CONFERENCE OF STATE BANK SUPERVISORS

October 5, 2016

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

Re: Proposed Rulemaking: Payday, Vehicle Title, and Certain High-Cost Installment Loans
Docket No. CFPB-2016-0025
RIN 3170-AA40

Dear Ms. Jackson:

The Conference of State Bank Supervisors ("CSBS" or "state regulators") appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") proposed rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans (RIN 3170-AA40). State regulators are concerned that the Bureau's proposed rule will discourage depository institutions from developing small dollar lending programs. It will also make it less likely that banks will continue to provide small dollar loans as an accommodation to existing customers.

As described by the Bureau in the rule's commentary, states have a range of practice in their regulation and supervision of lenders who make small dollar loans. Thirty-six states allow for storefront payday lending while the remaining 14 states and the District of Columbia either prohibit payday loans or have interest rate caps that are too low to sustain traditional payday business models[1]. States regulate payday lending differently given the specific regulatory regime determined by the legislature, making the application of a "one size fits all" regulatory framework difficult.

State regulators have a dual mandate to ensure safety and soundness, and also to foster the economic well-being of their local communities. The FDIC's 2012 Community Bank Research Study found that there are more than 600 counties—one in five counties in the U.S.—where a community bank is the only depository institution[2]. In many states and counties, consumers face limited options for accessing affordable small dollar credit. As the chartering authority and primary regulator of 78% of the nation's 5,602 community banks,[3] state regulators feel strongly that the ability of these institutions to serve as a vital source of small dollar credit should be enhanced by simplifying the rules and providing de minimis standards for small relationship lenders. For this reason, the comments below focus primarily on the

[1] *CFPB Proposed Rulemaking on Payday, Vehicle Title, and Certain High Cost Installment Loans*, Page 19
[2] *FDIC Community Banking Study*, 2012, Executive Summary, Page 5. Available here: https://www.fdic.gov/regulations/resources/cbi/study.html
[3] *FDIC Community Bank Study*, 2012, Chapter 1: Defining the Community Bank, Available here: https://www.fdic.gov/regulations/resources/cbi/report/CBSI-1.pdf

1129 20th Street, N.W. • ninth Floor • Washington, DC • 20036
www.csbs.org• 202-296-2840 • FAX 202-296-1928

ability of depository institutions to serve the small dollar credit needs of their local communities within the framework of the Bureau's proposed rule. The comments reflect feedback collected over the course of multiple conversations with various stakeholders, including banks.

IMPACT OF THE PROPOSED RULE ON STATE'S EXISTING CONSUMER COMPLIANCE FRAMEWORKS

Approximately one-third of the U.S. population lives in states that have banned payday lending[4]. Unlike the Bureau, whose authority to set interest rate caps is forbidden by Federal Law, most states set limits on the cost of credit through usury laws. State regulators appreciate that the Bureau has taken steps to emphasize that the rule is intended to set a floor for regulation and not a ceiling. However, the Bureau must recognize that in states where payday lending is prohibited, the state has already set the floor for permissible lending activity, and the proposed rule could contribute to lower standards for consumer protection. For example, industry stakeholders in multiple states are pressuring legislatures to loosen state usury law to allow for high-cost installment products that are not allowed under current state laws, but would be permissible under the proposed rule.

To discourage industry stakeholders from using the proposal to argue for the allowance of high-cost installment loans in states where they are currently prohibited, state regulators ask the Bureau to clarify within the rule that a violation of a state's usury or other consumer protection law is an unfair, deceptive, and abusive act or practice (UDAAP). The inclusion of this statement would ensure that states could retain and enforce their existing consumer compliance frameworks and better equip state regulators and Attorneys General to prohibit illegal online payday lending activity. With respect to illegal or unlicensed lending activity, the Bureau should also clearly state that companies that facilitate illegal payday lending, whether by generating leads, advertising, or processing payments, are engaging in UDAAP.

The Bureau should make clear that states have the authority to interpret how the rule will interact with state law. States will need to navigate questions regarding conflict preemption and provide determinations to the industry regarding whether specific elements of state requirements are stricter than the Bureau's. The Bureau should be prepared to respond to the findings of individual states regarding interpretations of the rules requirements and preemption of existing law.

IMPACT OF THE PROPOSED RULE ON DEPOSITORY LENDING

Payday Industry Consolidation Necessitates Small Dollar Lending by Depositories

The Bureau has acknowledged that there will be significant consolidation in the payday lending industry as a result of the rulemaking. Following the rule's finalization, consumer demand for small dollar credit is unlikely to decrease. Therefore, the ability of depository institutions to offer small-dollar credit will be vital to credit availability.

[4] Del Rio, Deyanira, and Morrison, Andy. "Here's what happens when payday loans are banned." *Washington Post*. July 5, 2016. Available here: https://www.washingtonpost.com/news/in-theory/wp/2016/07/05/heres-what-happens-when-payday-loans-are-banned/?utm_term=.5f5cdcd272f6

Community Banks are Unlikely to Develop New Small Dollar Loan Products Due to Compliance Burden

Community banks do not generate a considerable profit from their small dollar lending, and they generally offer these loans as an accommodation to existing customers. The complexity of the proposed rule is likely to discourage banks that currently offer small-dollar credit from continuing to do so. It will also make it unlikely that banks will innovate in this area by developing new products.

While most community banks do not offer loans with terms of less than 45 days, or APR's higher than 36%, it is concerning that if a bank made even one covered loan, they would need to be aware of and in compliance with the entirety of the Bureau's rule. A bank could find itself in this situation if the cost of credit for a particular loan rises above 36% due to the inclusion of state-approved ancillary products within the all-in APR calculation. Alternatively, a depository lender wishing to make use of the alternative lending options (exemptions) within the rule would need to understand and comply with all other sections of the rule, including the payment restrictions in Subpart D, compliance program, record retention, and information furnishing requirements. The resulting compliance burden and added regulatory risk will likely cause many smaller banks to cease the offering of any small dollar loans to their customers.

The costs associated with the creation of a compliance program specific to small dollar lending will be prohibitive for community banks, especially smaller banks in rural areas. In 2013, the Federal Reserve Bank of Minneapolis published a paper that quantified the costs of additional regulation on community banks. The paper found that the performance of the smallest institutions would be disproportionately impacted by the hiring of a single additional full time employee (FTE) dedicated to compliance. Specifically, 13% of banks with assets of less than $50 million would become unprofitable if they needed to hire one additional employee. The hiring of an additional FTE would results in a 10.2 basis point reduction to the return on assets (ROA) of a median bank with between $100M and $250M in assets[5]. In addition, a recent study from the Federal Reserve Bank of St. Louis found that higher compliance expenses at the smallest banks are not correlated with better compliance performance[6].

De Minimis Exemption for Depository Institutions

The Bureau does not cite evidence of consumer harm stemming from depository small-dollar lending. Requiring community banks to comply with the same regulations as payday lenders will make it harder for consumers to access affordable small-dollar credit. To the contrary, large non-depository lenders who are able to automate installment lending that is compliant with the Bureau's rule will have an advantage over relationship lenders. In multiple areas within the proposed rule's commentary, the Bureau asks for comment on whether they should create a de minimis exemption for certain segments

---

[5] Feldman, Schmidt, and Heinecke. "Quantifying the Costs of Additional Regulation on Community Banks", Federal Reserve Bank of Minneapolis, 2013. Available here: https://www.minneapolisfed.org/research/economic-policy-papers/quantifying-the-costs-of-additional-regulation-on-community-banks

[6] Dahl, Meyer, and Neely. "Scale Matters: Community Banks and Compliance Costs", Federal Reserve bank of St. Louis, July 2016. Available here: https://www.stlouisfed.org/publications/regional-economist/july-2016/scale-matters-community-banks-and-compliance-costs

of the industry. State regulators ask that the Bureau use their authority under section 1022(3) of the Dodd-Frank Act to provide a de minimis exemption from all of the rule's requirements for depository institutions. The exemption should apply to institutions that meet certain criteria regarding loan volume *and* the percentage of the institutions gross revenue resulting from small dollar lending. An exemption structured in this way would allow community banks, credit unions, and community development financial institutions (CDFIs) to continue to serve as a source of small dollar credit.

Concerning loan volume, the Bureau should set a threshold for de minimis exemption based on the number of covered loans originated in a given calendar year. The small creditor definition within the Bureau's Qualified Mortgage Rules provides a framework for setting a de minimis standard[7]. State regulators recommend that the Bureau collect industry feedback on the chosen threshold and reevaluate the measure twelve months after implementation.

State regulators recommend that, in addition to the loan volume criterion, the Bureau set a maximum gross revenue threshold of 10%. The inclusion of a maximum percentage of revenue as a criterion for the exemption would prevent non-depository lenders from changing their lending practices to take advantage of the exemption and avoid compliance with the rule.

Depository Lending Under Sections 1041.11 and 1041.12

The inclusion of a de minimis exemption for depository institutions is necessary because the alternative lending options will not provide any incentive for banks to conduct this type of lending. In outreach to bankers and other stakeholders, state regulators focused on the ability of banks to make small-dollar loans under the longer-term alternative lending exemptions, sections 1041.11 and 1041.12.

Concerning the alternative option that is generally aligned with the NCUA's Payday Alternative Loan (PAL) Program (1041.11), state regulators do not believe this will be a scalable option for banks. Through outreach, bankers have noted that the pricing structure required under the NCUA program is too restrictive to incentivize bank lending, especially when considering that a bank seeking to utilize this option would need to comply with requirements that go beyond the NCUA's requirements for such lending, in addition to complying with all other provisions of the Bureau's proposed rule. Unlike the Bureau, the NCUA does not set underwriting standards for PAL loans, and the specific amortization requirements within the exemption are different from those in the NCUA's program. In addition, a depository institution utilizing this option would not be able to exercise the right of set-off to collect from a consumer's deposit account, despite no evidence that depository institutions are abusing their right of set-off for collection purposes.

[7] Bankers and state regulators provided feedback to CSBS regarding the appropriate loan volume threshold for a di minimis exemption. Responses ranged from 500 to a few thousand loans. Banks operating in rural areas with limited banking options may necessitate a higher threshold. Similarly, depository institutions operating in states with highly concentrated banking sectors and significant storefront payday lending activity may need a higher loan volume threshold to be able to accommodate the demand resulting from payday storefront consolidation.

Participation in the NCUA's PAL program is already limited. According to the Bureau's analysis, only 700 Federal Credit Unions offered a total of $123.3 million PAL loans in 2015[8]. Limited lending activity within the PAL program over the past two years suggests that wider adoption by other depository institutions is unlikely. A PAL type loan is not one on which a bank or credit union would make a sizable profit. Like "accommodation" loans made by banks, credit unions typically offer PAL loans as a service or courtesy to members. In late June, the Credit Union National Association (CUNA) sent a letter to the National Credit Union Administration (NCUA) noting that, when faced with the need to comply with an extremely complex and lengthy rule that includes additional requirements for PAL lending, many credit unions may ultimately decide to cease offering a PAL product[9]. In addition, it is unlikely that community banks will utilize this alternative option given the compliance burden and strict limits on interest rate (28%), costs, and loan term.

The Bureau indicated that the portfolio default rate refund exemption (1041.12) would allow for a continuation of the "accommodation" lending currently occurring at banks. Under the exemption, a depository institution could make small dollar loans without satisfying the Bureau's Ability to Repay requirement as long as they are underwritten to achieve an annual portfolio default rate of no more than 5%. If the lender's portfolio default rate exceeds 5%, the lender must provide a timely refund of the origination fees charged on all loans included within the portfolio.

The portfolio default rate refund exemption has yielded strong reactions in discussions with bankers. First, the safe harbor origination fee of $50 proposed under 1041.12 will not create incentives for depository institutions to fill the anticipated demand in this area. Increasing the allowable safe harbor fee would increase the likelihood that depository institutions might participate. Some bankers and state regulators have suggested that it could cost as much as $100 to originate a loan. Before finalizing the rule, the Bureau should conduct a functional cost analysis of the loan origination process to provide more support for any limitations under this option.

Members of the CSBS Banker's Advisory Board expressed concern with the compliance burden that would stem from the manual tracking of defaults and subsequent refunds with the portfolio default rate refund exemption. In addition, they indicated that the income generated from offering these types of loans would not offset the collection and tracking expenses. Average default rates in certain states are higher than 5%, and in the case of natural disasters, such as the recent flooding in Louisiana, default rates would be expected to increase significantly. A lender could make a good faith effort to underwrite loans that are affordable by customers, however, natural disasters, economic downturns, or local events such as the closing of a factory could result in vastly different borrower circumstances that cannot be accounted for at the time of underwriting. These uncontrollable events could be especially damaging to the business of banks in small, concentrated markets, where a local factory may be the primary employer within the community. In short, there are circumstances that make default rates a poor proxy for the quality of underwriting.

---

[8] *CFPB Proposed Rulemaking on Payday, Vehicle Title, and Certain High Cost Installment Loans*, Page 102
[9] Letter from CUNA to NCUA regarding Bureau's Small Dollar Loan Proposal, June 27th, 2016. Available here: http://news.cuna.org/articles/110518-letters-to-cfpb-ncua-focus-on-payday-lending-concerns

The Bureau also sought comment on an additional alternative lending option that was included in the advance notice of proposed rulemaking, but not included in the proposed rule. The option would allow lenders to make small dollar loans that satisfy certain criteria as long as the maximum payment does not exceed 5% of a borrower's monthly income. While it is likely that large institutions may be able to automate such lending, it is unlikely that this option would entice the majority of the industry to get involved.

ATR Test and Access to Credit

State regulators have concerns regarding the application of an Ability to Repay test to small dollar loans as prescribed by the Bureau. A significant concern is the fact that the Bureau's ATR test will not result in a formulaic answer regarding a consumer's ability to repay. Without markers that can guide the decision making process, an institution making a lending decision is taking a risk that a loan could still trigger a UDAAP violation despite a good-faith effort to comply with the rules requirements.

Clear Guidance Needed for Depository Lending

In addition to providing for a de minimis exemption for depository institutions, the Bureau should work with the industry and other federal regulators to create guidance regarding how banks can offer a cost-effective, useful, small-dollar loan product. Clear guidelines should include markers for a consumer's ability to repay, limits on frequency, loan size, and "off ramps" for consumers who find themselves stuck in a cycle of debt.

CONCLUSION

In conclusion, state regulators ask the Bureau to reconsider the necessity of including community banks within the scope of the rule's coverage. In our outreach efforts, we saw an alignment of opinion between bankers and states regarding the need for banks to offer small dollar credit. Community banks are often the safest source of credit for consumers in rural communities. Demand for small dollar credit will not decrease following the finalization of the Bureau's rule. The ability of consumers to access credit from local depository institutions should not be diminished. State regulators appreciate the opportunity to comment on the proposed rule and look forward to continued collaboration as the Bureau works towards finalization.

Sincerely,

John W. Ryan
President & CEO