Protecting Credit Since 1916
American Financial Services Association

November 8, 2019

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

Re: Request for Information Regarding Tech Sprints
Docket No. CFPB-2019-0048

Dear Director Kraninger:

The American Financial Services Association (AFSA)[1] appreciates to opportunity to respond to the Consumer Financial Protection Bureau's (CFPB) request for information (RFI) on how to use Tech Sprints as a means to encourage regulatory innovation and collaborate with stakeholders in developing viable solutions to regulatory compliance challenges.

AFSA is pleased that the CFPB is examining how Tech Sprints could facilitate innovation. We suggest that the CFPB begin using Tech Sprints to identify and address inconsistencies that have been created in existing regulatory requirements. Unfortunately, some of the Bureau's own regulations are a significant impediment to innovation. Specifically, we suggest that the Bureau use a Tech Sprint to address the compliance problems that are stifling innovation as a result of the CFPB's Payday, Vehicle Title, and Certain High-Cost Installment Loans rule (Payday Rule).[2]

AFSA strongly supports the CFPB's goal of facilitating innovation. As the Bureau acknowledges in the RFI, it has a statutory responsibility laid out by the Dodd-Frank Act[3] to regularly identify and address outdated, unnecessary or unduly burdensome regulations in order to reduce unwarranted regulatory burdens. We believe that the CFPB, consumers, and the financial services industry would benefit by the use of Tech Sprints as a model for collaborative innovation. Used successfully by the United Kingdom and certain U.S. agencies, Tech Sprints gather regulators, technologists, financial institutions, and subject matter experts from key stakeholders for several days to work together to develop innovative solutions to clearly-identified challenges.

In the RFI, the Bureau states that it is seeking ideas on how it can use Tech Sprints to advance regulatory innovation and compliance. One of the ways that the CFPB states that it is interested in using Tech Sprints is to reduce unwarranted regulatory compliance burdens. The Bureau asks that commenters answer several specific questions. AFSA's comment focuses on two of these, namely: (1) What regulatory compliance issues, problems, procedures, or requirements could benefit from innovation through a Bureau Tech Sprint? and (2) Other than organizing Tech Sprints, what else might the Bureau do to encourage innovation in financial products and services. For example, could advances be encouraged by changes to certain Bureau rules or policies?

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[1] AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. Its more than 350 members include consumer and commercial finance companies, auto finance/leasing companies, mortgage lenders, mortgage servicers, credit card issuers, industrial banks and industry suppliers.
[2] 82 Fed. Reg. 54472-54921 (Nov . 17, 2017).
[3] 12 U.S.C. 5511(b)(3).

The answer to both those questions is that the CFPB should address the unworkable compliance burden the payments provision of the Payday Rule has imposed on installment lenders—a burden that will have a negative effect on a significant number of borrowers. (See the appendix for an explanation of who installment lenders are, the customers they serve, and the loans they make.)

The payments provision of the Payday Rule applies to covered longer-term loans that have a cost of credit exceeding a 36% APR and that have a leveraged payment mechanism giving the lender the right to initiate transfers from the consumer's account without further action by the consumer. To put it another way, under the Payday Rule consumers do not have the ability to set up recurring payments on a loan with an APR of over 36% without the loan being considered a "covered loan."

The Payday Rule only provides an exception for a single immediate payment transfer at the consumer's request when the funds are transferred within one business days of the request.[4] Moreover, the Payday Rule includes restrictions which make the relationship between installment lenders and their customers even more difficult and complicated, such as in those situations where there may be issues in the mechanical aspects of the funds transfer.[5] A summary of the requirements of this section of the rule is below.

> "The Payday Lending Rule's payment provisions impose two types of requirements regarding lenders' repeated attempts to withdraw payments from consumers' accounts after prior attempts have failed due to insufficient funds.
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> "First, where two consecutive withdrawal attempts have failed due to insufficient funds, the Rule prohibits a lender from attempting another withdrawal from the same account unless the lender obtains the consumer's new and specific authorization to make further withdrawals from the account. This prohibition on further withdrawal attempts applies whether the two failed attempts are initiated through a single payment channel or different channels, such as the automated clearinghouse (ACH) system or the check network. These requirements do not apply to a lender's withdrawal attempts if the lender is the institution that holds the consumer's account and the lender meets certain conditions.
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> "Second, a lender is required to provide a written notice before its first attempt to withdraw payment for a covered loan from a consumer's account and before subsequent attempts that deviate from scheduled amounts or dates or that involve a different payment channel than the prior attempt. The Rule also requires a lender to provide a consumer rights notice if two consecutive attempts to withdraw payment have failed due to insufficient funds in a consumer's account. The Rule details the information that must be included in the notices and how they can be provided, including permissible methods of electronic delivery. The Rule's notice requirements do not apply to a lender's withdrawal attempts if the lender is the institution that holds the consumer's account and the lender meets certain conditions."[6]

Under the Payday Rule, an Unusual Payment Withdrawal Notice is required to be provided if any of the following occur: A payment occurs on a date other than a regularly scheduled payment under the terms of the loan agreement, a different payment channel is used from the preceding payment, or the amount of the payment varies from the regularly scheduled payment. A lender must send an Unusual Withdrawal Notice within three business days prior to initiating the payment, if the lender has e-mail authorization, or six business days prior, if the lender has to send the notice by regular mail.

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[4] 12 C.F.R. §1041.8(a)(2).

[5] 12 C.F.R. §1041.8(b) & (c).

[6] CFPB, *Payday, Vehicle Title, and High-Cost Installment Lending Rule: Payment-Related Requirements Small Entity Compliance Guide*. June 2019. p. 8.

Here's the problem—these provisions directly restrict the flexibility consumers have in making payments. (Interestingly, at the same time the CFPB is restricting payment flexibility, the Federal Reserve Board has issued a proposed rule to support interbank settlement of faster payments to aid in the development of a real time payments system in the United States.[7]

For example, if a consumer enrolled in a recurring, remotely created check (RCC) program has authorized RCCs to be processed on the 10th of each month calls the lender on the 9th of the month and requests that the RCC for that month be processed on the 11th instead, the lender would have to deny the consumer's request because there is insufficient time (3 or 6 days being required) to issue an Unusual Payment Withdrawal Notice. Without this clarification, lenders would be required to wait 3 or 6 days before initiating the transfer, which may well cause the consumers to incur late fees and possibly negatively affect their credit ratings. Additionally, this affects consumers, such as off-shore workers, who give their lenders post-dated checks prior to leaving the mainland to go to work.

Similarly, a consumer who is enrolled in a recurring debit card payment program would not be afforded the discretion to log into her online account and adjust the payment schedule to suit her current situation because the lender would be forced to limit the consumer's flexibility to make changes to the payment schedule due to the time delays for notices (3 or 6 days) which must be factored into any changes. This is inconvenient and even harmful to consumers who need the flexibility to customize payment schedules in accordance with their expected cash flow and could easily cause late payments and late fees to be incurred by the consumer.

In another example, a consumer who calls a branch office on the 5th to inform the lender that she will be working offshore for the next three weeks will not be able to simply change her payment schedule. Currently, knowing that her payment is due on the 7th but that she will be offshore on the 7th, she would be able to ask the lender to set up a post-dated ACH payment to occur on the 7th. Under the Rule, the lender would have to deny her request because there would not be sufficient time to present the consumer with the 3 or 6 day notice. Therefore, the consumer would have to either pay early (which may not be an option for many consumers who live paycheck to paycheck), or pay late and incur a late fee.

Furthermore, the Payday Rule does not address how lenders should handle recurring payments that consumers set up on their own through their banks, credit unions, or card companies. If a consumer sets up a recurring payment on her own, is the lender supposed to block that function if it is discovered? This would cause confusion and likely much consternation for consumers.

Lenders have innovated to enable consumers to make payments in a variety of ways and at times that are convenient to the consumer. Many have built secure websites where consumers can log in and choose when their payments will be made. Because of the inflexibility in the Payday Rule, traditional installment lenders (who, by the way, are not the payday lenders the rule targeted) will have to either take down those sites or limit consumers ability to select payment dates. This is contrary to the CFPB's position of removing compliance burdens and encouraging innovation.

The CFPB could use a Tech Sprint to address the compliance concerns created by the Payday Rule. One of the key benefits to a Tech Sprint is that is all relevant information is visible (usually on walls or large spaces), making it far easier to organize and understand. In fact, AFSA members have used the sprint process to address inefficiencies and contradictory or ambiguous practices/requirements/policies. In addition to encouraging

[7] 84 Fed. Reg. 39297 (Aug. 9, 2019).

regulatory innovation, sprints could also be very helpful in addressing inconsistencies by demonstrating exactly how or why the inconsistencies are difficult to work through.

We support the CFPB's exploration of the benefits that Tech Sprints could provide and ask that the CFPB use the process to address the inefficiencies its regulations have created. Please contact me by phone, 202-776-7300, or e-mail, cwinslow@afsamail.org, with any questions.

Sincerely,

Celia Winslow

Celia Winslow
Vice President, Legal & Regulatory Affairs
American Financial Services Association

APPENDIX

AFSA members provide traditional installment loans to individuals and families. Their customers are teachers, lawn service employees, lawyers, stay-at-home parents, young adults renting a room with a relative, homeowners, nannies, farmers, *etc*. In short, they are Americans of almost all professions and socioeconomic classes. Sometimes, these customers are unbanked or under-banked. They may be credit-invisible or have credit histories containing insufficient or stale information. These customers often have impaired credit histories, so they may not be served by banks or credit unions. Some of these customers have prime credit scores and regular banking relationships. They may use installment loans because they like the product and the personal touch of the branch-based nature of finance companies. Or they may use installment loans because they have very little or no savings. Or they simply need quick access to smaller amounts of credit than banks will offer.

Some customers need access to credit to meet an immediate need. As the Federal Reserve Board's Report on the Economic Well-Being of U.S. Households found, "Sixty-one percent said they would pay the [hypothetical, unexpected] expense [of $400] with cash, savings, or a credit card paid off at the next statement; 27 percent would borrow or sell something; and 12 percent would not be able to cover it."[8] Moreover, 78% of workers live paycheck to paycheck.[9] If something unexpected happens, many need quick access to credit.

Using a home equity line of credit or a credit card is not necessarily an option for people with impaired credit and little or no home equity. Yet, when these consumers hit a bump in the road, they still need access to credit. The demand does not go away. That demand has many faces, including: vehicle repairs (transmission, tires), household appliances (washer, dryer, water heater—repairs or replacement), furniture, back to school expenses, debt consolidation, baby items (crib, car seat), funeral expenses, and medical expenses—generally, the everyday items and services essential to live productive and enjoyable lives, as well as to meet obligations.

Many customers use installment loans as a thoughtful process to manage their finances. These customers may use installment loans like other Americans use home equity lines of credit or credit cards. After some customers struggled to get out of credit card debt, they simply prefer the more structured nature of installment loans. Regardless, they still have a common need for small-dollar credit. And, because many installment lenders report to one or more of the credit reporting agencies, customers can use installment loans as a way to build or repair their credit.

According to a study done by three academics using industry data, in order to make a break-even loan at 36%, the loan would have to be made for at least $2,600.[10] Larger loans can be profitable because a lender gets a larger dollar return on a larger loan, even though the proportional return is the same. Many lenders' costs to originate and service loans are fixed, so lenders need to make a certain amount on each loan.

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[8] Board of Governors of the Federal Reserve System. *Report on the Economic Well-Being of U.S. Households in 2018.* May 2019. Available at: https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf.
[9] Friedman, Zack. *78% of Workers Live Paycheck to Paycheck.* Forbes. Jan. 11, 2019. Available at: https://www.forbes.com/sites/zackfriedman/2019/01/11/live-paycheck-to-paycheck-government-shutdown/#3ddc13054f10.
[10] Durkin, Thomas A., Gregory Elliehausen, and Min Hwang. *Rate Ceilings and the Distribution of Small Dollar Loans from Consumer Finance Companies: Results of a New Survey of Small Dollar Cash Lenders*. 2016. Working Paper.

Below is a chart prepared by Dr. Thomas W. Miller[11] that shows the costs associated with eight hundred $1,000 loans.[12] The chart demonstrates why a lender cannot make a profitable $1,000 loan below a 99% APR.

Each 12-Month Loan Size		$ 1,000	$ 1,000	$ 1,000
Number of Loans Outstanding		800	800	800
Customer Monthly Payment (12-Month Loan)	12	($100.46)	($119.29)	($134.42)
Interest Rate on Loan		36%	72%	99%
Revenue from Loan (Interest Collected)		$205.55	$431.49	$613.03
Revenue from all Loans		$ 164,436	$ 345,191	$ 490,421
Bad Debts (at Bad Debt Rate of 9%)	9.00%	$ (39,184)	$ (42,232)	$ (44,404)
Salaries		$ (140,000)	$(140,000)	$ (140,000)
Rent/Other Operating Expenses		$ (25,000)	$ (25,000)	$ (25,000)
Cost of Borrowing Money to Lend (at 6%)	6.00%	$ (18,215)	$ (19,570)	$ (20,535)
Overhead Paid to Home Office		$ (120,000)	$(120,000)	$ (120,000)
Branch Net Income		$ (177,963)	$ (1,611)	$ 140,483
Receivables:		$ 435,378	$ 469,242	$ 493,374
Furniture/Equip:		$ 20,000	$ 20,000	$ 20,000
Total Assets:		$ 455,378	$ 489,242	$ 513,374
Bank Debt:		$ 303,585	$ 326,161	$ 342,249
Equity:		151,793	163,081	171,125
Total D + E:		$ 455,378	$ 489,242	$ 513,374
Debt/Equity Ratio:		2	2	2
Target ROE:	15.00%	$ 22,769	$ 24,462	$ 25,669
Assets/Equity:		3	3	3

[11] Dr. Thomas W. Miller, Jr., Ph.D. is a Professor of Finance and the inaugural holder of the Jack R. Lee Chair in Financial Institutions and Consumer Finance at Mississippi State University. He has held positions at Saint Louis University, Washington University in St. Louis, and at the University of Missouri.

[12] In constructing the chart, Dr. Miller spoke with several different lenders to obtain information about costs.

Another helpful table, also prepared by Dr. Miller, shows the amortization of a $1,000 twelve-month loan at 36 percent interest (not APR).

Month	Beginning Principal Balance	Equal Monthly Payment	Interest Payment	Principal Payment	Ending Principal Balance
1	$1,000.00	$100.46	$30.00	$70.46	$929.54
2	$929.54	$100.46	$27.89	$72.58	$856.96
3	$856.96	$100.46	$25.71	$74.75	$782.21
4	$782.21	$100.46	$23.47	$77.00	$705.21
5	$705.21	$100.46	$21.16	$79.31	$625.91
6	$625.91	$100.46	$18.78	$81.68	$544.22
7	$544.22	$100.46	$16.33	$84.14	$460.09
8	$460.09	$100.46	$13.80	$86.66	$373.43
9	$373.43	$100.46	$11.20	$89.26	$284.17
10	$284.17	$100.46	$8.53	$91.94	$192.23
11	$192.23	$100.46	$5.77	$94.70	$97.54
12	$97.54	$100.46	$2.93	$97.54	$0.00
	Sum:	$1,205.55	$205.55	20.55%	

As you can see from the table, it takes ten payments to "pay back" $1,000—the principal. Any lender profit comes from the last two payments, nearly a year later. The amount of interest collected is $205.55 or 20.55% of $1,000.

Traditional installment lenders are community-based lenders in cities and towns nationwide. As recognized by so many and for so long, installment lending has proven to be the most affordable and responsible form of consumer credit for working Americans. Payday and title loans are relatively new and are radically different from installment loans in the way they are structured, priced, and regulated. These differences are what make installment loans a smarter and long accepted option for borrowers, offering them better rates and significantly higher levels of safety and affordability.

In fact, former CFPB Director Richard Cordray said, "We are trying to make sure there is room for responsible lending, for community banks and credit unions in particular, but [also] …installment lenders who are traditional and have responsible products."[13] Both the National Black Caucus of State Legislators and the National Hispanic Caucus of State Legislators have passed resolutions promoting access to safe and affordable small-dollar credit. The resolutions stress the importance of protecting vulnerable elements in society, including some service members, from harmful products, while at the same time preserving their access to beneficial forms of credit.

[13] United States. Cong. House. Committee on Financial Services. *Hearing on The Semi-Annual Report of the CFPB*. Sept. 29, 2015. (testimony of Richard Cordray, Director, CFPB). Available at https://www.youtube.com/watch?v=eJmBjHv2RNk.