BEFORE THE

BUREAU OF CONSUMER FINANCIAL PROTECTION

WASHINGTON D.C. 20552

In the Matter of
Proposed Rule on
Payday, Vehicle Title,
and Certain High Cost
Installment Loans

Docket No. CFPB-2019-0006-0001

COMMENTS OF THE COMPETITIVE ENTERPRISE INSTITUTE

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Introduction

On behalf of the Competitive Enterprise Institute ("CEI"), I am pleased to provide the following comment letter on the Bureau of Consumer Financial Protection's ("Bureau" or "CFPB") Proposed Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans ("the proposed rule").

Founded in 1984, CEI is a non-profit research and advocacy organization that focuses on regulatory policy from a pro-market perspective. A strong focus of CEI is on removing regulatory barriers that inhibit consumers' access to credit.

The Bureau is Justified in Rescinding Ability-to-Repay

The final Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule, originally promulgated in 2017 ("the final rule" or "the original rule"), was one of the most detrimental regulatory actions ever taken by the Bureau. Not only would payday loan volume and revenues have declined by 60 to 82 percent under the rule,[1] leaving millions of Americans without access to credit, but it would have done so through a fundamentally flawed rulemaking process.

As detailed below, the economic and legal theories that the Bureau relied upon to promulgate the payday loan rule were deeply problematic. The Bureau is well justified in rescinding the ability-to-repay provisions of the rule, as proposed, as the original rule emphatically failed to demonstrate a case for regulation.

Lack of Evidence Demonstrating Harm

In developing the payday loan rule, the CFPB produced two research reports, a "White Paper"[2] and a "Data Point,"[3] that focused largely on loan rollovers. These reports significantly influenced the development of the final rule.

In both reports, the Bureau acknowledges that discrete, short-term use of small dollar loans can be beneficial, but identified regular loan rollovers as a problem.[4] In particular, the CFPB points to consumer irrationality, whereby consumers systemically underestimate their ability

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[1] CFPB, "Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products," June 2016, p. 139, https://www.consumerfinance.gov/data-research/research-reports/supplemental-findings-payday-payday-installment-and-vehicle-title-loans-and-deposit-advance-products/. Other economic analyses put the number as high as 91 percent. See: Rick Hackett, "Evaluating CFPB Simulations of the Impact of Proposed Rules on Store front Payday Lending," NonPrime101.com, https://www.nonprime101.com/report-9-evaluating-cfpb-simulations-of-the-impact-of-proposed-rules-on-storefront-payday-lending

[2] CFPB, "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings," April 24, 2013, http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[3] CFPB, "Data Point: Payday Lending," CFPB Office of Research, March 2014, https://www.siliconvalleycf.org/sites/default/files/2014_CFPB_Payday_Lending_Report.pdf.

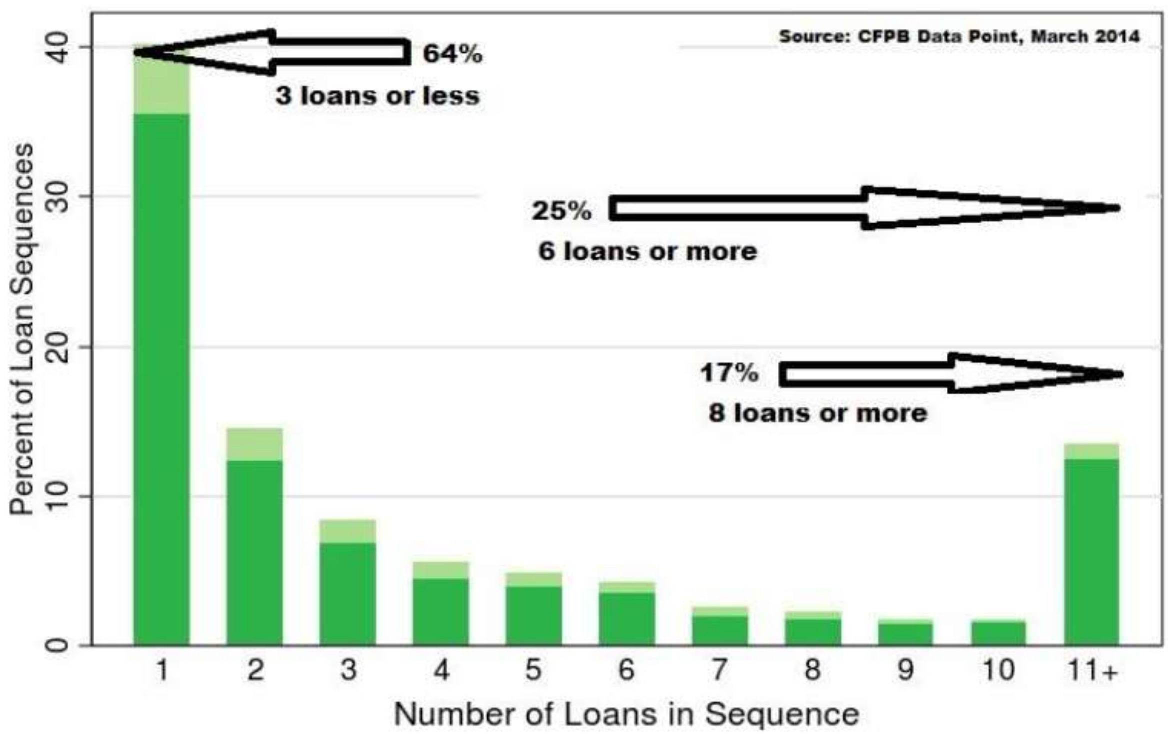
[4] CFPB White Paper, p. 43.

to repay a loan, as the main reason for persistent rollovers. This theory led the Bureau to believe that regulation would correct consumers' "optimism bias."

There are numerous problems with the Bureau's position.

First, the CFPB's concerns do not fit the data presented. The Bureau admits that short-term borrowing can be useful. The majority of all loans, 64 percent, are rolled over no more than three times. Further, only about one-quarter of all rollovers involve more than five loans, and less than one-fifth involve eight loans or more. The CFPB's concern that borrowers are regularly rolling over their loans are, at best, limited to a small group of consumers. Yet the effect of the Bureau's rule would be to eliminate at least 60 to 82 percent of all loans.[5]

Figure 1: CFPB Data Point, additional lines added by Hilary Miller for CEI.[6]



Second, while the Bureau's study determined that consumers roll over some of their loans some of the time, it never actually studied the harm or benefits of rollovers to consumers. Whether a consumer rolls a loan over or not is not an indication of harm *per se*. As Federal Reserve economist Gregory Elliehausen has contended,

[5] CFPB Supplemental findings.

[6] Hilary Miller "Ending Payday Lending Would Harm Consumers," *OnPoint*, No. 220, Competitive Enterprise Institute, October 5, 2016, https://cei.org/content/ending-payday-lending-would-harm-consumers.

> If payday loan customers live from paycheck to paycheck with very little discretionary income, even small expenses may cause financial problems and make emergencies a frequent event. In such cases, even frequent use of payday loans may be better than the alternatives.[7]

Further, as University of Chicago Economics Professor Marianne Bertrand and University of California, Berkeley Law Professor Adair Morse have written in their study of the industry:

> Indeed, the simple fact that individuals take out payday loans, even for relatively extended periods of time, certainly does not prove that these individuals are being fooled or preyed upon by payday lenders. Individuals might be fully informed about the fees associated with payday loans, might not have self-control problems, might not suffer from overly optimistic expectations about their ability to repay these loans, and instead might decide to borrow from payday lenders at high interest rates because they face a pressing need for cash at a moment when they lack access to other, cheaper, forms of financing.[8]

Demonstrating that some consumers roll over their loans is not enough to justify the near elimination of an industry. The CFPB should have gone further to test the welfare effects of persistent payday loan use.

The economic literature that has examined this question is not supportive of the Bureau's position. For example, Elliehausen and Lawrence found that a payday loan taken out to avoid late payments on utility and credit card bills can enhance consumer welfare.[9] This includes not only those who take out a single loan, but also those who roll over their loans several times. Jennifer Priestley of Kennesaw State University found that borrowers whose loans were outstanding for longer had *larger* positive changes in credit scores than those whose borrowing was more time-limited.[10] Further, a 2013 Federal Reserve study found "little to no effect of payday loans on credit scores, new delinquencies, or the likelihood of overdrawing credit lines."[11]

Moreover, the Bureau did not base its rulemaking on the consumer complaints portal or any empirical survey data concerning consumer sentiment. Perhaps that is because the best available research favors consumer satisfaction. One study by the Center for Financial

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[7] Gregory Elliehausen, An analysis of consumers' use of payday loans, *George Washington University*, 2009, https://www.researchgate.net/profile/Gregory_Elliehausen/publication/237554300_AN_ANALYSIS_OF_CONSUMERS%27_USE_OF_PAYDAY_LOANS/links/00b7d5362429f9db10000000/AN-ANALYSIS-OF-CONSUMERS-USE-OF-PAYDAY-LOANS.pdf?origin=publication_detail.

[8] Marianne Bertrand and Adair Morse, Information Disclosure, Cognitive Biases and Payday Borrowing and Payday Borrowing, *MFI Working Paper Series*, October 2009, https://bfi.uchicago.edu/RePEc/bfi/wpaper/BFI_2009-007.pdf.

[9] Gregory Elliehausen and Edward C. Lawrence, Payday Advance Credit in America: An Analysis of Customer Demand, *Credit Research Center*, McDonough School of Business, Georgetown University, April 2001, http://www.cfsaa.com/Portals/0/analysis_customer_demand.pdf.

[10] Jennifer Priestley, Payday Loan Rollovers and Consumer Welfare, Kennesaw State University, December 4, 2014, http://ssrn.com/abstract=2534628.

[11] Neil Bhutta, Payday Loans and Consumer Financial Health, *Finance and Economics Discussion Series*, Federal Reserve Board, September 2013, https://www.federalreserve.gov/pubs/feds/2013/201381/201381pap.pdf.

Services Innovation found that only 22 percent of consumers would not take out a payday loan again.[12] Another survey by Harris Interactive found that 95 percent of borrowers value having the option to take out a loan; the same proportion believe that payday loans provide a safety net during unexpected financial trouble.[13] Further, Elliehausen found that 88 percent of respondents were satisfied with their last transaction and only 3 percent mentioned difficulty of getting out of debt as a reason for being dissatisfied or only partially satisfied with their most recent loan.[14] If consumers had a problem with payday loans, they would have voiced those concerns in surveys or to the Bureau's complaint portal. That has not been the case, with complaints to the Bureau concerning payday and vehicle-title loans making up less than one percent of all complaints, respectively.[15]

Lack of Evidence to Support Legal Theory

Perhaps worst of all, however, is the fact that the Bureau failed to empirically demonstrate the behavioral economics claims made in favor of regulation.

The legal underpinnings of the payday loan rule include the Bureau's power to prohibit "abusive acts or practices." 12 U.S.C. § 5531(a)(2)(A)-(B), for example, states that a lender is prohibited from taking 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" and "the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service."

The Bureau claimed that because a small group of consumers roll over their loans frequently, they must be systematically irrational and harmed by their actions. In particular, the Bureau claimed that by exploiting a consumers "optimism bias," lenders took unreasonable advantage of a consumer's "lack of understanding," which led to the consumer's "inability to protect their interests." The Bureau largely relied on this behavioral economics theory in its rulemaking, but provided scant empirical evidence to support it.[16] For example, the Bureau almost exclusively relied on a 2011 study by Columbia Law Professor Ronald Mann, which sought to determine whether consumer's understood how long it would take to pay off a payday loan before taking it out.[17] While the Bureau relied

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[12] Rob Levy and Josh Sledge, "A Complex Portrait—An Examination of Small-Dollar Credit Consumers," Center for Financial Services Innovation, September 1, 2012, p.21, http://www.cfsinnovation.com/Document-Library/A-Complex-Portrait-An-Examination-of-Small-Dollar.aspx.

[13] Harris Interactive, "Payday Loans and the Borrower Experience," Prepared for the Community Financial Services Association of America, December 2013, p.5, http://cfsaa.com/Portals/0/Harris_Interactive/CFSA_HarrisPoll_SurveyResults.pdf.

[14] Elliehausen, 2009.

[15] CFPB, Semi-Annual Report: Fall 2018, February 12, 2019, https://www.consumerfinance.gov/data-research/research-reports/semi-annual-report-fall-2018/.

[16] For a more thorough discussion of the Bureau's use of behavioral economics in rulemakings, see: Daniel Press, "CEI Comments on The Bureau of Consumer Financial Protection's RIF Regarding Rulemaking Processes," *Comments of the Competitive Enterprise Institute*, June 8, 2018, https://cei.org/content/cei-comments-bureau-consumer-financial-protection%E2%80%99s-rif-regarding-rulemaking-processes.

[17] Ronald Mann, "Assessing the Optimism of Payday Loan Borrowers," *Supreme Court Economic Review*, Vol. 21, 2013, https://academiccommons.columbia.edu/catalog/ac:195485.

on the study to demonstrate that consumers' lack an understanding of the "material risks, costs, or conditions," the Mann study actually demonstrated the exact opposite. The study the Bureau relied upon entirely contradicted the claims made in favor of regulation, which suggests the Bureau's conclusion lacks any rational basis.

The principal conclusions of the Mann study were 1) consumers expected and understood ex ante that they were likely to keep borrowing after the first loan, and 2) about 60 percent of borrowers predicted ex ante within one pay period the date when they would finally be free from debt. Importantly, the estimation errors were randomly distributed and not the product of excessively optimistic repayment expectations.

Bizarrely, the CFPB somehow saw this evidence as affirming their claims. But that was not the opinion of the study's author. Professor Mann even went so far as to criticize the Bureau's use of his research in a comment letter to the agency, stating that it was "frustrating" that the CFPB's summary of his work was "so inaccurate and misleading," torturing the analysis to the extent that it was "unrecognizable."[18]

Furthermore, the Bureau also relied on a 2013 survey from Pew Research to support the rulemaking. In particular, the Bureau cited the fact that 37 percent of payday loan borrowers were reportedly so desperate to obtain credit that they would take a payday loan on any terms offered.[19] This allegedly shows that consumers do not deliberate on their decisions when taking out a loan, demonstrating consumer irrationality and lender exploitation.[20] As the Bureau wrote in the final rule, consumers who use short-term loans "are financially vulnerable and have very limited access to other sources of credit" and have an "urgent need for funds, lack of awareness or availability of better alternatives, and no time to shop for such alternatives."[21]

To start with, in the same vein as the critique of the Mann study above, a single survey does not support the near elimination of an entire industry. Policymakers should strive to rely on a mosaic of rigorous, replicable research results when promulgating regulations.[22]

Second, the survey contradicts other empirical research, which has found that consumers tend to shop around extensively for credit options before deciding on a payday loan.[23] For example, one study found that payday loan applicants had an average of five credit option inquiries during the 12 months before taking out a loan—three times greater than the general population.[24] Such deliberation suggests that consumers act purposively, logically,

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[18] Comment Submitted by Ronald Mann, Columbia Law School, October 7 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-141822.

[19] Pew Charitable Trusts, "Payday Lending in America, Report 2: How Borrowers Choose and Repay Payday Loans," February 2013, http://www.pewtrusts.org/en/research-and-analysis/reports/2013/02/19/howborrowers-choose-and-repay-payday-loans.

[20] However, a lack of deliberation is not a sufficient justification for regulation. There are perfectly rational reasons as to why consumers would not deliberate on certain aspects of a credit decision, such as high informational transaction costs and informative prior experience.

[21] 82 FR 54472 (November 17, 2017).

[22] Thomas W. Miller, Jr., *How Do Small Dollar NonBank Loans Work?* (Mercatus Center: 2019).

[23] Todd Zywicki, Payday Lending, Bank Overdraft Protection, and Fair Competition at the CFPB, *Review of Banking and Financial Law*, 2013, http://www.bu.edu/rbfl/files/2014/03/RBFL-V.-33_1_Zywicki_Clarke.pdf.

[24] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, "Payday Loan Choices and Consequences," *Vanderbilt University Working Paper*, 2012, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160947.

and in a utility-enhancing way when deciding on a loan. Further, there are extensive substitute products for payday loans, including check cashing, pawn broking, personal finance companies, banks, and more.

As the Bureau found, the majority of payday loan borrowers do not engage in protracted borrowing. Out of those who do engage in long term, repeat borrowing, the majority rationally expected to roll over their loans and understood, before taking out a loan, how long it would take for them to be free from debt. For those who did not, a substantial portion of empirical evidence points not to consumer harm, but to consumer satisfaction and responsible use of payday loan products.

To date, little empirical evidence has been found to suggest that regulation would be effective at addressing a consumer's cognitive biases. Regulation should not be justified on the mere appearance of market failure or cognitive biases, but on the real likelihood that regulation can effectively fix the problem. As the Bureau correctly noted in the proposed rule, "it would be reasonable… and prudent to have robust and reliable evidence to support key findings about "lack of understanding" and an "inability to protect" as needed to establish abusiveness." Because robust and reliable evidence was not established, the Bureau is justified in rescinding the ability-to-repay provisions of the rule.

The original payday loan rule also utilized the "abusive" standard in an inappropriate way, representing an attempt to define it through the lens of behavioral economics. By doing so, the Bureau has attempted to flip current consumer protection law on its head. Instead of focusing on preventing fraud and improving consumer's understanding through mandatory disclosure requirements,[25] the payday loan rule's definition of "abusive" focused on the "cognitive limitations" of consumers to justify paternalistic interventions.

For example, a consumer's "understanding" has long been understood to mean a general awareness of possible outcomes, something for which appropriate disclosures of relevant terms and fees is designed to address. And as the Bureau recognized in the original rule, consumers "typically understand that they are incurring a debt which must be repaid within a prescribed period of time and that if they are unable to do so they will either have to make other arrangements or suffer adverse consequences."

However, the Bureau stated that consumers lack the requisite level of understanding if they do not understand both their own individual "likelihood of being exposed to the risks" of the product and "the severity of the kinds of costs and harms that may occur." The Bureau concluded that, "though borrowers of covered loans are not irrational and may generally understand their basic terms, these facts do not put borrowers in a position to protect their interests."

The conventional practice of consumer protection involves requiring the general disclosure of information such as fees and terms, but entrusting individual consumers to make their own decisions. By interpreting the abusive standard through the lens of behavioral economics, the Bureau flips this standard on its head. It appears to justify interventions premised on the idea that consumers make the wrong decisions even if they have a general

[25] See, for example, the Truth In Lending Act (TILA), 15 U.S. Code § 1601.

understanding of the risks of the product, and that only the enlightened bureaucrats in Washington *really* know what consumers want and need.

It is encouraging, therefore, that the Bureau has recognized in the proposed rule the need to reform how the "abusive" standard is interpreted. In particular, the proposed rule states that the "lack of understanding" prong "would not require payday borrowers to have a specific understanding of their personal risks such that they can accurately predict how long they will be in debt after taking out a covered short-term or longer-term balloon-payment loan." Instead, the Bureau proposes to revert back to the conventional mode of consumer protection, stating that "consumers have a sufficient understanding… if they appreciate the general risks of harm associated with the products sufficient for them to consider taking reasonable steps to avoid that harm."

Restricting Access to Small Dollar Credit Would Harm Consumers

The original payday loan rule imposes an enormous burden on the industry and its consumers. By the Bureau's own admissions, the rule is expected to make up to 82 percent of loans unprofitable. It can therefore be expected that up to $11 billion worth of credit will be eliminated.[26] For the 12 million Americans who take out a payday loan each year, this is an enormous disruption to their ability to access vital consumer credit.

Given the impact of the rule, it would be reasonable to expect the Bureau to thoroughly assess the reduction of consumers' access to financial products. But this was not the case. For example, it gave little thought to what consumers would do when the supply of small dollar loans disappears. The options include defaulting on other loans, overdrawing a checking account, filing for bankruptcy, or working a second job. Consumers have always decided against these second-best options, which are often more expensive than small-dollar loans. Overdrawing a checking account, for example, typically comes with a charge of around $35, while the average charge for a payday loan is only $15 for every $100 borrowed.

The economic literature on the impact of withdrawal of high-rate credit is clear. The authoritative consumer credit textbook, *Consumer Credit and the American Economy,* extensively summarizes the current literature regarding high-rate credit and finds no evidence of systemic problems with the use of current, legal, high-rate credit products. As the textbook concludes:

> high-rate credit users generally are those who economic theory predicts may benefit from such credit, and many of them are fully aware of what they are doing, even as critics see their choices as outrageously shortsighted.[27]

The original rule largely disregarded evidence from past state experiences. Georgia and North Carolina were the first states to ban payday lending in 2005. A New York Federal

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[26] Miller.
[27] Thomas A. Durkin, Gregory Elliehausen, Michael E. Staten, and Todd J. Zywicki, *Consumer Credit and the American Economy*, (Oxford University Press: 2014), p. 386.

Reserve study found that households in those states bounced more checks, filed more complaints about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at much higher rates than states that had not prohibited payday lending.[28]

A recent natural experiment in New York showed similar results. Withdrawing access to certain high-rate credit products, the study found, led to an 8 percent rise in personal bankruptcies, particularly among households on low incomes.[29] This result should not come as a surprise, as these products are commonly used to consolidate debts and provide household liquidity, which reduces the likelihood of bankruptcy.

Further, a recent Mercatus Center study demonstrates the detrimental effect of Arkansas' constitutionally imposed interest rate cap of 17 percent. As Mississippi State University Finance Professor Thomas W. Miller, Jr. and Southern University Assistant Economics Professor Onyumbe Ben Lukongo found, there is a distinct "credit desert" in the interior counties of Arkansas, with residents of those counties holding just 3 percent of outstanding installment loans.[30] Credit is more available near the state's borders, as Arkansas residents often drive to neighboring states to acquire these loans. Nearly 97 percent of all outstanding installment loans were held by Arkansas residents who live in counties adjacent to one of the six bordering states that allow small-dollar lending.

In addition, the Bureau disregarded the concerns of numerous commenters suggesting that consumers who cannot access lawful loans will patronize illegal sources—dismissing the idea in a single footnote out of a 1,700-page rule. Rather, the Bureau claimed that cash-strapped individuals would still qualify for a "step-down" loan, which limits rollovers at two. Yet this explanation ignores the very real possibility that up to 80 percent of all payday loan stores will be put out of business by the rule. The Bureau never bothered to explain how consumers will continue to access loans once the vast majority of them are eliminated.

Worse, a large body of research contradicts the CFPB's claim. Former Columbia University Sociology Professor Sudhir Venkatesh documented the use of loan sharking by the urban poor in the early 2000s.[31] George Mason University Law Professor Todd Zywicki has explored evidence from France, the United Kingdom, Japan, Germany, and Italy, to demonstrate the correlation.[32] Furthermore, Mark Haller and John Alviti, writing in the 1970s, discuss how organized crime syndicates arose in the 1930s to control much of the

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[28] Donald Morgan and Michael Strain, "Payday Holiday: How Households Fare after Payday Credit Bans," Federal Reserve Bank of New York, November 2007, https://www.newyorkfed.org/research/staff_reports/sr309.html.

[29] Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy," July 5, 2018, https://philadelphiafed.org/-/media/bank-resources/supervision-and-regulation/events/2018/fintech/resources/paper 2_piotr_financial_technology_and_bankruptcy.pdf?la=en.

[30] Thomas Miller and Onyumbe Enumbe Ben Lukongo, "Adverse Consequences of the Binding Constitutional Interest Rate Cap in the State of Arkansas," Working Paper, Mercatus Center, October 12, 2017, https://www.mercatus.org/publications/constitutional-interest-rate-cap-arkansas.

[31] Sudhir Venkatesh, *Off the Books: The Underground Economy of the Urban Poor* (Harvard University Press: 2006).

[32] Todd Zywicki, "The Case against New Restrictions on Payday Lending," Mercatus Center Study No. 09-28, 2009, https://www.mercatus.org/system/files/WP0928_Payday-Lending.pdf.

small-loan market in many major American cities.[33] More recently, University of Pennsylvania Professor Lisa Servon outlined the benefits of extralegal lending in immigrant communities in her book, *The Unbanking of America*.[34] Anecdotes are even more numerous, including Rudy Giuliani prosecuting the New York mafia for loan sharking in the 1980s.[35]

Experience shows that consumers overwhelmingly demand a lawful form of short term, small-dollar loan. Destroying the legitimate market for these loans nationwide will only encourage consumers to seek them illegally or resort to worse options like overdrawing a bank account.

"Ability-to-Repay" Is Inappropriate for Small Dollar Loans

Beyond the flawed rulemaking process and detrimental impact of the original payday loan rule, it is important to recognize that the original loan rule relied on an unsound conception of consumer protection. The "ability-to-repay" standard is wholly inappropriate for small-dollar loans. If borrowers had an immediate ability to repay—including a month of no financial trouble—they would have no need to patronize payday lenders in the first place. Instead, they would access traditional sources of credit, such as their own savings, credit cards, or bank loans. As Thomas W. Miller, Jr. a professor of finance at Mississippi State University, has written, "Though [the ability-to-repay requirement] may sound sensible, basic living expenses are exactly what many payday loan borrowers seek to cover — meaning the rule *denies* them the option until their financial situation improves."[36]

Payday Loans Are Not "Predatory"

Central to the argument in favor of regulating small dollar loans is that the terms and fees are "predatory" and that small dollar lenders reap "huge profits."[37] But these claims are deceptive, at best.

To start with, the annual percentage rate (APR) of interest is inappropriate for small-dollar loans, as they are not used on an annual basis.[38] A 400 percent APR on a two-week loan may sound enormous, but in reality it equates to a little over $15 of interest for $100 borrowed, or 15 percent. As the acclaimed economist Thomas Sowell pointed out, using

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[33] Mark H. Haller and John V. Alviti, "Loan sharking in American Cities: Historical Analysis of a Marginal Enterprise," *American Journal of Legal History*, Vol. 21, No.2, April 1977, pp.125-156, https://www.jstor.org/stable/845211?seq=1#page_scan_tab_contents (as cited by Zywicki 2009).
[34] Lisa Servon, *The Unbanking of America How the New Middle Class Survives*, (Houghton Mifflin Harcourt: 2017).
[35] Mary Thornton, "9 Charged With Mafia Activities," *Washington Post*, February 27, 1985, https://www.washingtonpost.com/archive/politics/1985/02/27/9-charged-with-mafia-activities/982060d8-9a00-4563-b65a-4fb284eb3601/?utm_term=.b77aab2f4239.
[36] Thomas W. Miller Jr., "Righting a Flawed Payday Loans Rule," *Real Clear Policy*, March 19, 2019, https://www.realclearpolicy.com/articles/2019/03/19/righting_a_flawed_payday_loans_rule_111126.html.
[37] House Financial Services Committee Hearing, Ending Debt Traps in the Payday and Small Dollar Credit Industry, April 30, 2019 https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403646 .
[38] John Berlau, "The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn," *OnPoint*, No. 176 February 6, 2011, https://cei.org/sites/default/files/John Berlau-The 400 Percent Loan.pdf.

this same reasoning of pricing short-term products on an annual basis means that a hotel room should be advertised as upwards of $36,000.[39]

It is also important to note that what is called "interest" includes things like fees charged to cover the cost of doing business—not something that is typically considered to be part of an APR in a credit card or mortgage agreement. For example, a $3 fee on a $50 ATM withdrawal, in certain circumstances, could be considered the equivalent of a 730 APR loan.[40]

A relatively high-interest rate for small dollars loans makes sense simply due to the fixed costs of running any business, including the costs of operating a storefront, paying employees, the cost of capital, and the cost of bad debts. Lenders must charge a price that enables them to turn a profit. As an Ernst & Young analysis found, a $15 fee on a $100 loan turns $1.11 of pretax profit.[41]

The argument that payday lenders make huge profits lending to the poor is equally dubious. For the abnormal profits theory to hold true, small dollar lenders must hold significant market power to be able to charge a rate of interest that is "artificially" higher than what would be charged in a competitive market. And yet the small dollar lending market is highly competitive, with more storefront payday locations than either McDonald's or Starbucks.[42]

Further, a Federal Deposit Insurance Corporation paper of storefront payday loan profitability found no evidence of abnormally large profits, concluding, "To a great extent, the high APRs implied by payday loan fees can be justified by the fixed costs of keeping stores open and the relatively high default losses suffered on these loans."[43]

Another study found that payday lenders actually fall far short in terms of profitability when compared to a mainstream commercial lender, with an average 3.6 percent profit margin for payday lenders and 13 percent profit margin for commercial lenders, respectively.[44]

Rather than "predatory" loans that exploit the poor, small dollar loans typically reflect the risk and cost associated with making a small loan.

The Bureau Should Rescind the Payments Provisions

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[39] Thomas Sowell, "Payday Loans," *National Review*, November 2, 2011, https://www.nationalreview.com/2011/11/payday-loans-thomas-sowell/.

[40] Thomas W. Miller, Jr., How Do Small Dollar Nonbank Loans Work?, (Mercatus Center: 2019), https://www.mercatus.org/system/files/miller_small-dollar_nonbank_loans.pdf.

[41] Ernst & Young, "The Cost of Providing Payday Loans in a US Multiline Operator Environment," 2009.

[42] "CFPB Research Shows More Payday Stores Than McDonald's," *CUToday*, June 2, 2016, https://www.cutoday.info/Fresh-Today/CFPB-Research-Shows-More-Payday-Stores-Than-McDonald-s.

[43] Mark Flannery and Katherine Samolyk, "Payday Lending: Do the Costs Justify the Price?" *FDIC Center for Financial Research Working Paper,* No. 2005-09, June 2005, https://www.fdic.gov/bank/analytical/cfr/2005/wp2005/2005-09.pdf.

[44] Aaron Huckstep, Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits, *Fordham Journal of Corporate & Financial Law*, Vol. 12, No. 1, 2007, https://ir.lawnet.fordham.edu/jcfl/vol12/iss1/4/.

While the Bureau is to be applauded for rescinding the ability-to-repay requirements of the payday loan rule, it should go much further and rescind the *entire* rule, including the "payments" provision.

The rule prevents lenders from automatically charging a customer's account after two failed attempts at collection to prevent insufficient funds fees. The requirement is perplexing, as there is no other product or service that requires re-authorization after a failed attempt at obtaining payment. Indeed, consumers typically consider automatic payments a convenience, not a burden, and pay for numerous different products in this manner.

The payments provisions have important implications for creditors, as lenders have few avenues to collect on small, unsecured lines of credit. For example, storefront lenders take a postdated check from a consumer to ensure a relatively low-cost method of collection: they can deposit the check to obtain payment.[45] It is precisely this risk of an insufficient funds charge that provides a strong incentive for the customer not to default, and by reducing the probability of default and the expected collection costs, an incentive for lenders to provide credit in the first place.[46] This helps to reduce the bad debt costs for a lender and keeps prices lower than they otherwise would be.

Further, the payments provision particularly threatens the business model of online lenders. Online lenders do not obtain a postdated check like a storefront lender. Instead, they rely on having access to a customer's bank account. Without any collateral and a limited ability to service their debts, online lenders are at a much greater risk of fraud, default, or bad faith borrowing. When lenders cannot collect on their debts, they will respond by charging more, lending less, restricting access to credit altogether, or engaging in more aggressive collection tactics, such as litigation, more quickly. Indeed, the industry has noted that because lenders are not required to seek reauthorization, some may simply place the loan in collection after two failed attempts.[47] Given that the Bureau recently proposed regulations to address the consumer protection concerns surrounding debt collection, this would seem unwise to promote.[48]

The Bureau should also consider how the payments provision conflicts with certain state laws. For example, both Oklahoma[49] and Washington[50] prohibit lenders from communicating with borrowers for the purposes of reminding borrowers about their loan obligations or collecting on debts. Lenders are therefore stuck between a rock and a hard place - either violating state or federal law.

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[45] *Consumer Credit and the American Economy*, p. 357.
[46] Ibid.
[47] Online Lenders Alliance, "OLA provides perspective on payments provision of CFPB Small Dollar Rule," January 23, 2019, http://onlinelendersalliance.org/ola-provides-perspective-on-payments-provision-of-cfpb-small-dollar-rule/.
[48] CFPB, Proposed rule: Debt Collection Practices (Regulation F), May 7, 2019, https://www.consumerfinance.gov/policy-compliance/notice-opportunities-comment/open-notices/debt-collection-practices-regulation-f/.
[49] Oklahoma Administrative Code § 160:70-11-3.
[50] RCWA § 31.45.082(3)(a).

The Bureau should carefully consider whether the payments provision will do more harm than good through restricting the most common and effective measure lenders have to retrieve payments. At a minimum, the Bureau should exempt debit card transactions from the payments provisions, as these transactions do not result in insufficient funds charges.

Conclusion

The original Payday, Vehicle Title, and Certain High-Cost Installment Loan Rule was one of the most detrimental regulatory actions taken by the Bureau. The rulemaking process was flawed, the economic and legal theories advanced were dubious, and the impact of the rule would have been disastrous.

We applaud the Bureau in proposing to rescind the ability-to-repay portion of the payday loan rule. While we urge the Bureau to go further and rescind the entire rule, including the payments provisions, it is nevertheless encouraging to see the Bureau striving to respect the choices and motivations of individual consumers, rather than favoring the preferences of regulators in Washington.