

Despite this evidence, the CFPB believes consumers will have unrealistic expectations about future earnings, future expenses, or ability to save, what's known as "optimism bias," especially at a time of high need and high stress.[61] Once again, the CFPB, despite being a "data driven" agency, makes assumptions and inferential leaps but provides no hard data or evidence to support this assertion in the context of small dollar lending.

In reality, the premise of the CFPB's Proposal appears to be that consumers make the wrong choices, not that they fail to understand or have the ability to make better choices. The Bureau's discussion of non-recourse pawn loans is illustrative of this posture. Because such loans "involve the consumer physically relinquishing control of the item securing the loan," the Bureau believes "consumers may be more likely to understand and appreciate the risks" of the transaction.[62] The Bureau does not explain why it believes that more abstract reasoning is difficult for such consumers.

c) **Taking unreasonable advantage of consumer vulnerabilities**

The CFPB contends that lenders of covered longer-term loans take unreasonable advantage of consumers' lack of understanding and inability to protect themselves merely by making loans to consumers without adhering to the Proposal's prescriptive residual income standard. But how could lenders that look at DTI or DTA ratios rather than residual income – a perfectly reasonable practice that is done by mortgage loan originators and credit card lenders – be said to be "taking advantage" of borrowers? And how could the *lender* be taking advantage of the *borrower* by failing to ask the borrower for pay stubs and other verification evidence, or by failing to check credit reporting agencies for information about the borrower's credit history?

If the CFPB believes that consumers lack the ability to understand the risk of covered longer-term loans, the solution is to require lenders to explain those risks. Covered longer-term loans are relatively simple, straightforward products compared to mortgages, credit cards, and most other types of consumer credit. These products generally do not contain exotic or impenetrable terms and conditions, such as the double-declining balance method once used by credit card issuers, that cannot be readily explained to consumers. With simple, straightforward terms and proper disclosure, no lender could be said to be "taking advantage" of a lack of understanding.

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[59] G. Michael Flores, Bretton-Woods, Inc., *The State of Online Short-Term Lending: Statistical Analysis Report*, at 3 (July 2015).

[60] CFPB, Data Point: Payday Lending (Mar. 2014).

[61] 81 Fed. Reg. at 47,992 and 47,994.

[62] 81 Fed. Reg. at 47,918.

Finally, if the CFPB believes that consumers have an inability to protect their own interests because they need credit quickly and have few other options, the solution should not be to make it more difficult for those consumers to obtain the credit they need. A lender is not "taking advantage" of a consumer by providing funds to meet emergency or other needs. Under the Proposal's residual income standard, some needy borrowers will be shut out from obtaining credit, and will be forced to default on other important obligations. Those consumers' interests will not have been "protected" because of the CFPB's rule. The CFPB should not decide for those consumers what is in their best interests.

3. Use of the UDAAP authority leads to absurdities

The implication of the CFPB's rulemaking is that compliance with each of the CFPB's inflexible, prescriptive requirements is the <u>only</u> way to avoid engaging in an unfair or abusive practice. This makes no sense when considering practices in other markets and requirements of other regulations.

The CFPB maintains that the practice of making loans without regard to the borrower's ability to repay "stands in stark contrast to the practice of lenders in virtually every other credit market," and is inconsistent with safety and soundness principles.[63] This statement simply is not true: lenders generally cannot make ***any*** type of realistic ability to repay determination for borrowers of most private and Federally-guaranteed student loans, but must look to a guarantor or co-signer, if any. Lenders simply have no good way to predict whether a college freshman or sophomore will land a job following graduation that will enable the borrower to pay back the loan according to its terms. Moreover, for Federally-guaranteed student loans, the Federal guarantee reduces the incentive for a lender to consider a borrower's ability to repay, and high default rates on Federally-guaranteed student loans are evidence that lenders in that market do not, in fact, effectively consider a borrower's ability to repay. Further, borrowers of student loans are by definition younger, less experienced, and less educated than borrowers of covered loans. In addition, a borrower cannot discharge student loans in bankruptcy, which, unlike other types of loans, creates a true "debt trap."

From its observation about market practices, the CFPB then makes a remarkable leap to requiring a residual income test, which is plainly ***not*** a market practice in any market other than Veterans Administration ("VA") mortgage loans. The CFPB has recognized that the VA's residual income test is the only example of the routine use of residual income in credit underwriting.[64]

By contrast, credit card issuers and mortgage lenders have flexibility, under existing CFPB regulations, to use other, less burdensome means to make ability-to-repay determinations. The credit card and the mortgage ability to repay rules permit, but do not require, consideration of residual income, but allow the use of other methods, such as DTI ratios (credit cards and mortgages) or DTA ratios (credit cards). These rules provide lenders with far greater flexibility

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[63] 81 Fed. Reg. at 47,996.

[64] 78 Fed. Reg. 6,408, 6,486 (Jan. 30, 2013).

to choose underwriting methods than the Proposal. Credit card issuers also can rely solely on information provided by the consumer to satisfy the credit card ability to repay standard (e.g., stated income), or issuers may rely on information in a consumer report. Since covered small dollar loans are a substitute for credit cards, and since credit cards are analogous to covered loans in terms of not being limited to a specific type of purchase, such as a home or a car, and affording the consumer the ability to reuse and reborrow upon repayment, the small-dollar ATR requirement should be modeled after, and be just as flexible as, the credit card ATR requirement.

In light of these varying practices and regulations, the Proposal's reliance on the CFPB's authority to prohibit unfair or abusive acts or practices creates absurdities:

- It would be unfair or abusive for a lender to consider DTI or DTA ratios rather than residual income as a measure of ability to repay when making a covered loan to a consumer, but would <u>not</u> be abusive or unfair for the same lender to consider DTI or DTA ratios, rather than residual income, when making a credit card loan to the same consumer.

- It would be unfair or abusive not to consider a consumer's ability to repay for a covered loan, but not for small-dollar loans with a 36 percent total cost of credit and a leveraged payment mechanism, and not for federally-guaranteed student loans (which have high default rates).

- It would be unfair or abusive for a lender not to furnish information to a new type of credit reporting agency (the registered information system) or obtain and review consumer reports from a nationwide credit reporting agency and a registered information system when making covered loans, even though Congress has established a comprehensive regulatory structure governing consumer reporting, the Fair Credit Reporting Act, and has made the furnishing and use of consumer reports voluntary, not mandatory.

- If a lender made loans under the Five Percent Default Rate alternative, and macroeconomic conditions led borrowers to default at a six percent rate for a given year, the Proposal suggests that the lender's loans would become abusive and unfair *after the fact*.

B. The Proposal Is a Usury Limit In Violation of the Dodd-Frank Act

Section 1027(o) of the Dodd-Frank Act specifically forbids the CFPB from imposing a usury limit applicable to an extension of credit offered or made by a covered person to a consumer. Although the term "usury limit" is not defined in Dodd-Frank, a common definition of the term usury means the "charging of interest." Thus the "usury laws" of a given state are those laws that regulate the charging of interest.

Justice John Marshall famously wrote in *McCulloch v. Maryland* that "the power to tax involves the power to destroy."[65] Similarly, the power to regulate is the power to destroy. The Proposal would regulate the rate of interest charged by lenders by imposing stringent conditions and requirements on loans with an interest rate exceeding a 36 percent total cost of credit. By asserting stringent regulatory conditions and requirements on loans exceeding a specified interest rate, the Bureau would limit the ability of lenders to make such loans and to charge such an interest rate, and therefore is asserting power to impose a *de facto* usury limit on those loans. The Proposal's ATR requirement for covered longer-term loans would effectively be a usury limit.

In addition, under the Proposal's loan limits, lenders would not be allowed to make a longer-term loan with an interest rate in excess of 36 percent to a borrower who has taken out three covered loans in a sequence. Lenders could only make the loan if it bore an interest rate of 36 percent or less. The CFPB's loan limit would *actually be* a usury limit with respect to the borrower.

C. The Proposal Undercuts the Voluntary Data Furnishing Scheme Created by Congress in the FCRA

Congress has established a comprehensive regulatory structure governing consumer reporting, the FCRA, and has made the furnishing and use of consumer reports voluntary, not mandatory. The CFPB cannot use its general authority to prohibit unfair and abusive acts or practices to usurp Congressional powers, override a specific federal statute, mandate the creation of an entirely new type of consumer reporting agency – a new type of market participant – and mandate the furnishing of data to all of those consumer reporting agencies by lenders.

D. The Proposal is Arbitrary and Capricious

1. The CFPB has not established any consumer harm that needs to be remedied

The CFPB has not cited any research on installment lending, the purported injury associated with account access, or the failure of lenders to adequately underwrite when they have access to the borrower's account. The CFPB has no basis whatsoever to conclude that these practices result in consumer injury.

2. The CFPB's proposals bear no relation to the harm sought to be prevented

The Bureau also has not provided any evidence that a residual income determination or its outmoded document collection and verification proposal will remedy any identified consumer injury. Even if the Bureau had such evidence, it would beg the question: why are credit card and other lenders not required to comply with similar requirements?

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[65] 17 U.S. 316, 431 (1819).

3. The CFPB's proposals are not based on the relevant data in the evidentiary record

The CFPB concedes that it does not have particularly good data on longer-term loans, so it relies heavily on data regarding short-term loans in proposing rules for longer-term loans.[66] Thus, the CFPB lacks a credible empirical basis for applying the Proposal's requirements to covered longer-term loans.

We believe the data the CFPB does have concerning longer-term loans is outdated, in that it pre-dates the 2015 revisions to the NACHA rules and the new restrictions on returned items and re-presentments, and is largely based on data about lenders that are no longer in business.[67]

E. The CFPB Has Relied on Secret Data, Making it Impossible for the Public to Meaningfully Comment on the Proposal As Required Under the APA

The Proposal relies on data that the Bureau has obtained in the course of supervisory activities and is immune from public view and scrutiny through a FOIA request. Examples include:

- The CFPB's observation that for covered longer-term loans that are ultimately repaid rather than ending in default, the vast majority do not fall more than seven days delinquent.[68]
- The CFPB's observation that most consumers take out substantial cash when refinancing a longer-term installment loan.[69]
- The CFPB's finding that a "considerable segment" of consumers who repay a loan without an immediate rollover or reborrowing nonetheless return within the ensuing 30 days to reborrow.[70]
- The CFPB's finding that "some" lenders may debit a consumer's account at irregular times resulting in early collection of funds, overdraft fees, or fees for returned payments.[71]

In large part, the CFPB has not provided ***any information*** about the source of this data or even the underlying data itself. As a result:

- The public does not know whether the suppliers of the data are representative of the market as a whole.

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66 81 Fed. Reg. at 47,885-87.

67 *See infra* Section V.A.4.

68 81 Fed. Reg. at 48,026.

69 81 Fed. Reg. at 48,027.

70 81 Fed. Reg. at 47,958.

71 81 Fed. Reg. at 48,083.

- The public does not know whether the time period covered by the data represents current market practices, market participants, and state laws.

- The public does not know whether it would be more appropriate to view data in a subset of states, given the varying approaches of the states in regulating covered loans.

- The public does not know whether the CFPB's sample sizes are large enough so that statistically valid conclusions can be drawn.

- The public does not know whether the CFPB has drawn appropriate conclusions from the data.

- The public does not know whether the data was collected in an accurate or reliable way.

In other instances, the CFPB relies heavily on data from seven unidentified lenders that make vehicle title or covered longer-term installment loans.[72] Yet, without knowing what seven firms comprise the CFPB's sample, the public cannot know whether these firms are representative of the market, how many of them make covered longer-term installment loans (as opposed to vehicle title loans), how many are online lenders (as opposed to storefront lenders), and even whether they are still in business.

The CFPB's failure to release the data on which the rule is based violates the Administrative Procedure Act ("APA"). Courts have interpreted APA notice-and-comment procedures to require an agency to reveal "the 'technical studies and data' upon which the agency relies" for public evaluation.[73] Where an agency fails to disclose such "studies and data," and an affected party is thereby "prejudiced by the absence of an opportunity" to comment meaningfully, the agency action must be vacated.[74] Public release of this information is mandated by the APA, which generally requires that the public be provided the "most critical factual material"[75] used by the agency in developing a rulemaking.[76]

The CFPB's failure to release its data is also bad public policy. The CFPB should appreciate that data needs vetting from third parties. In the preamble to the Proposal, the Bureau questions conclusions drawn from a study about the optimism of payday loan borrowers, and even appears

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72 *See* CFPB Supplemental Findings (cited throughout the Proposal).

73 *Chamber of Commerce of the United States v. SEC*, 443 F.3d 890, 899 (D.C. Cir. 2006); *see also Am. Radio Relay League v. FCC*, 524 F.3d 227, 236 (D.C. Cir. 2008); *United States v. Nova Scotia Food Prods. Corp.*, 568 F.2d 240, 251 (2d Cir. 1977) (agency's failure to disclose underlying data prevents public "criticism of the methodology used or the meaning to be inferred from the data").

74 *Owner-Operator Indep. Drivers Ass'n v. FMCSA*, 494 F.3d 188, 202 (D.C. Cir. 2007); *see also Cal. Wilderness Coal. v. U.S. Dep't of Energy*, 631 F.3d 1072, 1095 (9th Cir. 2011) ("[W]here a regulation is promulgated in violation of the APA and the violation is not harmless, the remedy is to invalidate the regulation.").

75 *See Chamber of Commerce*, 443 F.3d at 900; *Appalachian Power Co. v. EPA*, 249 F.3d 1032, 1039 (D.C. Cir. 2001).

76 *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

to have emailed the author of the study to obtain more information about the underlying data.[77] Yet, the CFPB denies the public the same ability to see, probe, and evaluate the underlying data upon which the agency relies and to question the conclusions the CFPB draws from that data.

III. Ability to Repay Requirements

A. General Issues

1. The Proposal's ability-to-repay standard imposes disproportionately rigid and costly underwriting requirements on small dollar loans compared to other credit products

The Proposal's ATR standard imposes more rigid underwriting standards and substantially higher costs than the ATR standards that apply to underwriting a $2,500 credit card line, even though credit cards and small dollar loans are close substitutes for each other and share many similar attributes. The Proposal's ATR standard is comparable to, and in some respects even more onerous than, the ATR requirements for underwriting a $250,000 mortgage. We believe the proposed ATR requirements and costs are grossly disproportionate to the size and purported harm associated with covered longer-term loans. By imposing these disproportionate requirements on covered longer-term loans, the CFPB would treat borrowers of covered longer-term loans – who are more likely to be LMI consumers – less favorably than users of alternative credit products, such as credit cards.

a) **Residual income standard**

Existing ATR regulations ***permit***, but do ***not require***, credit card issuers and mortgage lenders to consider residual income in their assessment of a consumer's ability to repay a loan. Credit card issuers may determine a consumer's ability to repay using a DTI ratio or a DTA ratio, rather than residual income, while mortgage lenders may determine a consumer's ability to repay a mortgage loan by considering either a monthly DTI ratio or residual income. Here, however, the CFPB proposes to make a residual income test ***mandatory*** and the sole basis for making ATR determinations for small-dollar loans.

The existing credit card and mortgage ATR rules do not provide any meaningful guidance on how to apply or satisfy the residual income test. In the QM rule, for example, the CFPB left the appropriate monthly residual income threshold "for the creditor to determine," and, despite creating detailed quantitative criteria for DTI calculations in Appendix Q, concluded that it was not "necessary or appropriate to specify a detailed methodology in the final rule for consideration of residual income."[78] As a result, residual income is a throwaway test that credit card issuers and mortgage lenders do not use in making ATR determinations.

In fact, the CFPB has recognized that few lenders use residual income in underwriting: "Except for one small creditor and the VA, the Bureau is not aware of any creditors that routinely use

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[77] 81 Fed. Reg. at 47,928.

[78] 78 Fed. Reg. at 6,486-87.

residual income in underwriting, other than as a compensating factor."[79] It is difficult to understand, therefore, why the Proposal would make residual income the ***only permissible basis*** for determining a borrower's ability to repay a covered small dollar loan.

The Bureau contends that residual income is a better measure of ability to repay for LMI borrowers than a DTI ratio.[80] But if that is the case, then residual income should constitute the ATR standard for any credit product primarily sold to LMI borrowers, including certain types of credit cards and certain types of mortgages.

The Bureau also contends that, in contrast to other markets, the small dollar loan market lacks "long-established norms for DTI levels that are consistent with sustainable indebtedness."[81] Although the online lending market is a relatively young, innovative, and diverse market where such norms may not exist today, OLA and its members would welcome the opportunity to work with the Bureau to develop such norms so that lenders can preserve flexibility for how they can assess a consumer's ability to repay.

In addition, the credit card residual income standard, even on its own terms, is more flexible than the Proposal. The credit card standard assesses "the income the consumer will have after paying debt obligations."[82] Insofar as a card issuer chooses to use the residual income standard, the issuer need only consider "debt obligations," not the larger categories of "major financial obligations" plus "basic living expenses" used in the Proposal.

The CFPB has recognized that some borrowers use covered longer-term loans like a credit card: "it appears that most refinances for such products involve situations in which consumers are using longer-term installment loans somewhat like a line of credit to take out additional funds before paying back the original loan."[83] Given the similarities between covered longer-term loans and credit cards, the Bureau should adopt the same ATR standard in both contexts. Its failure to do so only raises questions about why borrowers of covered loans would be treated worse than credit card holders.

b) **Information verification**

The credit card ATR rules generally permit credit card issuers to evaluate a consumer's income and debt obligations based entirely on information provided by the consumer. The credit card ATR rules also permit, but do not require, issuers to consider information from a consumer report or other third-party sources.

In contrast, the Proposal would require lenders to obtain a consumer's written statement about the amount and timing of the consumer's net income and payments for major financial

[79] 78 Fed. Reg. at 6,486.

[80] 81 Fed. Reg. at 48,003.

[81] 81 Fed. Reg. at 48,003.

[82] 12 C.F.R. § 1026.51(a)(1)(ii).

[83] 81 Fed. Reg. at 47,991.

obligations, and to obtain, review, and retain documentation from various third-party sources to verify the consumer's written statement. In effect, the residual income test for small-dollar loans would impose on lenders making $2,000 six-month installment loans burdens far greater than the burdens imposed on creditors making a credit card loan with a $2,000 credit limit.

The verification requirements also impose more burdens on *borrowers* of covered loans than credit card holders, by requiring proof of income. The CFPB's message appears to be that the LMI borrowers, particularly women and minority borrowers who tend to take out covered loans, cannot be trusted to be truthful about their income, while the higher-income borrowers who apply for credit cards are trustworthy.

c) **Restrictions on reuse and reborrowing**

The credit card ATR rules require issuers to determine a consumer's ability to make the required minimum payments – not to pay off the credit at the end of the next billing cycle or after a specific period of time – and do not impose any monthly or yearly restrictions on a consumer's continued use of the credit card to make subsequent purchases.

By contrast, the residual income test for small-dollar loans would require lenders to determine a consumer's ability to repay based on repayment of the full loan amount at the end of the term without reborrowing and would restrict the number of small-dollar loans a consumer could obtain over specified time periods, thereby limiting access to credit.

In other words, consumers who use credit cards can make decisions for themselves regarding frequency of usage and reborrowing, but the CFPB does not trust consumers who use small-dollar loans to make their own decisions on such matters.

2. Lenders in this market *do* use underwriting standards that establish an "ability to repay," even if it is not the CFPB's rigid residual income standard

The CFPB makes much of the fact that small dollar lenders follow an "ability to collect" model, rather than an "ability to repay" model. The CFPB concedes that while some lenders do obtain and review consumer reports and turn down a majority of new applicants, they do so primarily to prevent fraud, not to determine ability to repay.[84]

OLA members do, however, underwrite to their customers' ability-to-repay, even if they do not do so using the Proposal's novel residual income standard and document collection requirements.

[84] 81 Fed. Reg. at 47,987-89.

3. The Proposal's residual income standard provides a distorted assessment of a consumer's ability to repay

The Proposal's residual income standard does not permit lenders to include in a consumer's net income the principal amount of a covered longer-term loan.[85] The Proposal also does not permit the principal amount of a covered longer-term loan to reduce or offset a consumer's payments for major financial obligations or basic living expenses that will be incurred during the term of the loan. This approach results in an arbitrary and distorted view of a consumer's ability to repay a covered longer-term loan.

Covered longer-term loans likely will be used by consumers to pay major financial obligations or meet basic living expenses that they cannot satisfy from other income sources, such as wage or salary income. Yet, the proposed residual income standard will force lenders to pretend that the principal amount of a covered longer-term loan will not be used by a consumer to satisfy major financial obligations or meet basic living expenses. OLA believes that any residual income test should allow lenders to apply the principal amount of the prospective covered loan as an offset to a consumer's major financial obligations or basic living expenses.

4. The Proposal ignores the fact that individuals within households share income and expenses

The Proposal's residual income test ignores the fact that households share income and expenses, a serious design flaw that would punish married and other cohabitating consumers in several ways. It also does not reflect the economic reality of households that share income and expenses informally among household members. This design flaw would have serious adverse effects on consumers.

First, by requiring the *consumer* to earn enough *individual* income to support repayment of the covered loan and other expenses, the Proposal would prevent millions of stay-at-home consumers, or consumers with part-time employment, who share their spouse or partner's income from obtaining covered loans. This treatment would be unfair to consumers who provide family care or who work only part-time and would be inconsistent with existing ATR standards for credit cards.

In 2013, the CFPB amended Regulation Z to make it easier for stay-at-home spouses and partners to qualify for credit cards.[86] The Bureau's amendment permits credit card issuers to consider, with respect to an applicant that is age 21 or older, income to which the applicant has a "reasonable expectation of access." The Bureau's press release accompanying the amendment noted that because over 16 million married people do not work outside the home, "one out of every three married couples . . . now may have easier access to credit cards as a result of the

85 81 Fed. Reg. at 48,172.

86 79 Fed. Reg. 25,818 (May 3, 2013).

Bureau's amendment," and that the amendment will "ease access to credit particularly for stay-at-home spouses or partners who have access to a working spouse or partner's income."[87]

The CFPB made no such accommodation in the Proposal for non-working or not full-time employed applicants, such as stay-at-home spouses or partners, applying for covered loans. We see no justification for such a difference in treatment. Does the CFPB believe stay-at-home spouses who use this type of credit are less trustworthy, deserving, or able to handle their finances?

In fact, this disparity between the Proposal's residual income test and the Regulation Z credit card household income rule may have the unintended consequence of codifying by regulations a disparate impact in credit underwriting. The Proposal cites an FDIC study showing that female borrowers and Hispanic and African-American borrowers are more likely to use payday loans than male and non-minority borrowers.[88] By contrast, more affluent, non-minority borrowers are more likely to be able to take advantage of the credit card rules' household income standards and qualify for credit even if they rely on the income of a spouse or partner. Thus, the CFPB's application of a different and less favorable underwriting standard to covered loans than it applies to credit cards may disproportionately reduce access to credit for women and minority borrowers and legalize this form of disparate impact. We doubt, and frankly would be surprised, if this is the result the CFPB intends – after all, the CFPB is charged with administering and enforcing the Equal Credit Opportunity Act, the country's principal fair lending law. However, such a result would be one consequence of adopting the Proposal in its current state.

Second, the Proposal would require lenders to consider the basic living expenses of all of the consumer's dependents. By allowing lenders to consider only the *consumer's* income, but requiring lenders to consider both the consumer's individual expenses and all expenses for the consumer's dependents in the same household, the Proposal would artificially and arbitrarily reduce the residual income of consumers who may share responsibility with a spouse or partner for paying the expenses of a dependent of both of them. For instance, a lender considering a loan to an applicant who has a full-time job and whose spouse who also has a full-time job would have to attribute to the applicant all the expenses of dependents of both the applicant and the spouse, but could not consider the spouse's contribution to the applicant's household income and the role such income plays in covering the expenses of common dependents. This asymmetry between the Proposal's requirements to consider the *consumer's* income compared to the expenses of all dependents in the household is a fundamental flaw in the residual income test and raises arbitrary barriers to credit for consumers in dual income households. The CFPB should not punish consumers seeking covered loans by measuring their repayment ability through an artificial, distorted comparison.

By contrast, the credit card residual income standard requires only a comparison between the income to which a consumer has reasonable access, and the *consumer's* debt obligations. In fact,

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[87] *See* CFPB Press Release, The CFPB Amends Card Act Rule to Make it Easier for Stay-at-Home Spouses and Partners to Get Credit Cards (Apr. 29, 2013).

[88] 81 Fed. Reg. at 47,920.

the CFPB has explicitly declined to require credit card lenders to consider household expenses and debt obligations because such a requirement would deny consumers access to credit. When finalizing the household income rule for credit cards, the CFPB stated that:

> Several consumer groups indicated that if the Bureau is going to permit the payment of expenses by a household member to be considered as ''income'' for an applicant, then it should also establish a parallel requirement that issuers consider those expenses when determining an applicant's ability to pay. In other words, if payment of household expenses by another constitutes income, then those household expenses should be included in the analysis required by § 1026.51(a)(1)(ii). . . . [T]he Bureau declines to add additional requirements for considering debt obligations. The Bureau believes that the current commentary provides card issuers the flexibility to obtain information regarding debt obligations directly from the consumer or in a consumer report and does not prohibit a card issuer from considering household expenses in evaluating a consumer's current obligations. ***The Bureau also believes it would be unduly burdensome to require card issuers to consider the debt obligations of a non-applicant because such information may generally not be available to the consumer at the time of applying for credit and to require such information may needlessly result in the denial of credit to otherwise creditworthy individuals or discourage consumers from applying at all.***[89]

We note again that covered loans present the same concerns, and should not be treated differently.

Third, by requiring the lender to consider all expenses of a consumer's dependents, the Proposal would require lenders to ask sensitive and possibly unlawful questions about applicants' marital status and information concerning a spouse in order to apply the residual income test correctly and understand the effect of applicants' income and expenses.

Without asking whether an applicant is married or cohabitating or has children, a lender could not know whether there are dependents in the applicant's household for which the applicant must pay living expenses. Yet, Regulation B prohibits lenders from asking for information about spouses, unless an applicant is relying on a spouse's income for repayment. The CFPB should consider how lenders can obtain information about dependents' expenses and calculate a borrower's residual income without violating these important and longstanding provisions of Regulation B. Once again, adopting the credit card ATR provision, with its focus on the *consumer*'*s* debt obligations, would avoid this problem.

[89] 78 Fed. Reg. 25,818, 25,828 (May 3, 2013) (emphasis added).

In sum, we strongly urge the CFPB to revise the Proposal's ATR provisions to allow lenders to consider the income to which an applicant has a reasonable expectation of access, and only require lenders to consider the consumer's debt obligations.

5. The Proposal will have an adverse impact on lower income borrowers and a disparate impact on women and minority borrowers

OLA members include a number of specialty consumer reporting agencies ("CRAs") that provide valuable services to online lenders. Several of these specialty CRAs conducted a numerical evaluation of the potential impact of the Proposal's residual income test on consumer credit eligibility. The specialty CRAs estimated that Americans who earn $40,000 per year or less would be unlikely to qualify for a $500 small dollar loan. The consequences for LMI consumers are significant. According to the 2010 U.S. Census, more than 140 million adults in the United States earn less than $40,000 per year.[90] In addition, data from the U.S. Census Bureau shows that the 2014 median income for African-American households was $35,398 while the 2014 median income for households headed by women was $39,621.[91] As this data shows, the Proposal is likely to have an adverse impact on LMI consumers and a disparate impact on women and African-American borrowers.

6. A narrow focus on ability to repay ignores important underwriting factors such as willingness to repay

A statistical analysis of records of 87 million payday loans made by five large lenders in 37 states over more than five years, found that a higher payment-to-paycheck ratio of the borrower (which indicates a greater ability to repay) does *not* correlate with a lower probability of default.[92] The CFPB has not addressed this important finding, nor has it otherwise established that residual income is determinative of creditworthiness. In fact, as described above,[93] the CFPB actually found an inverse relationship between payment to income ratio and credit default, indicating that a borrower's income had very little to do with whether the borrower eventually repays a loan.

While an ability to repay determination seems reasonable, it is only one part of a creditworthiness determination. The Proposal overlooks an equally important factor that demonstrates a borrower's creditworthiness: *willingness* to repay. Lenders generally use a borrower's history of repayment, expressed through credit scores and other analytics, as an indicator of willingness to repay. A borrower's residual income, or capacity to repay, does not

[90] *See* Bureau of Labor Statistics and the Census Bureau, Current Population Survey (CPS): Selected Characteristics of People 15 Years Old and Over by Total Money Income in 2010, Work Experience in 2010, Race, Hispanic Origin, and Sex, http://www.census.gov/hhes/www/cpstables/032011/perinc/new01_001.htm.

[91] *See* Carmen DeNavas-Walt and Bernadette D. Proctor, U.S. Census Bureau, *Income and Poverty in the United States: 2014*, at 5, 10 (Sept. 2015).

[92] *See* Peter Toth, *Measures of Reduced Form Relationship Between the Payment-Income Ratio and the Default Probability*, NonPrime101.com (Feb. 17, 2015).

[93] *See supra* Section II.A.1.

mean that he or she will actually repay. As such, residual income has limited usefulness as an underwriting standard.

7. Residual income ignores other sources of repayment

The Bureau argues that those consumers who will lose access to credit because of the rigid underwriting test in the Proposal can seek money from their friends and family, cut back on expenses, delay paying bills, or sell or pawn possessions.[94] The evidence on this point is mixed. With respect to covered short-term loans, the Proposal relies upon a Pew Trusts study that found that, without small dollar loans, 81 percent of borrowers would cut back on expenses; 62 percent would delay paying bills; 57 percent of borrowers would borrow from friends or family, 57 percent would sell or pawn possessions, 44 percent would get a loan from a bank or credit union, and 37 percent would use a credit card.[95] The Bureau elsewhere suggests that borrowing from family or friends would be an option for some covered short-term loan borrowers, as would obtaining pawn loans, reducing expenses, and delaying bill payment.[96] However, another survey cited by the Bureau indicated that fully 62 percent of online small dollar loan borrowers had already sought assistance from family and friends, suggesting that many consumers may have tried and exhausted certain options.[97] The Proposal does not, however, allow *lenders* to make similar assumptions regarding consumers' opportunities for reducing expenses when determining a consumer's ability to repay.

Lenders who operate in this market understand that consumers may have a variety of resources at their disposal beyond traditional income, including choices about which bills to pay first or which expenses to cut. The residual income test does not take into account the resourcefulness of borrowers or the market reality that borrower sometimes need to make choices to pay their obligations.

B. Issues With Specific Elements of Residual Income

1. Net Income

a) The net income standard punishes seasonal, self-employed, and cash-compensated workers

A net income-based residual income standard disadvantages consumers who have sporadic or seasonal employment, consumers whose income has been temporarily interrupted, self-employed consumers, and consumers who receive some of their income in a form that cannot easily be documented and verified, such as service industry consumers who rely on cash tips for income. The rigid residual income test risks unnecessarily depriving these consumers of access to credit.

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[94] 81 Fed. Reg. at 48,141.

[95] 81 Fed. Reg. at 48,130.

[96] 81 Fed. Reg. at 48,130; *see also* 81 Fed. Reg. at 48,141.

[97] 81 Fed. Reg. at 47,921.

The CFPB made certain accommodations for these types of circumstances in the mortgage ATR rules,[98] but, despite these adjustments, even CFPB Director Cordray recognized the Bureau has continuing concerns about lack of access to mortgage credit for self-employed, temporary, and seasonal workers.[99]

Populations with erratic income patterns have the greatest need for the flexible, unsecured credit products offered by online lenders to help "smooth" their income. Yet, the CFPB's residual income test would effectively deprive these borrowers of access to such credit.

b) The net income standard is vague

Net income means the total amount a consumer receives after the payer deducts amounts for taxes, other obligations, and voluntary contributions. This standard is vague. For example, it is not clear whether child support *received* is part of net income, even though this is critical income for consumers that helps offset the cost of housing and other basic living expenses.

The exclusions from net income are also not entirely clear:

- The exclusion of voluntary contributions is ambiguous and suggests that consumers seeking loans are not expected to modify their financial priorities to repay their debt obligations. It is not clear, for example, whether net income excludes voluntary contributions to 401(k) and other retirement savings plans or charitable contributions. A lender might reasonably expect a consumer to suspend those discretionary contributions in order to repay a loan. The Proposal, however, leaves this open to interpretation.

- The term "other obligations" also is not defined in the proposed rule text or commentary.

c) The CFPB should explain how far back income verification needs to go

The Proposal would require lenders to obtain a reliable record of an income payment covering "sufficient history" to support the lender's projection, but does not indicate how much history would be sufficient or whether sufficiency depends, in part, on the duration of the covered loan. The NCUA requires two pay stubs. The CFPB similarly should provide a safe harbor.

2. Basic Living Expenses

The proposed residual income test for small-dollar loans does not establish an objective method for calculating the amount of funds necessary to meet basic living expenses or the amount of residual income that is sufficient to establish a consumer's ability to repay given certain variables, such as income level, household size or geographic location. Instead, the Proposal

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98 *See* 12 C.F.R. Part 1026, Appendix Q (containing special rules for calculating DTI ratios with respect to income for seasonal employment, self-employed consumers, and overtime and bonus income).

99 *The Consumer Financial Protection Bureau's Semi-Annual Report to Congress: Hearing Before the Comm. on Banking, Housing, and Urban Affairs*, 114th Cong. (July 15, 2015) (testimony of R. Cordray).

describes certain methods lenders may use to calculate basic living expenses, but reserves for itself the option to conclude that the lender chose "implausibly low amounts of funds to meet basic living expenses" or selected an unreasonable method if the lender experiences "high rates of default and reborrowing" relative to other lenders.[100]

For example, the Proposal does not make clear whether food expenses include the cost of restaurant meals, whether health and welfare expenses include the cost of gym or swim club memberships, or whether similar discretionary, but seemingly optional, expenditures would qualify as basic living expenses. A reasonable lender might expect that a consumer seeking credit would eliminate unnecessary living expenses and tighten his/her belt in order to pay back the loan. Indeed, the CFPB assumes the very same thing in conducting its impact analysis.[101] Unquestionably, individual consumer spending behavior can and does impact a consumer's repayment or default on a loan. The proposed definition of "basic living expenses," however, gives no indication that lenders may assume, when calculating basic living expenses, prudent and responsible consumer spending behavior, including a consumer reducing optional, non-essential spending to make loan payments.

3. Housing Expenses

The Proposal assumes that housing expenses can be verified by a lease, reliable records of recent housing expense payments, or an estimate based on local housing expenses. The Proposal does not contemplate other living arrangements, such as a consumer who rents a room from or lives with a family member, or a consumer who rents an apartment but has a roommate to split the cost of rent and utilities. These expense-reducing arrangements can neither be (1) verified by a lease or record of expenses, or (2) estimated based on local housing expenses.

4. Other Major Financial Obligations

The CFPB's focus on a consumer's ability to meet other major financial obligations assumes that other financial obligations are, or should be, more important than repaying a small-dollar loan obtained to cover an unexpected car repair or other emergency expense.[102] This assumption is flawed and counterintuitive, given the emergency circumstances the CFPB identifies as the primary reasons consumers take out small-dollar loans.[103]

The CFPB provides no evidentiary support for the notion that other major financial obligations are more important than repaying covered longer-term loans. The CFPB is making value judgments about the relative importance of various financial obligations consumers undertake, substituting its judgment for the judgment of consumers themselves. The CFPB notes that "in order to stop lenders from withdrawing (or attempting to withdraw) funds, borrowers may have to cease depositing funds into their account (and possibly close their accounts) or remove funds

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[100] 81 Fed. Reg. at 47,011.

[101] 81 Fed. Reg. at 48,130.

[102] *See* 81 Fed. Reg. at 47,990.

[103] 81 Fed. Reg. at 47,988 and 47,992.

quickly enough that lenders are unable to access them."[104] The CFPB's statement suggests that the Bureau is encouraging consumers to avoid repaying their legal obligations by shifting funds out of accounts where they can be used to pay debts. It is cynical, contrary to the rule of law, and irresponsible public policy for a federal regulatory agency to provide consumers with a roadmap for avoiding paying debts they legally owe, or to favor repaying certain lenders over others.

C. The Proposal's Methods for Assessing Reasonableness of an Ability to Repay Determination Are Inappropriate

1. Lack of objective standards

The Proposal would require lenders to select a reasonable method of determining basic living expenses, such as: (a) setting minimum percentages of income or dollar amounts based on a statistically valid survey of expenses of similarly situated consumers, taking into consideration the consumer's income, location, and household size; (b) obtaining additional reliable information about a consumer's expenses beyond what the regulation requires; or (c) any method that reliably predicts basic living expenses.[105] Upon closer examination, each of these methods is unworkable:

- The statistical survey described in (a) above would be costly and burdensome to implement, and there is no assurance that the CFPB will accept as reasonable a lender's reliance on such a survey.

- The approach described in (b) above is vague and subjective since it is not clear what, if any, additional information may exist, or whether the CFPB would find the consideration of any such additional income sufficient. At a minimum, the Bureau should provide examples of such additional information and illustrate how lenders may consider such information.

- The catch-all provision described in (c) above is nothing more than a circular restatement of the requirement.

The CFPB also proposed no criteria for evaluating the sufficiency of residual income.

The Proposal's lack of objective criteria for determining the adequacy of basic living expenses and the sufficiency of residual income creates potential regulatory enforcement traps and allows the CFPB to challenge lenders' ATR decisions after the fact. In the case of "basic living expenses" discussed above, a lender's incorrect assumption that a consumer will use the available residual income in a responsible manner during the loan term may lead the CFPB to conclude that the lender chose "implausibly low amounts of funds to meet basic living expenses."[106] The Proposal's definition of "basic living expenses" – one that may make a

[104] 81 Fed. Reg. at 47,989.

[105] 81 Fed. Reg. at 48,202.

[106] 81 Fed. Reg. at 48,202.

lender's compliance dependent upon the idiosyncrasies of individual consumer spending behavior – is subject to interpretation and creates a regulatory enforcement trap for lenders.

2. Novel income cushion requirement

Even after determining the sufficiency of a consumer's residual income, the Proposal would require a lender to account for the possibility of volatility in the consumer's residual income and basic living expenses over the term of the loan. To do so, the Proposal provides that lenders are expected to establish an "income cushion" that is large enough to enable a consumer to have sufficient residual income to make payments despite experiencing volatility.[107]

Introduction of the concept of an "income cushion" is inappropriate because it goes beyond a determination of a consumer's ability to repay and ventures into the realm of speculation. What's more, no other ATR standard requires a lender to consider an income cushion, even for loans designed for LMI borrowers. If an income cushion is to be included in any ATR rule, it would be most appropriate to include such a cushion in the mortgage ATR rules because mortgages are very long-term loans and the probability of consumers experiencing volatility in income and expenses increases over longer time horizons.

Moreover, the CFPB provides no guidance regarding how to calculate an income cushion or how much of a cushion would be deemed adequate. A lender has no idea whether the right cushion is 1 percent, 2 percent, or 5 percent of a consumer's net income, basic living expenses, or some other benchmark. Absent such guidance, the sufficiency of a consumer's residual income depends entirely upon the lender's predictions about possible, but uncertain, events of unknown magnitude or duration. In effect, the Proposal seems to demand that lenders engage in fortune telling, rather than in responsible underwriting.

3. Comparing lenders

The Proposal provides that any method that results in a lender experiencing "high rates of default and reborrowing" relative to other lenders will face a substantial risk of being deemed unreasonable, after the fact, by the CFPB.[108] By using comparisons between lenders' default and reborrowing rates as the touchstone for identifying legal violations – a questionable practice at best – the Proposal creates another regulatory enforcement trap. OLA believes that the Proposal should be designed to facilitate compliance, and not to give the Bureau multiple opportunities to second-guess lender underwriting decisions and generate enforcement actions against lenders that experience above-average rates of default and reborrowing.

Indeed, the implication of this comparative standard is that a lender could meet *all* of the requirements of the rule (residual income + written budget + verification + credit checks + satisfaction of presumptions) yet still fail to make a reasonable determination of the consumer's ability to repay.

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[107] 81 Fed. Reg. at 48,203.

[108] 81 Fed. Reg. at 48,202.

Rather than provide a test with which lenders can comply, the CFPB has left itself ultimate flexibility to determine "unreasonableness" after the fact, based on overall rates of default and reborrowing.

Again, the implication of such a look-back standard is that a lender could meet all the requirements of the rule and still fail to make a reasonable determination of the consumer's ability to repay.

D. The Rule Should Not Require Lenders to Fully Re-Underwrite Repeat Borrowers

Consumers who have borrowed in the past already understand the effects of a covered longer-term loan (including a leveraged payment mechanism) on their finances. These consumers plainly do not have a lack of understanding that would support the CFPB relying on its authority to prohibit unfair or abusive acts or practices.

One of the best ways for a lender to know whether a customer has the ability to repay a loan is if a customer has *actually repaid* similar loans to the lender in the past. Customers who have paid in the past are the ones who are most likely to pay in the future, and all financial services – insurance, credit cards, auto loans, securities – depend on repeat business for profitability, because of the high costs of acquisition, underwriting, fraud and credit losses. The ability to loan to existing customers improves underwriting outcomes, and minimizes acquisition and underwriting costs, as well as fraud and credit loss.

OLA members want to decrease fees and interest rates for repeat borrowers, but will not be able to do so if they are required to re-underwrite those borrowers fully each time. Each underwriting cycle under the Proposal would impose large costs that lenders would need to recoup. Each time a lender would be required to re-underwrite a consumer that it otherwise would not re-underwrite, because the consumer is a repeat borrower, the lender would incur substantial variable costs:

- costs of paying each registered information system to obtain reports for each applicant that the lender would otherwise approve;
- obtaining additional written statements from consumers and additional verification evidence from consumers and third-party sources regarding income, expenses, and obligations;
- re-underwriting each subsequent loan by reviewing the additional information described in the prior bullet;
- data storage and transmission costs; and
- foregone revenue from losing the opportunity to make a loan to a consumer that would repay, but would not have sufficient documentation of residual income under the Proposal.

E. Alternatives to Proposal's Ability to Repay

1. An informational remedy would be more effective and less restrictive

If the CFPB is concerned about borrowers' understanding of the all-in costs of a loan or the remedies available to a lender, the solution is more and better disclosure, not a rule that in effect eliminates borrowers' ability to access the product. As President Obama has written, "giving careful consideration to benefits and costs . . . means using disclosure as a tool to inform consumers of their choices, rather than restricting those choices."[109]

The disclosure could even be dynamic, requiring consumers to fill out a form that would demonstrate how much residual income they have each month based on their projected income and expenses. Consumers could see whether they will have less residual income than they had anticipated, and if the costs of potentially incurring a residual income shortfall outweigh the benefits of additional cash to pay current obligations.

2. The CFPB should regulate the actual harm it has identified

As discussed above in section II.A.1, the only harm the CFPB has identified in connection with covered longer-term loans relates to repeated unsuccessful attempts to debit consumer accounts, and the potential consequences to consumers who may incur NSF fees or overdraft fees, or have their accounts closed. We believe these issues have been largely addressed by NACHA's revised return thresholds, including a 15 percent rate of total returns, three percent rate of administrative returns, 0.5 percent rate of unauthorized transaction returns, and prohibitions on payment splitting and re-presentment. While we dispute (1) the accuracy and relevance of the CFPB's stale data, and (2) the causal relationship between covered loans and this alleged harm, the harm could be addressed much more directly. Rather than impose underwriting requirements and mandate that lenders obtain new payment authorizations after repeated debits, the CFPB should require lenders to include in their payment notices a reminder that consumers have the ability to revoke their existing authorizations, as we discuss below in section V.B.

3. The CFPB should model the ability-to-repay test for small dollar loans after the credit card ability-to-repay standard

Any ATR requirement for covered longer-term loans should be comparable to the credit card ATR standard. Such a standard should allow lenders to rely entirely on information provided by consumers or, at their option, on information obtained from third parties, such as consumer reporting agencies. Use of the credit card ATR standard is the most appropriate model for covered small dollar loans because: (1) covered small dollar loans function as a substitute for credit cards and have similar use cases, for example, both can be used to meet emergency expenses; (2) most credit cards, like most covered small dollar loans, involve unsecured credit; and (3) covered small dollar loans and credit cards are both "open use" credit, specifically, they may be used for various purchases and purposes, unlike a mortgage, auto, or student loan, each of which is linked to the purchase of a specific good or service.

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[109] Barack Obama, *Toward a 21st-Century Regulatory System*, Wall Street J., Jan. 18, 2011.

In the credit card ability to repay provisions, credit card issuers make ATR determinations based on borrower-reported income and debts.[110] To conduct this analysis, card issuers may rely on the income and debt obligations reported by the consumer on his or her card application, which is expressly permitted under the commentary to Regulation Z.[111] Credit card issuers also may obtain information relating to obligations by reviewing the trade lines set forth on a consumer's credit report, which is permitted, but not required, under the commentary to the regulation.[112] If this analysis is sufficient for credit cards, including subprime credit cards, it also should be sufficient for covered small dollar loans. There is no rational basis for the CFPB to impose a more burdensome ATR requirement on a non-bank lender making a small dollar loan than a large bank making a subprime credit card loan.

The residual income test should be permitted, not required, just as it is in the credit card and mortgage ATR regulations. Use of a DTI or DTA ratio should be permitted as alternative methods of determining a consumer's ability to repay. Lenders should be able to consider household income for which a consumer has a reasonable expectation of access, just as credit card issuers can. And lenders making covered small dollar loans should not be required to include an income cushion in their ATR calculations because credit card issuers have no similar obligation.

4. At a minimum, the CFPB should propose a more workable residual income test

The CFPB could have followed the example provided by the VA, which has required use of a residual income test in the underwriting of VA mortgage loans.[113] The VA's residual income test provides clear, objective standards in the form of a residual income table; such standards are conspicuously absent from the CFPB's proposed residual income test. The VA's residual income table is incorporated into VA loan underwriting regulations, sets precise dollar figures for the required residual income based on variables including the loan amount, region of the country, and family size, and fits on a single page.[114]

In the discussion accompanying the QM rule, the CFPB stated that it did not know how to construct a residual income test and recognized that the VA's residual income test and table was the only example of the routine use of residual income in credit underwriting.[115] The CFPB indicated that, while it could not do so at that time, it would consider conducting a future study of residual income.[116]

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110 *See* 12 C.F.R. § 1026.51.

111 *See* 12 C.F.R. § 1026.51(a)(1)(i)-5.i and -7.

112 *See* 12 C.F.R. § 1026.51(a)(1)(i)-7.

113 38 C.F.R. § 36.4340(c)-(e).

114 38 C.F.R. § 36.4340(e).

115 78 Fed. Reg. at 6,486.

116 78 Fed. Reg. at 6,486-87.

The CFPB never undertook such a study before proposing its residual income test for covered loans. If fact, the Proposal does not even mention the VA's residual income test or residual income table.

If the CFPB opts to make a residual income test mandatory, it should follow the example of the VA and establish a clear, objective, and easy to use standard – with appropriate compliance safe harbors – so that lenders can make residual income determinations efficiently and with confidence that they are satisfying their regulatory obligations, and without the risk of having their determinations second-guessed by the CFPB's subjective, after-the-fact reassessment.

And, similar to the credit card residual income test, the small-dollar residual income test should compare any income to which the consumer has reasonable access to the consumer's debt obligations.

5. Subsequent purchasers of covered loans that do not participate in the credit decision should not be liable for an inadequate ability to repay determination

The rule should clarify that purchasers of covered loans on the secondary market that do not participate in the credit decision are not liable for an inadequate ability to repay determination. Absent such a clarification, the CFPB's rule would cast a shadow over the existing secondary market for installment loans and stifle the development of new secondary market outlets for covered loans, decreasing the availability of credit and increasing the cost of credit to consumers.

6. Lenders should be able to use modeled income

Databases of income and expense information,[117] or providers of "modeled" income and expense information, can accurately predict a given applicant's income and expenses based on job description and locale.[118] A lender could compare this information against an applicant's stated income and obligations as a "check" against fraud. Moreover these means of verification are more efficient and less susceptible to fraud.

IV. Use of All-In APR

The applicability of the Proposal for longer-term loans is based on the loan's all-in APR. Section II.B above describes why this method of regulation violates a specific statutory prohibition that Congress imposed on the CFPB. We also believe that, as a policy matter, the APR, and particularly the all-in APR which includes costs not related to the cost of credit, are inappropriate metrics to trigger the rule's coverage.

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[117] For example, TALX Corp. maintains a database of employment and income history, known as The Work Number, that can be used by verifiers.

[118] For example, Experian Information Solutions has developed income estimator models and debt-to-income models, which are validated using verified income information. TransUnion has developed similar models. Salary.com also contains income statistics for specific occupations and specific regions that can be used to compare against an applicant's stated income.

A. APR is a Flawed Metric

1. APR is not a proxy for affordability

If the CFPB is concerned about consumers, particularly LMI consumers, taking out "unaffordable" loans, then it should extend the residual income and document verification requirements to all loans, including those with an APR of 36 percent or less. Affordability is not just a function of the APR, but also depends upon the principal amount, loan term, and, ultimately, periodic payment amount.

2. APR is distorted by short maturities

An APR expresses the cost of a loan as an annualized rate, which makes it a poor barometer of affordability for a short-term loan. When interest accrues for a time period of less than one year, APRs are necessarily higher, even if the borrower pays the smaller absolute amount. In other words, the duration of a loan is a key driver of the APR calculation and makes shorter-term loans appear more costly than longer-term loans, all else being equal.

The economics of short-term, small dollar lending are not well-represented by APRs. As stated by one commentator, imposing an APR cap on a shorter term loan "makes as much sense as taking the $22 cab fare from the Los Angeles Airport to Hermosa Beach, CA (a 7 mile trip), and calling it exploitation because at that rate it would cost over $6,500 for the cab ride from Los Angeles to Montgomery, AL, when a flight runs in the $600 range."[119]

The graph below shows just how unrealistic a 36 percent all-in APR is in the small-dollar lending market. One OLA member has estimated that the current cost to originate a covered longer-term loan is $390 per loan, *before* taking into account the additional costs this Proposal would impose on lenders. For a six-month loan, the graph shows that limiting interest and fees to a 36 percent all-in APR would make it unprofitable to make any loan smaller than $2,166.67. Consumers who require smaller loans simply could not be served profitably at or below the 36 percent all-in APR level at today's cost structure. And the Proposal will substantially increase lender costs, making 36 percent all-in APR loans even less realistic for the small-dollar loan market.

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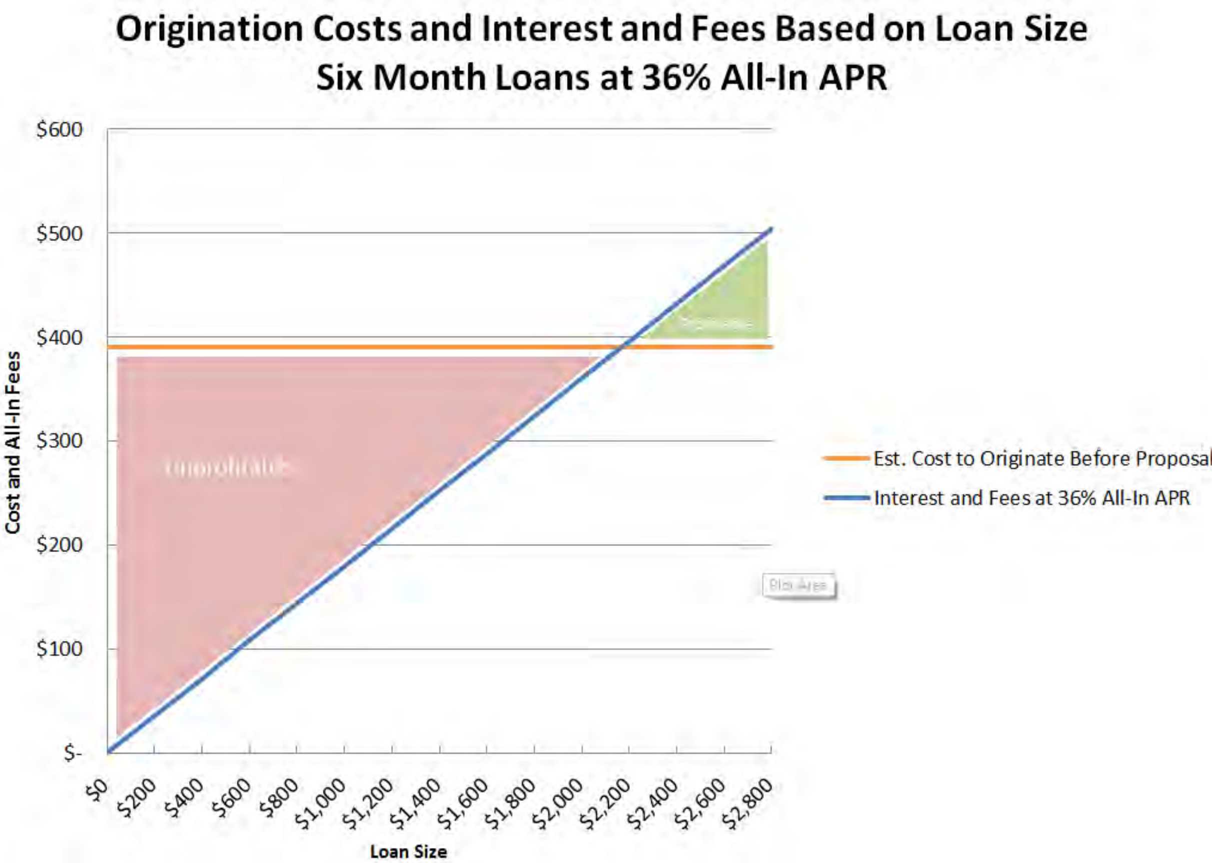
119 Prof. Daniel J. Smith, *Restrictions on Payday Lending are Unfair and Harmful to Borrowers*, Al.com (Feb. 6, 2015) (emphasis omitted).



3. APRs confuse consumers

There is strong evidence that APRs confuse consumers and, therefore, use of an APR as a trigger for coverage under the Proposal could cause consumers to choose more expensive alternatives that do not suit their needs simply because they appear to be lower cost, as the result of a lower APR. The Federal Reserve Board has found that APRs confuse consumers, and either eliminated effective APR disclosures or diminished the prominence of APR disclosures for purposes of certain Truth-in-Lending Act private student loan disclosures under Regulation Z.[120]

In its TRID-RESPA rulemaking, the CFPB found that APR was not necessarily a useful tool for consumers.[121]

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120 *See* 74 Fed. Reg. 43,428, 43,508 (Aug. 26, 2009) ("The quantitative consumer research conducted by the Board validated the results of the qualitative testing; it shows that most consumers do not understand the effective APR, and that for some consumers the effective APR is confusing and detracts from the effectiveness of other disclosures."); 74 Fed. Reg. 41,194, 41,199 (Aug. 14, 2009) ("Consumer testing of private education loan disclosures . . . confirmed that most consumers understand the interest rate and that it is one of the most important terms to them. At the same time, most consumers do not understand the APR and incorrectly believe that the APR is the interest rate.").

121 *See, e.g.*, 78 Fed. Reg. 79,730, 79,779 (Dec. 31, 2013) ("[T]he Bureau also recognizes concerns by some commenters that, even under an expanded finance charge definition, the APR is limited in its usefulness as a
(continued…)

B. "All-In" or "Military" APRs Are Doubly Flawed

The Department of Defense adopted the Military APR to regulate credit to servicemembers under the Military Lending Act. The Military APR calculation requires consideration of several types of fees not traditionally covered by state usury limits: application fees, finance charges, credit insurance premiums, and fees for non-credit products that are "ancillary" to the credit.[122]

Military APRs include fees that are unrelated to the cost of credit and result in an arbitrary and distorted measurement of the cost of credit. The use of the all-in APR can cause even a small, routine fee to result in a highly inflated figure that far exceeds an annualized 36 percent. As evidence, even payday loan alternatives encouraged and endorsed by the CFPB and consumer advocacy groups could exceed the CFPB's rate cap because of their fees:

- ***Payday Alternative Loans.*** The National Credit Union Administration encourages credit unions to offer a "Payday Alternative Loan," a low cost, small-dollar loan. Loans range from $200 to $1,000, with application fees not to exceed $20 and an interest rate not to exceed 28 percent APR. Terms range from one to six months. However, when the application fee is included in the APR calculation, many of these loans would exceed the CFPB's 36 percent rate cap. For example, a one month $500 loan with a $20 application fee and 28 percent annual interest would reach an all-in APR of more than 70 percent and a $200 loan a nearly 150 percent all-in APR. Therefore, the NCUA itself has expressed concern that the rate and fee for many PALs would be higher than a 36 percent all-in APR cap.[123]

- ***FDIC Small Dollar Lending Program.*** Under the FDIC's 2007 Affordable Small-Dollar Loan Guidelines, banks were encouraged to offer affordable small-dollar loans. The guidelines promoted loans under $2,000 with APRs no greater than 36 percent, *plus* reasonable fees. Therefore, loans made pursuant to the FDIC's guidelines could exceed the CFPB's rate cap.

C. 36 Percent is an Arbitrary Price Cap, and an Accident of History

It is arbitrary for the CFPB to conclude that an all-in APR of 36 percent or less is not unfair or abusive, but that an all-in APR of greater than 36 percent is unfair and abusive, assuming the same underwriting process in either case. Although many states and certain federal laws and

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measure of the cost of credit. For example, it is not always the case that a loan with a lower APR is the "best" loan for a consumer because consumers have different time horizons with respect to their financing decisions and because loans with different interest rate-point combinations will have different APRs.").

[122] 12 C.F.R. § 232.3(h)(1); *see also* 80 Fed. Reg. 43,560, 43,608 (July 22, 2015).

[123] NCUA, *Proposed Defense Department Lending Rule Could Affect Credit Unions, Members* (Sept. 26, 2014).

agencies use a 36 percent APR as a rate cap, this widespread reliance on the 36 percent rate is an accident of history and the result of a political compromise dating back 100 years.[124]

The National Consumer Law Center argues in a 2013 paper that the 36 percent rate cap is not an arbitrary number, yet the facts discussed in the paper provide no empirical support for the number, but show that the 36 percent rate cap represented a "political compromise" at a time when most state usury caps were around 6 percent.[125] This artificially low 6 percent usury cap kept legitimate lenders out of the consumer lending market and led to widespread loan sharking.[126] At that time, the 36 percent rate cap was viewed as a way to bypass the 6 percent usury laws and induce legitimate lenders to make small dollar consumer loans.[127]

Neither the CFPB nor any other regulator has undertaken a data-driven determination of whether any annualized rate above 36 percent constitutes an unfair or abusive act or practice under current market conditions. It is therefore striking – and arbitrary – that the CFPB, a 21st century, data-driven agency, would default to building its small dollar loan around a rate cap devised 100 years ago as a political compromise without any empirical evidence showing that today's rates in excess of 36 percent are presumptively unfair and abusive, as Congress defined those terms in 2011.

V. Leveraged Payment Mechanisms

A. Payment Authorization Does Not Expose Consumers to Additional Risk

1. Consumers are in control of their own accounts

The Proposal would subject to the residual income and document collection, verification and retention requirements any loan in excess of a 36 percent all-in APR where the lender has authority to debit the borrower's checking account for repayment. The proposal treats these ACH authorizations as equivalent to non-purchase money security interests in automobiles, but these are very different legally and functionally. For instance, unlike a secured loan, consumers may revoke ACH authorizations at any time under the CFPB's Regulation E.

The Electronic Fund Transfer Act and Regulation E prohibit lenders from conditioning an extension of credit on a consumer's agreement to authorize recurring debits.[128] That is, lenders must provide an alternate form of payment to automatic recurring debits for installment loans.

Regulation E, as well as the NACHA Rules, permit consumers to revoke authorizations, stop payments or charge back payments that they believe to be unauthorized.

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124 *See* Lauren K. Saunders, Nat'l Consumer Law Ctr., *Why 36%? The History, Use, and Purpose of the 36% Interest Rate Cap* 1-2 (Apr. 2013).

125 *Id.*

126 *Id.*

127 *Id.* at 2.

128 *See* 12 C.F.R. § 1005.10(e).

The CFPB has not presented any data demonstrating that consumers are not able to protect themselves by revoking authorization or stopping payments, or by using an alternative form of payments. Rather, the CFPB merely assets that "it is often not feasible for consumers to prevent lenders from collecting payment from their accounts once the authorizations are granted."[129] It is not clear why this is the case, because account holding institutions are required by Regulation E to stop payment on such preauthorized transfers if they receive notice from the consumer revoking authorization at least three days before the date of the scheduled transfer. If the CFPB is concerned that consumers do not understand their options, the solution is better disclosure or an educational campaign. If the CFPB believes lenders and banks are not complying with Regulation E by honoring consumer revocations – and the Bureau indicated that some bank operations staff do not believe consumers have any right to stop payment or send back unauthorized transactions or may not correctly implement consumer instructions[130] – the solution is to take action against those institutions, and not to impose heightened underwriting and paperwork requirements on lenders and borrowers.

2. Providers should not be discouraged from offering the convenience of recurring payments to consumers

Authorization of recurring payments ultimately is a convenience to the consumer and should not be discouraged. The CFPB claims that "Lenders are able to convince many consumers that advance authorizations will be more convenient,"[131] as if consumers would have no reason to choose recurring payment authorization were it not for lender persuasion. Millions of consumers, in fact, choose automatic recurring debits to pay mortgages, credit card balances, insurance premiums, gym memberships, condo fees, phone bills, and cable subscriptions, as well as covered small dollar loans. This widespread consumer use of automatic recurring debits demonstrates that consumers understand how such automated repayment features work with credit products and that the use of such a feature in connection with an extension of credit is not an unfair act or practice. Similarly, the widespread consumer use of automatic recurring debits does not square with the CFPB's insinuation that advance authorizations are not actually a convenience for consumers. Consumers want and expect the option to authorize automatic recurring payments to lenders, as they do with other financial and non-financial products.

Lenders will be less likely to offer automatic recurring payments if doing so would sweep their loans within the definition of covered longer-term loans, and subject the loans to overly burdensome underwriting requirements. The CFPB should not restrict consumers' choices or discourage financial institutions from offering payment options that consumers expect, want, and find convenient.

[129] 81 Fed. Reg. at 47,989.

[130] 81 Fed. Reg. at 48,053-54.

[131] 81 Fed. Reg. at 47,989 n.663.

3. Consumer-authorized debits do not receive preferential treatment over other debits

Contrary to the CFPB's assertion, authorization to debit a borrower's account does not provide non-bank lenders a "preferred payment position" ahead of the consumers' other obligations.[132] Non-bank lenders incur the same risk of non-payment as all other ACH debit originators. Lender ACH debits have no special account access priority over other debits, including checks and electronic presentments of checks converted by banks to ACH debits and presented against a consumer's account that day.

ACH payments are processed in batch, meaning that all ACH debits and credits received before 2:00 AM ET on the prior day are generally processed at 8:00 AM ET the next morning in the order determined by the receiving depository financial institution. Non-bank lenders cannot be sure when an account debit will be posted or when a paycheck or other credits will be directly deposited to a consumer's account. Whereas banks and credit unions take payment for their fees as soon as a direct deposit of a paycheck or other credits hit a consumer's account, non-bank lenders do not have this visibility or ability to time payments. Non-bank lenders stand in line with the consumer's other creditors and obligations, and can neither verify nor confirm the number and amount of other obligations or promises to pay to which the applicant has committed. The number of other competing payments – including utilities, prearranged bill payments, checks being presented for payment, and the depository institution itself – and the order of posting those competing payments are beyond the control of the non-bank lender.[133]

4. The CFPB overstates the rate of overdrafts caused by online lender presentments and re-presentments

The Proposal relies heavily on the CFPB's April 2016 study: Online Payday Loan Payments (the "Online Payday Report").[134] Because the Online Payday Report's underlying data is confidential supervisory information, it is exempt from the Freedom of Information Act, meaning that the public cannot fully examine the CFPB staff's conclusions. For instance, there is no way to know how many or which lenders account for the bulk of the CFPB's data. It is possible that very few lenders accounted for a large number of the presentments and re-presentments. There is no way to verify that the 332 merchants the CFPB identified as online lenders are actually unique online lenders, or the same lender operating under different DBAs. And, given the fairly high turnover of Internet merchants, there is no way of knowing if individual companies or families of companies contributing to the high rates of re-presentments are even still operating.

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[132] 81 Fed. Reg. at 47,912.

[133] *See* Nat'l Consumer Law Ctr., *Consumer Banking and Payments Law*, at § 2.6.3.9 (5th ed. 2013) (discussing bank policies with respect to ordering of transactions, state law considerations, banking agency guidance, and related class action litigation).

[134] CFPB, Online Payday Loan Payments (Apr. 2016).

The Online Payday Report is based on consumer checking account data from 2011 to 2012. This period predates new requirements, practices, and developments that have dramatically decreased rates of failed presentments:

- ***NACHA's total return thresholds.*** In September 2015, NACHA implemented new rules providing for a 15 percent total return rate and a three percent rate of administrative returns to remain a participant in the ACH payments system. Return rates exceeding these thresholds trigger an eight-step investigation of the originating bank's ACH activity. NACHA has also reduced the limit on returns for unauthorized transactions from one percent to 0.5 percent to remain a participant in the ACH payments system. Unauthorized return rates exceeding this threshold trigger a risk investigation or enforcement proceeding. In practice, originating banks rarely initiate transactions for non-compliant originators exceeding these thresholds.[135]

- ***NACHA prohibitions on payment splitting and re-presentment.*** In September 2015, NACHA also implemented new rules that require Reinitiated Entries contain the same amount as the Returned Entry and that specifically prohibit Reinitiated Entries from including an amount greater than the previously Returned Entry or an amount(s) less than the original Entry.[136] These provisions prohibit payment splitting for returned items. The new rules also prohibit an Originator or ODFI from submitting a Reinitiated Entry that has been returned for insufficient or uncollected funds more than two times following the return of the Original Entry.[137]

- ***OLA Best Practices prohibiting payment splitting.*** OLA best practices prohibit members from processing multiple ACH debit attempts to an individual loan on the same effective date.[138]

- ***NACHA rules requiring NSF fee be a separate entry.*** Since January 2015, NACHA rules have required NSF fees to be separately batched from the re-presented payments – i.e., an NSF fee must be presented as a separate debit entry.[139]

- ***FTC actions against Western Sky and AMG.*** In September 2011 and April 2012, the FTC took actions against Western Sky Financial, LLC and AMG Services, respectively, companies that were among the largest online lenders (although not OLA members). These enforcement actions effectively changed business practices for many lenders with

135 NACHA Operating Rules §§ 2.17.2.2-2.6, 8.112, and 8.113. For a summary of these rule changes, please see NACHA's website explaining the rule changes, NACHA, *ACH Network Risk and Enforcement Topics*, https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics (last visited Oct. 5, 2016).

136 NACHA Operating Rules §§ 2.12.4.2 and 2.12.4.3.

137 NACHA Operating Rules § 2.12.4.1.

138 *See* Online Lenders Alliance, *Best Practices*, at 20 (Apr. 2016).

139 NACHA Operating Rules § 2.14.3 (requiring that Originators submit Return Fee Entries "as a separate batch that contains the words 'RETURN FEE' in the Company Entry Description field of the Company/Batch Header Record").

respect to payments. In addition, Western Sky and AMG do not appear to be operating any longer, and due to their former size, may account for a significant portion of the failed payments in the CFPB's data set.

- ***Increased scrutiny on returns caused by Operation Chokepoint.*** Beginning in 2013, the United States Department of Justice sent subpoenas to financial institutions that processed transactions for merchants with high payment return rates. In response, financial institutions have refused to process transactions for originators with high return rates, and online lenders have significantly improved their return rates to ensure they still have access to the payments system.

The changes discussed above make the CFPB's reliance on data from 2011 and 2012 suspect. Relying on obsolete data that does not reflect current practices as the basis for a rule is bad public policy. The CFPB should instead obtain and evaluate data from post-September 2015 so that it constructs its rule on the basis of relevant and current data, rather than on obsolete data that OLA believes provides a distorted picture of lender practices.

The CFPB also misinterprets the data to overstate re-presentments and NSF fees. The CFPB's data show that 25 percent of payment attempts the Online Payday Report classifies as re-presentments happened 14-15 days following a prior failed payment.[140] It is misleading to claim with respect to these payment attempts that these lenders "follow up [a failed payment attempt] by making repeated attempts to extract payments from the account."[141] These 14-15 day waiting periods should not be treated as re-presentments – such presentments are either requests for the next payment in an installment loan, or good faith efforts by lenders to access funds once the consumer has received another paycheck. Although some lenders re-presented payments mid-cycle in the sample (about 75 percent of second payment attempts were made within 5-6 days of the first failed payment attempt), the CFPB's conclusions substantially overstate this phenomenon.

It is also misleading for the CFPB to focus on the "average" (i.e., the mean) dollar amount of NSFs that consumers paid over the sample period. Means are skewed by outliers, and the CFPB's data clearly has a significant concentration of outliers with 10+ overdrafts and NSFs.[142] The Online Payday Report does not tell us what the *typical* borrower of online loans paid (the median).

In fact, the CFPB's data shows a very low overall rate of failed payments:

- The CFPB's data on the re-presentment of failed payments is based only on the six percent of payments that fail. Thus, when the CFPB claims that half of failed payments are re-presented – it amounts only to three percent of total initial payment attempts.

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140 CFPB, Online Payday Loan Payments at 17, Figure 3.

141 Richard Cordray, CFPB, *Prepared Remarks of CFPB Director Richard Cordray on Payday Lending Research Report Press Call* 2 (Apr. 20, 2016) [hereinafter "Cordray Speech"].

142 CFPB, Online Payday Loan Payments at 11, Figure 1.

- Even of the six percent of initial presentments that result in an NSF, a significant portion could be borrowers who never intended to repay their debts. Where these failed payments are re-presented, or the lender presents a new payment request on the next scheduled payment date, the payments will return, because the account is still empty. The Online Payday Report does not take into account the possibility that some re-presentment activity relates to fraudulent applications and never-pays.

The CFPB also provided no data on the presentment, re-presentment, NSF, or overdraft rates of other merchants, storefront lenders, bank lenders, or debt collectors to the same borrowers. The public therefore cannot tell whether online lenders' rates in these categories are higher than, lower than, or comparable to the norm.

Moreover, the CFPB has not established that the use of online loans leads to higher rates of account closures when compared to similarly situated consumers that do not take out online loans. The rate the CFPB presents for bank-ordered account closures for all bank customers of all income levels (three percent) is not comparable to the presumably higher closure rate for LMI customers. As Pew Charitable Trusts has recognized, a debit from an online lender will fail for the same reason the bank will close the account: the accountholder does not have sufficient funds.[143] Thus, we believe it is more likely that small dollar borrowing *reduces* overdraft events by providing low-income consumers with the means to pay other obligations and maintain cash in their deposit accounts to avoid overdrafts. The CFPB's data does not show anything to the contrary.

5. Timing of payments protects consumers

According to the CFPB, "the lender's ability to pull payments from the consumer's account gives the lender the ability to time and initiate payments to coincide with expected income flows into the consumer's account."[144]

However, there is nothing improper about seeking payment from a consumer when the consumer gets paid. In fact, timing payment attempts in this manner is beneficial to consumers living paycheck-to-paycheck. Lenders frequently ask borrowers when they expect to get paid, and allow borrowers to designate payment due dates. Lenders frequently attempt to time payment due dates or dates for automatic debit to coincide with inflows to the borrower's deposit account. Not only does this help to ensure that the lender gets paid as expected, but it helps the borrower to have his or her account debited when funds become available, rather than at some other point when the availability of funds may be less certain.

This assumption also reveals a basic inconsistency in the premise of the Proposal: the CFPB criticizes lenders for initiating payments when the consumer *has* money in his or her account,

[143] *See* Pew Charitable Trusts, *Overdraft Frequency and Payday Borrowing*, at 3 (Feb. 2015) (stating that a higher usage of "payday" loans among high-frequency overdrafters "cannot conclude whether payday borrowing causes overdrafts or vice versa, but it is clear that the same consumers are using the two products").

[144] 81 Fed. Reg. at 47,915.

and also criticizes lenders for initiating payments when the consumer does *not* have money in his or her account.

6. New NACHA rules change the payments landscape

The new NACHA rules, effective September 2015,[145] substantially address the CFPB's consumer protection concerns. The NACHA rules provide for a 15 percent total return rate and a three percent rate of administrative returns to remain a participant in the ACH payments system. Return rates exceeding these thresholds trigger an eight-step investigation of the originating bank's ACH activity. We believe that, in practice, originating banks no longer initiate transactions for non-compliant originators exceeding these thresholds.

NACHA has also reduced the limit on returns for unauthorized transactions from one percent to 0.5 percent to remain a participant in the ACH payments system. Unauthorized return rates exceeding this threshold trigger a risk investigation or enforcement proceeding.

These rules have had a direct and dramatic effect on the behavior of non-bank lenders seeking to collect payments from consumers' accounts. Lenders have been incentivized to apply even more sophisticated underwriting criteria to ensure they fall below these new total return rate thresholds, and to monitor and manage their returns much more effectively, including by taking measures to ensure that consumers have sufficient funds and by limiting re-presentment after failed payment attempts.

B. The Proposal's Requirements to Re-obtain Authorization for Payments Will Frustrate Consumers' Reasonable Expectations

Consumers expect that when they authorize recurring debits from their accounts, their authorizations are valid and will not be dishonored by lenders. We know of no other financial or non-financial product that is subject a regulatory requirement to re-obtain payment authorization after a particular number of failed attempts. Borrowers are not likely to understand or appreciate the inconvenience of having to do so only for covered longer-term loans.

Moreover, unexpected and unilateral revocations of borrowers' payment authorizations would exacerbate the very harms the Proposal seeks to alleviate. A lender may not able to obtain payment reauthorization from a borrower in a timely manner for a number of reasons: a borrower may not understand or respond to the request, given her prior authorization; a borrower may not notice the request; or a borrower may not be able to find an alternative payment arrangement in time for the next payment. As a result, even though the borrower wanted to make the next payment through her prior authorization, the Proposal would override the borrower's choice of payment and amplify the very harms the CFPB is hoping to mitigate through the Proposal. By automatically revoking borrowers' payment authorizations, a borrower may default or become delinquent on the loan, incur additional interest and penalties, and have negative information reported to a registered information system, consequences that could have

[145] NACHA has established a website explaining the rule changes, located at https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics.

been avoided or deferred if the lender were able to attempt to collect the next payment. The CFPB should not adopt a requirement revoking payment authorizations against the borrower's will because such a requirement would cause defaults and delinquencies and exacerbate other harms the Proposal seeks to mitigate.

Instead of the Proposal's unprecedented requirement for *lenders* to revoke consumers' valid payment authorizations, the CFPB should require payment notices to contain a reminder that *consumers* have the right to revoke their authorizations under Regulation E. The CFPB could even require the payment notice to include a simple hyperlink for borrowers to use to revoke payment authorization. Such a disclosure would allow consumers, not lenders, to control the exercise of their rights.

C. The CFPB's Definition of "Leverage Payment Mechanism" Will Sweep Too Broadly

The CFPB acknowledges that its definition of covered longer-term loans will cover some installment loans "that are made on the basis of an assessment of the consumer's ability to repay, and where, for example, the lender obtains repayment from the borrower's account as a convenience to the borrower not as an alternative to careful underwriting."[146]

It is not at all clear how the CFPB distinguishes covered longer-term loans where the lender does consider a consumer's ability to repay from loans where the lender follows the so-called "ability to collect" model, and where use of a leveraged borrowing mechanism is an excuse for failing to consider ability to repay, rather than a convenience to the borrower. In fact, we consider it inappropriate for the Bureau to make such sweeping assertions about the motivations and practices of different types of creditors that make the same types of loans using the same leveraged payment mechanisms.

In a footnote, the CFPB acknowledges that some loans made by community banks, credit unions, and traditional finance companies would be covered by the Proposal, but the CFPB believes that "the rule would have a minimal effect on such lenders because they already engage in substantial underwriting."[147]

Further, it simply cannot be true that the Proposal would have a "minimal effect" on lenders that "already engage in substantial underwriting," because "substantial underwriting" – whatever that term means – is not sufficient to satisfy the rule. To avoid engaging in unfair or abusive acts or practices, lenders must scrupulously follow the CFPB's residual income-based ability to repay test – a ***particular form*** of underwriting – and all of the ancillary requirements associated with that test; engaging in "substantial underwriting" in any other manner would constitute an unfair or abusive practice under the Proposal. Whatever "substantial underwriting" community banks, credit unions, and other lenders undertake today, it would be purely coincidental if that

[146] 81 Fed. Reg. at 47,987.

[147] 81 Fed. Reg. at 47,987 n.655.

underwriting were anything like the residual income-based ability-to-repay requirements set forth in the Proposal.

Certain commentary provisions also are inconsistent with the definition of "leveraged payment mechanism." The definition of "leveraged payment mechanism" covers situations where the lender: (i) has the right to initiate a transfer from a consumer's account; (ii) has the contractual right to obtain payment directly from the consumer's employer or other source of income; or (iii) requires the consumer to repay the loan through a payroll deduction or deduction from another source of income. The accompanying proposed comment 1041.3(c)(1)-1 states that a leveraged payment mechanism depends on a lender's ability to initiate a transfer of money "without the consumer taking further action."[148] The proposed comment then contradicts the earlier statement by providing that a "push" transaction from the consumer to the lender could be a leveraged payment mechanism if "the consumer is contractually obligated to initiate the transaction."[149]

A consumer, however, is always contractually obligated to make payments to repay a loan, so simply being contractually obligated to initiate a transaction to pay an outstanding loan should not constitute a leveraged payment mechanism. There is also no legal prohibition on contractually requiring consumers to pay electronically; the sole prohibition is against conditioning an extension of credit on the consumer's repayment by preauthorized electronic fund transfers. For consistency with the proposed rule text, the CFPB should revise proposed comment 1041.3(c)(1)-1 to eliminate reference to consumer-initiated transactions as potentially constituting a leveraged payment mechanism.

Proposed comment 1041.3(c)(1)-2.i. gives as an example of a lender-initiated transfer the circumstance where a lender or service provider "obtains a check, draft, or similar paper instrument written by the consumer."[150] This commentary provision is overbroad because it would cover any covered loan transaction where a consumer pays by check. Payment by check is the opposite of a "leveraged payment mechanism" and does not meet any of the prerequisites for a "leveraged payment mechanism" under proposed section 1041.3(c)(1)-(3). The CFPB should revise proposed comment 1041.3(c)(1)-2 by eliminating the check example in paragraph i., or, alternatively, by revising the example so that it addresses post-dated checks given to a lender or service provider as security for future repayment.

D. The CFPB's Definition of "Leveraged Payment Mechanism" Is Vague

A purchase money security interest loan is not exempted from the definition of "covered loan" if "the item that is purchased with the credit is not a good or if the amount financed is greater than the cost of acquiring the good."[151] The Proposal does not specify whether a service contract is a "good." This standard also leaves unanswered the treatment of negative equity loans, ancillary products, and services that are not ancillary such as a service contract for a vehicle.

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148 81 Fed. Reg. at 48,191.

149 81 Fed. Reg. at 48,191.

150 81 Fed. Reg. at 48,192.

151 81 Fed. Reg. at 48,192.

VI. Information Collection and Verification

A. The Proposal's Verification Standards Are Not Necessary to Establish Ability to Repay

The rule should require validation of the consumer's written statement, not verification of data. For example, a lender should determine whether the written statement is reasonable and plausible, but should not be required to collect voluminous verifying information. Moreover, lender obligations related to borrower information should be based on the risk that the borrower presents. For example, absent some indication that a consumer may be submitting false income or expense information – such as facially inconsistent application information – lenders should not be required to verify income and expense information.

The Proposal would allow a lender to project a higher amount of income or a lower amount of expenses only if the lender obtains from the payor of the income or the payee of the obligation a written statement of the amount and timing of the "new or changed net income or payment."[152] It is not clear why this option is limited to "new or changed" circumstances. The Proposal provides no flexibility in cases where information on a written statement cannot be verified. As discussed in Sections VI.C.-E. below, lenders will not have the ability to verify income in many cases.

OLA also does not understand why a lender needs to obtain a detailed written statement *and* verify the information in that statement. Only one of these activities should suffice to make an ATR determination.

Finally, the Bureau asserts, without evidence, that applicants for covered loans will overstate their income and therefore that income verification is necessary.[153] The Bureau makes no similar assumption when it permits credit card issuers to rely on the stated income of applicants for credit cards. We find no rationale for this disparity in treatment, unless the CFPB believes LMI borrowers who use covered small dollar loans may be less honest than more affluent borrowers who seek credit cards. We hope this is not the case, as it would be inappropriate and elitist for the CFPB to assume that working class borrowers struggling to make ends meet have less integrity and are more prone to lying than more affluent borrowers.

The Bureau does not, however, assert that applicants for covered loans will understate their expenses. As a result, the CFPB has not established any reasons why lenders cannot rely on self-reported expenses that appear to be reasonable.

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[152] 81 Fed. Reg. at 48,172.

[153] 81 Fed. Reg. at 48,017 ("When there is no verification evidence for a consumer's net income, the Bureau believes the risk is too great that projections of net income would be overstated and that payments under a covered longer-term loan consequently would exceed the consumer's ability to repay.").

B. The Proposal's Verification Standards Also Are Not Sufficient to Establish Ability to Repay

The CFPB appears to believe that applicants for covered longer-term loans are in desperate circumstances and therefore willing to lie to obtain credit, and therefore requiring such borrowers to provide verification evidence of income will offset this tendency to overstate income. Setting aside the offensiveness of this assumption, as discussed above, it is also well-recognized that documentation of income (pay stubs) and obligations (bank statements) is highly susceptible to fraud. For those consumers who are intent on defrauding lenders, pay stubs and bank statements are easily doctored or fabricated.[154]

C. Income Verification Penalizes Certain Workers

Some borrowers work cash-only jobs where no pay stub is readily accessible, receive a portion of their income in cash, such as service industry tips, or freelance, seasonal, or hourly jobs where pay stubs may not be representative of their short-term future earnings. Other borrowers – such as an individual living with a family member – may be unable to document expenses.

These borrowers may be creditworthy but cannot document their ability to repay under the standards contained in the Proposal. The CFPB's requirements will have the effect of shutting these creditworthy borrowers out of the system. This issue also has been raised with respect to the ATR requirements for mortgages, and in testimony, Director Cordray said that the CFPB intends to revisit the income-verification standards under the QM ATR rule. According to Director Cordray, the CFPB is "increasingly aware of and concerned about" the possibility that self-employed, temporary and seasonal workers may see limited mortgage credit due to documentation requirements. "It's not an easy thing to figure out how to handle, but it's something we need to go back and think more about."[155] Even in the existing QM rule, however, lenders are permitted to make an allowance for seasonal employment.[156] The Proposal contains no allowance for such circumstances.

D. Effective Income Verification Is Not Possible in Some States

Many states – Alabama, Arkansas, Florida, Louisiana, Mississippi, Nebraska, Ohio, South Dakota, and Tennessee – do not require employers to give statements of wages or earnings to employees. Other states require that a statement contain deductions to the employee's wages or earnings, but they do not require that employers state the actual wages or earnings on the statement. Still other states, such as Georgia and Ohio, require employers to give paystubs only in certain circumstances. Consumers in these states have no way to compel their employers to produce a pay stub.

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[154] *See* PayStubb.com, *Create Pay Stubs in Seconds* (2016), http://www.paystubb.com/ and numerous similar websites.

[155] *The Consumer Financial Protection Bureau's Semi-Annual Report to Congress: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 114th Cong. (July 15, 2015) (testimony of Richard Cordray, Director, Consumer Financial Protection Bureau).

[156] 12 C.F.R. Part 1026 Appendix Q.

The CFPB's mortgage ATR rule accommodates these consumers by permitting lenders to rely on W-2s, check cashing service receipts, or funds transfer service receipts.[157] We see no reason why small dollar lenders should not be able to rely on other forms of income verification as well.

E. Income Verification Can Omit Important Information

Many consumers have payment arrangements set up with their employers to pay bills automatically from their paycheck. Many states require such arrangements for the payment of child support. These arrangements are also an option for auto loans and other financial obligations. However, bank account statements only show the net amount that a consumer receives in deposit, not amounts that may have been deducted prior to the deposit. Yet, lenders would seemingly have to assume the child support has to be paid with what is deposited, leading to an incorrect double-deduction from residual income.

F. Document Collection and Verification Requirements Will Reduce Competition

Online lenders will need to invest in new systems to collect, verify and retain documents, assuming that it is even possible to collect and verify paper documentation in an online environment. In addition to these fixed costs, lenders will incur higher incremental costs for the labor and credit reporting involved.

In 2010, the State of Washington amended its Check Cashers and Sellers statute.[158] Changes included a paystub/income verification requirement and a 30 percent Gross Monthly Income requirement. The chart below shows a substantial decrease in the number of licensed payday lender locations (71 percent) and the number of loans made (73 percent) in the State of Washington since 2009:[159]

	2006	2007	2008	2009	2010	2011	2012	2013
Companies	130	138	133	109	85	68	52	46
Branches	612	591	584	494	339	188	151	128
Total Locations	742	729	717	603	424	256	203	174
Loans Made (000's)	3504	3266	3197	3244	1094	856	910	872

The Proposal would have an even more dramatic effect on the market. Lenders who survive the

157 12 C.F.R. § 1026.43(c)(4).

158 Wash. Rev. Code §§ 31.45.010 *et seq*.

159 Chart constructed with data from Washington State Department of Financial Institutions, 2013 Payday Lending Report (Aug. 11, 2014).

CFPB's rule are likely to raise prices, both to take advantage of their larger market share and to recoup the foregone revenue and increased expenses associated with complying with the rule. Ultimately, consumers will be harmed.

G. Collection and Verification of Documents Disadvantages Small Lenders

Developing the policies, procedures, systems, employees, call centers and other facilities for collecting and verifying documentation relating to income, major obligations, and borrowing history imposes a disproportionate burden on small businesses, putting those businesses at a competitive disadvantage.

Large businesses will have the capital and customer base to make the needed upfront investment in the systems and facilities. In addition, larger businesses will be able to spread the cost of compliance over a larger number of loans, for a lower per unit cost. Small lenders, unlike their large competitors, will not achieve the volume to offset their high fixed costs, nor the economies of scale to offset their high incremental costs of compliance.

H. Document Verification Disadvantages Online Lenders

Documents submitted by fax, mobile image capture or scanned and emailed are frequently not legible or easily interpreted. Moreover, mobile image capture does not work for pay stubs and other irregular documents. In order for a digital image capture to be effective, the documents being captured must be in a standard format for companies to process the image automatically and correctly. That is, the software can read the appropriate information in order to process the information only when the information is in the same format and in the same location – for every single document. This works with checks deposited to bank accounts because the information read by the software is (1) all numerical and (2) located in the same location on the check. By contrast, pay stubs and other documents the CFPB would require lenders to collect are not standardized. Even if customers could submit these documents electronically via a mobile app, lenders would still need to manually process and verify the documents on the back end.

I. Verification Will Frustrate Consumers and Drive Consumers to Inferior Alternatives

Consumers in the online credit market value speed and convenience,[160] and the CFPB's proposed requirements will frustrate consumers' expectations.

The time required to obtain and verify detailed documentation regarding income and obligations will drive consumers to inferior alternatives, such as overdraft protection, unregulated lenders or nonpayment of utilities, resulting in reconnection fees.

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[160] FDIC, National Survey of Unbanked and Underbanked Households, at 41 (Dec. 2009); Texas Appleseed, Short-Term Cash, Long-Term Debt: The Impact of Unregulated Lending in Texas - A Survey of Payday Borrowers, at 9 (Apr. 2009); Alan Kline, *Five Reasons You Can't Ignore the Neobanks,* Am. Banker (Apr. 27, 2015); Pew Charitable Trusts, *How Borrowers Choose and Repay Payday Loans*, at 42 (Feb. 2013).

J. The Proposal Raises Significant Data Privacy and Security Concerns

The Proposal would require lenders to collect information about consumers' income, assets, debts, and borrowing history, and to keep such information for 36 months after the last entry on the loan. The Proposal is inconsistent with FTC data security guidance and rules, such as the FTC's Safeguards Rule and data minimization best practices, which dictate that companies should collect the minimum amount of information necessary, and keep that information for as little time as possible.

Moreover, the CFPB encourages consumers to transmit sensitive documents by taking photos with their smartphones, which is not a secure transmission method. Photos and documents sent via email are not encrypted and can be intercepted by third parties – at any point during their transmission.[161]

The CFPB proposal would replace a system that is secure for both consumers and lenders and replace it with an antediluvian system of paper-based or insecure electronic document and collection and verification techniques that presents heightened security risks to both parties, an anachronistic approach that flies in the face of current government and industry efforts to enhance data security and privacy in the modern digital world.

Today, our members' customers typically enter information on a web app that is secured by https and obfuscated so that when customers type in information, the characters are immediately hidden. Information transmitted through the app is encrypted, unlike when a customer emails documentation. Lenders can proactively monitor and scan their websites and systems for data breaches by utilizing multiple separate independent vendors at various security layers. Each vendor performs a set of comprehensive application and network penetration tests or assessments based on regulatory standards and best practices. Lenders' websites can be protected by a zone-based architecture with layered security components including routers, firewalls, network intrusion detection systems and host intrusion detection systems. Lenders also employ web application code scanning to detect any security defects before any application is released into production.

Under the Proposal, instead of just entering information into a web app, lenders would be required to collect documents, not digits, from customers. Lenders have well established practices for securely collecting information from customers that they enter in a web app, but the same level of security for collecting documents transmitted via the Internet does not exist. The consequences of adopting a system to borrowers and lenders could be significant, including putting borrowers at increased risk of identity theft and exposing lenders to increased risk of data breaches and fraud.

[161] 81 Fed. Reg. at 47,955.

VII. Loan Limits (Restrictions on Reuse and Reborrowing)

A. Refinancing of a Credit Product is Not Abusive or Unfair

The CFPB has failed to show that refinancing of a covered longer-term loan is an abusive or unfair practice.

First, consumers who have borrowed in the past already understand the effects of a covered longer-term loan (including a leveraged payment mechanism) on their finances. These consumers, having used the product, plainly understand how the product works and what it requires of them. It is not unfair or abusive to make loans to consumers who have experience using the product and know how it works. Thus, loan limits should not apply to these consumers.

Second, reborrowing rates on covered longer-term loans are not particularly high compared to comparable products. The CFPB noted that in a study of high-cost unsecured installment loans, it found that 37 percent of these loans are refinanced.[162] A 37 percent rate of reborrowing is not an unfair or abusive practice, but is actually quite consistent with reborrowing rates for traditional credit products. In credit cards, for example, a revolver who carries a balance from month to month is, in effect, reborrowing each month. Credit card revolvers comprise approximately 42.3 percent of all credit card users according to an American Bankers Association study.[163] If it is not unfair or abusive for credit card issuers to allow 42.3 percent of consumers to reborrow through the revolving nature of open-end credit cards, then it is arbitrary and capricious to treat the 37 percent rate of reborrowing for unsecured installment loans as an unfair or abusive act or practice.

Third, repeated borrowing cannot be unfair or abusive in light of the fact that consumers can use credit cards to accomplish the same thing. The CFPB proposes to restrict, as an unfair or abusive act or practice, the number of times a consumer can take out covered longer-term loan alternatives during a 12-month period. Credit cards, however, permit consumers to reuse their credit cards to make additional purchases, without set limitations on the number of transactions, even if the consumer is carrying a revolving balance and even if the consumer only makes the minimum monthly payments due. It is difficult to see how reuse of a credit product can be unfair or abusive in the case of unsecured installment loans, but be perfectly legal – and an integral feature of the product – in the case of credit cards.

Fourth, the proposed limits on reborrowing for covered longer-term loans bears no relation to the harm or injury identified by the CFPB, specifically the potential for the consumer to incur overdraft or NSF fees based on use of a leveraged payment mechanism. The injury or harm resulting from overdraft or NSF fees results from the consumer not having sufficient funds in his or her account to repay an outstanding loan when due; it has no connection with reborrowing.

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[162] 81 Fed. Reg. at 47,887.

[163] *See* American Bankers Association Report: Consumers Opening More Credit Card Accounts as Market Grows (Sept. 9, 2015).

The CFPB has not established that reborrowing poses a greater risk of a consumer incurring overdraft or NSF fees compared to a consumer who does not reborrow. As a result, the Bureau lacks the authority to adopt limits on reborrowing because such limits have no connection to the injury or harm the Bureau has identified.

Fifth, the CFPB's concerns regarding reborrowing for covered longer-term loans focus primarily on loans with balloon payments,[164] so any such restrictions should be limited to balloon payment loans.

B. Loan Limits Do Not Protect Consumers

Limiting the ability of lenders to lend to repeat customers does not help consumers – it just increases loan acquisition and origination costs and makes it more difficult for lenders to predict ability to repay. Moreover, if the CFPB's proposed ATR requirement performs as intended, then limits on reborrowing or prohibitions on having multiple loans outstanding would be unnecessary and superfluous.

Customers who have paid in the past are the ones who are most likely to pay in the future, and all financial service providers depend on repeat business for profitability, because of the high costs of acquisition, underwriting, fraud and credit losses. The ability to lend to existing customers improves underwriting outcomes, and minimizes acquisition and underwriting costs, as well as fraud and credit loss. Conversely, an inability to lend to existing customers requires lenders to incur increased acquisition costs. Increased acquisition costs are more easily borne by larger companies, and thus the loan limits would disadvantage smaller lenders and startups.

By imposing loan limits, the Proposal will also make it much more difficult for borrowers to improve their credit, and thereby get access to lower cost credit. The best way for consumers to establish a positive credit history is to allow them to make consistent, successful loan repayments.

Imposing loan limits actually penalizes consumers for repaying their debts, which creates perverse incentives for a consumer protection rule. If consumers are only permitted to borrow a certain number of times per year, or are subject to cooling off periods, they will quickly adapt to those limits and end up borrowing more money than they need for a longer period of time, and carrying more debt and for a longer period than they would in the absence of loan limits. In addition, consumers may not pay back their loans as quickly as possible, because they will not be rewarded for early repayment, but will continue to be barred from reborrowing.

The complexity and inflexibility of the Proposal's loan limits will likely frustrate consumers, who may find that government-mandated waiting periods for small loans are an unnecessary and intrusive burden, especially when other financial products they use, including credit cards, student loans and overdrafts, do not include such restrictions. Consumers have developed relationships with trusted lenders. The Proposal would limit consumers' ability to borrow from those lenders and force them to search for inferior alternatives.

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[164] 81 Fed. Reg. at 47,987.

C. Loan Limits Should Be More Flexible

We support the CFPB's "off-ramp" proposals in principle, and believe a simplified off-ramp would be more effective than blunt loan limits. If the CFPB is concerned about borrowers continually rolling over their loans, the rule could require the consumer to pay down a specified percentage (e.g., 25 percent) of principal before reborrowing.[165] Such a rule would be at least as effective as a flat restriction on reborrowing in a sequence without causing major disruptions for consumers and lenders.

However, assuming that the CFPB's eventual rule includes some form of loan limits, it is important that these limits be flexible. If a consumer obtains a loan and pays it back in full without a refinancing, rollover, or taking out another loan, the consumer should be free to obtain another loan. Consumers should not be locked out of the market for short-term credit because unexpected events arise that create another need for emergency borrowing. Consumers cannot predict when they will need to borrow money short-term – there is no playbook for financial emergencies or a set timetable for when those events will occur. There is no justification for a rule that precludes a consumer who receives an unexpected $200 medical bill from borrowing to meet that expense simply because she successfully borrowed and repaid another loan 25 days earlier.

The Proposal also might allow for a borrower to demonstrate that the intended use of the loan proceeds meets a need that outweighs the cost of the loan. That is, if a borrower has had three loans and is in the proposed 30-day mandatory waiting period, the borrower should be able to present his or her case that the need for credit is justified because the benefits resulting from the loan outweighs the cost of the loan. For example, if the consumer must pay for a car repair that is critical for the consumer's ability to get to work and earn a living, then denying that consumer access to credit for that purpose would create much greater financial harm than the cost of the additional loan.

In addition, the proposed exception to the loan limits for a change in a consumer's financial circumstances will have little utility in the real world. If the consumer's financial situation improves, it is less likely he or she would need a second or third loan.

D. The CFPB's Presumptions Are Inappropriate

The presumption of inability to repay would apply if the consumer has expressed within the past 30 days an inability to make one or more payments. However, these are the consumers who need credit the most. Consumers go to lenders when they are in distress and need money. To exclude these consumers from the market defeats the purpose of extending credit. These are the consumers most in need of service, and should not be shut out of the market.

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[165] In the Proposal, the CFPB seeks comment on the advisability of imposing a presumption of unaffordability when a lender refinances an outstanding loan on which the consumer has repaid less than 75 percent of the loan. 81 Fed. Reg. at 48,026. We believe that such a limitation would be tantamount to a prohibition on refinancing, which is not supported by the CFPB's authority to prohibit unfair or abusive acts or practices, and would be "arbitrary and capricious."

In addition, it is entirely unclear how a lender is to conclude that a consumer has expressed an inability to make one or more payments. In many cases, it will be a judgment call, which exposes lenders to significant enforcement risk.

VIII. Covered Loan Alternatives

The Proposal's product alternatives to an ability-to-repay determination for covered longer-term loans are not viable or realistic options for lenders. Therefore, these alternatives are little more than window dressing to which the CFPB can point to claim that it is not creating a mandatory ATR requirement.

A. NCUA Payday Alternative Loans

Loans under the PAL program have proven to be unprofitable, even though credit unions have access to low cost NCUA-insured and FDIC-insured deposit funding, as well as direct access to share and deposit accounts, which can be debited for repayment. (Moreover, credit unions enjoy a valuable tax advantage.[166]) The National Association of Federal Credit Unions has stated that PALs are "loss-leaders in credit unions and are offered strictly for the benefit of their members who are in need of short-term small-dollar alternatives to payday lenders."[167]

If credit unions cannot make these loans profitably, non-bank lenders that have no insured deposit funding, direct access to consumers' accounts, or tax-exempt status cannot possibly do so.

B. Five Percent Default Rate Loans

A five percent default rate is an unrealistically low maximum default rate for this market. The CFPB knows through its own data that even the most conservative lenders of covered longer-term loans cannot consistently achieve such a low default rate. Lending to LMI borrowers, especially on an unsecured basis, involves substantial credit risk, and this alternative presumes that this is not so. As a result, this alternative is not a feasible option for any lender.

In addition, the Proposal's origination fee refund provision is unprecedented and excessive. Lenders making loans with the refund feature will not be able to attract any funding, since no lender in this market can accurately predict its default rate from year to year. No one would invest in or lend to a company that has such a massive contingent liability that could be realized based on factors outside its control. In a downturn, for example, default rates will rise, whether or not a lender makes a sufficient ATR determination when underwriting the loan. In addition, the remedy of mailing refund checks to consumers is also problematic because many consumers who had loans during the calendar year comprising the refund period may have moved – and the population served by lenders exhibits a high degree of transience – and may be difficult to locate.

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[166] Kenneth J. Kies and Bert Ely, *Tax Exemption for Credit Unions: An Unjustifiable $10 Billion Tax Expenditure* (Sept. 2013) (discussing credit unions' exemption from federal income tax).

[167] Nat'l Ass'n of Fed. Credit Unions, *Comment Letter to Department of Defense Proposed Rule on Limitations on Terms of Consumer Credit Extended to Service Members and Dependents* 3 (Dec. 23, 2014).

These loans could only be made viable if the CFPB made two changes to their structure:

1. If the CFPB adopts any maximum default rate in its final rule, the rate should be at least 20 percent, and should be indexed to account for changes in macroeconomic conditions.

2. Rather than a refund provision, enforcement of the rule should be subject to CFPB authority to prevent unfair or abusive acts or practices. The Bureau's existing authority gives it the flexibility to address violations based on the particular facts and circumstances presented. Using this discretionary authority, the CFPB could determine whether a lender whose default rates exceed the maximum rate for a given year actually loaned to borrowers who, at origination, did not have the ability to repay, or whether the lender engaged in reasonable underwriting but macroeconomic conditions outside the lender's control led to a spike in default rates for the year.

IX. Consumer Notices

A. The CFPB's Notice Requirements and Model Forms Are Not Adequately Tested on Consumers

Prior to proposing the forms, the Bureau tested them with only 28 consumers, an unreasonably small sample size.[168] The final rule should make clear that any notice does not need to be exactly the same as its model forms, so that lenders are free to correct this confusing information without being subject to an enforcement action.

B. The Proposal's Electronic Disclosure Requirements Defy Congress's Intent in the ESIGN Act

In the Electronic Signatures in Global and National Commerce ("ESIGN") Act, Congress has provided an extensive and pervasive scheme that dictates: (1) the requirements for a lender to obtain affirmative consent from a consumer to receive disclosures electronically when such disclosures otherwise must be provided in writing; and (2) the circumstances in which the consumer's consent remains valid. Despite this clear statutory scheme, the Proposal would adopt different standards for both of these situations.

The Proposal would create a new list of special requirements for a lender to obtain consent from a consumer, as if the ESIGN Act did not exist. These additional requirements include providing consumers with an option to receive a notice by email, requiring electronic notices to be given in machine readable text, and prohibiting electronic disclosures if the lender "receives notification that the consumer is unable to receive disclosures through that delivery method at the address or number used."[169] The CFPB does not explain why the ESIGN Act requirements are insufficient in this context. These special requirements also could conflict with the ESIGN Act.

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[168] 81 Fed. Reg. at 47,898.

[169] 81 Fed. Reg. at 48,177.

In particular, the prohibition on providing disclosures electronically if a lender "receives notification" that the consumer is unable to receive notices at the address or number provided creates considerable uncertainty regarding the circumstances in which a lender will be deemed to have "received notification" that the consumer is unable to receive notices. And the Proposal's requirement is more onerous than section 101(c) of the ESIGN Act, which allows a lender to make disclosures electronically so long as the consumer has affirmatively consented to electronic disclosure and has not *withdrawn* such consent.

The CFPB should follow ESIGN's requirements, not override a comprehensive statutory scheme that speaks clearly on Congress's view of what constitutes appropriate consent for providing consumers with disclosures electronically when written disclosures would otherwise be required.

X. Registered Information Systems and Data Furnishing Requirements

A. Expense of Registering With All Systems

The Proposal's requirement for lenders to integrate with all registered information systems would impose a significant burden on small lenders and provide a significant competitive advantage to larger lenders, which are able to spread the cost of integration over a larger number of transactions.

B. The Proposal Contains Onerous and Impractical Duties on Registered Information Systems and Makes No Contingency Plan If the CFPB Does Not Approve Any Registered Information System

The registration requirements are far too onerous, and would take many best practices and turn them into law violations. For instance:

- One requirement is that a registered information system must have the capability of generating reports that include information that is furnished by a lender "substantially simultaneous" to the receipt of the information by the system. The nationwide consumer reporting agencies are not able to provide real-time consumer reports; they must intake, digest, standardize, review for accuracy, and match with existing data all information reported to them. Registered information systems will have to perform similar functions on the data they receive from lenders. Thus, it is extremely unlikely that registered information systems will be able to meet such an impractical standard.

- The Proposal would require registered information systems to maintain a compliance management system ("CMS"), and, if they failed to do so, it would be an independent law violation. Although maintenance of a CMS is currently a CFPB supervisory expectation and perhaps a best practice, it is not a legal requirement.

- The Proposal would require a registered information system to develop, implement, and maintain a comprehensive information security program that complies with the FTC's Safeguards Rule. The CFPB has no authority to enforce the FTC's Safeguards Rule. This provision would make a violation of the Safeguards Rule an unfair or abusive act or practice, punishable by the CFPB through fines or revocation of a system's status as a registered information system.

- The Proposal would require a registered information system to provide to the CFPB in its application for provisional registration or registration and on at least a biennial basis thereafter within 60 days after the period covered, a written assessment of its information security program. The FTC's Safeguards Rule does not require independent assessments of information security programs. This requirement is a disincentive to participating as a registered information system, and, at a minimum, will result in increased costs of obtaining reports from registered information systems that must conduct these information security assessments.

- The Proposal would require a registered information system to acknowledge it is, or consent to being, subject to the CFPB's supervisory authority. This requirement would override the CFPB's larger participant rule for consumer reporting agencies: if the company has less than $7 million in revenue, falling below the larger participant threshold, it would still be subject to CFPB supervision.

- The Proposal would allow the CFPB to suspend or revoke approval for a registered information system in its discretion and without due process. The Bureau states that except in cases of willfulness or where the public interest requires otherwise, the CFPB will provide written notice of the facts or conduct that may warrant suspension or revocation and give the entity or information system an opportunity to demonstrate or achieve compliance or address the CFPB's concerns. We fail to see how providing regulated entities with due process can be contrary to the public interest.

The decline in covered lenders, which the CFPB itself expects will be one consequence of its Proposal, creates an economic disincentive for companies to become registered information systems. As a result, we believe there is a possibility that no systems will register with the CFPB. If no systems register, or if no systems that apply satisfy the CFPB's stringent requirements for becoming a registered information system, the CFPB has no apparent contingency plan to keep the market functioning.

C. Mandatory Furnishing to Registered Information Systems Is Inconsistent with FCRA Requirements

There is a reason that Congress chose to make furnishing to consumer reporting agencies voluntary and not mandatory. Voluntary furnishing ensures that lenders will only furnish data that is accurate. Mandatory furnishing would require lenders to furnish data that may not be accurate. Moreover, under the Proposal, if a registered information system has reason to doubt the accuracy of the data that has been furnished to it, it has no ability to exclude the data, meaning there is no reasonable procedure to ensure accuracy. Thus the mandatory furnishing requirement could easily force both lenders and registered information systems to engage in conduct that would violate the FCRA.

D. The Information Required to be Furnished to Registered Systems Is Unclear

The Proposal provides that when a covered loan is outstanding, the lender must furnish updates within a reasonable period of time of the event which causes the information previously furnished to become stale. It is not clear whether the update requirement essentially requires cycle reporting for all covered small dollar loans.

The Proposal also provides that when a loan ceases to be outstanding, the lender must furnish certain information. The Proposal does not explain when a loan ceases to be outstanding. We believe that occurs when the loan is paid in full; however, the answer is less clear for delinquent loans where the date of charge-off, 180 days past due, or some other metric may determine when the loan ceases to be outstanding.

E. The Rule Should Include a Safe Harbor from Liability for Lenders Who Check Registered Information Systems

Because lenders will not be providing information in real-time to the registered information systems, lenders are subject to enforcement risk because consumers often apply for multiple loans at the same time, and may take out a loan from a different lender between the time the first lender checks the registered information systems and the time the first lender funds a loan. The final rule should provide a safe harbor from liability for a lender that checks a registered information system, but subsequently discovers that a borrower has another covered loan outstanding.

XI. Recordkeeping

The CFPB's requirement that lenders keep detailed personally identifiable information – including multiple copies of credit reports, bank statements, canceled checks, pay stubs, and written household budgets for three years after a loan is paid off – exposes consumers and lenders to a significant data security risk.

XII. Effective Date

A. The CFPB Should Allow for a Longer Implementation Period for Lenders

The CFPB should allow a longer implementation period for this rule. Lenders will need more than 15 months to revise their underwriting standards, develop new loan origination processes, train staff in the new processes, upgrade their systems to meet new underwriting, disclosure, and recordkeeping requirements, and integrate their systems with the approved registered information systems. OLA suggests that the implementation period should be at least 24 months.

B. The CFPB Should Delay the Requirement to Check Registered Information Systems

The CFPB should delay the requirement for lenders to check registered information systems for two reasons. First, if no system applies or qualifies for preliminary registration at the beginning of the effectiveness of the rule, the CFPB should have time to develop a contingency plan.

Second, even if certain companies apply to become registered information systems, if the CFPB takes longer than it expects to approve preliminary and final applications to become registered information systems, it would leave very little time for lenders to integrate their systems with approved registered information systems.

XIII. Anti-Evasion Provision

A. The CFPB's Anti-Evasion Provision is an Enforcement Trap

This Proposal's anti-evasion provision allows the CFPB to attack any lender practice as an unfair or abusive act or practice. If the CFPB believes that its rule contains loopholes – which would be a remarkable shortcoming in a 1,341 page rule – it should close those loopholes, not provide itself with open-ended authority that essentially amounts to a trap for lenders.

Most comparable rules do not have anti-evasion provisions because such provisions tend to have a chilling effect on credit based on the uncertainty they create. The Bureau claims that "[a]nti-evasion provisions are a feature of many Federal consumer financial laws and regulations."[170] Yet, for support for this claim, the CFPB cites only to the FCRA – a *statutory* anti-evasion provision. Only Regulation Z contains limited anti-evasion provisions in its high-cost mortgage provisions.[171] However, the Home Ownership and Equity Protection Act ("HOEPA") provides the Bureau with specific statutory authority for Regulation Z's anti-evasion provisions.[172] By contrast, the Proposal is derived from much more general statutory authority that contains no such mandate.

In addition, the Regulation Z anti-evasion provisions are more specific, targeting certain practices. By contrast, the Proposal's anti-evasion provision is as broad and limitless as possible, providing only that "A lender must not take any action with the intend of evading the requirements of this part."[173]

B. The Anti-Evasion Provision Reflects the CFPB Stacking the Deck Against Lenders

The anti-evasion provision would put lenders in a double bind:

- If a lender made loans in compliance with *every single* aspect of the rule, it would still be subject to an enforcement action because the CFPB has provided itself authority to determine that the lender's loan default rates were too high after-the-fact.

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[170] 81 Fed. Reg. at 48,112.

[171] *See* 12 C.F.R. §§ 1026.34(b) ("A creditor shall not structure any transaction that is otherwise a high-cost mortgage in a form, for the purpose, and with the intent to evade the requirements of a high-cost mortgage subject to this subpart, including by dividing any loan transaction into separate parts."); 1026.35(d) ("In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in §1026.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.").

[172] *See* 15 U.S.C. § 1639b(e).

[173] 81 Fed. Reg. at 48,182.

- If, on the other hand, a lender structured its loans so that it does not need to comply with *any* aspect of the rule, it would still be subject to an enforcement action because the CFPB has provided itself authority to determine that the lender's loans were inconsistent with the purposes of the rule.

As a result, the CFPB's Proposal would create a significant zone of uncertainty that disincentivizes lenders from making loans covered by the rule *and* loans outside the scope of the rule.

The Proposal's limitless anti-evasion provision is especially inappropriate because the CFPB has proposed an extraordinarily rigid, prescriptive rule. The CFPB would preserve the ultimate flexibility for itself to bring enforcement actions against lenders that comply with the requirements of the rule. At the same time, the CFPB would deny lenders *any* flexibility to underwrite outside the confines of the rule. Fundamentally, the proposed anti-evasion provision is an unfair way to write a rule.

XIV. The CFPB Has Not Satisfied Applicable Procedural Requirements

A. Cost/Benefit and Impact Analyses

Section 1022(b)(2)(A) of the Dodd Frank Act requires the CFPB to consider (i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from the Proposal; and (ii) the impact of the Proposal on covered persons and the impact on consumers in rural areas.

The Proposal would impose substantial new costs on businesses, but the CFPB has not quantified the *benefits* to consumers, and therefore, has not established that the benefits possibly outweigh the costs. For example, the CFPB has not established that borrowers of covered loans – who in many cases are in stressful financial positions prior to taking out a covered loan – would be in a better position if covered loans were unavailable to them because of the Proposal's residual income standard, or only available at a higher cost. In fact, the CFPB has not even shown that the proposal would improve borrowers' ability to repay loans, or would result in lower rates of default.

In addition, the CFPB's cost-benefit and impact analyses are deficient because the Bureau did not consider all the costs described above in section I.B.

B. Regulatory Flexibility Analysis

The CFPB has failed to satisfy the initial regulatory flexibility analysis requirement of 5 U.S.C. § 603. Specifically, the CFPB has failed to provide each of the following parts of the analysis required under the statute:

1. A description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule

The Proposal fails to describe significant aspects of each of these requirements.

a) Reporting requirements

Developing such a substantial and comprehensive automated data furnishing system will be exceptionally costly. Small businesses without the required expertise will have to hire sophisticated vendors to develop such a system, which could cost up to $300,000.

Although the CFPB acknowledges that small businesses will have to develop procedures to comply with the Proposal, it does not "describe" these procedures. The CFPB does not describe what small businesses must do to develop these procedures, including consulting with lawyers, vendors, and navigating through the complexity of the rule.

The CFPB's assumption that lenders can easily upgrade existing systems to incorporate the furnishing requirements is misguided. The complex reporting requirements will require extensive consultation and development of a separate system that might work with, but is not an enhancement of, an existing system.

Even after an automated system is functioning, small businesses will have to invest in the system to maintain, test, and update it on a regular basis. The CFPB does not acknowledge any of these costs.

For small lenders who fill out web-based forms manually, these forms will require employees to understand what type of covered loan is at issue, and furnish information based on this determination. The Proposal is immensely complicated and such a determination would be difficult for small business employees. The CFPB's estimate that it will take employees five to ten minutes to fill out the form does not acknowledge the complexity of the rule.

The CFPB's reference to other state registered information systems is not helpful. As the CFPB acknowledges, lenders who currently report to a registered information system are not required to report to multiple systems.

The CFPB severely underestimates the amount of time it will take employees to comply with procedures, including the furnishing requirements of the Proposal. Even where a lender upgrades an existing automated system, employees will still need to operate and monitor this system to ensure compliance with the rule.

The CFPB also underestimates the amount of staff training that would be required to ensure compliance with the rule. It is surprising that the CFPB anticipates that employees will only require half an hour of initial training and 15 additional minutes of training per year. Employees will require much more training to understand and comply with the furnishing requirements of the Proposal. Small businesses will also need to hire additional employees to ensure compliance with the Proposal.

b) Recordkeeping requirements

The CFPB does not identify any costs associated with the 36 month retention period. Even if a small business lender maintains records electronically, storage space is costly, and a 36 month period is excessive.

The CFPB does not acknowledge any ongoing costs associated with the Proposal's recordkeeping requirements. Employees will have to spend time managing records and setting up recordkeeping systems.

The CFPB underestimates the amount of training that would be required for small business employees to learn to operate the proposed recordkeeping system. Employees must understand the ability-to-repay requirements and must learn to operate a completely new system.

c) Other compliance requirements (ability to repay)

The CFPB does not identify the following aspects of compliance with the ability-to-repay requirements:

- ***Obtaining Consumer Reports:*** The CFPB's estimate of a $0.50 cost per consumer report obtained from a registered information system is unduly optimistic.[174] Today, the typical cost to online lenders for obtaining a consumer report from a CRA is approximately $1.00 per hit, more than twice the CFPB's estimate. Further, registered information systems will need to integrate data from other systems and include reporting fields not currently used today, which could further increase costs above today's standard. OLA also notes that the Proposal's verification evidence provisions will require lenders to obtain consumer reports not only from registered information systems but also from nationwide CRAs, thus doubling the cost for consumer reports in many cases. In addition, OLA notes that lenders will pay these costs even in connection with unsuccessful applications (i.e., those applications where the reports reveal unfavorable information). Although lenders will seek to pull reports only for applicants who may qualify, lenders will not know whether certain applicants can qualify until they purchase a consumer report from a registered information system – costs that would have to be spread among loans actually made.

- ***Time to Review Verification Evidence:*** It will take much more than the three to five minutes estimated by the CFPB for an employee to review verification evidence to ensure that it is complete and complies with the ATR requirements. This rule is complex and requires a substantial amount of documentation. Employees who are charged with reviewing verification materials will need adequate time to ensure that all required information is in the consumer's file.

- ***Time to Make or Review Ability-to-Repay Decisions:*** The CFPB's estimate that it will only take 10 minutes for manual decisions and no time at all for automated systems is not reasonable. It will take an employee much longer than 10 minutes to comply with the ATR determination requirements, and even for those small businesses that use an automated underwriting system, employees are still required to monitor the system and ensure that it is functioning appropriately.

[174] 81 Fed. Reg. at 48,134.

- ***Reliance on Attorneys and Vendors as Cost-Savers:*** In acknowledging that making ability-to-repay determinations will be a challenge for small entities, the CFPB emphasized that vendors and law firms can offer "helpful products and guidance," which would lower the costs of developing procedures**.** This description of costs seems misplaced: attorneys and vendors will cost small businesses money. It is unclear why the CFPB refers to attorneys and vendors as cost-savers when they are additional costs that should be described in the IRFA.

- ***Automated Ability-to-Repay Underwriting Systems:*** The CFPB estimates that it would cost $10,000 for lenders to license a system at the entity-level and $100 per seat for lenders that are licensing software through a seat-level contract.

- ***Employee Training:*** The CFPB estimates that employees will require only 4.5 hours of initial training and 2.25 hours of periodic ongoing training per year to comply with the ATR requirements. This is not enough time and demonstrates that the CFPB does not appreciate the complexity of the Proposal.

- ***Total Costs of Ability-to-Repay Determinations:*** In total, the CFPB estimates that making an ability-to-repay determination (including obtaining verification evidence, estimating basic living expenses, making the ATR determination based on this evidence) would require (1) *no time* for a fully automated electronic system and (2) between 15 to 20 minutes for a fully manual system, with incremental costs based on wages paid to staff and existing utilization rates, plus the $0.50 and $2.00 for the two consumer reports. The CFPB does not describe the wages paid to staff to comply with this system and does not recognize that employees would be required to operate a fully automatic system as well.

- ***Lack of Guidance:*** The CFPB does not acknowledge that its lack of guidance for ATR determinations will generate additional costs, not only in developing procedures and systems, but also in the form of supervisory or enforcement actions and litigation.

d) **Other compliance requirements (limitations on reborrowing)**

The CFPB does not describe the costs associated with developing a system with the capacity to detect when the applicant has taken out recent covered loans. The CFPB also does not reference the costs associated with employee wages to determine if an applicant has taken out recent covered loans.

e) **Other compliance requirements (alternatives to ability to repay)**

The CFPB does not identify the following aspects of compliance with the covered longer-term loan alternatives:

- ***Five Percent Default Rate Loans.*** Although some costs might be less for these loans than the ability-to-repay approach, small businesses will still have to understand the rule, develop procedures for compliance, and devote more employee time to ensure that all requirements are followed. Moreover, it is not realistic to expect small businesses to monitor portfolio default rates on an ongoing basis and to be able to withstand the shock of being required to refund all of their origination fees in the event that those default rates exceed 5 percent in any twelve-month period.

- ***PAL Loans.*** Small businesses have attempted to provide NCUA-type loans but have not obtained profits from them. These loans are therefore not a feasible alternative for many small businesses. Credit unions are able to pass down savings to their customers because of their unique regulatory scheme. Credit unions fund themselves with low-cost deposits and have special tax privileges. It is not practical for lenders that are not credit unions to operate with these profit margins.

- ***Costs of Required Disclosures for Either Type of Alternative Loan.*** Employees would be required to oversee the disclosure system, even if disclosures are sent automatically. The CFPB does not acknowledge this cost.

f) Other compliance requirements (payment practices and related notices)

(1) Limitation on payment withdrawal attempts

It is unlikely that a consumer will sign a new authorization to withdraw funds from the consumer's account, especially when the consumer is informed that he or she is not required to under the Proposal.

Small businesses attempt to collect directly from accounts for security reasons. This enables small businesses to lend to borrowers who might not otherwise have access to credit.

Contrary to the CFPB's assumptions, small businesses do not currently have the capability to track two failed withdrawal attempts from consumer accounts. Small businesses will have to develop, monitor, and maintain such systems.

(2) Required notices

The CFPB underestimates the amount of employee time required to ensure that the lender sends appropriate notices to consumers.

The CFPB does not mention the development of policies and procedures as a cost for disclosures.

(3) Costs of possible lender responses to major proposed provisions

The loss of vehicle security interests for account access will lead to increased defaults and delinquencies.

Lowering the total cost of credit is not economic.

2. An estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record

The CFPB's claim that it does not anticipate any additional professional skills conflicts with its recommendation for small businesses to use vendors and attorneys for guidance in understanding and complying with the Proposal. The Proposal is incredibly complex; professional skills are certainly required to comply with the various requirements of the rule. Compliance officers must be well versed on these requirements, which requires professional expertise. Lenders would need to hire armies of lawyers and consultants to understand and operationalize hundreds of pages of rule text.

3. An identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule

The CFPB does not identify E-SIGN and ECOA/Regulation B as relevant Federal rules which duplicate, overlap or conflict with the Proposal. The Proposal conflicts with E-SIGN because it adopts a different and new definition for consumer consent to receive electronic disclosures. The Proposal conflicts with ECOA because it does not permit a lender to consider household income or expenses in making an ATR determination, and requires a lender to ask about the number of dependents in order to model household expenses.

4. A description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities

The CFPB considers only two alternatives relevant to longer-term loans: (1) disclosures as an alternative to ability-to-repay; and (2) strict limitations on withdrawing payments as an alternative to disclosures (i.e., no payment reminders).

The CFPB does not reference a specific analysis that it uses to determine that a disclosure-only approach would have "substantially less" impact. It is unclear why the CFPB focuses on the "volume" of the covered loans and not on the consumer's understanding of the loans. Enhanced disclosures without the ATR requirements would inform consumers of all relevant information while allowing the consumer to access credit in emergency situations.

It is contradictory for the CFPB to claim that disclosures are insufficient with respect to the ability-to-repay requirements, but that they are still "necessary" with respect to the Proposal's limitations on withdrawing payments from borrowers' accounts.

5. **The analysis shall discuss significant alternatives such as—**

a) **the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities**

The CFPB does not address in the IRFA different compliance or reporting requirements or timetables that take into account the resources available to small entities.

b) **the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities**

The CFPB does not address the clarification, consolidation, or simplification of compliance and reporting requirements for small entities.

c) **the use of performance rather than design standards**

The CFPB does not address the use of performance rather than design standards in the IRFA.

d) **an exemption from coverage of the rule, or any part thereof, for such small entities**

The CFPB considered creating an exemption (partial and whole) for small entities. The CFPB stated that it learned through the SBREFA process that small lenders rely heavily on consumers who regularly take out long sequences of short-term loans. The CFPB also references a study cited by small entity representatives ("SERs") regarding the significant decrease in revenue and profits to their businesses. The CFPB stated that it does not have reason to believe that small business "are engaged in meaningfully different lending practices," so it does not believe that an exemption for small businesses would be consistent with the objectives of Title X of the Dodd-Frank Act.[175]

The CFPB failed to consider that small lenders engage in a substantial number of loans that would be considered "covered loans" under this rule, and would thus be especially affected by the Proposal. Moreover, small businesses are "engaged in meaningfully different lending practices" in that they have more interface with their customers.

6. **A description of any projected increase in the cost of credit for small entities**

The CFPB does not provide a description of any projected increase in the cost of credit for small entities, when in fact there are many reasons, including those discussed in section I.B above, to believe that the Proposal will increase the cost of credit for small lenders.

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[175] 81 Fed. Reg. at 48,165.

7. A description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities

The IRFA fails to consider several significant alternatives that would accomplish the stated objectives of the Proposal and would minimize the increase in cost of credit for small entities:

a) Furnishing requirements

There should only be one registered information system. Although the Bureau indicates that it intends to encourage common data standards for registered information systems, this is not enough to prevent the unnecessary burdens associated with reporting to multiple registered systems.

b) Ability-to-repay requirements

The ability-to-repay requirement is not necessary. The CFPB has not considered that best practices, as disseminated by NACHA and trade associations, have had an exceptionally positive effect on underwriting. A system operating under these best practices is just as effective as the Bureau's proposed ability-to-repay requirements and does not impose high costs on lenders.

The CFPB should recognize that some borrowers will need to access credit in emergency situations, even if their income and other credit factors do not indicate that they can afford the loan. If the CFPB's objective is to protect consumers from injury, consumers should be able to obtain credit for emergency purposes.

It is unnecessary for small businesses to determine a returning customer's ability to repay; the small business would have already obtained extensive information about the applicant under the Proposal.

c) Safe harbors

The CFPB should consider additional safe harbors to ensure that small businesses can continue operating. Specifically, small businesses should be exempt from the furnishing and ability-to-repay requirements.

8. A description of any advice and recommendations of representatives of small entities relating to any projected increase in the cost of credit for small entities

The CFPB is not complying with the SBREFA requirements of 603(d)(1)(c). The small business owners who participated in the SBREFA process as small entity representatives were deeply disappointed that the CFPB did not consider any of their suggestions.

The small business panel's final report, dated June 25, 2015, provided four recommendations for the CFPB to consider as alternatives, none of which were reflected in the CFPB's Proposal. The SBREFA report recommended the CFPB consider changing the rule in the following ways: (i) determining that regulations in place at the state level are sufficient to address concerns about unaffordable loan payments, and that existing state regulations could provide a model for the small dollar rule; (ii) streamlining the requirements related to reporting the use of covered loans to consumer reporting agencies; (iii) adopting an alternative to the ability-to-repay requirements that would allow lenders to make covered loans with a payment-to-income ratio of more than 5 percent; and (iv) not requiring lenders to provide written notice in advance of regular payments submitted at the time and in the amount that the consumer explicitly authorized.[176]

The CFPB is required by the RFA to describe the advice and recommendations of representatives of small entities relating to the cost of credit issues. The CFPB failed to comply with the RFA in this regard; the Proposal remained largely unchanged from the CFPB's May 2015 outline.

9. A description of any advice and recommendations of representatives of small entities relating to any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities

The CFPB does not describe any advice or recommendations of small entity representatives relating to any significant alternatives to the Proposal which would accomplish the stated objectives but which would minimize any increase in the cost of credit for small entities.

10. A description of any advice and recommendations of representatives of small entities relating to

a) **the reasons why action by the agency is being considered**

The CFPB does not describe advice and recommendations of small entity representatives with respect to the reasons why agency action is being considered.

b) **the objectives of, and legal basis for, the proposed rule**

The CFPB does not describe advice and recommendations of small entity representatives with respect to the objectives and legal basis for the Proposal.

c) **the number of small entities to which the proposed rule will apply**

The CFPB does not describe advice and recommendations of small entity representatives with respect to the number of small entities to which the Proposal will apply.

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[176] Consumer Fin. Prot. Bureau, Final Report: of the Small Business Review Panel on CFPB Rulemaking on Payday, Vehicle Title, and Similar Loans, at pp. 29-32 (June 25, 2015).

d) **the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record**

The CFPB does not describe advice and recommendations of small entity representatives with respect to the projected reporting, recordkeeping or other compliance requirements of the Proposal; the estimate of the classes of small entities which will be subject to the requirements; or the type of professional skills necessary for preparation of the report or record.

e) **relevant Federal rules which may duplicate, overlap or conflict with the proposed rule**

The CFPB does not describe advice and recommendations of small entity representatives with respect to Federal rules which may duplicate, overlap or conflict with the Proposal.

11. Other Deficiencies of IRFA Analysis

In most cases, the CFPB merely "identifies" and does not "describe" the costs that would be imposed on small businesses. This does not satisfy the CFPB's requirements under the RFA. Where the CFPB does provide costs or time estimates, it grossly underestimates them.

The CFPB does not describe the costs associated with lawyers and consultants that would be necessary to achieve compliance with the Proposal.

The Proposal imposes costs that would put many small businesses out of business. The proposal would impose exorbitant costs and burdens on lenders making covered loans that are disproportionate to the size and duration of the loans. These concerns were communicated to the CFPB during the SBREFA process, but were largely ignored.

The CFPB does not anticipate that small businesses will have to hire new employees to ensure compliance with the proposal.

Lenders would be subject to substantial enforcement and litigation risks that would not only hurt lenders' bottom lines if those risks materialized, but also would scare off investors and creditors, thereby increasing lenders' cost of capital.

With fewer covered loans in the market, service providers would increase prices for the remaining lenders making covered loans or cease providing services that allow lenders to stay profitable, such as lead generation.

The CFPB failed to consider loss of revenue as a significant cost of the proposal to small businesses. Lenders would forego substantial revenues by losing the opportunity to make loans to:

- consumers that do not have the ability to document their ability to repay, or to transmit their documents to the lender, even if such consumers have sufficient residual income to support a covered loan;

- consumers that have DTI or DTA ratios that would support a credit card loan, but do not have the residual income to support a covered loan;

- stay-at-home consumers that have access to their spouse's income, and therefore would have income for purposes of the CFPB's credit card ability-to-repay rules but not the Proposal;

- consumers that have already taken out three consecutive loans and therefore would be subject to the Proposal's loan limits, even if those consumers have the actual ability to repay a new loan; and

- consumers that become frustrated with the lengthy loan application process and leave the lender's application webpage.

The CFPB cross-references, but does not explicitly consider, the costs associated with small businesses having to significantly change their loan portfolios to comply with this rule.

The CFPB also does not consider the costs to loan applicants who are in desperate need of credit and who will have to turn to more costly alternatives.

C. Small Business Process

In passing SBREFA and subjecting the CFPB to it, Congress recognized the importance of small businesses and intended for the CFPB to take the concerns of SERs into account before adopting major rules like the Proposal. SBREFA requires the CFPB to, among other things, convene a small business advocacy review panel to consult with and collect advice and recommendations from SERs on any regulation expected to have a significant impact on small entities.[177] SBREFA also requires the CFPB to consider significant alternatives to such a regulation that would accomplish the stated objectives of applicable statutes and which would minimize any significant economic impact of the proposed rule on small entities.[178]

The CFPB began the SBREFA process by releasing an outline of proposals under consideration on March 26, 2015. The CFPB then discussed its outline with SERs in an outreach meeting on April 29, 2015. Many SERs also provided written feedback on the outline in letters to the CFPB.[179]

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177 5 U.S.C. § 609(b)(2), (b)(4).

178 5 U.S.C. § 603(c), (d)(1)(B).

179 The CFPB has collected the SERs' written comments on its website at http://www.consumerfinance.gov/policy-compliance/rulemaking/small-business-review-panels/payday-vehicle-title-and-similar-loans/.

The small business advocacy review panel's findings in its June 25, 2015 final report reflect some of the SERS' feedback. After considering the impact that the CFPB's rule, as outlined, would have on small entities, the panel recommended that the CFPB consider changing the rule in the following ways:

- determining that regulations in place at the state level are sufficient to address concerns about unaffordable loan payments, and that existing state regulations could provide a model for the small dollar rule;

- streamlining the requirements related to reporting the use of covered loans to consumer reporting agencies;

- adopting an alternative to the ATR requirements that would allow lenders to make covered loans with a payment-to-income ratio of more than 5 percent; and

- not requiring lenders to provide written notice in advance of regular payments submitted at the time and in the amount that the consumer explicitly authorized.[180]

The CFPB made none of these changes when it released the Proposal. In fact, despite clear and consistent feedback from SERs and the small business advocacy review panel, the CFPB changed very little about the outline in the Proposal. How could the CFPB be said to have considered the advice and recommendations of SERs if the Proposal is essentially the same as the outline it developed before meeting with SERs?

We believe SBREFA requires more than a token acknowledgment of the concerns of small businesses. We urge the CFPB to listen to Congress and actually take the concerns of small businesses into account before finalizing a version of the rule that, like the Proposal, would clearly favor large businesses over small businesses.

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[180] Consumer Fin. Prot. Bureau, Final Report of the Small Business Review Panel on CFPB Rulemaking on Payday, Vehicle Title, and Similar Loans, at pp. 29-32 (June 25, 2015).

In sum, OLA is deeply concerned that the Proposal will put the hard-working consumers who need and responsibly use covered longer-term loans at an unequivocal disadvantage in obtaining necessary credit compared to more affluent consumers who can obtain credit cards and other forms of credit without facing the same underwriting obstacles. The CFPB's Proposal would create a two-tiered credit system – a flexible, minimally burdensome system for the "haves" and an inflexible, highly burdensome system for the "have nots." OLA and its members firmly believe that such a two-tiered credit system is fundamentally unfair to consumers and inconsistent with the CFPB's mission of protecting consumers.

We appreciate the opportunity to provide input on this important regulatory initiative. If you have questions or need additional information, please feel free to contact me at lmcgreevy@oladc.org.

Very Truly Yours,

Lisa S. McGreevy
President and CEO