

**Testimony of David Silberman
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Consumer Financial Protection Bureau
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Subcommittee on Financial Institutions and Consumer Credit
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Chairman Neugebauer, Ranking Member Clay, and Members of the Subcommittee, thank you for the opportunity to testify today about the Consumer Financial Protection Bureau's (Bureau or CFPB) extensive and ongoing work related to payday lending. My name is David Silberman, and I serve as Associate Director for Research, Markets, and Regulations at the CFPB, a position I have held since 2011. Last month I also was named as Acting Deputy Director.

In November 2010, I joined the Bureau as part of the implementation team. Prior to the Bureau, I served as General Counsel and Executive Vice President of Kessler Financial Services, a privately-held company focused on creating and supporting credit card and other financial services to membership organizations. My involvement in consumer financial services began when I was Deputy General Counsel of the AFL-CIO. While at the AFL-CIO, I helped to create an organization to provide financial services to union members and the first AFL-CIO credit card program. I began my career as a law clerk to Justice Thurgood Marshall.

As you know, the CFPB is the nation's first federal agency with a sole focus on protecting consumers in the consumer financial marketplace. Through fair rules, grounded on evidence-based findings and stakeholder input, consistent oversight, appropriate enforcement, and broad-based consumer engagement, the Bureau is working to restore consumer trust in the financial marketplace and to level the regulatory playing field for honest businesses. To date, our enforcement actions have helped secure approximately \$11.2 billion in relief for millions of consumers victimized by violations of Federal consumer financial laws.

Since 2011, I have led the Research, Markets, and Regulations Division. The division is responsible for articulating a research-driven, evidence-based perspective on consumer financial markets, consumer behavior, and regulations, informing Bureau thinking on priority areas, identifying areas where Bureau intervention may improve market outcomes, and supporting efforts to reduce outdated, unnecessary, or unduly burdensome regulations. Where our research and analysis suggests the need for regulatory intervention, the Bureau seeks to develop regulations which will protect consumers without unintended consequences or unnecessary costs. As part of the rulemaking process, the Bureau carefully assesses the benefits and costs that the regulations we consider may have on consumers and financial institutions. Balanced regulations are essential for protecting consumers from harmful practices and ensuring that consumer financial markets function in a fair, transparent, and competitive manner.

Since the subject of today's hearing is the Bureau's work with respect to short-term, small dollar lending, let me begin by tracing the Bureau's work in this area.

When the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was enacted, payday loans were a particular area of concern to Congress. Indeed, the Dodd-Frank Act gives the Bureau plenary authority to supervise any entity that offers payday loans regardless of size. As a result, when the Bureau began supervising non-depository institutions in 2012, payday lending was the first industry that was brought into our supervisory program. To that end, the Bureau developed examination procedures for small dollar lenders that were published as part of the Bureau's Supervision and Examination Manual,¹ which is available on our website, consumerfinance.gov.

Bureau examiners use the examination procedures in the Manual to make sure payday lenders – depositories and non-depositories – are complying with Federal consumer financial law. Specifically, the Short-Term, Small Dollar Lending Procedures describe the types of information that the agency's examiners will gather to evaluate payday lenders' compliance management systems (CMS), assess whether lenders are in compliance with Federal consumer financial laws, and identify risks to consumers throughout the lending process. The procedures track key payday lending activities, from initial advertisements and marketing to collection practices.

At the same time, the Bureau decided to begin the process of fact gathering to assess whether there was a need for federal regulations to prevent unfair, deceptive, or abusive acts or practices. In January 2012, the Bureau held a field hearing in Birmingham, Alabama to hear directly from stakeholders and the public about actual consumer experience with small dollar loans, including both loans offered by non-depository institutions and loans offered by certain banks and credit unions. Alabama is a state with one of the highest number of payday lenders per capita in the country. The field hearing included testimony from consumer and civil rights groups, industry representatives, and members of the public and provided the CFPB with insight into the payday lending market. The Bureau invited the Alabama Congressional delegation to that event and was honored to have Congresswoman Terri Sewell attend and participate in the event as well.

During the year that followed the Birmingham field hearing, the Bureau obtained data from a number of payday lenders and banks making short-term, small-dollar loans and engaged in an in-depth study of the market. Based on that study, in April 2013 the Bureau issued a report entitled, *Payday Loans and Deposit Advance Products - A White Paper of Initial Data Findings* (White Paper).² The White Paper was one of the most comprehensive studies ever undertaken of the market. It was an important step toward bringing more clarity to the complicated markets for payday lending and deposit advance products. The White Paper also provided market participants with insight into Bureau concerns based on our findings as of that time.

The White Paper found that most payday loans are for several hundred dollars and have finance charges of \$15 or \$20 for each \$100 borrowed. For the two-week term typical of a payday loan, these fees equate to an Annual Percentage Rate (APR) ranging from 391 percent to 521 percent.

¹ Available at <http://www.consumerfinance.gov/guidance/supervision/manual/>.

² Available at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

If a consumer does not repay the loan in full by the due date or agree to extend the loan for an additional two weeks, the loan agreement typically permits the lender to directly access the consumer's deposit account, such as with the consumer's post-dated check or Automated Clearing House (ACH)³ authorization, to obtain repayment.

Typically, a consumer's ability to repay the loan while meeting other debts and ordinary living expenses is not taken into account. Eligibility to qualify for a payday loan generally requires proper identification, proof of income, and a personal checking account. No collateral is held for the loan, although the consumer does provide the lender with a personal check or authorization to debit her deposit account for repayment. Credit score are also generally not taken into account. The median borrower studied in the Bureau's analysis reported \$22,000 in income.

The White Paper showed that making these short-term loans to low and moderate income consumers without any assessment of the consumer's ability to repay put many consumers at risk of turning short-term, emergency loans into a long-term, expensive debt burden. Additionally, the Bureau found that payday loans and the deposit advance loans offered by a small but then-growing number of depository institutions were generally similar in structure, purpose, and the consumer protection concerns they raise.

Specifically, the White Paper traced over a period of 12 months the experience of borrowers who had a payday loan in the first month covered by the data. It found that the median borrower took out 10 loans over the course of the year and was in debt for 199 days out of the year. The median borrower thus paid over \$150 in fees for every \$100 borrowed. Moreover, almost a third of the borrowers took out more than 20 loans, paying twice that amount.

During the year following the publication of the White Paper, the Bureau continued its research and analysis as well as its supervisory activities. Also in 2013, the Bureau announced two important updates to its Supervision and Examination Manual. The Bureau informed supervised entities that Bureau examiners may examine a range of products offered by the supervised entity, including title loans, installment loans, and money services. Additionally, the Bureau released guidelines for examiners to identify consumer harm and risks related to Military Lending Act (MLA) violations when supervising payday lenders.⁴

In November 2013, the Bureau took another important step to gain insight into the payday loan market by beginning to take consumer complaints regarding payday lending. Consumer complaints can be an important source of information about problems consumers experience with different financial products and thus play a vital role in the Bureau's work, especially in targeting its supervisory and enforcement activities to companies that appear to pose the greatest risk to consumers. As of January 1, 2016, the Bureau has handled approximately 37,000 complaints related to payday lending, 12,000 were identified by the consumer as payday

³ ACH stands for Automated Clearing House, which is an electronic network for processing credit and debit transactions, such as direct deposits and consumer payments, such as those pre-authorized when a consumer applies for a payday loan.

⁴ Available at: http://files.consumerfinance.gov/f/201309_cfpb_payday_manual_revisions.pdf.

complaints and 24,000 were identified by the consumer as debt collection complaints related to a payday loan.

The next step in the Bureau's study occurred in March 2014 with the publication of a second report, entitled *CFPB Data Point: Payday Lending* (Data Point),⁵ which further analyzed the data used in the White Paper. In response to feedback about the methodology used in the Bureau's first report, the Data Point looked at consumers at the start of a borrowing cycle and traced their experience until they paid off their loan and went two weeks without reborrowing. The Bureau found that only 35 percent of borrowers were able to repay the loan when due without quickly reborrowing, and that 15 percent of borrowers took out 10 or more loans in rapid succession. Indeed, the Bureau found that 50 percent of all loans went to consumers in these lengthy loan sequences.

Looking at payday consumers who receive their incomes on a monthly basis, the Data Point found one out of five who took out a payday loan remained in debt for the entire year of the Bureau's study. Payday consumers who fell into this category include elderly Americans and those persons receiving Supplemental Security Income and Social Security Disability.

The Bureau also found that very few consumers managed to reduce the amount they owed over the course of the loan sequence. The more typical pattern was that consumers paid only the fees due and reborrowed the full amount of the principal time after time. Indeed, over 80 percent of consumers owed at least as much on the last loan as they had borrowed initially.

In states with mandated cooling-off periods, where lenders are not permitted to immediately re-lend to consumers paying off a prior loan, the Bureau found that the 14-day renewal rates are nearly identical to the rates in states without these limitations. In other words, these short cooling off periods did not have any material effect in breaking the cycle of indebtedness.

Finally, the Bureau found that over the course of a sequence of loans, 20 percent of consumers ended up defaulting and thus became the object of collections activity. While most of the defaults occurred early in a sequence of loans, a significant percentage of consumers defaulted after having paid substantial fees to continue to roll over or renew their loans.

The Bureau released its second report in conjunction with a second field hearing on payday lending, this one in Nashville, Tennessee. Like the Birmingham hearing, the Nashville hearing gave Bureau staff the opportunity to hear first-hand from consumers, lenders, advocates, and faith leaders about consumer experiences with these products.

Shortly after the release of the Data Point and the Nashville hearing, the Bureau released an edition of its periodic *Supervisory Highlights*, which described findings that the Bureau had made in its payday lending examinations.⁶ Specifically, the Bureau reported that examinations had found that a number of payday lenders had not implemented effective compliance

⁵ Available at http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

⁶ See *Supervisory Highlights: Spring 2014*, available at

http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf.

management systems. Generally, CMS concerns covered a range of issues, including lack of oversight of compliance management, ineffective oversight of third-party service providers, inadequate complaint management, failure to adopt appropriate written policies and procedures, failure to adequately train staff, and lack of effective compliance audit programs. At several short-term, small-dollar lenders, Bureau examiners found inadequate compliance management systems for collection activity. Lenders did not adequately monitor collections calls, attempt to understand the root causes of complaints arising from collections practices, provide training for collectors, and properly oversee third-party service providers. As a result of poor record-keeping, some payday lenders have been unable to fully respond to Bureau information requests or examiner inquiries on-site.

Bureau examinations have also found deceptive practices at payday lenders. Upon a borrower's default, payday lenders frequently will initiate one or more preauthorized ACH transactions pursuant to the loan agreement for repayment from the borrower's checking account. At one or more lenders, the Bureau cited a deceptive practice when communications with consumers threatened ACH transactions that were contrary to the agreement, and that the lender did not intend to initiate.

Finally, in October 2014, the Bureau held a government-to-government Tribal Consultation with tribal leaders interested in the subject of small-dollar lending to hear their input as the Bureau was in the process of formulating its proposals. This Consultation, as well as the Bureau's other engagements with tribal nations, are discussed later in this testimony.

All of this brings me to the outline of proposals under consideration which the Bureau released in March 2015, as the first formal step in the rulemaking process.

As outlined above, over the course of three years the Bureau engaged in intensive analysis of the short-term and longer-term credit markets for personal loans. The Bureau considered the history of the demand for such loans and the conditions that create such demand. The Bureau focused carefully on how people are affected by the kinds of credit products that have evolved to meet this demand. After much study and analysis, in March 2015, the Bureau outlined the proposals under consideration⁷ designed to protect borrowers from the risks the Bureau's research has identified. The proposals released for consideration would cover payday, vehicle title loans, deposit advance products, and certain high-cost installment loans and open-end loans.

To collect feedback on the approach from small lenders, the Bureau published the outline of the proposals under consideration in preparation for convening a Small Business Review Panel, and obtaining feedback from Small Entity Representatives pursuant to Regulatory Flexibility Act. The proposals under consideration cover both short-term and longer-term credit products that are marketed heavily to financially vulnerable consumers. The Bureau recognizes consumers' need for affordable credit, and is concerned that the practices often associated with these products, such as failure to underwrite for affordable payments, repeatedly rolling over or refinancing

⁷ Available at http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf.

loans, holding a security interest in a vehicle as collateral, accessing the consumer's account for repayment, and performing costly withdrawal attempts, can trap consumers in debt. These debt traps can also leave consumers vulnerable to deposit account fees and closures, vehicle repossession, and other financial difficulties.

The core of the proposals under consideration is aimed at ending debt traps with a requirement that, before making a covered loan, lenders would be obligated to make a good-faith, reasonable determination that the consumer has the ability to repay the loan. That is, the lender would have to determine that after repaying the loan, the consumer would have sufficient income to pay major financial obligations, including a rent or mortgage payment and other debt, and also to pay basic living expenses, such as food, transportation, childcare or medical care, without the need to reborrow in short order.

Until recently, a bedrock principle of all consumer lending was that before a loan was made, the lender would first assess the consumers' capacity to repay the loan. In a healthy credit market, both the consumer and the lender succeed when the transaction succeeds - the consumer meets his or her need and the lender gets repaid. This proposal seeks to address consumer harm caused by unaffordable loan payments due in a short period of time.

The proposals under consideration to require lenders who make short-term, small dollar loans to assess a prospective borrower's ability to repay and avoid making loans with unaffordable payments parallels a rule adopted by the Federal Reserve Board in 2008, in the wake of the financial crisis. That rule requires lenders making subprime mortgages to assess the borrower's ability to repay. The proposals under consideration also parallel ability to repay requirements that Congress enacted in the Credit Card Accountability Responsibility and Disclosure Act (CARD Act) in 2009 for credit card issuers, and in the Dodd-Frank Act in 2010, for all mortgage lenders.

As an alternative to the basic prevention requirements of assessing a borrower's ability to repay, the proposals under consideration also contain what we have called protection requirements. These requirements would allow lenders to extend certain short-term loans without conducting the ability to repay determination outlined above, so long as the loans satisfy certain screening requirements and contain certain structural protections to prevent short-term loans from becoming long-term debt. Under this proposal, lenders would have the option of either satisfying the ability to repay requirements or satisfying the alternative requirements.

The protection requirements the Bureau outlined for consideration would allow lenders to make up to three loans in succession, with a maximum of six total loans or a total of 90 total days of indebtedness over the course of a year. The loans would be permitted only if the lender offers the consumer an affordable way out of debt. The Bureau is considering two options for paths out of debt either by requiring that the principal decrease with each loan, so that it is repaid after the third loan, or by requiring that the lender provide a no-cost "off-ramp" after the third loan, to allow the consumer to pay the loan off over time without further fees. For each loan under these alternative requirements, the debt could not exceed \$500, carry more than one finance charge, or require the consumer's vehicle as collateral. After a sequence of three loans, a lender could not take advantage of the protection requirements again for a period of 60 days.

The Bureau's proposals under consideration raised the question of whether offering such an alternative for lenders, including small lenders that may have difficulty conducting an ability to repay determination with a residual income analysis, may be helpful in providing access to credit to consumers who have a genuine short-term borrowing need, while still protecting consumers from harms resulting from long-term cycles of debt. This alternative would also reduce the compliance costs for lenders.

Stakeholders on all sides of the issue have provided valuable feedback on the proposals under consideration. Consumer advocates, for example, have argued that the Bureau should not permit any lending which does not meet the basic ability to repay standard. They argue that consumers need prevention *and* protection - not either, or. Industry stakeholders, on the other hand, argue that the protection requirements under consideration are too restrictive because those requirements would allow no more than three loans in a row and no more than six loans per year. Industry stakeholders want to be able to continue making many more loans to consumers without regard to their ability to repay. State policymakers have urged the Bureau to both protect consumers across all small dollar lending markets and to seek feedback from the states on their regulation of small dollar lending products. Tribal governments have urged the Bureau to consider the impact of any regulation on the revenue the tribes receive from these products.

The Bureau released the outline of the proposals under consideration at a field hearing held in Richmond, Virginia. Like the prior two field hearings on this subject, the Richmond event provided the Bureau with a rich and wide-ranging set of perspectives from consumers, lenders, advocates, and faith leaders.

In over 10 months since the Bureau formally released the outline of proposals under consideration, the Bureau has engaged in further outreach and engagement with a wide variety of stakeholders. That process began by convening a Small Business Review Panel and meeting with 27 Small Entity Representatives, including not only storefront payday and vehicle title lenders, but also banks and credit unions, tribal lenders, and online lenders. The Small Business Review Panel submitted its report to the Bureau last June, and the Bureau is continuing to consider those recommendations.

In addition to participating in the Small Business Review Panel, the Bureau has continued to seek input through formal meetings between Bureau staff and various stakeholders and through many more informal meetings and discussions. From October 14, 2014 to September 15, 2015, the Bureau conducted over 30 meetings on consumer lending with nonprofit groups, including consumer advocacy, faith-based, and civil rights organizations. In the same period, the Bureau met to discuss consumer lending with state, municipal and Tribal officials a total of 17 times, and with representatives from industry and trade associations and over 30 times. A group of lenders and advocates also joined together to discuss areas of agreement, and the Bureau met with this group three times to obtain its consensus recommendations as well as to hear areas of discussion.

Additionally, the Bureau has taken special care to acknowledge and respect the unique legal relationship between the federal government and tribal nations. This relationship is a critical one, and its importance is reflected in the Bureau's Tribal Consultation Policy,⁸ as well as the Bureau's extensive outreach and engagement with the tribes.

The Bureau finalized its Tribal Consultation Policy in April 2013. Since the Policy went into effect, the Bureau has conducted two Tribal Consultations on the CFPB's potential rulemakings for payday, vehicle title, and similar loans and welcomes input on ways that we can improve our Tribal Consultation Policy. In both the drafting of the Tribal Consultation Policy and the execution of the two Consultations, the Bureau conferred with other federal agencies, including the U.S. Department of Interior, to draw on their experiences and incorporate their best practices for effective Tribal Consultation. The Bureau is committed to ensuring that our Tribal Consultation policy provides a meaningful opportunity for the Bureau to consult with tribes on policies that affect them.

Specifically, the Bureau invited all 566 federally recognized tribes⁹ to two Consultations related to the Bureau's small-dollar lending rulemaking proposals. These Consultations were frank discussions that allowed tribal leaders to share their views about the proposals with the Bureau. The first of these Consultations took place in November 2014, before the Bureau had formulated the outline of proposals under consideration. The second took place in June 2015 to discuss the Bureau's outline. The Bureau also has held a number of other meetings with tribes at the Bureau's headquarters and across the country.¹⁰ The tribe's feedback is being considered as the Bureau moves forward on a Notice of Proposed Rulemaking.

The Bureau also spoke directly to state and federal regulators and policy makers at field hearings and in other settings across the country. In June 2015, the Bureau's Office of Consumer Advisory Board and Councils, which is charged with managing the Bureau's advisory groups and serving as the liaison between advisory group members and the Bureau, held meetings and field events associated with the Bureau's Consumer Advisory Board (CAB) in Omaha, Nebraska about payday, vehicle title, and similar loans. The CAB advises and consults with the Bureau in the exercise of its functions under the Federal consumer financial laws, and provides information on emerging practices in the consumer financial products and services industry, including regional trends and other relevant information. The events included a community roundtable, welcome reception with community leaders and representatives, an industry and community engagement panel, a community tour including a visit to a payday lending store, CAB committee meetings, and a day-long public session, which focused on the Bureau's proposals under consideration, trends in payday and auto-title lending, and mortgages. In addition to the Omaha

⁸ Available at http://files.consumerfinance.gov/f/201304_cfpb_consultations.pdf.

⁹ The Bureau is aware that the U.S. Department of the Interior recognized a 567th tribe on July 2, 2015 and intends to include this additional tribe in all future tribal engagements. See Interior Department Issues Final Determination for Two Federal Acknowledgement Petitioners, Dept. of Interior, July 2, 2105, available at www.indianaffairs.gov/cs/groups/public/documents/text/idc1-030832.pdf.

¹⁰ Associate Director Zixta Martinez addressed a plenary session of the 2014 National Congress of American Indians (NCAI) Annual Meeting, and Bureau leadership met with the NCAI Executive Committee during that event. In addition, the Bureau has partnered with tribes on key consumer education and engagement programs related to K-12 financial education and the Bureau's *Your Money Your Goals* initiative.

meetings, the Consumer Advisory Board convened six discussions on consumer lending, the Community Bank Advisory Council held two discussions, and the Credit Union Advisory Council conducted one discussion.

Since October 2014, Bureau staff has held meetings and roundtables with over 40 entities from industry, including 13 national trade associations and over 30 of their member businesses. The entities represented small dollar lenders operating in communities and online, vehicle/title lenders, installment lenders, retail banks, community banks and credit unions. The meetings were open forums for industry groups to share their knowledge of small dollar lending operations, underwriting processes, state laws, and anticipated regulatory impact.

The Bureau's Office of Research has reviewed numerous industry-sponsored, advocate-sponsored and independent research reports on payday, auto title and similar lending in the United States. It has invited several of the authors to share their methods and data via follow-up teleconferences or in-person visits here in Washington.

Bureau leaders, including Director Cordray, have also spoken at events and met with industry representatives. In February 2015, Bureau leaders met with the Board of Directors of the Community Financial Services Association of America. These meetings have provided the Bureau with opportunities to hear the industry's insight and suggestions for how to craft a proposed rule that would preserve access to small dollar lending in underserved communities.

The Bureau continues to receive feedback from Congress, State, Local and Tribal officials, consumers, industry, and others on its proposal under consideration. The Bureau's next step will be to formally issue a proposed rule. Once the proposal is issued, the public will be invited to submit written comments. The Bureau will carefully consider those comments before final regulations are issued. The Bureau will move as quickly as reasonable, recognizing the importance and the complexity of the subject, and will be thoughtful and thorough as we continue this work.

In the end, the Bureau intends for consumers to have a marketplace that works both for short-term and longer-term credit products. For lenders that sincerely intend to offer responsible options for consumers who need such credit to deal with emergency situations, the Bureau is making conscious efforts to keep those options available. There should be opportunities available for loans with affordable payments that will enable the consumer to repay the loan and still meet their other obligations and pay their living expenses. Lenders that rely on fees and profits from consumers in long-term debt traps, however, will not be able to continue business as usual. Consumers should be able to meet their needs without finding themselves stuck in an extended debt trap.

Chairman Neugebauer, Ranking Member Clay, and Members of the Subcommittee, thank you for helping us to achieve that goal and for the opportunity to testify today. I look forward to your questions.