Online Lenders Alliance

May 19, 2016

Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Re: CFPB Report on Online Payday Loan Payments

Dear Director Cordray,

We are writing in regards to the CFPB's April 20, 2016, report on Online Payday Loan Payments (the "Report"). OLA members appreciate and welcome that the Bureau is reviewing the relationship between small dollar loans provided over the internet and overdraft and NSF fees charged by banks. We all share the goal of having satisfied customers who are treated fairly and have access to credit that helps their financial well-being. OLA's members do **not** benefit when a payment request causes a bank to apply NSF fees, and have focused on reducing the incidence of failed payments in recent years.

We are concerned, however, that the Report's data and conclusions do not present an accurate picture of the relationship between online loans and overdraft and NSF fees for the following reasons:

- The Report is based on obsolete data that predates the implementation of stringent new NACHA requirements and better industry practices that have dramatically decreased re-presentments;

- The data was misinterpreted to overstate re-presentments and NSF fees;

- What the data does show – even though it is five years old and before new requirements were put in place – is a very low rate of failed payments;

- The Report suggests that online loans "cause" account closures, but there is <u>no evidence</u> of causality;

- The Report erroneously asserts that online lenders have "preferential" access to their customers' bank accounts; and

- The Report fails to point out that electronic payments are a convenience to consumers, who authorize the payments and can revoke them at any time.

The CFPB has signaled that the Report's findings will form the foundation for the Bureau's upcoming proposed rule to regulate small dollar loans.[1] For the reasons outlined above, which are discussed in more detail in this letter, the Bureau should not in good faith rely on the Report to support its small dollar rulemaking. Online lending, marketplace lending and other "fintech" is the future of the financial services industry. The delivery of financial services to consumers over the Internet is fast, convenient, and efficient, and the CFPB should not seek to limit this valuable innovation based on flawed data and conclusions.

The Report is Based on Obsolete Data

The Report is based on consumer checking account data from 2011 to 2012.[2] 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 3 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 1.0 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.[3]

- ***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.[4]

- ***NACHA prohibitions on payment splitting and re-presentment.*** In September 2015, NACHA implemented new rules that require Reinitiated Entries contain the same amount as the Returned Entry and that specifically prohibit Reinitiated Entries from including an

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

[2] Because the 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.

[3] 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, located at https://www.nacha.org/rules/ach-network-risk-and-enforcement-topics.

[4] *See* Online Lenders Alliance Best Practices, at 20 (Apr. 2016).

amount greater than the previously Returned Entry or an amount(s) less than the original Entry.[5] 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.[6]

- ***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.[7]

- ***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 respect to payments. In addition, Western Sky and AMG do not appear to be operating any longer, and due to their size, may account for a significant portion of the failed payments in the CFPB's data set.[8]

- ***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 CFPB Misinterprets the Data to Overstate Re-presentments and NSF Fees

The CFPB's data show that 25 percent of payment attempts the Report classifies as re-presentments happened 14-15 days following a prior failed payment.[9] 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."[10] These aren't re-presentments – they 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

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[5] NACHA Operating Rules §§ 2.12.4.2 and 2.12.4.3.

[6] NACHA Operating Rules § 2.12.4.1.

[7] 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").

[8] *See* n. 2, above.

[9] Report at 17, Figure 3.

[10] Cordray Speech.

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.[11] The Report does not tell us what the average borrower of online loans paid (the median).

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 6 percent of payments that fail. Thus, when the CFPB claims that half of failed payments are re-presented – it amounts only to 3 percent of total initial payment attempts.

Even of the 6 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 Report does not take into account the possibility of these 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. How is the public supposed to know whether online lenders' rates are higher than the norm?

The CFPB Makes Erroneous Inferences About the Causality of Online Loans and Account Closures

The CFPB asserts that "many online borrowers hit with an overdraft or NSF fee end up losing their checking or savings accounts altogether,"[12] suggesting that online loans are the cause of consumers' account closure. But the CFPB cannot show any causal link between online borrowing and checking account closure. The rate the CFPB presents for bank-ordered account closures for all bank customers of all income levels (3 percent) is not comparable to the closure rate for low-income 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.[13] 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.

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[11] Report at 11, Figure 1.

[12] Cordray Speech.

[13] *See* Pew Charitable Trusts, Overdraft Frequency and Payday Borrowing, at 3 (February 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").

Online Lenders Do Not Have Preferential Access to Bank Accounts

Contrary to the CFPB's assertion, authorization to debit a consumer's account does not provide non-bank lenders "preferential access to people's accounts" ahead of the consumer's other obligations.[14] Banks have visibility into the consumer's account, and can prioritize their own credit to the consumer, but non-bank lenders have no visibility and incur the same risk of non-payment as all other ACH debit originators.

ACH payments are processed in batch, meaning that all ACH debits and credits received before 2:00 AM ET on the prior day are 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. 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 and the order of posting those competing payments are beyond the control of the non-bank lender.[15]

Electronic Debits Are a Convenience to Consumers, Who Authorize the Payments and Can Revoke Them at Any Time

Consumers have control of their deposit accounts and can revoke authorization or stop payment at any time, before or after a failed presentment. 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.[16] That is, lenders must provide an alternate form of payment to automatic recurring debits for installment loans. NACHA Rules and Regulation E permit consumers to revoke authorizations, stop payments or charge back payments that they believe to be unauthorized.

Yet, the CFPB claims that "borrowers face steep, hidden costs to their online loans in the form of unanticipated bank penalty fees."[17] If bank fees are "hidden" or "unanticipated," that is the fault of the bank, not creditors seeking repayment of known amounts. Moreover, any NSF made days after an initial failed attempt cannot be called "unanticipated." If certain consumers are using overdraft protection in an unhealthy way or if certain banks are being too generous with the extension of discretionary overdraft protection, the answer is to reform overdraft protection, not to risk eliminating the electronic payment option for millions of responsible borrowers.

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14 Cordray Speech.

15 *See* National Consumer Law Center, Consumer Banking and Payments Law, at § 2.6.3.9 (discussing bank policies with respect to ordering of transactions, state law considerations, banking agency guidance, and related class action litigation).

16 *See* 12 C.F.R. § 1005.10(e).

17 Cordray Speech.

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