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By electronic delivery to:
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Consumer Financial Protection Bureau
1700 G Street NW
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Re: Consumers' Research Comment on the CFPB's Proposed Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule Docket Number: CFPB-2019-0006

Introduction

Consumers' Research appreciates the opportunity to comment on the proposed rulemaking by the Consumer Financial Protection Bureau (CFPB) titled *Payday, Vehicle Title, and Certain High-Cost Installment Loans* ("2019 Proposed Rule").[1]

Consumers' Research is an independent educational 501(c)(3) nonprofit organization whose mission is to increase the knowledge and understanding of issues, policies, products, and services of concern to consumers and to promote the freedom to act on that knowledge and understanding. Founded in 1929, Consumers' Research is the nation's oldest consumer affairs organization. Consumers' Research believes that the cost, quality, availability, and variety of goods and services used or desired by American consumers — from both the private and public sectors — are improved by greater consumer knowledge and freedom.

In the 2019 Proposed Rule, the CFPB proposes to rescind the mandatory underwriting provisions of the *Payday, Vehicle Title, and Certain High-Cost Installment Loans* final rule ("2017 Final Rule").[2] The CFPB now believes that the evidence used to justify these provisions was insufficiently robust and that the CFPB failed to consider properly the negative impact the rule would have on firms and consumers.

The CFPB's 2019 Proposed Rule signals the CFPB's commitment to an objective and evidence-based approach to consumer protection. It is the opinion of Consumers' Research that the CFPB has conducted a thorough analysis of the evidence and is properly considering the short- and long-term impact of its policymaking in its issuance of the 2019 Proposed Rule. This approach creates a regulatory environment that promotes market competition and consumer choice.

1 *Consumer Financial Protection Bureau. 2019. Payday, Vehicle Title, and Certain High-Cost Installment Loans.*

2 *Consumer Financial Protection Bureau. 2017. Payday, Vehicle Title, and Certain High-Cost Installment Loans.*

Based on an analysis of both rules, Consumers' Research has determined that consumers would be better off under the 2019 Proposed Rule than they currently are under the 2017 Final Rule for at least three reasons. First, the 2019 Proposed Rule conducts a more rigorous welfare analysis than the 2017 Final Rule. Available consumer sentiment data suggests that borrowers are not disproportionately injured or harmed by lenders directly affected by the rule ("covered lenders") and their products ("covered loans"). Second, the 2019 Proposed Rule eliminates the immense costs the 2017 Final Rule's mandatory underwriting provisions impose on lenders, which flow downstream to consumers. Third, the 2019 Proposed Rule protects the novel structure of the covered lenders and fosters innovation, which consumers will benefit from in the future. These three reasons provide sufficient justification to enact the 2019 Proposed Rule. With its adoption, consumers will be better off.

Background

In 2017, the CFPB finalized a rule titled *Payday, Vehicle Title, and Certain High-Cost Installment Loans* ("2017 Final Rule") governing the small-dollar lending market. The 2017 Final Rule contained[3] two major features: the "mandatory underwriting provisions" and the "payment provisions." The mandatory underwriting provisions required covered lenders to assess the ability of borrowers to repay their loans before extending credit. These requirements were complex, including step-down provisions meant to retain consumer access to the market. The payment provisions, meanwhile, established requirements and limitations regarding a lender's ability to withdraw payments from a borrower's checking or other payment account.

With the 2019 Proposed Rule, the CFPB proposes to rescind major aspects of the mandatory underwriting provisions. Specifically, the CFPB proposes to rescind the following:

- A provision stating it is an unfair and abusive practice for a lender to make covered loans without determining that the borrower has a reasonable ability to repay;
- A provision that establishes the CFPB's designed underwriting practices for the covered loans;
- A provision exempting certain covered loans;
- A provision that requires lenders to manage information related to covered loans in registered information systems and to develop related processes;
- Recordkeeping requirements related to the mandatory underwriting provisions.

The CFPB is not proposing to rescind the 2017 Final Rule's payment provisions; however, the bureau does intend to delay and further reexamine the payment provisions in a separate rulemaking process.

[3] *For the sake of convenience and clarity, this comment will refer to the 2017 Final Rule in the past tense. It should be noted that, were the 2019 Proposed Rule rejected, the 2017 Final Rule would come into effect.*

The CFPB's 2019 Proposed Rule offers the following justifications for its proposed rulemaking. The CFPB reasons that:

- Evidence supporting the rule was insufficiently robust, specifically in regard to the CFPB's determination that failing to assess a borrower's ability to repay was unfair and abusive, therefore requiring stringent underwriting provisions;
- Its assessment of the mandatory underwriting provisions was faulty, underestimating their effect on covered lenders and the ability of consumers to obtain covered loans.
- Apart from this faulty assessment, the CFPB has no additional evidence that would support the mandatory underwriting provisions and pursuing additional research is not cost effective at this time;
- Its prior approach in determining unfairness and abusiveness was generally problematic.

Toward a More Rigorous Welfare Analysis

Emphasizing Consumer Sentiment

The CFPB is seeking comment as to whether consumers can reasonably avoid the substantial injury caused or likely to be caused by short-term and longer-term balloon-payment loans.[4] In determining the level of consumer harm, the CFPB correctly notes in the 2019 Proposed Rule that research investigating the consumer welfare effects of payday loans is mixed,[5] making welfare determinations based on academic research alone challenging at best.

For a truly robust welfare analysis, researchers and regulators must consider the thoughts and feelings of consumers in tandem with academic findings. Widely-used definitions of consumer welfare demand as much. The Organization for Economic Cooperation and Development (OECD), for instance, stresses the importance of striking a balance between the two. Consumer welfare, the OECD says, includes "the individual benefits derived from the consumption of goods and services. In theory, individual welfare is defined *by an individual's own assessment of his/her satisfaction*, given prices and income"[6] (emphasis added).

If the OECD's definition is valid, the CFPB would be justified in using consumer sentiment data to support a more rigorous welfare analysis. A balanced consideration of three consumer sentiment measures — survey results, complaint data, and regulatory comments — shows that consumers generally appreciate access to and use of the covered products. The 2017 Final Rule's flawed analysis of these measures undermined the quality of its welfare analysis and contributed to the weakness of its justification for

4 Ibid., 1. (pp.72).

5 Ibid., 1, 4. (pp.121).

6 https://stats.oecd.org/glossary/detail.asp?ID=3177 the mandatory underwriting provisions. By emphasizing consumer sentiment, the 2019 Proposed Rule offers a more complete picture of the harm facing consumers in the market.

Analyzing Consumer Survey Data

Survey data is a strong measure of consumer sentiment and provides insight into the levels of consumer welfare, injury, or harm in this market. In a 2007 survey of payday borrowers, Elliehausen found that 88.4 percent of payday borrowers reported being very or somewhat satisfied with their experience.[7] Only 10.8 percent reported being somewhat or very dissatisfied. Additionally, in a presentation prepared for the National Council of State Legislatures, payday lender Advance America reported that 96 percent of its customers rated their experience as "good to excellent" and that 93 percent will consider Advance America in the future.[8]

In 2017, LendEDU, a website that helps consumers learn about financial products and compare them, surveyed 1,000 consumers who had used a payday loan in the last year.[9] 44.2 percent of respondents said they were "better off" for using a payday loan; 30.3 percent replied that they were "worse off"; 51 percent of respondents didn't regret using payday; over 60 percent reported saving money on bank fees; and more than 75 percent reported being well-informed throughout the payday process.

In a 2015 report titled *Auto Title Loans: Market practices and borrowers' experiences*, The Pew Charitable Trusts surveyed 313 auto title borrowers.[10] 82 percent reported their loan terms being "very or somewhat clear"; 59 percent reported that the loans "mostly help," while 33 percent said that they "mostly hurt"; 58 percent reported the loans were "something that has relieved stress and anxiety" compared to 28 percent reporting them as "more of a source of stress and anxiety." However, 52 percent responded that the loans "take advantage" of borrowers.

The CFPB might consider measures of payday and vehicle title loan satisfaction in relation to consumer survey data on other products and services. For example, according to *Consumer Reports*, only 38 percent of surveyed pay-TV subscribers said they are "very" or "completely" satisfied with their service.[11] Accenture found that 60 percent of smartphone users were dissatisfied with their connectivity and experience

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7 Elliehausen, Gregory. 2009. "An Analysis of Consumers' Use of Payday Loans." The George Washington University School of Business. Financial Services Research Program, Monograph No. 41.

8 Fulmer, Jamie. 2012. "Advance America and Payday Lending: Who Borrows and Why." http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf

9 Brown, Mike. 2017. "Payday Loan Borrowers Largely Positive About the Product." https://lendedu.com/blog/payday-loans/

10 Urahn, Susan K., and Travis Plunkett. 2015. "Auto Title Loans: Market practices and borrowers' experiences." The Pew Charitable Trusts. https://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf

11 Willcox, James K. 2018. "People Still Don't Like Their Cable Companies, CR's Latest Telecom Survey Finds." Consumer Reports. https://www.consumerreports.org/phone-tv-internet-bundles/people-still-dont-like-their-cable-companies-telecom-survey/

and would switch providers.[12] According to an Experian survey of credit card users, "slightly more than half…said they weren't completely satisfied with their current credit cards, and 62 percent agreed there was probably a better card for their needs."[13]

It is reasonable to disagree about whether the available consumer survey evidence suggests that the covered lending products overwhelmingly increase consumer welfare. However, the available evidence does not support the claim that these products are injurious and cause substantial harm or welfare reduction to borrowers. Consumers seem to be generally satisfied with their access to and use of these credit products, especially when contrasted with other consumer goods. As such, the 2019 Proposed Rule increases welfare by retaining consumers' ability to choose the credit best suited for their situation.

Reconsidering Consumer Complaint Data

Another way for the CFPB to measure consumer sentiment is through the analysis of consumer complaint data. The 2017 Final Rule notes that there were 3.7 complaints per 10,000 payday borrowers compared to only 1.7 complaints per 10,000 credit card users.[14] The CFPB argued, then, that payday consumers were disproportionately experiencing harm and that the substance of their complaints justified the mandatory underwriting and payment provisions in the 2017 Final Rule. But this analysis is flawed for at least three reasons, leading to the Bureau's overestimation of consumer injury and harm in the market.

First, the disparity between credit card and payday complaints is less significant than the CFPB suggested it was. While 3.7 payday complaints per 10,000 borrowers might justify further inquiry by the CFPB, this statistic hardly provides overwhelming evidence that consumers in this market face substantial harm. Indeed, one could reasonably view this rate as quite *low* considering the costs and risks associated with this market. It is also unclear what the CFPB's threshold was for an unacceptable complaint rate. The complaint rate for vehicle title borrowers, for instance — 1.6 complaints per 10,000 borrowers — was lower than for credit card users, undermining the coherence of the CFPB's argument.[15]

Second, the CFPB's 2017 comparison of payday complaints to credit card complaints was myopic. A comparison of payday to mortgage complaint data demonstrates as

12 2016. "Majority of Smartphone Users Surveyed Unhappy with Service and Ready to Switch Mobile Providers, Accenture Screenager Report Finds." https://newsroom.accenture.com/news/majority-of-smartphone-users-surveyed-unhappy-with-service-and-ready-to-switch-mobile-providers-accenture-screenager-report-finds.htm

13 Experian. 2017. "Survey Findings: How Do Consumers Feel About Credit Cards." https://www.experian.com/blogs/ask-experian/survey-findings-how-do-consumers-feel-about-credit-cards/

14 Ibid., 2. (pg. 40).

15 By our calculations there were 1.6 vehicle title complaints per 10,000 borrowers.

Pew: 2 million title borrowers: https://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf

CFPB: 328 title complaints in 2016: https://files.consumerfinance.gov/f/documents/201703_cfpb_Consumer-Response-Annual-Report-2016.PDF much. By the end of 2017, the CFPB received 37,300 mortgage-related complaints[16] from 96,000,000 outstanding mortgage and home equity revolving accounts.[17] These numbers work out to 3.88 complaints filed per 10,000 mortgage borrowers, a rate greater than the 3.7 complaints per 10,000 payday borrowers and far greater than the 1.6 complaints per 10,000 vehicle title borrowers. And while the mortgage industry is heavily regulated, the CFPB would not likely consider a rule that would reduce the supply of mortgages by 60 to 80 percent.

Third, the CFPB's comparison failed to consider the existence of a confounding variable. A confounding variable is a variable that has an effect on the dependent variable but is not explicitly accounted for in the analysis. For example, weight gain can be explained by an individual's diet. However, weight gain can also be explained by one's genetics, activity levels, or stress. Failing to control for these variables can introduce bias that overestimates or underestimates the effects of the defined independent variable on the observed outcome.

The 2017 Final Rule characterized payday loan use as the cause of the observed complaint rate per 10,000 payday borrowers. In reality, the market for small-dollar lenders and small-dollar loans could have any number of confounding variables that the 2017 Final Rule did not consider. The CFPB cannot justify the near elimination of an entire industry of credit without first proving thoroughly that the covered products are the main cause of the measured complaint rate.

Analyzing Submitted Regulatory Comments

Analysis of Random Samples

A third way for the CFPB to measure consumer sentiment is through the review of public interest comments. In this spirit, Consumers' Research analyzed three separate random samples of comments submitted to the CFPB regarding the 2019 Proposed Rule. We downloaded the full set of available comments from the 2019 Proposed Rule's docket folder on regulations.gov on three separate occasions: April 17, 2019; May 8, 2019; and May 14, 2019. These sets included 2,086; 5,946; and 25,995 comments, respectively.

To conduct our analysis, we calculated the necessary sample size, given a 95 percent confidence level and 5 percent margin of error, using a sample size calculator provided by SurveyMonkey.[18] The calculator determined that the necessary sample size at those error levels was 325 comments for the first sample, 361 comments for the second, and 379 for the third.

16 Consumer Financial Protection Bureau. 2018. "Consumer Response Annual Report." https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_consumer-response-annual-report_2017.pdf

17 United States Census CFPB. American Community Survey (ACS) (2017). https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_17_SPL_K202508&prodType=table

18 For reference: https://www.surveymonkey.com/mp/sample-size-calculator/

We then created a column in the Excel output in each of the populations to calculate and assign a random number to each comment within the populations. After each comment was assigned a unique random number, we sorted the comments in ascending order, taking the first 325, 361, and 379 randomly assigned comments, respectively, as our random samples.

Next, using the links to each comment provided in the Excel output from regulations.gov, we opened each individual comment from our random samples. For each comment, we determined if the comment expressed a positive sentiment toward payday lending (or one otherwise in favor of the 2019 Proposed Rule); a negative sentiment (or otherwise in opposition to the 2019 Proposed Rule); or an ambiguous sentiment. We also noted those comments that we highly suspected or confirmed were form letter submissions.

Across the first two samples, the overwhelming majority of the submitted comments expressed positive sentiments toward payday lending or a view otherwise in favor of the proposed rule. Indeed, 215 of the 325 comments from the first sample (66 percent) and 279 of the 361 comments from the second sample (77 percent) were positive toward payday lending. Only 67 of the 325 sampled comments (21 percent) from the first sample, and 22 of the 361 comments (6 percent) from the second sample were negative toward payday lending or otherwise in opposition to the proposed rule.

In the third analysis, the gap between positive and negative comments was smaller. In our third sample, 192 of the 379 comments (51 percent) expressed positive sentiments toward payday lending compared to 148 comments (39 percent) that were negative.

In the first sample, 43 comments (13 percent) were determined to be ambiguous compared to 60 comments (17 percent) in the second sample and 39 comments (10 percent) in the third sample. We labeled a comment as "ambiguous" if it was not *abundantly* clear that it was a positive or negative comment. That said, comments labeled as ambiguous often seemed to be written with a positive perspective.

Only 20 of the 325 comments (6 percent) from the first sample were confirmed as form letters. All 20 were negative toward payday lending or otherwise in opposition to the proposed rule. In the second sample, 49 of the 361 comments (14 percent) were suspected of being form letters. Contrary to our findings from the first sample, 86 percent of the form letters from the second sample were positive toward payday lending or otherwise in favor of the proposed rule. Only 14 percent of the form letters from the second sample, meanwhile, were negative toward payday lending.

The influence of form letters changed significantly for the third sample. Here, 191 of the 379 analyzed comments (50 percent) were confirmed or highly suspected of being form letters. Of these comments, 53 percent expressed positive sentiments toward payday lending, while 47 percent were negative or otherwise opposed to the 2019 Proposed Rule.

Form Letters in Context

There exists concern that form letters are polluting the CFPB's regulatory process. A recent *Wall Street Journal* article[19] covered a report by Allied Progress, a consumer advocacy organization, arguing as much. Allied Progress found that 27 percent of the comments submitted to the CFPB regarding the 2019 Proposed Rule contained duplicate language expressing support of the proposed rule.[20] Therefore, Allied Progress argued, payday lenders are uniquely, and negatively, impacting the regulatory process.

Consumers' Research does not dispute the findings of Allied Progress' report. Indeed, in our third analysis, Consumers' Research identified a similar percentage of positive form letter submissions expressing support for the 2019 Proposed Rule. Recall that 50 percent of the sampled comments were form letters, while 53 percent of those form letters expressed positive sentiment. This suggests that 26 percent of the submitted comments considered in our third analysis were form letters of positive sentiment, a finding that is nearly identical to Allied Progress' finding of 27 percent.

That said, Consumers' Research does not agree with Allied Progress' conclusion that the rulemaking process has been "tainted" by the meddling of payday lenders and their customers.

First, the dataset presented by Allied Progress, and subsequently reported on by the *Wall Street Journal*, is narrow and therefore does not tell the full story. Consumers' Research does not have access to Allied Progress' methodology, but it appears that it flagged all form letter comments expressing positive sentiment (or otherwise supporting the 2019 Proposed Rule) while neglecting to flag form letter comments expressing negative sentiment. In Consumers' Research's analysis, which did consider negative comments, nearly identical numbers (53 percent in favor and 47 percent against) were identified. In other words, for nearly every positive form letter submitted, there existed an opposing form letter advocating against the 2019 Proposed Rule. By failing to report the rate of negative form letter submissions, Allied Progress — and subsequently the *Wall Street Journal* — overstated the influence of payday lenders in the submission process.

Second, both Allied Progress and the *Wall Street Journal* note that many payday lenders provided easy access to comment submission on their websites. However, groups opposed to the 2019 Proposed Rule did the same thing. For example, the Pew Charitable Trusts provided the ability to submit comments from its website, as well as a form letter opposing the 2019 Proposed Rule.[21] Furthermore, the *Wall Street Journal* article reports

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19 Hayashi, Yuka. "Payday Lenders Mobilize in Support of Rule's Repeal, Consumer Group Says." The Wall Street Journal. (May 14, 2019). https://www.wsj.com/articles/payday-lenders-mobilize-in-support-of-rules-repeal-consumer-group-says-11557826201

20 Allied Progress. 2019. "CFPB Payday Rulemaking Tainted By Industry Money, Fake Comments." https://drive.google.com/file/d/1AFEFTLqTFzxv8roe7O3NOC3PbY8VZXnq/view

21 For reference: https://act.pewtrusts.org/HVHrHRM that Allied Progress itself sent out 140,000 email messages with a link to the submission portal.

To summarize, in the third sample Consumers' Research found that 26 percent of the submitted comments were form letters expressing favor for the 2019 Proposed Rule. This figure near perfectly reflects Allied Progress' finding of 27 percent. However, Consumers' Research also found that 23 percent of the submitted comments were form letters opposing the 2019 Proposed Rule. Allied Progress apparently failed either to identify or report these submissions. Finally, organizations opposed to the 2019 Proposed Rule made form letters and simplified comment submission available to consumers, just as payday lenders did.

It is with all of this in mind that Consumers' Research concludes that Allied Progress' methodology was incomplete. A broader analysis suggests that form letters were used at roughly equal rates by both proponents and opponents of the 2019 Proposed Rule.

Original Comments Over Form Letters

All of this said, the CFPB should place greater emphasis on organic comments as opposed to form letter submissions. Those individuals who bear the costs of writing and submitting an original letter signal that they care more about the issue than those who did not.

Our analysis of the sampled comment letters generally affirms high levels of consumer satisfaction with payday products. This point, understood as part of a mosaic of evidence that includes the consumer survey and complaint data findings detailed earlier in this comment, underscores the apparent fact that the majority of payday consumers appreciate their access to and use of these financial products. By ensuring continued access to this form of credit, the 2019 Proposed Rule makes the majority of those that submitted comment letters to the CFPB better off.

The Importance of Downstream Costs

Analysis of 2017 Final Rule

During the 2017 Final Rule's regulatory process, the CFPB conducted market simulations to determine its likely effects.[22] Payday volume and revenue were estimated to drop by 71 to 76 percent, while vehicle title volume and revenue were projected to fall by roughly 48 to 77 percent. In justifying the dramatic reductions, the CFPB argued that only 7 to 11 percent of consumers would not receive their first loan due to the 2017 Final Rule's step-down provisions.

The CFPB's simulations provided insight into the primary effects of the 2017 Final Rule, but ultimately this analysis was incomplete. The CFPB failed, for instance, to consider

22 Consumer Financial Protection CFPB. 2016. "Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products." https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf

how market actors would react to these costs. By neglecting downstream costs, the CFPB dramatically underestimated the rule's overall impact on the market, in particular the percentage of consumers that would lose access to credit. It is unreasonable to assume that the remaining small-dollar lenders would continue business-as-usual if their volume and revenue were to fall by nearly 80 percent. Rather, it's far more reasonable to assume that lenders would change their behavior.

Under the mandatory underwriting provisions, small-dollar lenders will likely exit the market, leaving many consumers of their products worse off. Research on payday profitability illustrates this point. Elliehausen (2009) found that payday lenders earned an average operating profit of $14.08 per $100 in outstanding loans.[23] The author argued that this margin was not large as compared to other high-risk lenders. Huckstep (2007) found that payday lenders' profit margins were less than half of their mainstream lending counterparts.[24]

Faced with fixed costs, increased risk of default,[25] and decreased revenue and volume under the 2017 Final Rule, firms' profitability would be highly constrained. Lenders exiting the market would reduce competition and increase costs for consumers. The 2019 Proposed Rule, by comparison, takes this loss into account. It says: "[T]he loss of revenue from these loans and in the corresponding reduction in supply would have a dramatic effect on competition, especially if lenders cannot stay in business in the face of such decreases in revenue."[26]

A long-term reduction in supply also imposes greater search costs on consumers, as it takes more time and resources to find and procure credit. Such an increase in costs is particularly harmful for payday and vehicle title borrowers as they already face fewer credit options at higher prices than borrowers of traditional credit. Lukongo and Miller Jr. (2017) estimated these costs borne by Arkansas consumers, who must drive out of state to obtain installment credit due to the state's 17 percent rate cap.[27] Adjusting for travel costs, they found that Arkansas residents paid an average implied APR of 93 percent. Far from reducing consumer demand, Lukongo and Miller Jr.'s work suggests that a reduction in supply of the payday and vehicle title industry simply imposes greater costs on consumers.

<u>Analysis of 2019 Proposed Rule</u>

23 Ibid., 7

24 Huckstep, A. 2007. "Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?" Fordham Journal of Corporate and Financial Law 12, no. 1: 203–31.

25 The institution of the step-down provisions and restriction on allowable loan rollovers should increase the default risk for borrowers at the margin as they have less access to credit.

26 Ibid., 1, 4, 5. (pg. 84)

27 Lukongo, Onyumbe Enumbe Ben, and Thomas W. Miller, Jr. 2017. "Adverse Consequences of the Binding Constitutional Interest Rate Cap in the State of Arkansas." Mercatus Center at George Mason University. https://www.mercatus.org/system/files/lukongo_wp_mercatus_v1.pdf

The CFPB's 2019 Proposed Rule alleviates the primary and downstream costs imposed on consumers by the 2017 Final Rule. The CFPB estimates that removing the mandatory underwriting provisions will increase payday loan volume by 104 to 108 percent and revenue by 204 to 213 percent, as compared to the market under the 2017 Final Rule.[28] Additionally, the CFPB estimates that vehicle title volume will increase by 809 to 1,329 percent.

Flannery and Samolyk (2007) found that, because default losses account for a high share of total operating costs, payday store profitability is largely driven by loan volume.[29] These findings indicate that an estimated increase in loan volume bolsters the solvency of payday and vehicle title lenders. More than helping lenders, though, increased volume also delivers significant welfare gains to consumers through maintained and expanded credit access and choice.

The CFPB should also be commended for removing the $500 loan cap instituted under the 2017 Final Rule. A basic economics lesson — which applies to everything from apples to apartments — suggests that instituting a price ceiling restricts supply and creates artificial shortages. Elliehausen (2009) found that 8.7 percent of payday loans are for more than $500.[30] Lifting the $500 cap would thus expand credit access to more than 1 million consumers. Under the 2017 Final Rule, they would have been cut off from loans they would otherwise use.

Innovation in the Past and Going Forward

In the 2019 Proposed Rule, the CFPB writes: "as the 2017 Final Rule recognized, a number of innovative products are seeking to compete with traditional short-term lenders…The 2017 Final Rule included exclusions to accommodate these emerging products, thereby recognizing that providers offering these products were doing so without assessing the consumers' ability to repay without reborrowing."[31]

By carving out regulatory exemptions, the 2017 Final Rule correctly recognized the value that innovative products provide to consumers. However, it is not just the innovations of the future that create value for consumers, but also the innovations of the past. By regulating firms out of business, the 2017 Final Rule implicitly rejected the innovative nature of payday and vehicle title lending.

A foundational paper in economics provides insight into this situation. Stiglitz and Weiss (1981) investigated why banks ration credit rather than raise interest rates or collateral requirements to clear the market.[32] The authors found that, while higher

28 Ibid., 1, 4, 5, 26. (pg. 119).

29 Flannery, Mark J., and Katherine A. Samolyk. 2007. "Scale Economies at Payday Loan Stores."

30 Ibid., 7, 23..

31 Ibid., 1, 4, 5, 26, 28. (pp. 84).

32 Stiglitz, Joseph E, and Andrew Weiss. 1981. "Credit Rationing in Markets with Imperfect Information." The American Economic Review. Vol. 71 (No. 3), pp. 393 – 410.

interest rates and collateral requirements increase the potential payoffs for lenders, they also induce riskier borrowers to enter the market, thereby lowering the probability of success for their loan portfolios. The same is true on the borrower's side of the equation. As the interest rate or collateral requirements rise, borrowers are incentivized to undertake riskier projects with a greater potential payoff to accommodate for their increase in borrowing costs.

Therefore, in a market with imperfect information, a lender might find it more profitable to ration credit for borrowers rather than attempt to price properly their credit and risk. This rationing creates a market failure that decreases consumer welfare, as some willing and able consumers are restricted from the market, while others have their credit priced in an inefficient manner.

Storefront and online payday and vehicle title lenders can be understood as innovative solutions to the market failure of credit rationing as both lenders emerged after Stiglitz and Weiss' publication. By offering specialized credit products, the covered lenders solve at least two market problems that make consumers better off. First, they provide credit access to high-risk borrowers excluded from the mainstream market, as evidenced by the millions of borrowers that rely on storefront and online lenders. Second, they facilitate a separating equilibrium in the broader credit market. By clearly delineating borrowers, lending institutions offer more efficiently priced credit for all consumers.

The 2017 Final Rule neglected the fact that payday (both storefront and online) and vehicle title lenders *are themselves the products of innovation.* Forcing these lenders to act more like traditional depository institutions — namely, through mandatory underwriting requirements — undermines their business models. Treating them as such inadvertently compromises their valuable roles as solutions to the market failure of credit rationing. The structure of these lenders is a feature of their existence, not a bug. The CFPB's 2017 Final Rule was misguided in its attempt to encourage future innovation while simultaneously undermining the foundations of past innovation.

The 2019 Proposed Rule properly recognizes the innovative nature of the covered lenders and is correct when it says, "a prohibition of making short-term or balloon-payment loans without assessing consumers' ability to repay would constrain innovation in this market." [33] Removing the mandatory underwriting provisions acknowledges the important structure of these credit products that made them innovative in the first place. It also creates a regulatory environment that encourages competition, innovation, and growth.

In the short-term, the estimated increase in lending volume and revenue dramatically increases the expected value of lending. This increase in value incentivizes lenders to reorganize their resources toward higher-valued uses, from outside this market under

33 Ibid. 1, 4, 5, 26, 28, 31. (pp. 84-85).

the 2017 Final Rule to now inside this market under the 2019 Proposed Rule. Likely outcomes include higher firm investment in product quality and increased consumer choice.

In the longer-term, removing the mandatory underwriting provisions reduces large barriers to market entry for new firms, increasing present competition and incentivizing future innovation. The CFPB should measure its success by the regulatory environment it creates. By reducing compliance costs and barriers to entry, the CFPB is ensuring a more competitive environment that promises greater consumer welfare.

Conclusion

Based on an analysis of the 2017 Final Rule, the 2019 Proposed rule, and consumer complaint data, Consumers' Research has determined that the 2019 Proposed Rule makes consumers better off for at least three reasons.

First, the 2019 Proposed Rule conducts a stronger welfare analysis. The 2017 Final Rule failed to consider properly the thoughts and feelings of consumers. Emphasizing consumer sentiment not only empowers consumers in the CFPB's rulemaking process but also provides necessary insights into the level of harm individuals in this market face. The available consumer survey data does not support the 2017 Final Rule's claim that consumers face substantial harm. Further, a reconsideration of the 2017 Final Rule's use of complaint data uncovers serious limitations not previously considered by the Bureau. Lastly, an analysis of submitted public comments suggests that payday and vehicle title consumers overwhelmingly appreciate access to these products. By emphasizing the thoughts and feelings of the consumer and properly weighing the evidence, the 2019 Proposed Rule makes consumers better off.

Second, the 2019 Proposed Rule dramatically reduces the downstream costs imposed on consumers. The 2017 Final Rule failed to consider how firms and consumers would respond to the mandatory underwriting provisions and loan caps. Under the 2017 Final Rule, firms would likely have exited the market due to dramatically reduced revenue, volume, and profit, coupled with increased risk of default, leaving consumers even more financially vulnerable. By rescinding the mandatory underwriting provisions and loan cap, the 2019 Proposed Rule maintains the viability of the industry. More importantly, such a measure protects and expands consumer access and choice in the market today.

Third, the 2019 Proposed Rule encourages market innovation. In the not-too-distant past, consumer financial markets arguably experienced moments of market failure as lenders chose to ration credit to unknown or risky borrowers. The innovative emergence of payday and vehicle title lenders expanded credit access to these borrowers and facilitated more efficient credit pricing in all markets. The mandatory underwriting provisions would have forced payday and vehicle title lenders to act as traditional lenders and undermined their welfare-enhancing structure. By rescinding these provisions, the 2019 Proposed Rule recognizes the role innovation plays in making consumers better off today, while also fostering a regulatory environment of competition and innovation for the future.

Sincerely,

Joe Conway

Research Fellow