

**BEFORE THE  
BUREAU OF CONSUMER FINANCIAL PROTECTION  
WASHINGTON D.C. 20552**

In the Matter of

Docket No. CFPB-2018-0009

Rulemaking Processes

**COMMENTS OF  
THE COMPETITIVE ENTERPRISE INSTITUTE**

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## Introduction

On behalf of the Competitive Enterprise Institute (CEI), we are pleased to provide the following comments on the Bureau of Consumer Financial Protection's (bureau or BCFP) Request for Information (RFI) regarding rulemaking processes.

Founded in 1984, the Competitive Enterprise Institute 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 deny access to capital and credit to businesses, consumers, and investors.

## BCFP and the Importance of the Rulemaking Process

The BCFP is simultaneously one of the most powerful and one of the most unaccountable regulators in United States history. It alone has broad rulemaking, supervision, and enforcement powers over nearly every consumer financial product in the U.S. economy.<sup>1</sup> Because of this immense power, an accountable and transparent rulemaking process is critically important to consumers, businesses, and democratic governance.

The bureau's rulemaking should be guided by well-researched, thoroughly justified, and appropriately crafted rules that implement the intent of Congress in the most efficient way possible. Regrettably, this largely has not been the case.

Problems with promulgating regulations are not foreign to the BCFP, but are commonplace among regulators. Typical deficiencies in agency rulemakings, as former U.S. Chamber of Commerce Vice President William Kovacs has identified, include:

- Agencies often make unproven factual assumptions;
- The public—and often the agency itself—often lack enough information to understand how a rule will work in real life;
- 30-, 60-, or 90-day comment periods are too short to allow stakeholders to develop and submit detailed comments about complex or opaque proposed rules;
- The information agencies rely upon is often of poor quality or not verifiable;
- Agencies are required by law to consider the impacts of a new rule on regulated entities, but these reviews are often limited, rushed, or not done.<sup>2</sup>

Further, as Jerry Ellig of the Mercatus Center at George Mason University points out, even for regulations subject to the most stringent analytical requirements, agencies often fail to:

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<sup>1</sup> Todd Zywicki, "The Consumer Financial Protection Bureau: Savior or Menace?" *George Washington Law Review*, Vol. 81, No. 3 (April 2013), pp. 856-928, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2130942](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2130942).

<sup>2</sup> William Kovacs, "U.S. Senate Committee on Homeland Security and Governmental Affairs Hearing, The Administrative State: An Examination of Federal Rulemaking," U.S Chamber of Commerce, April 20, 2016, <https://www.hsgac.senate.gov/imo/media/doc/Testimony-Kovacs-2016-04-20.pdf>.

- Conduct an evidence-based assessment of the underlying problem;
- Identify a range of alternatives;
- Provide a sound demonstration, using scientific and economic analysis, that the regulations will accomplish policy objectives at a reasonable cost; or
- Require rigorous and objective examination of existing regulations for effectiveness, efficiency, duplication, or obsolescence.<sup>3</sup>

Reasonable people can disagree on specific regulatory actions and outcomes. However, how agencies go about making these rules should transcend political differences. The administrative process should be carried out with accountability, transparency, and integrity. Congress requires as much, both through the Administrative Procedure Act and additional requirements on agency actions.

For example, when promulgating a rule, the BCFP is required to consider the impact of its actions, including the regulatory costs and benefits and impact on small businesses, rural communities, access to credit, paperwork burdens, and more. Such analysis is designed to act as a check on agency actions. Yet it is too often and too easily ignored. This is made all the worse by the bureau's unique ability to flout Congressional and Executive oversight. Congress has delegated so much legislative power to the bureau while abdicating oversight. As a result, the bureau has little incentive to develop economically sensible rules.

Absent legislative changes, the burden of improving agency accountability, transparency, and integrity falls on the bureau itself. In this respect, we applaud Acting Director Mulvaney's leadership in seeking public comment on the bureau's operations. Below is our analysis of the BCFP's rulemaking process, with a particular focus on the payday, vehicle title, and high-cost installment loan rule.

## **Initial Research**

The BCFP aims to be a "21<sup>st</sup> century agency"<sup>4</sup> that uses hard data and analysis to develop well-crafted regulations. For all the promise, however, this claim largely has fallen flat.

It is clear that the bureau's rulemaking decisions are not based on robust research, consumer data, or consumers' desire for regulation. The consumer complaint database that the bureau administers is telling in this regard. According to the latest BCFP semiannual report to Congress, payday loans made up 1 percent of all consumer complaints, while auto-title loans, which were also included in the rulemaking, made up 0.1 percent of all complaints.<sup>5</sup> Other discretionary rulemakings, such as the prepaid card rule, and regulatory actions

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<sup>3</sup> Jerry Ellig, Evaluating the Quality and Use of Regulatory Impact Analysis: The Mercatus Center's Regulatory Report Card, 2008–2013, *Mercatus Working Paper*, July 6, 2016, <https://www.mercatus.org/publication/evaluating-regulatory-impact-analysis-regulatory-report-card>.

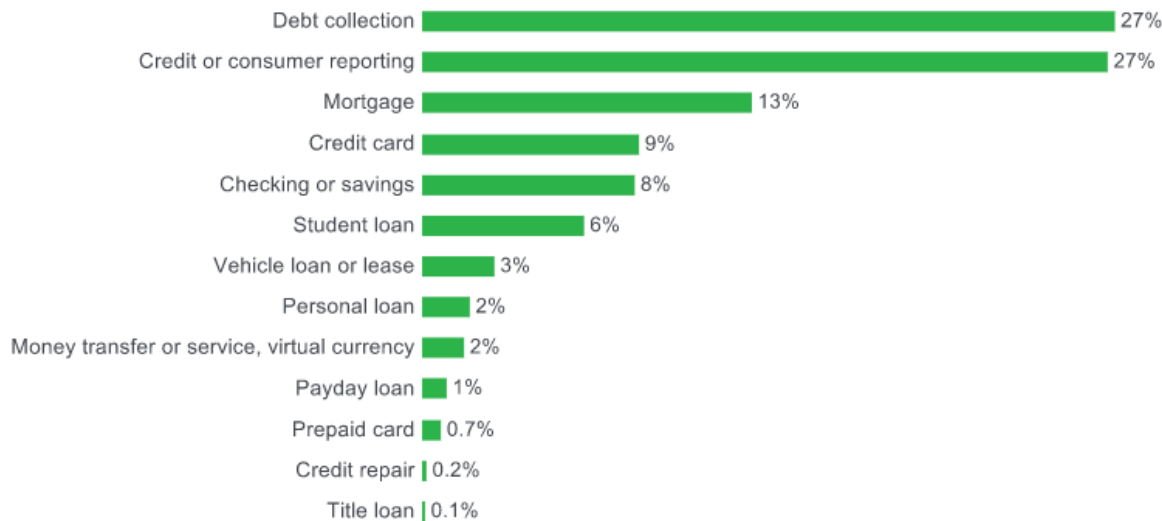
<sup>4</sup> BCFP, "CFPB Issues Report on Agency Progress," July 18, 2011, <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-issues-report-on-agency-progress/>.

<sup>5</sup> BCFP, "Semi-annual report of the Bureau of Consumer Financial Protection," April, 2018, [https://files.consumerfinance.gov/f/documents/cfpb\\_semi-annual-report\\_spring-2018.pdf](https://files.consumerfinance.gov/f/documents/cfpb_semi-annual-report_spring-2018.pdf).

against auto lenders (that was later deemed to be a rule by the Government Accountability Office<sup>6</sup>), does not seem to have been based off a genuine consumer desire for regulation. The consumer complaint share of prepaid cards was a mere 0.7 percent, while vehicle loans and leases constituted 3 percent. This kind of data theoretically guides the bureau's rulemaking, yet it is unpersuasive that there was ever a consumer protection problem to begin with.

The BCFP has appeared to let ideological considerations influence its rulemaking. For example, the bureau began studying the payday lending market in January 2012 in preparation for a rulemaking, just six months after it officially opened, even as it dealt with the enormous task of setting up a new government agency and writing required new rules, and despite no Congressional mandate or consumer complaint data at the time.

**FIGURE 1: CONSUMER COMPLAINTS BY PRODUCT<sup>68</sup>**



Because the BCFP's final rules are deeply influenced by its initial research, it is critically important that the bureau develop thorough and appropriate studies. It is even more important for the bureau to carefully consider both external criticisms and internal limitations of its studies. Regrettably, in the rulemakings for which CEI has provided comments, this has not been the case.

### *Payday Loan Rule*

<sup>6</sup> Government Accountability Office, "Applicability of the Congressional Review Act to Bulletin on Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act," December 5, 2017, <https://www.gao.gov/products/B-329129>.

In developing the payday loan rule, the BCFP produced two research reports, a “White Paper”<sup>7</sup> and a “Data Point,”<sup>8</sup> 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.<sup>9</sup> In particular, the BCFP points to consumer irrationality, whereby consumers systemically underestimate their ability 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 research the BCFP conducted was deeply flawed.<sup>10</sup> The Data Point, the more credible of the two studies, reveals that the bureau studied only a handful of lenders over a 12-month period; it took a broad view of the lending industry, not a deep dive. You cannot possibly get a clear and accurate view of the industry by briefly examining several lenders across multiple jurisdictions with different rules and regulations. The BCFP failed to analyze how these different regulatory structures impact payday loan borrowing, including whether or not certain regulatory structures are more effective at resolving the supposed issues identified by the bureau. For example, the bureau excluded the study of fourteen states that impose regulations targeting the consumers’ ability to pay.

Further, the BCFP’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 BCFP’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 between 75 to 91 percent of all loans.<sup>11</sup>

Figure 1: BCFP Data Point, additional lines added by Hilary Miller for CEI.<sup>12</sup>

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<sup>7</sup> BCFP, “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](http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf).

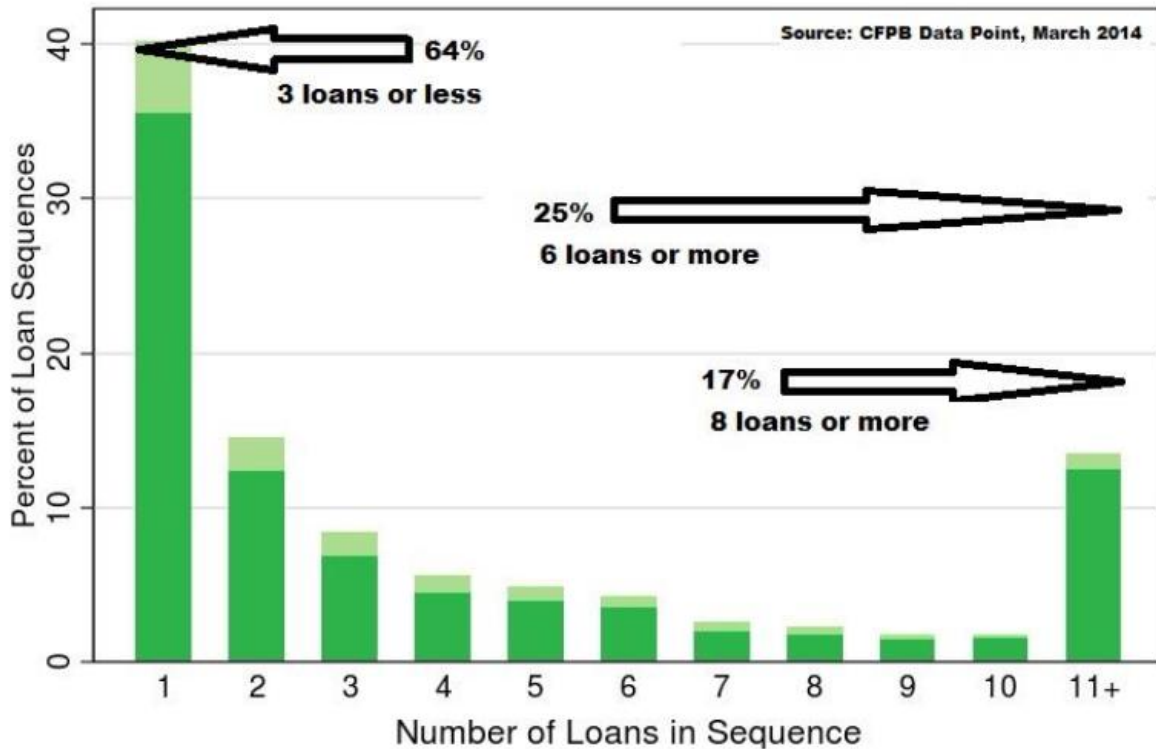
<sup>8</sup> BCFP, “Data Point: Payday Lending,” CFPB Office of Research, March 2014, [https://www.siliconvalleycf.org/sites/default/files/2014\\_CFPB\\_Payday\\_Lending\\_Report.pdf](https://www.siliconvalleycf.org/sites/default/files/2014_CFPB_Payday_Lending_Report.pdf).

<sup>9</sup> BCFP, 2013, p. 43.

<sup>10</sup> Rep. Dennis Ross, “Congress Should Correct CFPB’s Willful Ignorance on Payday Lending,” *Morning Consult*, February 16, 2018, <https://morningconsult.com/opinions/congress-should-correct-cfpbs-willful-ignorance-on-payday-lending/>.

<sup>11</sup> 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>.

<sup>12</sup> Hilary Miller, Ending Payday Lending Would Harm Consumers, *On Point* No. 220, Competitive Enterprise Institute, October 5, 2016, <https://cei.org/content/ending-payday-lending-would-harm-consumers>.



Nevertheless, there is an even greater problem with the bureau's research. Notably, it never actually studied the harm or benefits to consumers. Whether a consumer rolls a loan over or not is not an indication of harm *per se*. As current Federal Reserve Governor Gregory Elliehausen has contended,

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.<sup>13</sup>

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

<sup>13</sup> 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](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).

because they face a pressing need for cash at a moment when they lack access to other, cheaper, forms of financing.<sup>14</sup>

Gregory Elliehausen and University of Missouri-St. Louis Finance Professor Edward C. Lawrence found that a payday loan taken out to avoid late payments on utility and credit card bills can enhance consumer welfare.<sup>15</sup> 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 in Georgia found that borrowers whose loans were outstanding for longer had *larger* positive changes in credit scores than those whose borrowing was more time-limited.<sup>16</sup> 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.”<sup>17</sup>

Yet the BCFP never even considered these welfare effects. Instead, the bureau concluded that because a small group of consumers take out a number of loans in a row, they must be systematically irrational and harmed by their actions. But that is an empirical question that must be tested; it cannot just be assumed. For example, the White Paper produced by the bureau states, “It is unclear whether consumers understand the costs, benefits, and risks of using these products.” The bureau did not study consumers’ understanding and the dataset employed by the bureau had no relevant data on the matter. It is unclear as to how the bureau could have come to this conclusion.

One theory to support the bureau’s conclusions was advanced by former Harvard Law Professor Elizabeth Warren and New York University Law Professor Oren Bar-Gill.<sup>18</sup> The two theorized that optimism bias lead borrowers to systematically overestimate their financial health, which led them to need to borrow again when a payday loan comes due. The bureau largely relied on this theory in its rulemaking, but provided scant empirical evidence to support it. In fact, the empirical literature on consumer rationality largely concludes the opposite. Columbia Law Professor Ronald Mann administered a survey in 2011 that found that 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

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<sup>14</sup> 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](https://bfi.uchicago.edu/RePEc/bfi/wpaper/BFI_2009-007.pdf).

<sup>15</sup> 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](http://www.cfsaa.com/Portals/0/analysis_customer_demand.pdf).

<sup>16</sup> Jennifer Priestley, Payday Loan Rollovers and Consumer Welfare, Kennesaw State University, December 4, 2014, <http://ssrn.com/abstract=2534628>.

<sup>17</sup> 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>.

<sup>18</sup> Oren Bar-Gill and Elizabeth Warren, “Making Credit Safer,” *University of Pennsylvania Law Review*, Vol. 157, No. 1 (November 2008), <https://www.law.upenn.edu/live/files/112-bargillwarren157upalrev12008pdf>.



estimation errors were randomly distributed, not the product of excessively optimistic repayment expectations.<sup>19</sup>

The economic theory underlying the payday loan rule—behavioral economics—places a great premium on the level of deliberation when considering consumer rationality. For example, if consumers do not make the effort required to educate themselves in order to make an informed decision when considering whether to take out a loan, then it may indicate (though not prove) that consumers make less informed, impulsive decisions.<sup>20</sup> Given the reliance on behavioral economics, the bureau should take into account consumer deliberation when assessing rationality. However, the bureau neither conducted nor considered such research.

Moreover, the empirical research does not indicate widespread consumer irrationality. Consumers tend to shop around extensively for credit options before deciding on a payday loan.<sup>21</sup> 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.<sup>22</sup> Such deliberation suggests that consumers act purposively, logically, and in a utility-enhancing way when deciding on a loan.

Consumer perception may be a good indicator of whether harm has occurred that warrants regulatory intervention. Yet the best available research favors consumer satisfaction. One study by the Center for Financial Services Innovation found that only 22 percent of consumers would not take out a payday loan again.<sup>23</sup> 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.<sup>24</sup> 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.<sup>25</sup> 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.

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<sup>19</sup> Hilary Miller.

<sup>20</sup> 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.

<sup>21</sup> 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](http://www.bu.edu/rbfl/files/2014/03/RBFL-V.-33_1_Zywicki_Clarke.pdf).

<sup>22</sup> 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](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160947).

<sup>23</sup> 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>.

<sup>24</sup> 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](http://cfsaa.com/Portals/0/Harris_Interactive/CFSA_HarrisPoll_SurveyResults.pdf).

<sup>25</sup> Elliehausen, 2009.



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.

This suggests there is a very small group of consumers that may in theory benefit from regulation. However, such findings do not represent a sufficient justification for regulation, let alone the near-elimination of an industry. To date, little empirical evidence has been found to suggest that regulation would be effective at addressing consumer's cognitive biases. (As discussed in the section on cost-benefit analysis, the bureau disregarded research detailing the substantial harm such regulation has done in the past.) 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. Importantly, the bureau could have tested its proposal in a small-scale setting, but it declined the opportunity to do so. This is a significant flaw in the rule's development.

To summarize, in its study of the payday lending market while drafting the rule, the bureau:

- Did not base its rulemaking on the consumer complaints portal or any empirical survey data concerning consumer sentiment.
- Failed to design an appropriate and representative study of the small dollar loan market.
- Failed to study whether protracted borrowing actually harmed consumers through reduced consumer welfare.
- Failed to demonstrate the behavioral economic claims made in favor of regulation.
- Failed to consider empirical research that refuted its claims for both protracted borrowing and behavioral economic claims.
- Failed to test the implications of its proposals, even when it had the ability to do so.

### **Misguided Reliance on Behavioral Economics**

No other economic theory has been as influential on the BCFP's regulatory agenda as Behavioral Law and Economics (BLE). The theory has permeated the bureau since its founding and provided the intellectual blueprint for many of its rulemakings, including the payday lending rule.<sup>26</sup> This has led many commentators to describe the bureau as the first

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<sup>26</sup> During the bureau's formative years, Elizabeth Warren, who relied on behavioral economics in much of her writings on consumer credit, and Sendhil Mullainathan, a leading behavioral economist, were given prominent positions in the agency. BCFP, "Treasury Department Announces Senior Leadership Hires for the Consumer Financial Protection Bureau," May 11, 2011, <https://www.consumerfinance.gov/about-us/newsroom/treasury-department-announces-senior-leadership-hires-for-the-consumer-financial-protection-bureau/>.

behavioral law and economics regulator.<sup>27</sup> The Obama administration even issued an Executive Order requiring regulatory agencies to utilize behavioral science insights when developing regulations.<sup>28</sup>

Behavioral economics claims that individuals fail to act in their own best interests due to “cognitive biases,” or defects in one’s decision-making process.<sup>29</sup> It seeks to combine economics and psychology to demonstrate that individuals’ choices depart from the predictions of neoclassical economics. It is concerned with the nature of choice and the rationality of decision-making.<sup>30</sup>

That consumers do not always make the cognitive efforts required for an extensive decision process is not a surprise. Humans are fallible; Wikipedia lists 257 different cognitive biases, and it seems reasonable to conclude that most people suffer from some of them.<sup>31</sup> However, very few studies demonstrate beyond a theoretical level that cognitive biases either exist or are prevalent in the marketplace, let alone whether government intervention would enhance consumer welfare. To date, such results exist only in experimental settings and do not appear to be useful for policy purposes. BLE findings are not robust to even small changes in experimental settings.<sup>32</sup> Slight changes in the decision-making context of experiments can reduce or eliminate cognitive biases,<sup>33</sup> while biases documented in experimental settings do not prove robust when exposed to market institutions.<sup>34</sup> Its practical implications are even less authoritative, given the lack of robust empirical evidence into the effectiveness of behavioral-based government intervention.

Despite its popularity, Behavioral Law and Economics is not as groundbreaking or commanding as behavioral economists claim.<sup>35</sup> Not all decision-making errors imply

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<sup>27</sup> Joshua Wright and Douglas Ginsburg, “Behavioral Law and Economics: Its Origins, Fatal Flaws, and Implications for Liberty,” *Northwestern University Law Review*, Vol. 106, No. 3, 2012, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2147940](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2147940).

<sup>28</sup> The White House, “Executive Order -- Using Behavioral Science Insights to Better Serve the American People,” September 15, 2015, <https://obamawhitehouse.archives.gov/the-press-office/2015/09/15/executive-order-using-behavioral-science-insights-better-serve-american>.

<sup>29</sup> Ibid.

<sup>30</sup> Adam Smith and Todd Zywicki, Nudging in an Evolving Marketplace: How Markets Improve Their Own Choice Architecture, *George Mason Law & Economics Research Paper*, April 29, 2016, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2757712](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2757712).

<sup>31</sup> Wikipedia, List of Cognitive Biases, [https://en.wikipedia.org/wiki/List\\_of\\_cognitive\\_biases](https://en.wikipedia.org/wiki/List_of_cognitive_biases).

<sup>32</sup> Gregory Mitchell, Libertarian Paternalism Is an Oxymoron, *Northwestern University Law Review*, Vol. 99, No. 3 (2005), [https://www.researchgate.net/publication/228249621\\_Libertarian\\_Paternalism\\_Is\\_an\\_Oxymoron](https://www.researchgate.net/publication/228249621_Libertarian_Paternalism_Is_an_Oxymoron).

<sup>33</sup> Mitchell, 2005; Kathryn Zeiler and Charles Plott, “The Willingness to Pay/Willingness to Accept gap, the ‘Endowment Effect,’ Subject Misconceptions and Experimental Procedures for Eliciting Valuations, *American Economic Review*, Vol. 95, No. 3 (2004) (as cited by Smith and Zywicki), <https://www.aeaweb.org/articles?id=10.1257/0002828054201387>.

<sup>34</sup> Edward Glaeser, Paternalism and Psychology, *University of Chicago Law Review*, 2006.

<sup>35</sup> For an extended criticism of the behavioral economics literature, see: Thomas A. Durkin, Gregory Elliehausen, Michael E. Staten, and Todd J. Zywicki, Consumer Credit and the American Economy, Chapter 4: Behavioral Analysis and the Demand for Consumer Credit, *Oxford University Press*, August, 2014; Steven Levitt and John List, Viewpoint: On the Generalizability of Lab Behaviour to the Field, *Canadian Journal of Economics*, May 2007, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=986752](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=986752); John List, Does Market Experience Eliminate Market Anomalies?, *NBER Working Paper No. 16908*, May 2011; Jayson Lusk, Are You

irrationality. Perfect decision-making is costly, so rational economic actors economize on both information and transaction costs. Therefore, even if there were robust evidence of irrationality in markets, regulators must be able to distinguish truly irrational behavior from rationally made and therefore efficient mistakes.<sup>36</sup> The bureau has not taken such an approach in its rulemakings.

Further, regulators suffer from the same cognitive biases, behavioral inadequacies, and knowledge problems as the consumers they seek to regulate, and rarely take their own biases into consideration.<sup>37</sup> One study, for example, found that 95.5 percent of the BLE academic articles proposing paternalistic policy interventions lack any analysis of policymakers' biases.<sup>38</sup>

In spite of this, BLE interventions are based on the assumption that regulators will be able simultaneously 1) identify the distribution of individuals' "true preferences;" 2) access sufficient reliable empirical data; 3) interpret those data accurately; and 4) design and implement policies to increase consumer welfare. Regulators cannot possibly undertake such a superhuman task.<sup>39</sup>

The BLE literature also ignores a crucial component of markets—the ability of consumer choice and competitive pressure to improve consumers "choice architecture." In a free, competitive market, firms only remain sustainable by satisfying consumers.<sup>40</sup> Businesses that fail to satisfy customers suffer losses and are forced to close. Consumers acting within a marketplace are not passive spectators waiting to be exploited by unscrupulous business people. They have choice. That is why, for example, the BCFP's arbitration study found that nearly 60 percent of credit card consumers would simply cancel their cards if they were mistreated.<sup>41</sup> As Adam Christopher Smith and Todd Zywicki point out, "the decentralized, dynamic, discovery process of the market is more likely to generate welfare-improving nudges than the static, central-planning mindset of government bureaucrats seeking to

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Smart Enough to Know What to Eat: A Critique of Behavioral Economics as a Justification for Regulation, *European Review of Agricultural Economics*, 2014; Robert Sugden, Why Incoherent Preferences Do Not Justify Paternalism, *Constitutional Political Economy*, 2008.

<sup>36</sup> Wright and Ginsburg.

<sup>37</sup> W. Kip Viscusi and Ted Gayer, Behavioral Public Choice: The Behavioral Paradox of Government Policy, Vanderbilt Law and Economics Research Paper No. 15-2, February 4, 2015, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2559408](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2559408).

<sup>38</sup> Niclas Berggren, Time for Behavioral Political Economy? An Analysis of Articles in Behavioral Economics, *Review of Austrian Economics*, 2012.

<sup>39</sup> Mario Rizzo and Douglas Glen Whitman, "The Knowledge Problem of New Paternalism," *BYU Law Review*, Volume 2009, Issue 4, <https://pdfs.semanticscholar.org/60f9/f2e4757015185db505fc476866dd86fed6a1.pdf>; F.A. Hayek, The Use of Knowledge in Society, *American Economic Review*, Vol. 35, No. 4. (1945), pp, 519-530, [https://www.kysq.org/docs/Hayek\\_45.pdf](https://www.kysq.org/docs/Hayek_45.pdf).

<sup>40</sup> Daniel Press, "What Should Direct Our Economy: The Invisible Hand or the Iron Fist?" Intercollegiate Studies Institute, Fall 2017, <https://home.isi.org/what-should-direct-our-economy-invisible-hand-or-iron-fist>.

<sup>41</sup> Consumer Financial Protection Bureau, "Arbitration Study: Report to Congress," 2015, <http://www.consumerfinance.gov/reports/arbitration-study-report-to-congress-2015/>.

construct nudges.”<sup>42</sup> Further, Smith and Zywicki point out the enlightening examples of Netflix:

Netflix arose in part as a market solution to the excessive number of late fees charged by the then-dominant firm Blockbuster. Blockbuster relied on these late fees to generate sufficient revenue for the firm and its “profits were highly dependent on penalizing its patrons.” Focusing on whether the practice was unfair or exploitive of underlying consumer bias misses the larger point of the market’s ability to improve its own choice architecture. By providing a service that eschewed these fees, Netflix has replaced Blockbuster as the dominant firm with the latter company exiting the market altogether in 2010.<sup>43</sup>

BLE arguments are not fundamentally different from earlier calls for paternalistic intervention. The idea that consumers are manipulated into making credit decisions that are not in their best interest has been around for centuries.<sup>44</sup> For example, in 1963 an author in the *Commercial Law Journal* wrote, “The luxuries of the last generation are deemed to be necessities... The person who can’t pay ... is nevertheless assured by high pressure sales talk that he can do so by easy weekly or monthly payments which only come to a few cents a day.”<sup>45</sup> Consumer credit was long considered only appropriate for wealthy men, as women and the poor were seen as not “cognitively fit” to responsibly use credit.<sup>46</sup> Thus, as economist Deirdre McCloskey described it, behavioral economics may be considered to be little more than the “applied theory of bossing people around.”<sup>47</sup>

#### *Payday loan rule*

While empirical research has not been able to ascertain the effect of cognitive biases in real world credit decisions, this has not stopped the bureau from relying on cognitive biases to justify regulation.

The payday lending rule is based on the premise that consumers underestimate their ability to repay a loan and therefore resort to repeat borrowing. There is no empirical basis behind this claim. The bureau never studied consumers’ cognitive biases or welfare effects associated with payday lending. Instead, the BCFP merely assumed that 1) consumers mistakenly roll over their loans, 2) this high error rate implies irrationality, 3) irrationality

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<sup>42</sup> Adam Smith and Todd Zywicki, “Nudging in an Evolving Marketplace: How Markets Improve Their Own Choice Architecture,” *George Mason University Law and Economics Research Paper Series*, April 29, 2016, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2757712](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2757712).

<sup>43</sup> Ibid.

<sup>44</sup> Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit* (Princeton, N.J.: Princeton University Press, 1999); John Caskey, *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor* (New York: Russell Sage Foundation, 1996).

<sup>45</sup> Todd Zywicki, Consumer Credit and the American Economy, Speech at the Cato Institute, September 30, 2014, at 06:21, <https://www.cato.org/multimedia/events/consumer-credit-american-economy>.

<sup>46</sup> Calder.

<sup>47</sup> Deirdre Nansen McCloskey, “The Applied Theory of Bossing People Around,” *Reason*, March 2018, <https://reason.com/archives/2018/02/11/the-applied-theory-of-bossing>.

implies the need for choice-reducing regulation, and 4) choice-reducing regulation increases consumer welfare.

Worse, the two behavioral studies that actually tested the bureau's BLE claims contradict the regulatory intervention proposed, in particular, the ability-to-repay requirement. As discussed, Ronald Mann's study cautioned in favor of consumer' rationality.

Further, Bertrand and Morse found that a particular kind of disclosure form could have a small but statistically significant effect on overconfidence in payday loan use.<sup>48</sup> Unlike the bureau's rule, this regulatory proposal was actually tested in the field and yielded positive solutions for the problem identified. Further, this kind of regulation would have come closer to representing the kind of "libertarian paternalism" that BLE scholars often tout—maintaining choice while reducing cognitive biases. Yet there was no libertarian aspect to the final payday rule at all, only paternalism. Consumer choice in taking out a loan is not preserved when upwards of 75 percent of consumers will no longer be able to make that choice.<sup>49</sup>

To summarize, the bureau's reliance on behavioral economics to justify regulatory interventions is misguided at best and destructive at worst. Not only has the bureau failed to adequately demonstrate the existence of cognitive biases in credit decisions, it has consistently ignored evidence to the contrary. Moving forward, the BCFP should focus less on BLE, and instead recognize the severe limitations present in the literature. At the very least, the bureau should make the effort to at least empirically test its BLE claims.

### **Cost-Benefit Analysis**

Under the bureau's rulemaking authority as described in 12 USC §5512, the bureau shall 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 such rule; and
- (ii) the impact of proposed rules on covered persons, as described in section 5516 of this title, and the impact on consumers in rural areas.

In the rulemakings in which CEI has participated, the BCFP has consistently flouted such requirements. The cost-benefit analysis provided often involves no serious collection, quantification, and analysis of the costs, while merely offering up abstract qualitative benefits to government regulation.

While the bureau's cost-benefit analysis are particularly inadequate, they are by no means an isolated case. An analysis of agency regulatory impact analyses by the Mercatus Center

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<sup>48</sup> Marianne Bertrand and Adair Morse, Information Disclosure, Cognitive Biases, and Payday Loan Borrowing, *Journal of Finance*, Vol. 66, No. 6 (December 2011)-, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1533012](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1533012).

<sup>49</sup> Hilary Miller.



found that nearly 50 percent of the 130 economically significant regulations proposed by executive agencies between 2008 and 2013 were not accompanied by any significant evidence demonstrating the existence, magnitude, or cause of the problem the regulation sought to solve.<sup>50</sup> Further, a mere 22 percent of the regulations included reasonably thorough evidence that the regulation would likely achieve the desired outcomes.<sup>51</sup> The economic analysis of independent agencies is typically even worse.<sup>52</sup>

A central problem of cost-benefit analysis is that, while the public is free to submit comments on regulatory proposals, the agency ultimately decides which estimates to use, with little oversight or internal scrutiny. This is an unfortunate reality of regulation, as regulatory agencies do not have a monopoly on policy expertise. To improve its economic and cost-benefit analysis, the bureau could institute a policy of sharing its raw data and methodology with third-party groups, such as trade associations, think tanks, universities, and even other regulators, such as the Federal Reserve or Office of Financial Research. As was the case with the BCFP's rule governing arbitration agreements in 2017, two different regulators, the BCFP and the Office of the Comptroller of the Currency, had two conflicting analyses of the same data. Further, the bureau could voluntarily submit its proposals to the Office of Management and Budget for review.

One example of an independent agency improving its rulemaking process is the Securities and Exchange Commission (SEC). In 2012, after losing a number of court cases regarding the adequacy of its cost-benefit analysis,<sup>53</sup> the SEC issued new guidance directing its staff to follow best practices similar to those that executive branch agencies must follow. As Jerry Ellig and Hester Peirce of the Mercatus Center note, the guidance improved the quality of the SEC's analysis measurably.<sup>54</sup>

### *Payday Loan Rule*

The bureau's recently finalized 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 around 75 percent of loans unprofitable. Given that around three quarters of the industry will be potentially put out of business, it can be expected that up to \$11 billion worth of credit will be eliminated.<sup>55</sup> 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.

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<sup>50</sup> Jerry Ellig, *Evaluating the Quality and Use of Regulatory Impact Analysis: The Mercatus Center's Regulatory Report Card, 2008–2013*, Mercatus Working Paper, July 6, 2016, <https://www.mercatus.org/publication/evaluating-regulatory-impact-analysis-regulatory-report-card>.

<sup>51</sup> *Ibid.*, 23.

<sup>52</sup> Arthur Fraas and Randall Lutter, *On the Economic Analysis of Regulations at Independent Regulatory Commissions*, *Administrative Law Review*, 2011, [https://www.jstor.org/stable/23065483?seq=1#page\\_scan\\_tab\\_contents](https://www.jstor.org/stable/23065483?seq=1#page_scan_tab_contents).

<sup>53</sup> *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

<sup>54</sup> Jerry Ellig and Hester Peirce, "SEC Regulatory Analysis: 'A Long Way to Go and a Short Time to Get There,'" *Brooklyn Journal of Corporate, Financial, & Commercial Law*, Vol. 8, No. 2 (Spring 2014), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2485582](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2485582).

<sup>55</sup> Hilary Miller.

Given the impact of the rule, it would be reasonable to expect the bureau to thoroughly assess not only its benefits, but also its costs, including 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. The median interest rate for these overdraft fees is up to 20 times that of a payday loan. Overdrawing a checking account typically comes with a charge of around \$35, while the average charge for a payday loan is only \$15.

The cost-benefit analysis also 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 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.

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 Onyumbé 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.<sup>56</sup> 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.

Experience in the states 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.

In addition, the bureau did not adequately consider any of these costs in its cost benefit analysis. For example, the bureau disregarded the concerns of numerous commenters suggesting that consumers who cannot access lawful loans will patronize illegal sources—disregarding 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

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<sup>56</sup> Thomas Miller and Onyumbé 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>. While installment loans were exempted from the CFPB's Final Rule, the Mercatus study is instructive as to the impact of a federal rulemaking on small-dollar loans



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 BCFP's claim. Former Columbia University Sociology Professor Sudhir Venkatesh documented the use of loan sharking by the urban poor in the early 2000s.<sup>57</sup> George Mason University Law Professor Todd Zywicki has explored evidence from France, the United Kingdom, Japan, Germany, and Italy, to demonstrate the correlation.<sup>58</sup> Furthermore, Mark Haller and John Alvit, writing in the 1970s, discuss how organized crime syndicates arose in the 1930s to control much of the small-loan market in many major American cities.<sup>59</sup> More recently, University of Pennsylvania Professor Lisa Servon outlined the benefits of extralegal lending in immigrant communities in her book, *The Unbanking of America*.<sup>60</sup> Anecdotes are even more numerous, including Rudy Giuliani prosecuting the New York mafia for loan sharking in the 1980s.<sup>61</sup>

It is outrageous for an agency to simply assert a number of abstract qualitative benefits in favor of a regulation while simultaneously dismissing a wealth of quantitative research refuting such claims. This cannot qualify as the kind of cost-benefit analysis mandated by Congress. The bureau must institute rigorous quantitative analysis of all possible costs associated with a proposed rule, including the serious consideration of all possible alternatives.

### **Small Business Review Process**

In 1980, Congress passed the Regulatory Flexibility Act (RFA) to give small businesses a voice in the federal rulemaking process. The RFA requires federal agencies to assess the impact of their proposed regulations on small businesses and to consider alternatives that would lessen their impact.

The RFA is a critically important check on agency rulemaking. Agencies have a tendency to narrowly focus on the conduct of the largest players in a market, ignoring the rules' impact on some of the smallest entities. The RFA should lead to an important consideration of regulatory costs, benefits, and alternatives. Instead, it tends to be a more of a box-checking exercise used to push a predetermined regulatory agenda.

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<sup>57</sup> Sudhir Venkatesh, *Off the Books: The Underground Economy of the Urban Poor* (Cambridge, Mass.: Harvard University Press, 2006).

<sup>58</sup> Todd Zywicki, "The Case against New Restrictions on Payday Lending," Mercatus Center No. 09-28, 2009, [https://www.mercatus.org/system/files/WP0928\\_Payday-Lending.pdf](https://www.mercatus.org/system/files/WP0928_Payday-Lending.pdf).

<sup>59</sup> Mark H. Haller and John V. Alvit, "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](https://www.jstor.org/stable/845211?seq=1#page_scan_tab_contents) (as cited by Zywicki 2009).

<sup>60</sup> Lisa Servon, *The Unbanking of America How the New Middle Class Survives*, (Boston: Houghton Mifflin Harcourt, 2017).

<sup>61</sup> 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](https://www.washingtonpost.com/archive/politics/1985/02/27/9-charged-with-mafia-activities/982060d8-9a00-4563-b65a-4fb284eb3601/?utm_term=.b77aab2f4239).

A recent Government Accountability Office (GAO) study looked into the BCFP's compliance with the RFA.<sup>62</sup> Some concerning findings include:

- Only three out of seven proposed rules included quantitative estimates of compliance costs for small entities.
- Only four out of seven final rules included quantitative estimates of compliance costs for small entities.
- In some cases, the analyses stated that costs likely would be minimal or described difficulties in estimating costs such as a lack of information about the current practices of subject entities.
- Of the analyses that included cost estimates, several did not quantify all identified costs or explain why such estimates were not available.
- In considering alternative regulatory approaches, it was not clear whether BCFP had identified alternatives of its own.

### *Payday Loan Rule*

Under the Small Business Regulatory Enforcement Act (SBREFA) the BCFP is required to collect input from small entities on regulations and identify alternative regulatory approaches for small businesses. From just about all accounts of those involved, the BCFP entirely ignored SBREFA commenters. One lender involved in the process, Check City Partnership, noted that “it is patently clear to us that the BCFP has ignored 100 percent of the concerns raised by the small business representatives at this hearing. It looks as if the BCFP conducted the hearing only because they were forced to do so, with no intention of thoughtfully considering the comments”.<sup>63</sup> Sens. Marco Rubio (R-Fla.), John Kennedy (R-La.), and James Risch (R-ID) filed comments with the BCFP in which they noted that the Small Business Administration's Office of Advocacy “found that BCFP grossly violated the [SBREFA requirements] in promulgating the Payday Lender Rule.”<sup>64</sup>

### **Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 (PRA), like the Regulatory Flexibility Act, was designed to realign the incentives of agency rulemaking. When promulgating a rule, it costs an agency nothing to pile on substantial paperwork burdens, yet it poses an enormous burden for businesses and individuals to comply with it. The PRA was designed to require agencies to account for, justify, and minimize these burdens.

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<sup>62</sup> Government Accountability Office, “FINANCIAL SERVICES REGULATIONS: Procedures for Reviews under Regulatory Flexibility Act Need to Be Enhanced,” January 30, 2018, <https://www.gao.gov/products/GAO-18-256>.

<sup>63</sup> Check City Partnership, Comments on the Payday Loan Rule, September 26, 2016, p.5, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143064&attachmentNumber=1&contentType=pdf>.

<sup>64</sup> United States Senate, Committee on Small Business and Entrepreneurship, Letter from Sens. Marco Rubio, John Kennedy, and James Risch to Consumer Financial Protection Bureau Director Richard Cordray, June 30, 2017, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-211929&attachmentNumber=1&contentType=pdf>.

### *Payday Loan Rule*

Attachment A to this filing is a formal request from CEI to the Office of Management and Budget for the rejection of the bureau's Information Collection Request as part of its development of the payday lending rule. The filing describes many flaws in the bureau's consideration of the PRA. As we describe in detail, the bureau systematically flouted the PRA requirements in finalizing the rule. Specifically, the bureau 1) imposed onerous and unreasonable burdens on both lenders and consumers; 2) failed to adequately account for the paperwork burden costs; 3) omitted significant paperwork burden costs from the estimate; 4) failed to reasonably consider less burdensome alternatives; and 5) disregarded public comments submitted to it.

Unfortunately, this is not a unique problem. As the Government Accountability Office has put it, internal agency review of information collection requests "has been reduced to a routine administrative process, rather than the rigorous analytical process envisioned by Congress, and does not appear to be effective in reducing the burden."<sup>65</sup>

To improve the rulemaking process, the BCFP should more carefully study, assess, and consider the impact of the paperwork burdens it is imposing, including the consideration of alternative regulatory proposals.

### **Discretionary vs. Required Rulemakings**

Upon creation of the BCFP, Congress charged the newly created bureau with a number of mandated rulemakings. This includes the Section 1071 rulemaking, extending the Equal Credit Opportunity Act to cover women and minority owned small businesses, which is yet to be promulgated.

While CEI opposes much of the policy substance of these required rulemakings, they are, by law, required for the agency to promulgate. That means that they should be the agency's top rulemaking priority. Yet, the bureau has often prioritized discretionary rulemakings based partly on its own political preferences instead of the requirements set by Congress. For example, the prepaid card and payday lending rule were not required, yet were subject to years of agency resources over required rulemakings such as Section 1071. In the spirit of executing the laws passed by Congress in the most efficient way possible, the bureau should focus on required rulemakings over discretionary rulemakings.

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<sup>65</sup> Linda Koontz, Letter to the Honorable Candice S. Miller and the Honorable Stephen F. Lynch, Government Accountability Office, July 19, 2005, p. 3, <http://www.gao.gov/new.items/d05909r.pdf>.

## Recommendations

### Create an Office of Cost Analysis

Last month, the BCFP announced the creation of an Office of Cost Benefit Analysis.<sup>66</sup> Inspired by the Federal Trade Commission's Bureau of Economics, the office will be housed within the Office of the Director. This fits within the bureau's statutory mandate to consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services" as it adopts new rules.

The creation of such an office is encouraging, but changes can be made to improve it. The proposed office need not to assess the benefits of proposed regulation. Instead, it should be structured as a rigorous review office that seeks to assess the quantitative and qualitative *costs* of regulations, enforcement actions, and supervisory activity, including the dynamic economic effects of regulation and impact on market competition and innovation. The new office should challenge the agency's agenda, asking tough questions that reassess whether a certain kind of regulation or enforcement action is warranted on the merits. In short, the bureau should create an office that challenges whether proposed regulatory activity is appropriate.

There already exist strong forces in both Congress and executive agencies for more regulation. When Congress passes legislation, it usually considers the intended benefits, but rarely the costs. The bureau's Office of Research, Office of Enforcement, and Office of Regulations spend most of their energy on justifying regulatory or enforcement activity. Agencies commonly tout the supposed benefits of a regulatory action, while costs are often ignored. The bureau should institute a counterweight to balance out the overwhelming bias towards ever more regulatory activity. At a minimum, this will improve the quality of regulation promulgated.

The bureau's leadership should carefully think through the unintended consequences of implementing structural changes.<sup>67</sup> Housing the Office of Cost Benefit Analysis directly under the director's control would subject the department to the whims of that director. The bureau's current cost-benefit analysis is woefully inadequate, often doing little more than rubber-stamping proposed regulations. And because bureaucracies have a tendency to grow and expand their powers and activity over time, it is likely that an easily influenced or amended office will become a force for more regulation rather than less.<sup>68</sup> As described in

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<sup>66</sup> Ryan Rainey, "CFPB's Cost-Benefit Analysis Office to Be Modeled After FTC's Bureau of Economics," *Morning Consult*, May 10, 2018, <https://morningconsult.com/2018/05/10/cfpbs-cost-benefit-analysis-office-to-be-modeled-after-ftcs-bureau-of-economics/>.

<sup>67</sup> Clyde Wayne Crews, "The Only Way Trump's Washington Can Be Smaller in Four Years," *Forbes*, April 17, 2017, <https://www.forbes.com/sites/waynecrews/2017/04/17/the-only-way-trumps-washington-can-be-smaller-in-four-years>.

<sup>68</sup> Clyde Wayne Crews, Chapter 5: One Nation, Ungovernable? Confronting the Modern Regulatory State, *What America's Decline in Economic Freedom Means for Entrepreneurship and Prosperity*, April 2015, Fraser Institute,

this comment letter, the same fate has befallen the Small Business Regulatory Enforcement Act, the Paperwork Reduction Act, and many existing cost-benefit requirements.

Instituting rigorous and effective standards of cost review for all rulemakings and enforcement actions will require strong institutional insulation. First, robust and objective economic and legal cost analysis should be established through an independent office free from the director's immediate control or the influence of the rule writing and enforcement departments. Second, career advancement within that office should be based on the quality and objectivity of the analysis conducted.

An Office of Cost Analysis that plainly looks at costs to the industry, consumers, innovation, and market competition, including unintended consequences, is one of the most important structural changes the bureau could make. But focusing on the costs of regulation requires insulation from bureaucratic tendencies.

### Impose a Regulatory Budget

One way to attempt to control the costs that agencies impose on the regulated public is through putting the agency on a regulatory budget.<sup>69</sup> A functioning regulatory budget could be self-implemented by the bureau, and would incentivize the bureau to more carefully consider what they may compel the private sector to spend on regulatory compliance. Putting an annual cap on the compliance costs that the bureau could impose on the private sector through regulation would reduce the impact of unnecessary, excessive and conflicting rules. It would also force the bureau to make necessary tradeoffs, such as repealing other expensive and less effective regulations in order to impose new regulations that it deems more necessary.

### Allow for Third-Party Access to Economic Data and Methodology

In order to scrutinize the economic and cost-benefit analyses conducted by the BCFP, the bureau should make available its economic data and methodology to third parties, such as trade associations, think tanks, and universities. Submitting analysis to other regulatory bodies with the appropriate expertise, such as the Federal Reserve, Office of Financial Research, or Office of Management and Budget, will further help ensure its validity. The bureau should publish for public comment their preliminary analysis for every rulemaking, as well as the associated benefits and costs of each alternative under consideration, before it selects a preferred approach and writes a new regulation.

### End Reliance on Behavioral Economics

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<https://www.fraserinstitute.org/sites/default/files/One-Nation-Ungovernable-Confronting-Modern-Regulatory-State-by-Crews.pdf>.

<sup>69</sup> Clyde Wayne Crews, Ten Thousand Commandments 2018, *Issue Analysis*, Competitive Enterprise Institute, April 19, 2018, <https://cei.org/10KC/Chapter-2>. For an extended discussion on regulatory budgeting, see Marlo Lewis, Reviving Regulatory Reform: Options for the President and Congress, *Issue Analysis* No.3, March 22, 2005, <https://cei.org/studies-issue-analysis/reviving-regulatory-reform-options-president-and-congress>.



The BCFP is the first regulator to rely on Behavioral Law and Economics in its analysis. This should change. The BLE literature is not as rigorous as its proponents claims. Many of its theoretical findings are not appropriate for the analysis of consumer credit markets. To bolster the kind of objective, rigorous analysis that sound rulemaking requires, the bureau should end its' misguided reliance on BLE and, like other agencies, focus on conventional economic and legal analysis.

### Require Sunset Clauses and Rigorous Ex-Post Cost-Benefit Analysis

Agencies rarely conduct retrospective analysis. Virtually no agency has an ongoing, robust effort to assess the actual benefits and costs of its major regulations.<sup>70</sup> More problematically, when it does occur, the analysis is conducted by the same agency that promulgated the regulation being reviewed. This is not a recipe for robust, honest analysis.

Instead, an independent body with a predetermined methodology should be charged with analyzing existing regulations with an eye toward deregulation. Such an office could be modeled on the Office of Cost Analysis proposed above. It should be required to determine whether the benefits of a particular regulation have been met under reasonable cost. If the intended benefits are not being realized, or if the rule has had adverse impacts upon the industry, consumers, innovation, or market competition, the rule should be put aside for rescission.

Another provision that may facilitate greater ex-post cost-benefit analysis is the inclusion of sunset clauses in promulgated regulations. A sunset clause is a measure within a regulation that provides that the regulation shall cease to have effect after a specific date, unless further action is taken to extend it.<sup>71</sup> Ten state governments include comprehensive review sunset clauses, whereby all statutory agencies undergo sunset review on a preset schedule.<sup>72</sup> The bureau, for example, could set a 5-year sunset clause for discretionary rulemakings. In the case of the payday lending rule, if the bureau conducted an ex-post cost-benefit analysis that determined that the rule did not have its desired effect, then it could set aside for expiration. Given that the bureau made contentious claims regarding the impact of the rule, if those goals were not deemed to be met, it should be allowed to expire.

### Involve the Office of Innovation in Rulemakings and Create a Fintech Liaison within the External Affairs Department

One of the most important considerations often neglected in the bureau's rulemaking is the potential for financial innovation to solve many the problems that regulation is trying to address. Whether it be reducing costs, improving the quality of products, or resolving issues

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<sup>70</sup> Patrick McLaughlin and Richard Williams, "The Consequences of Regulatory Accumulation and a Proposed Solution," *Mercatus Working Paper*, February 11, 2014, <https://www.mercatus.org/publication/consequences-regulatory-accumulation-and-proposed-solution>.

<sup>71</sup> Brian Baugus and Feler Bose, "Sunset Legislation in the States: Balancing the Legislature and the Executive," *Mercatus Research*, August 2015, <https://www.mercatus.org/system/files/Baugus-Sunset-Legislation.pdf>.

<sup>72</sup> *Ibid.*

of asymmetric information and cognitive biases, innovation is often more flexible and effective than government rules. Therefore, the bureau should seek and seriously consider input from the Office of Innovation on the costs that regulation imposes on financial innovation, and allow the Office to propose less burdensome alternatives. The bureau should also create a financial technology liaison placed under the external affairs department for closer outreach and coordination with the industry.

#### Create a Small Business Liaison and Coordinate SBREFA Process with the Office of Advocacy at the Small Business Administration

The bureau could significantly improve its Small Business Regulatory Enforcement Act process and Regulatory Flexibility Act analysis by more closely interacting with the Small Business Administration (SBA). SBA is an independent voice for small business within the federal government, advancing the views and concerns of small business before federal agencies such as the BCFP. Creating a small business liaison under the external affairs department for closer outreach and coordination with SBA would improve the bureau's compliance with rulemaking requirements. The bureau should also more deeply include SBA's Office of Advocacy in designing and chairing the SBREFA process and assessing the RFA analysis.

#### Prioritize Required Rulemakings over Discretionary Rulemakings

In the spirit of executing the laws that Congress implemented in the most efficient way possible, the bureau should prioritize required rulemakings over discretionary rulemakings.

#### Strengthen the Requirements of the Rulemaking Process

As described at length in this comment, the bureau appears not to have taken seriously the requirements imposed upon it by Small Business Regulatory Enforcement Act and Paperwork Reduction Act. The BCFP should require that each new rulemaking process appropriately address each of the rulemaking requirements, such as accurately accounting for all the paperwork burden hours and costs.



## **Attachment A: Request for OMB Rejection of the Bureau’s Submission for its Final “Payday Lending” Rule Under the Paperwork Reduction Act**

January 11, 2018

Naomi Rao, Administrator  
Office of Information and Regulatory Affairs  
Office of Management and Budget  
725 17th Street NW  
Washington, D.C. 20503

### **RE: Bureau of Consumer Financial Protection Information Collection Request; Request for OMB Rejection of the Bureau’s Submission for its Final “Payday Lending” Rule**

Dear Ms. Rao:

The Competitive Enterprise Institute (CEI) hereby requests that OMB reject the information collection request currently pending before it for the Consumer Financial Protection Bureau’s (CFPB) final “Payday Lending” Rule. The rule, formally titled the Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule, was published on Nov. 17, 2017. 82 FR 54,472. The rule was accompanied by an information collection request (reference No. 201711-3170-002). Under 44 U.S.C. 3507(d)(4)(C) and 5 C.F.R. § 1320.11(h), the deadline for OMB action on that submission is January 16, 2018.

For the reasons set forth below, CEI submits that CFPB’s information request is totally inadequate under the PRA’s requirement that unreasonable burdens not be imposed on industry and consumers. Requiring more burdensome paperwork on small dollar loans than on a \$250,000 mortgage is excessive. Requiring loan providers to collect a consumer’s housing expense, required payments under debt obligations (including outstanding loans), child support obligations, and alimony obligations, and all potential sources of income and then calculate from this and other information the ability to repay the loan turns loan providers into financial planners and goes well beyond what is necessary. Contrary to the PRA, CFPB has failed to properly assess these and numerous other burdens.

It is true that CFPB is an independent agency and that independent agencies “administered by two or more members of a commission, board, or similar body” can override the determination of the OMB under the PRA.<sup>73</sup> However, under the Dodd-Frank Act which created it, CFPB is a single-headed agency and therefore does not fall under this provision of the PRA.<sup>74</sup> Moreover, even under the PRA provision, OMB is still responsible for making a determination in the first instance regarding PRA compliance; it is CFPB which must affirmatively override that determination if it chooses to.<sup>75</sup>

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<sup>73</sup> 44 U.S.C § 3507(f).

<sup>74</sup> 12 U.S.C. § 5491(a), (b).

<sup>75</sup> Another provision in the Dodd Frank Act requires OMB to treat CFPB rules “on the same terms and conditions as apply to any rule or order prescribed or proposed by the Board of Governors of the Federal Reserve System.” 44 U.S.C. § 3513(c). However, this does not mean that the CFPB and the Federal Reserve Board are to be treated the

**Identity of the Requester:** CEI is a nonprofit 501(c)(3) organization, founded in 1984, dedicated to opposing government economic overregulation. CEI has long been active in economic and financial regulatory issues, and is currently involved in a court challenge to the constitutionality of CFPB's structure. CEI staff have written extensively on the Payday Loan issue, and filed comments on the proposed rule. CEI, along with the 60 Plus Association and the State National Bank of Big Spring, Texas, are challenging the constitutionality of CFPB in *State National Bank of Big Spring v. Lew*.<sup>76</sup> Our challenge is being held in abeyance pending the resolution of *PHH Corp. v. CFPB*.<sup>77</sup> Some recent reports by CEI on the issue of the payday loan and CFPB include: *Ending Payday Lending Would Harm Consumers*,<sup>78</sup> *How Dodd-Frank Harms Main Street*,<sup>79</sup> and *The Case against the Consumer Financial Protection Bureau: Unconstitutionally Structured and Harmful to Consumers*.<sup>80</sup>

Most recently CEI filed comments on this very rule.<sup>81</sup> In that comment, we explained why the rule was such a bad policy. In this request, we focus not on how bad the policy is, but on the extensive and unnecessary paperwork burdens imposed by this rule.

## **I. CFPB's Paperwork Reduction Act Analysis is Inadequate, Especially with Respect to its Examination of the New Evidence Submitted to It**

Under the Paperwork Reduction Act of 1995 (PRA),<sup>82</sup> federal agencies are generally required to seek approval from the OMB for information collection requirements prior to implementation. This involves approving that the agency has accurately assessed costs of each paperwork burden, balanced these costs and benefits, considered the need for and utility of each individual paperwork requirement, and minimized the collection burden of the information collection request. CFPB's rulemaking has failed to comply with these requirements.

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same, only that the same "terms and conditions" apply. One of these conditions is that, as with other multi-member independent boards, at least two Fed Reserve board members are required to overrule OMB. The Board of Governors can usually satisfy this condition since it normally has seven members, but this is not always the case. For example, if the Board of Governors were to have six vacancies and only one member during some time period, it would be unable to overrule the OMB. Since CFPB has only one member (its director), it too cannot overrule OMB. And once again, under the PRA, it is OMB that must first make the determination.

<sup>76</sup> *State National Bank of Big Spring, et al. v. Lew, et al.*, Case No. 12-1032 (D.D.C. held in abeyance pending outcome in *PHH Corp. v. CFPB* July 12, 2016).

<sup>77</sup> *PHH Corp. v. CFPB*, Case No. 15-1177 (D.C. Cir. *en banc* oral argument May 24, 2017).

<sup>78</sup> Hilary Miller, *Ending Payday Lending Would Harm Consumers*, Oct. 5, 2016, [https://cei.org/sites/default/files/Hilary\\_Miller\\_-\\_Ending\\_Payday\\_Lending\\_Would\\_Harm\\_Consumers.pdf](https://cei.org/sites/default/files/Hilary_Miller_-_Ending_Payday_Lending_Would_Harm_Consumers.pdf).

<sup>79</sup> Iain Murray, *How Dodd-Frank Harms Main Street*, July 20, 2015, <http://www.cei.org/sites/default/files/Iain%20Murray%20-%20How%20Dodd%20Frank%20Harms%20Main%20Street.pdf>.

<sup>80</sup> Iain Murray, *The Case against the Consumer Financial Protection Bureau: Unconstitutionally Structured and Harmful to Consumers*, September 2017, <https://cei.org/sites/default/files/Iain%20Murray%20-%20The%20Case%20against%20the%20Consumer%20Financial%20Protection%20Bureau.pdf>.

<sup>81</sup> Ian Murray and John Berlau, *Comments of the Competitive Enterprise Institute*, Oct. 7, 2016, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143356&attachmentNumber=1&contentType=pdf>.

<sup>82</sup> 44 U.S.C. 3501.

*A. The fact that CFPB's rule is based so heavily on paperwork makes a proper analysis of its paperwork burdens all the more important.*

Every single provision of the short-term lending rule is structured around information collection requests subject to the PRA. The rule's central requirement is that lenders determine a borrower's ability to repay by demanding financial information from the borrower, reviewing and verifying the information, and then recording the result of various calculations. This involves purchasing new technology, consulting with credit reporting systems, consulting with vendors and lawyers, employing and training data and compliance specialists, and retaining data, amongst other requirements. Each of these requirements is its own paperwork burden.

According to the Bureau, the following aspects of the rule are information collection requirements under the PRA:

- development, implementation, and continued use of notices for covered short-term loans made under § 1041.6, upcoming payment notices (including unusual payment notices), and consumer rights notices;
- obtaining a consumer report from a registered information system;
- furnishing information about consumers' borrowing behavior to each registered information system;
- retrieval of borrowers' national consumer report information;
- collection of consumers' income and major financial obligations during the underwriting process;
- obtaining a new and specific authorization to withdraw payment from a borrower's deposit account after two consecutive failed payment transfer attempts;
- application to be a registered information system;
- biennial assessment of the information security programs for registered information systems;
- retention of loan agreement and documentation obtained when making a covered loan, and electronic records of origination calculations and determination, records for a consumer who qualifies for an exception to or overcomes a presumption of unaffordability, loan type and term, and payment history and loan performance.<sup>83</sup>

*B. CFPB did not adequately analyze the rule's paperwork burdens.*

Given the vast amount of information collection requirements, it would be expected that the Bureau provided a focused, comprehensive justification and quantification of paperwork burdens. Indeed, in "Section IX Paperwork Reduction Act" analysis of the final rule, the Bureau recognized that it "received a fairly significant number of comments pertaining to the expected burden of the proposal, including burdens accounted for in the PRA. Some of those comments specifically noted the PRA, and argued that the proposed collections of information did not fill a legitimate regulatory purpose." Despite this, CFPB has failed to provide the required analysis under the PRA.

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<sup>83</sup> CFPB, Payday, Vehicle Title, and Certain High-Cost Installment Loans final rule, Nov. 17, 2017, 82 FR 54871.

In the proposed rule, the Bureau provided a limited 3-page analysis of the paperwork burdens under the PRA, in which it failed to provide a justification for each paperwork burden.<sup>84</sup> However, the Bureau at least provided a supporting statement to the rule, breaking down the total cost and hours of the paperwork burden and describing the burden estimate methods.<sup>85</sup> The final rule provided no such analysis.

In finalizing the rule, the Bureau has substantially changed the rule's calculated paperwork burdens lenders. For example, under the proposed rule the annual time burden in hours was estimated to be 6,629,201, while the Annual Cost Burden in dollars was estimated to be 129,825,941.<sup>86</sup> The final rule saw this change drastically, raising the Annual Time Burden to 8,199,819 hours, while reducing the Annual Cost Burden fell to 100,844,367.<sup>87</sup> At a minimum, such a change should have included its own separate, revised analysis to determine and explain the changes in the paperwork burden, as well as the justification for each burden. Instead, the Bureau reiterated its analysis under the proposed rule almost identically, without providing *any* supporting statement describing the burden or estimation methods. Under Section IX, the Bureau states that the explanation is included in Section V and VII, the section-by-section analysis and the Section 1022(b)(2) Analysis. Yet these sections are not coherent attempts to quantify and justify the change in the paperwork burden. They are related to responding to comments and the cost-benefit analysis required by the Dodd-Frank Act. The paperwork burden discussions that are included are on an ad-hoc basis, spread out over nearly 1,300 pages, and are predominately in response to public comments. Instead of a focused, comprehensive analysis, the Bureau's justification of its information collection requirements, as described in Section IX, is limited to the following cursory conclusion:

[T]he Bureau is confident that each of the collections of information is worth the burden and serves an important purpose. Specific to the verification of income and debt requirements, the Bureau believes that these requirements are not overly burdensome. In many cases, covered lenders already verify income. Verification of debt will be achievable through obtaining consumer reports, an approach that would not burden consumers, and is consistent with industry practices in most other credit markets. These requirements advance the stated goal of assessing ability to repay because they ensure that lenders verify essential variables for a reasonable ability-to-repay determination, and they combat significant risks associated with lenders' potential evasion of the rule.<sup>88</sup>

In finalizing the rule, the agency has made little attempt to accurately account for the changes in paperwork burden as required under the PRA. There has been no focused attempt to accurately assess costs, balance these costs and benefits, consider the need for and utility of each individual paperwork requirement, and minimize the collection burden in the final rule. As

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<sup>84</sup> CFPB, Payday, Vehicle Title, and Certain High-Cost Installment Loans proposed rule, Jul 22, 2016, 82 FR 54871.

<sup>85</sup> CFPB, Supporting Statement Part A, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-0002&contentType=pdf>.

<sup>86</sup> Reporting, Recordkeeping, and Disclosure Requirements, new, [https://www.reginfo.gov/public/do/PRAViewIC?ref\\_nbr=201606-3170-001&icID=221772](https://www.reginfo.gov/public/do/PRAViewIC?ref_nbr=201606-3170-001&icID=221772).

<sup>87</sup> Reporting, Recordkeeping, and Disclosure Requirements, modified, [https://www.reginfo.gov/public/do/PRAViewIC?ref\\_nbr=201711-3170-002&icID=221772](https://www.reginfo.gov/public/do/PRAViewIC?ref_nbr=201711-3170-002&icID=221772).

<sup>88</sup> 82 FR 54871.

discussed below, the justifications provided by the Bureau in Section IX are directly refuted by numerous comments filed to the Bureau. Not only are the paperwork requirements excessively burdensome, but many are so complex that they are almost impossible to reasonably fulfill. Even worse, the Bureau's paperwork burden estimates are resoundingly inaccurate, and vastly understate the total burden to both lenders and consumers, as pointed out by numerous commenters. However, it is difficult to determine the extent to which the Bureau has underestimated such costs, because it does not provide a separate, comprehensive analysis of the paperwork burdens in the final rule. More importantly, there has been little attempt to engage with these detailed criticisms of its analysis of the proposed rule's costs. Instead, the Bureau often disregarded these concerns citing its authority without reasonable discussion. CFPB's attempt to comply with the PRA can only be described as wholly inadequate.

*C. The inadequacy of CFPB's analysis is highlighted by the more detailed PRA analyses that it has provided in the past.*

In past rulemakings, the Bureau has issued far more detailed PRA analyses. For example, the Qualified Mortgage Standards received analysis regarding the ability to repay, documentation and record retention requirements.<sup>89</sup> This involved quantification and justification of the paperwork burdens in its own dedicated section in the final rule. The Prepaid Accounts rule involved the same kind of consideration.<sup>90</sup> In finalizing the payday loan rule, the Bureau provided no such analysis, restricting its discussion to a single paragraph, quoted above.

## **II. The Bureau Imposes Unreasonable Burdens On Lenders and Consumers**

Under the PRA, the Bureau is required to consider the need for and utility of each individual paperwork requirement and to minimize the collection burden of the information collection request. The vast requirements described above cannot reasonably be considered as fulfilling either condition. An annual paperwork burden of over 8,000,000 hours and 100,000,000 dollars (which is drastically underestimated) is a substantial and unreasonable burden on both lenders and consumers. These requirements are often taxing for consumers and prohibitively expensive for small dollar lenders.

*A. The rule's underwriting requirements are far more substantial than those of larger credit instruments such as mortgages and credit cards*

Numerous commenters pointed out that the Bureau's rule required significant collection of consumer's personal data in order to determine a customer's "ability to repay," and that the total constituted more than a much larger and more complex loan. Mark Asmus, the chief compliance officer at First Nebraska Bank, stated that: "These items aren't even required to make six-figure real estate mortgages, so why would they be necessary for a small dollar loan?"

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<sup>89</sup> CFPB, Ability-to-Repay and Qualified Mortgage Standards under Truth in Lending Act (Regulation Z) Final Rule, Jan 30, 2013, 78 FR 6407.

<sup>90</sup> CFPB, Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), Dec 23, 2014, 82 FR 13782.

The paperwork necessary for a \$1,000 loan should not be more in depth than that required for a \$300,000 home loan; it must be in a reasonable proportion to the size of the request.”<sup>91</sup>

Furthermore, the Online Lenders Alliance noted that:

The Proposal’s [Ability to Repay] 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.<sup>92</sup>

The Bureau also received tens of thousands of comments from customers concerned about the amount of information they would have to provide in order to qualify for a loan. One commenter stated that “I like that I don’t have to give a lot of personal information to get a payday loan currently. The CFPB’s new rule would change this process and create a lot more paperwork to fill out.”<sup>93</sup> Such sentiment is echoed by thousands of other commenters and confirmed by much of the academic literature, which has found that one of the most common reasons customers cited for using payday loans was that it was an easy, convenient process with little paperwork.<sup>94</sup>

As part of the information collection request, the final rule forces customers to provide extensive information about their financial history, income, employment, housing expenses, child care payments, debt obligations, and much more. It then requires lenders to collect and report this information to a credit reporting agency, make an ability to repay assessment, and then store this financial data. Such an extensive procedure is an unreasonable burden for a small-dollar loan, which typically amounts to \$300. In comments to the Bureau, the Financial Services Centers of America noted that these requirements “would essentially turn lenders into financial planners.”<sup>95</sup> Indeed, such paperwork burdens are prohibitively expensive, and will likely make small-dollar loans unprofitable for most lenders.

In promulgating the rule, CFPB has not attempted to minimize the collection burden of the information collection request. A \$300 loan should not require such extensive personal financial information that it is more burdensome than many forms of credit for much larger

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<sup>91</sup> Mark Asmus, First Nebraska Bank, October 7, 2016, p.2, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-147176&attachmentNumber=1&contentType=pdf>.

<sup>92</sup> Online Lenders Alliance, October 7, 2017, p.32, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>93</sup> Garcia Bailey, July 12, 2016, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-5838&attachmentNumber=1&contentType=pdf>.

<sup>94</sup> Gregory Elliehausen, *An analysis of consumers’ use of payday loans*, George Washington University, January 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](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).

<sup>95</sup> Financial Services Center of America, October 7, 2016, p.10, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-186584&attachmentNumber=1&contentType=pdf>.

amounts. As discussed below,<sup>96</sup> the Bureau had many alternative options that would have significantly reduced the paperwork burden on both lenders and consumers, yet it failed to appropriately consider them.

*B. The rule's excessively expensive underwriting requirements are so disproportionate that they should be rejected under the PRA.*

CFPB admitted in the final rule that it had “received a significant number of comments from industry arguing that the underwriting requirements in the proposed rule would be too costly, take too much time to administer, be too restrictive and require too much document verification.”<sup>97</sup>

One such example is from the Financial Services Center of America. FiSCA describes how the rule's underwriting requirements will drastically raise costs on lenders:

The Proposed Rule would require lenders to obtain at least two different forms of credit reports at the time of origination, as well as to furnish information about the loan product and loan performance to multiple credit reporting agencies. These requirements would exponentially increase cost to lenders. Lenders will have to implement the reporting requirements, which will require new policies and procedures, employee training, and likely new systems. Furthermore, requiring lenders to report information regarding every covered loan to all registered furnishers will create significant operational costs associated with compliance, as well as operational risks associated with data security and data integrity.<sup>98</sup>

The Online Lenders Alliance provided evidence, in comments to the Bureau, that the average cost of underwriting a covered longer-term loan would increase by \$58.00 to \$88.30 per loan, representing an increase of \$30.30 or 52 percent per loan.<sup>99</sup> Another lender, Personal Finance Company, noted that its estimated costs will likely rise by 68 percent.<sup>100</sup>

The cost of the loan origination and data furnishing system required by the Bureau will be very expensive to lenders. OLA again noted that “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.”<sup>101</sup> Another lender, Check Into Cash, reiterated these concerns, stating that “In total, 19,090 hours of work are required to meet the Proposed Rule's demands on

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<sup>96</sup> See Part II.D.

<sup>97</sup> CFPB final rule, 82 FR 54630.

<sup>98</sup> FiSCA, p.19, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-186584&attachmentNumber=1&contentType=pdf>.

<sup>99</sup> OLA, p. 13, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>100</sup> Personal Finance Company, October 7, 2016, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-141771&attachmentNumber=1&contentType=pdf>.

<sup>101</sup> OLA, p. 75, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.



a lender's loan origination systems. Given a standard 40 hour work week, it would take a team of four (4) programmers over 26 months to complete these tasks alone."<sup>102</sup>

The burdens associated with the information collection requirements of CFPB are enormous, and will likely put thousands of lenders out of business. According to OLA "Lenders will not be able to absorb those costs since profit margins in the industry are relatively low".<sup>103</sup> Instead of recognizing how burdensome the procedural requirements are, CFPB largely ignored their impact on lenders. Instead, it claims the largest effects on lenders come from the limitations on rollovers. Yet lenders almost unanimously noted that the enormous paperwork burdens themselves would put them out of business. Underestimating the true costs of the paperwork burdens allows the Bureau to claim a much smaller impact on lenders than is the case.

*C. Many of the rule's paperwork requirements are nearly impossible to fulfill.*

In order to assess a customer's ability to repay, the Bureau imposed enormous paperwork burdens on both customers and lenders. Perhaps worst of all, many of these procedural requirements are incredibly hard to fulfill, such as having to determine that a customer will be financially stable for the next thirty days after taking out a small dollar loan. This includes forecasting a customer's major financial obligations and basic living expenses. The Bureau expansively defines basic living expenses as "expenditures... that a consumer makes for goods and services that are necessary to maintain the consumer's health, welfare, and ability to produce income, and the health and welfare of the members of the consumer's household who are financially dependent on the consumer," and major financial obligations as a "consumer's housing expense, required payments under debt obligations (including, without limitation, outstanding covered loans), child support obligations, and alimony obligations."<sup>104</sup>

The Financial Services Centers of America discussed just how burdensome these requirements would be: "While the complexity of verifying housing and income alone is daunting, it pales in comparison to the requirements to project a consumer's ability to meet financial obligations for 30 days after the highest loan payment, and to show improvement in financial capacity before extending additional credit. These concepts are abstract and vague and would essentially turn lenders into financial planners."<sup>105</sup> FiSCA went on to note that "The verification requirements will significantly increase the time needed to underwrite a loan," making most loans unprofitable to make.

A storefront payday lender, Advance America, further noted the immense difficulty of predicting a consumer's average housing costs:

The Bureau's expense verification method is purely speculative and cannot serve a legitimate public interest, as there is no way to ensure the accuracy of, for example, the average housing expenses in the applicant's area. Wide variations of

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<sup>102</sup> Check Into Cash, October 4, 2016, p. 49, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-187768&attachmentNumber=1&contentType=pdf>.

<sup>103</sup> OLA, p. 13, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>104</sup> CFPB final rule, 82 FR 54874.

<sup>105</sup> FiSCA, p. 10, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-186584&attachmentNumber=1&contentType=pdf>.

home values and other expenses within a single area are common within urban areas. Where these variations exist, the higher expenses of individuals with higher incomes will inevitably be imputed to individuals with lower incomes who live nearby; thus, lower income, under-banked individuals, who are often minority protected class members, will be effectively barred from obtaining access to credit.<sup>106</sup>

Many borrowers use small dollar loans specifically because their incomes are fluctuating and hard to predict. They themselves struggle to forecast their income accurately, as many work flexible hours or seasonal jobs. As a comment submitted on behalf of the Mercatus Center notes:

Many subprime borrowers, however, tend to be hourly workers who live paycheck to paycheck. Unlike prime borrowers, these subprime consumers are painfully familiar with income variability. Salaried employees get paid when they are sick and cannot come to work. Hourly employees do not get paid unless they work. Roofers do not work—and therefore do not get paid—when it rains. Restaurant servers do not get paid to take a child to the doctor. This income variability imperils consumers' credit and gives rise to the need for short-term loan products.<sup>107</sup>

It also makes it extremely difficult to forecast their ability to repay.

CFPB is required under the PRA to assess the relative merits of each paperwork requirement and to minimize the costs of these requirements. Imposing procedures that are just about impossible for a lender to fulfill is a sure sign that the Bureau has not faithfully attempted to fulfill their requirements under the PRA. Indeed, accurately predicting a customer's living expenses, major financial obligations, and ability to repay while maintaining good financial health for the next 30 days is far beyond most credit issuers, let alone lenders making loans of \$300. Commenters proposed multiple alternative options for confirming that a customer has the ability to repay that would have been much less burdensome to make, such as written testimony from a consumer of their ability to repay, but CFPB refused to consider these proposals.

*D. The bureau failed to minimize the paperwork burden by adequately considering alternatives.*

The final rule issued by CFPB largely proceeds with many of the paperwork burdens in the proposed rule, despite numerous commenters suggesting alternatives to minimize such burdens.

As part of its rulemaking, CFPB is required to undertake the Small Business Regulatory Enforcement Act (SBREFA) process in order to, in part, identify alternative regulatory approaches that reduce the paperwork burden on smaller entities. Under the SBREFA process, lenders aired numerous concerns in regards to the paperwork burdens of the rule, proposing alternatives that would have minimized the costs while still addressing the concerns of the Bureau.

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<sup>106</sup> Advance America, October 2, 2016, p. 26, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142467&attachmentNumber=1&contentType=pdf>.

<sup>107</sup> Mercatus Center, October 7, 2016, p. 4, <https://www.mercatus.org/system/files/miller-payday-lending-pic-v1.pdf>.

The final report of Small Business Review Panel of small businesses selected by the CFPB concluded:

[T]he [Small Entity Representatives] stated that the proposals under consideration by the Bureau were unnecessary and onerous. Many of the SERs rejected the premises of the Bureau's rulemaking and argued that they would be unable to continue operating profitably once the Bureau's rule went into effect. The SERs stated that their goal, as lenders, was to engage in successful transactions. The SERs expressed the belief that the Bureau, in considering these proposals, seemed to assume that the lenders were being unfair or abusive rather than simply being businesses operating lawfully within their jurisdictions and serving the financial needs of their communities. Numerous SERs recommended that the Bureau forgo the ability-to-repay requirements entirely and either defer to existing state regulation or model federal regulation on the laws or regulations of certain states.<sup>108</sup>

According to people involved in the SBREFA process like Paul Hoffer of Xpress Cash, CFPB entirely ignored the alternative approaches proposed by the SBREFA members.<sup>109</sup> One lender, Check City Partnership, involved in the process noted that "When reading CFPB's proposed rule it is patently clear to us that CFPB has ignored 100% of the concerns raised by the small business representatives at this hearing. It looks as if CFPB conducted the hearing only because it was forced to do so, with no intention of thoughtfully considering the comments raised in the hearing as it drafted the proposed rule."<sup>110</sup>

In the words of the American Financial Services Association, some of the alternative proposals raised as part of the SBREFA process included:

1. Allowing lenders to consider a borrower's ability to repay using less prescriptive means. Returning customers that have borrowed and repaid loans in the past, for example, have already demonstrated their ability to repay several times over. Customers that need money for emergencies should also not be shut out from obtaining credit due to rigid underwriting requirements. The Bureau could adopt an alternative to the ability-to-repay requirements based, for example, on a payment-to-income standard.
2. Recognizing other consumer safeguards. State law, NACHA requirements, and trade association best practices have transformed loan underwriting for the better in recent years, without any need for a prescriptive ability-to-repay

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<sup>108</sup> Final Report of the Small Business Review Panel on CFPBs' Rulemaking on Payday, Vehicle Title, and Similar Loans, June 25, 2015, p. 14-15, available at <https://www.acainternational.org/assets/payday-lending-rulemaking/part-1-cfpb-sbrefa.pdf>.

<sup>109</sup> Paul Hoffer, Xpress Cash Management LLC, Oct. 5, 2016, p.4 ("It now seems that they were just going through the motions during the SBREFA process and had very little intention of listening, let alone of trying to come up with a rule that would not so drastically kill the small businesses in the industry, not to mention the bigger businesses as well."), <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142156&attachmentNumber=1&contentType=pdf>.

<sup>110</sup> Check City Partnership, September 26, 2016, p. 5, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143064&attachmentNumber=1&contentType=pdf>.

requirement. The Bureau must take these improvements into account when fashioning the final rule.

3. Streamlining the requirements for reporting the use of covered loans to consumer reporting agencies. Although Traditional Loan Product providers have relationships with credit-reporting bureaus, the Proposed Rule would take the unprecedented step of requiring lenders to integrate with all registered information systems. This mandate will necessitate significant expenditures of time and money by lenders without producing any apparent benefit, and will lead many lenders to exit the market for covered Traditional Loan Products entirely.<sup>111</sup>

According to the Online Lenders Alliance and many others, CFPB failed to consider these approaches adequately:

In fact, despite clear and consistent feedback from [Small Entity Representatives] 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.<sup>112</sup>

Three Senators, Sen. Rubio (R-FL), Sen. Kennedy (R-LA), and Sen. Risch (R-ID), also filed comments to the Bureau requesting a delay in promulgating the rule. It was the belief of the Senators that CFPB has failed to appropriately address the concerns of the U.S. Small Business Administration, particularly in regards to paperwork burdens. The Senators wrote:

In August 2016, the Government Accountability Office (GAO) released a report on CFPB's use of SBREFA panels. GAO's findings showed bare minimal compliance with the letter of the law, and a disregard for congressional intent that agencies not railroad small businesses with unduly burdensome regulations...

It was our hope that the CFPB would improve its rulemaking efforts in response to GAO's performance audit. Instead, the Office of Advocacy at the Small Business Administration (SBA) found that CFPB grossly violated the [Regulatory Flexibility Analysis] in promulgating the Payday Lender Rule by:

- Underestimating the potential economic impact on small entities;
- Failing to perform a complete analysis of the costs of compliance;
- Failing to provide an adequate estimate of the aggregate impact of requirements on the revenue stream for financial services customers;

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<sup>111</sup> The American Financial Services Association, October 6, 2016, p.53, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142151&attachmentNumber=1&contentType=pdf>.

<sup>112</sup> OLA, p. 85, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

- Proposing a rule that was materially different from the initial proposed rule;
- Adding unnecessary hurdles for regulated small entities;
- Failing to consider other less harmful methods of regulation;
- Neglecting a more than 70 percent decrease in revenue for regulated small entities;
- Failing to provide an exception for emergencies;
- Neglecting to recognize state regulations of these same entities;
- Failing to consider the effects on rural communities and tribes;
- Ignoring projections of harm for a large percentage of payday lenders and small businesses needing credit; and
- Neglecting the expertise of NCUA’s, Deloitte, SBREFA panelists, and the SBA Office of Advocacy.<sup>113</sup>

Instead of adopting reasonable measures to reduce the paperwork burden of the final rule, the Bureau failed to even consider alternative measures proposed by either commenters or lenders in the SBREFA process. It cannot be said that the Bureau has therefore sought to minimize the paperwork burden on lenders, as it is required to under the PRA.

### **III. The Bureau Has Not Accurately Accounted for the Paperwork Burden on Lenders**

Consistently throughout the final rule, CFPB has failed to accurately assess the paperwork burdens on lenders and consumers. Numerous commenters suggest that the Bureau was so deficient that it appears that it neglected its responsibility to conduct the appropriate analysis altogether. Not only does this significantly underestimate the total paperwork burden hours and cost, but it enables the Bureau to claim that the costs of the procedural requirements may have a marginal impact on the small dollar loan market. Instead, it claims that “the larger effects will come from the limitations on lending,”<sup>114</sup> that is, the limitations on rollovers. Yet lenders almost unanimously noted that the enormous paperwork burdens themselves would put them out of business. Underestimating the true costs of the paperwork burdens allows the Bureau to claim a much smaller impact on lenders than is the case.

#### *A. The time needed to process ability-to-pay applications is much longer than estimated.*

In the proposed rule, the Bureau estimated that an ability to pay determination would “take essentially no time for a fully automated electronic system” and between 15 and 20 minutes for a fully manual system. Many commenters’ noted that this estimate was far too low, with various commenters’ estimating that one to four hours is a more accurate account. The only concession the Bureau made was to increase the estimated manual processing time from 15-20

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<sup>113</sup> Sen. Rubio (R-FL), Sen. Kennedy (R-LA), and Sen. Risch (R-ID), June 30, 2017, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-211929&attachmentNumber=1&contentType=pdf>.

<sup>114</sup> CFPB final rule, 82 FR 54834.

minutes to 15-45 minutes. Many commenters provided evidence of procedures that the Bureau has not accounted for in its calculation.

Gary Elkins, the founder of a small-dollar loan business, Personal Credit Corporation, found that this estimate was so greatly underestimated that it “leads a person to believe that the group of people who wrote the proposed rules are completely ignorant of what they have proposed or do not understand what they are proposing.”<sup>115</sup> He described the estimate that the manual processing would only take 15 - 20 minutes as “naive.”<sup>116</sup>

The American Financial Services Association described the estimate as “unreasonable.”<sup>117</sup> Describing the steps to successfully underwrite an ability-to-repay loan by manual process, the association noted that “the employee must discuss what is required with the applicant, answer the applicant’s questions, assist the applicant in obtaining documentation from employers and others, compile the information, ensure the information is complete, and then review the completed information to determine ability to repay.”<sup>118</sup>

For those businesses with an automated underwriting system, which the Bureau believed would take no time at all,<sup>119</sup> AFSA stated that the Bureau has not considered the fact that “employees would still be required to monitor the system and ensure that it is functioning appropriately. The Proposed Rule fails to consider these monitoring costs, as well as other costs necessary to create, maintain, and monitor a properly functioning ability-to-repay decision making system.”<sup>120</sup>

Further, the American Association of Responsible Auto Lenders found that the Bureau’s estimate “completely misses the mark.”<sup>121</sup> AARAL claimed that “Many small lenders will not be able to afford to set up ‘fully automated systems’, and the idea that the layers of analysis required by the rule can be completed ‘in essentially no time’ is laughable even with such automation.”

An online and storefront lender, Check into Cash, provided evidence that manually processing applications in the U.K. takes one to four hours. The company described,

[A] similar manual process employed by a [Check-Into-Cash]-affiliated lender in the United Kingdom under the Financial Conduct Authority regulations similar to

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<sup>115</sup> Gary Elkins, Personal Credit Corp, September 30, 2016, p.39, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-208314&attachmentNumber=1&contentType=pdf>.

<sup>116</sup> *Id.*

<sup>117</sup> Comment Submitted by Bill Himpler, AFSA, Oct. 6, 2016, p. 51, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142151&attachmentNumber=1&contentType=pdf>.

<sup>118</sup> *Id.*

<sup>119</sup> CFPB final rule, 82 FR 54599.

<sup>120</sup> Comment Submitted by Bill Himpler, AFSA, Oct. 6, 2016, p. 51, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142151&attachmentNumber=1&contentType=pdf>.

<sup>121</sup> The American Association of Responsible Auto Lenders, October 7, 2016, p. 31 <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142821&attachmentNumber=1&contentType=pdf>.

those proposed by the Bureau for small loans takes significantly longer. To process a customer application, scan and upload the required supporting documentation, review and grade the customer's declared income and expenditures against national averages for the same, analyze the customer's full credit report and bank account statements showing the customer's actual monthly expenses and outstanding debts, then answer any lingering questions regarding the application with the customer that need clarification and execute the loan agreement, requires one (1) to four (4) hours of employee time for each customer credit application.<sup>122</sup>

This is substantially longer than the estimated provided by the Bureau. The Bureau also noted a community bank survey that stated that respondents anticipated three hours of processing time on average to complete ability-to-repay verification and determination.<sup>123</sup>

The Bureau's response to these commenters was incredibly limited. Despite receiving strong evidence, the Bureau disregarded these issues without further investigation, stating that the Bureau's analysis "seems to be based on the most applicable information... and thus informs the Bureau's estimates."<sup>124</sup> However, as noted, multiple commenters objected to this, with at least two providing credible evidence of 3 hours and 1-4 hours. Given the large disparity in the documented manual processing times, the Bureau should have provided a more thorough consideration of these claims. It is likely, therefore, that the paperwork burden may be much more significant than the Bureau has claimed.

*B. CFPB failed to adequately analyze the cost of utilizing a credit reporting system.*

The direct cost of purchasing a credit report is more than twice what CFPB estimates. The CFPB estimates \$0.50 per consumer report, but the typical cost is substantially higher than this. The Online Lenders Alliance estimates twice the cost estimated by CFPB.<sup>125</sup> According to CFPB: "The comments were approximately evenly split as to whether the estimated costs were substantially too low, slightly too low, or approximately accurate."<sup>126</sup> And yet despite a third saying the estimated costs were "substantially too low" and a third saying they were "slightly too low" and none saying they were too high, CFPB didn't change its estimated costs at all, totally ignoring the comments.

In addition to these direct costs of pulling the report are the costs of integrating these credit reports into the decision making process. This requires programmers, training, and support personnel. None of these was estimated by CFPB in the burden imposed.

These costs will need to be paid even for people who don't actually end up borrowing anything. So the price increase passed on to each consumer who does purchase something will be

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<sup>122</sup> Comment submitted by Check Into Cash, Oct. 4, 2016, p. 50, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-187768&attachmentNumber=1&contentType=pdf>.

<sup>123</sup> CFPB final rule, 82 FR 54855.

<sup>124</sup> 82 FR 54840.

<sup>125</sup> Comments by OLA, Oct. 7, 2016, p.76, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>126</sup> 82 FR 54864

substantially larger. Exactly how much is unknown as it depends on how many consumers who do not qualify would apply.

In addition to the costs in money, there is the additional time it will take to run the credit report and evaluate it. According to CFPB it will cost nine minutes to manually pull the credit report. In addition to this cost, is the time to process and understand what that credit report means and figure out how that changes the loan terms. For loan decisions that were quick, they will no longer be due to CFPB's requirement to pull a credit report.

But even beyond the direct increase in costs of pulling a credit report, there is also the harm that pulling such a report does to the consumer's credit report. On average people lose 3-5 points per hard pull of their credit report. For some people, with very good credit reports and no recent hard pulls, as many as 30 points could be lost from a single hard pull of their credit report.

Each of these one-time losses is compounded by how many places they search for credit. Those with bad credit may need to go to many different places in search of someone who will extend them credit. Each time, a new credit report will be required to be pulled, further decreasing their credit score. There is the possibility that a kind of credit death spiral will occur in that the search for credit itself will prevent the person from being able to get credit.

*C. CFPB severely understated employment and training costs, despite the evidence submitted to it.*

Small-dollar lenders will need to hire and train new employees to comply with the vast and complex procedural changes imposed by the rule. Numerous commenters raised this issue, yet the Bureau's discussion of these concerns was limited to a two sentence statement: "Commenters also raised concerns that the Bureau's time estimates for initial and periodic ongoing training estimates were too low. The Bureau has reviewed its assessment, and the broader set of comments, and has concluded that the training estimates laid out were reasonable."<sup>127</sup> The Bureau claimed elsewhere that "the vast majority of the comments from more directly-related trade groups and lenders remained silent on these estimates."<sup>128</sup> As the comments directly below demonstrate, this is not the case.

CFPB estimates that employees will require only 4.5 hours of initial training and 2.5 hours of periodic ongoing training per year to comply with the ATR requirements. These training costs represent the total costs to comply with the rule, including training to conduct an underwriting assessment, pull a credit report, assess borrower history, and comply with disclosure requirements. According to the Online Lenders Alliance, this is incredibly inadequate. "The CFPB... underestimates the amount of staff training that would be required to ensure compliance with the rule. 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... This is not enough time and demonstrates that the CFPB does not appreciate the complexity of the Proposal."<sup>129</sup>

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<sup>127</sup> CFPB final rule, 82 FR 54856.

<sup>128</sup> 82 FR 54823.

<sup>129</sup> OLA, p. 75, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.



Further, a comment from the Florida Community Financial Services Association stated:

Providers must significantly expand their employee training manuals and related training courses, guidance and scripts to address the requirements of the Proposed Rule. This is a process that will require countless hours of labor and compliance, escalating costs beyond what may be sustainable for the operation of the business. There must also be an extensive and costly effort to “train the trainers” so that they may effectively educate both existing employees and new hires about the Proposed Rule.<sup>130</sup>

At least one commenter, the Personal Finance Company specifically estimated the costs of training, stating that “A very rough initial estimate at this time is approximately \$15,000 per year in training costs.”<sup>131</sup> Meanwhile, PFC noted that one-time costs for training time and expense would be \$30,000.<sup>132</sup> Given that CFPB has failed to provide a comprehensive, dedicated assessment of the paperwork burden, it is difficult to determine exactly what the dollar costs of employee training are. However, a \$15,000 per year assessment is *much* larger than the cost of 2.5 hours of periodic ongoing training per employee per year to comply with the ATR requirements. CFPB has largely underestimated the true costs of the paperwork burden by failing to accurately assess the amount of time and money it will take to appropriately train staff.

*D. CFPB understated the cost of utilizing technology for underwriting process.*

In order to conduct an ATR assessment, lenders are required to develop compliant loan management systems. For many lenders, this will require establishing new systems or upgrading old ones. Just one example of the new burden imposed that will have to be absorbed by the lenders is CFPB’s estimate of a \$10,000 fee for upgrading their software to collect the new information and \$100 increase per user.<sup>133</sup> One of the authors of the instant request to OMB is Devin Watkins, who was a senior software developer at Intel. According to Mr. Watkins, this vastly underestimates the costs required to upgrade and maintain such a significant increase in data collection and the complicated algorithms required to calculate the ability to pay. While we suspect the software costs are going to be much more significant, even these fees are an additional burden on an industry with razor thin margins as is.

This is established in many comments to the Bureau. Check-Into-Cash, a storefront and online lender, explained that “CIC is left to conclude that the Bureau conducted no real analysis of the software requirements necessary to meet the Proposed Rule’s requirements as our internal

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<sup>130</sup> Florida Community Financial Services Association, September 30, 2016, p. 7, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-199452&attachmentNumber=1&contentType=pdf>.

<sup>131</sup> Personal Finance Company, p. 17, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-141771&attachmentNumber=1&contentType=pdf>.

<sup>132</sup> *Id.*

<sup>133</sup> CFPB final rule, 82 FR 54821.

estimates are ten times (10x) longer than those presented by the Bureau.”<sup>134</sup> Personal Finance Company also noted that initial costs of technology to be \$95,000.<sup>135</sup>

Furthermore, the Online Lenders Alliance notes:

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...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.<sup>136</sup>

Despite such a wide differential, the Bureau entirely failed to address the costs appropriately. The final rule states:

Across a number of business processes, commenters raised concerns that the Bureau’s estimates for the one-time costs to update policies, systems, and materials were underestimated. Regarding the disclosure requirements of the proposed rule, commenters stated that the time and costs to develop and ensure disclosures are accurate was underestimated. Similarly, commenters also stated that the estimated one-time costs to update credit reporting systems were too low. Finally, commenters stated that the Bureau’s estimates of the costs to upgrade general computer systems... were underestimated. The Bureau appreciates these comments, but believes its estimates, and the cost framework used throughout the rule, are accurate.<sup>137</sup>

Not only has the Bureau failed to accurately assess the costs of the information collection burdens that it is imposing, but it has neglected to review its proposal in light of commenters’ concerns. Worst of all, there is no way to determine whether its estimates, and the cost framework used throughout the rule are accurate because it does not provide a concise Paperwork Reduction Act analysis in the final rule, nor does it provide a supporting statement to the final rule’s information collection request. In short, the Bureau has not provided an adequate analysis of the paperwork burdens in the rule, and in the sparsely located places it has, it has largely underestimated such burdens.

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<sup>134</sup> Check Into Cash, p. 48, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-187768&attachmentNumber=1&contentType=pdf>.

<sup>135</sup> Personal Finance Company, p. 17, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-141771&attachmentNumber=1&contentType=pdf>.

<sup>136</sup> OLA, p. 75, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>137</sup> CFPB final rule, 82 FR 54856.

*E. CFPB failed to address the cost of lawyers and other vendors needed for compliance.*

In acknowledging that making ability-to-repay determinations will be a challenge for small entities, CFPB stated that, “The Bureau expects that vendors, law firms, and trade associations are likely to offer both products and guidance to lenders” in order to successfully comply with the information collection requirements of the rule. Yet the Bureau never included a discussion and estimation of what these costs were to be. Failing to account for these burdens masks the total impact of the rule on lenders.

Furthermore, the Bureau even regarded the employment of these vendors and law firms as beneficial to lenders, lowering the costs of developing compliance procedures. The Online Lenders Alliance regarded this description of costs as “misplaced,” as “attorneys and vendors will cost small businesses money. It is unclear why CFPB refers to attorneys and vendors as cost-savers when they are additional costs that should be described in the [Initial Regulatory Flexibility Analysis].”<sup>138</sup> Further, OLA states that “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.”<sup>139</sup> Another commenter, Personal Finance Company, stated that “A very rough initial estimate at this time is... at least \$10,000 in legal, compliance, and audit costs [annually].”<sup>140</sup> Further, PFC believed that the onetime cost of legal services to review and analyze the rule, provide legal advice and draft documents to be \$80,000, and the onetime cost of legal and compliance staff time to create policies and procedures to be \$6,000.<sup>141</sup> In ignoring the costs of third parties that will be required to comply with the paperwork burdens of the rule, CFPB has not accurately accounted for the costs as required by the PRA.

The Bureau also received comments noting that lenders will have to incur additional costs associated with dispute resolution. One commenter specifically noted that consumers would dispute negative data contained on their reports which would require investigation along with company responses. The commenter cited a figure of \$50,000 per year to handle these disputes and other costs of furnishing.<sup>142</sup>

The Bureau’s response to both of these concerns is inadequately and limited to the following discussion:

Litigation risks and the pricing of vendor or consulting services could also change in response to the rule. While the exact form of these indirect costs is uncertain and the Bureau does not have the data available to estimate them, small lenders may face a relatively higher burden than larger lenders, given their smaller scale

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<sup>138</sup> OLA, p.77, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-143973&attachmentNumber=1&contentType=pdf>.

<sup>139</sup> *Id.* at 75.

<sup>140</sup> Personal Finance Company, p. 17, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-141771&attachmentNumber=1&contentType=pdf>.

<sup>141</sup> *Id.* at 16, 17.

<sup>142</sup> CFPB final rule, 82 FR 54821.

over which to spread fixed investments, and their potentially more limited access to financing options.<sup>143</sup>

The Bureau has failed to account for the costs associated with the imposed information collection requirements, such as hiring lawyers and employing vendors, for which commenters have specifically addressed in comments to the Bureau. In doing so, CFPB has further underestimated the total paperwork burden resulting from the final rule.

*F. CFPB admitted that it could not assess the impact on online lenders.*

Despite the Bureau's requirement to do so, to date, the Bureau has failed to accurately assess the costs of procedural requirements on online lenders. CFPB estimated the impact of the rule on storefront payday loans and vehicle title loans. For storefront payday loans, CFPB estimated that revenues would decrease between 60 and 81 percent and loan volume would decrease between 60 and 82 percent. However, CFPB has not provided any estimate of the impact of the rule on online lenders.

In the final rule, CFPB admits that it does not have enough data on the online lending market to make a sufficient analysis of the rule's impact. The rule states: "The available information does not allow for reliably tracking sequences of online payday loans, as borrowers appear to change lenders much more often online and there is no comprehensive source of data on all online lenders."<sup>144</sup> But instead of calling for further study of online lenders, as it did with certain longer-term installment loans, the Bureau decided to regulate lenders for which it admits it lacks adequate data. If the Bureau cannot reasonably estimate the impact that the rule will have on online lenders, then it cannot be said that they have attempted to accurately assess the costs of paperwork burdens on lenders.

*G. The bureau underestimated the cost of recordkeeping requirements.*

In the final rule, CFPB reported that it does "not believe that these new [recordkeeping] requirements would impose a meaningful new burden on lenders."<sup>145</sup> In particular, it believes the only cost to be a \$50 purchase of additional electronic storage.

According to The American Financial Services Association, this cost is largely underestimated:

Those [recordkeeping] costs are significant. Even if a lender maintains records electronically, it will incur substantial additional costs in developing a document retention policy, obtaining additional computer storage space to maintain the documents, programming the computer system to keep the documents for 36 months and then delete them, training employees to comply with the recordkeeping requirements, and monitoring the implementation of these new procedures. Despite these significant costs, the Bureau's initial regulatory

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<sup>143</sup> CFPB final rule, 82 FR 54856.

<sup>144</sup> 82 FR 54833.

<sup>145</sup> 82 FR 54850.

flexibility analysis fails to account for the cost of the new recordkeeping requirements.<sup>146</sup>

#### **IV. Conclusion**

CFPB payday rule imposes substantial and unnecessary paperwork burdens on millions of business and consumers. CFPB has failed to properly account for these burdens. When the paperwork burdens for small-dollar loans are greater than mortgages or large credit card lines of credit, the burden is far from reasonable.

The burdens from underwriting and determining the consumer's "ability to pay" are extensive, requiring inquiring into every aspect of the consumer's financial life. And yet these extensive burdens are required even for a \$50 loan. The disproportionateness of the burdens demonstrates that these paperwork requirements are unnecessarily burdensome.

CFPB has completely failed to adequately account for the burdens of requiring a credit report to be pulled on every loan, the secondary support personal that would be required to comply with this regulation, and even acknowledges that it doesn't know the extent of the burden imposed on online lenders.

For all these reason and others explained in detail above, CFPB has failed to satisfy their burden under the Paperwork Act, and so the OMB should deny their information collection request.

Sincerely,

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<sup>146</sup> AFSA, p. 50, <https://www.regulations.gov/contentStreamer?documentId=CFPB-2016-0025-142151&attachmentNumber=1&contentType=pdf>.