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"CFPB's Role in Empowering Predatory Lending: Examining the Proposed Repeal of the Payday Lending Rule"

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Chairman Krishnamoorthi, Ranking Member Cloud, distinguished members of the Subcommittee, thank you for the opportunity to testify today. My name is Thomas Pahl, and I am the Policy Associate Director of the Research, Markets, and Regulations Division at the Consumer Financial Protection Bureau (CFPB or Bureau). Immediately before assuming this role, I served as the Acting Director of the Bureau of Consumer Protection at the Federal Trade Commission. I have worked at the Federal Trade Commission and at the CFPB on consumer protection matters for more than 25 years, primarily as a career, civil service attorney. I welcome this opportunity to talk with you about the CFPB's recent work relating to payday, vehicle title, and certain high-cost installment loans, collectively "small dollar loans."

Consumers sometimes face a financial shortfall due to an emergency expense or a pressing bill and a lack of liquid savings. A large proportion of Americans living paycheck to paycheck may find themselves in these circumstances. CFPB research has found that 29 percent of consumers have less than $250 in liquid savings. A separate Federal Reserve Board study found that over 40 percent of consumers would seek credit if faced with a $400 emergency expense. Consumers facing these financial shortfalls and who lack access to other sources of credit are the primary potential customers for small dollar lenders.

Congress established the CFPB's purpose and objectives in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act declared that the Bureau's "purpose" is to assure that consumers, including those facing financial shortfalls, have "access to markets for consumer financial products or services" and that those markets are "fair, transparent, and competitive." More specifically, the Dodd-Frank Act tasked the Bureau with achieving a number of objectives, including ensuring that "consumers are provided with timely and understandable information to make responsible decisions about financial transactions"; that "consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination"; and that "markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation."

The Dodd-Frank Act gave the Bureau a range of tools to achieve this purpose and these objectives, including consumer education, rulemaking, supervision, and law enforcement. The Bureau uses and will continue to use all of these tools to advance our mission.

Much of the debate concerning small dollar loans has focused on CFPB rulemaking. However, to provide a complete understanding of what the CFPB has done and will do to protect consumers in connection with small dollar loans requires consideration of how the Bureau is using its other tools. The statement below first describes the CFPB's use of these other tools, then turns specifically to the CFPB's pending rulemakings.

Empowering Consumers and Turning Financial Education into Action

The CFPB has developed a range of financial education programs to strengthen and support consumers so they can make better-informed financial decisions. The Dodd-Frank Act specifically charged the Bureau with developing and implementing a strategy to improve the financial literacy of consumers through activities that include opportunities for consumers to access financial counseling, and information to assist with the evaluation of credit products, and also to access activities intended to improve consumers' financial situation. Helping consumers help themselves, protect their own interests, and choose the financial products and services that best fit their needs is vital to preventing consumer harm and building a high level of financial well-being.

Emergency savings are a key element as people address the broader issues in their financial lives around attaining and retaining good credit, managing their debt, and maintaining a healthy habit of savings. The Bureau has undertaken a number of research projects to explore the effectiveness of various alternative methods to promote savings. We also are undertaking research to better understand the specific events that can cause consumers to have difficulty making ends meet and the choices they face when that happens.

Recently, the Bureau launched our "Start Small, Save Up" initiative, which offers tips, tools and information to help consumers build a basic savings cushion and develop a savings habit. Later this year, we will be launching a savings "boot camp," a series of videos, and a very readable, informative booklet that serves as a roadmap to a savings plan. And, we are committed to bringing together partners from across sectors to develop and execute a strategy to learn from and promote the best practices of others, and to significantly increase the level of emergency savings across the country.

Our "Start Small, Save Up" initiative is the latest part of the Bureau's long-term on-going work to help consumers take control of their financial futures and make better-informed financial choices. We also offer a range of other materials to help consumers increase their knowledge, skills, and resources when it comes to money matters. These tools are offered to help consumers address financial issues, create goals, budget, and understand different financial products so they can make better-informed choices.

In addition, since 2012 the Bureau has hosted on its website Ask CFPB, an interactive online tool that provides consumers with plain language answers to a wide variety of financial questions.

Ask CFPB contains approximately 1,000 questions and answers on financial topics organized into ten topic areas, including answers to twenty-one questions about payday loans.

Ensuring a Culture of Compliance through Supervision

In addition to educating consumers so they can protect themselves better, the Bureau engages in activities to ensure that small dollar lenders comply with the law. Such lenders must understand and live up to their legal obligations if the Bureau is to be effective in protecting consumers in connection with payday loans. Supervision is a critical tool in ensuring they do so.

There are a range of federal consumer protection laws enumerated in the Dodd-Frank Act that apply to small-dollar lenders, including the Truth in Lending Act (TILA) and its implementing Regulation Z (which require disclosures consumers must receive in connection with payday and other similar loans); the Electronic Fund Transfer Act (EFTA) and its implementing Regulation E (which govern the electronic debiting of consumers' bank accounts); the Fair Credit Reporting Act (FCRA) and its implementing Regulation V (which address the furnishing of information to consumer reporting agencies); and the Gramm-Leach-Bliley Act (GLBA) and its implementing Regulation P (which address financial privacy). In addition, the Dodd-Frank Act itself contains provisions that apply to small-dollar lenders, including the prohibition of unfair, deceptive, and abusive acts and practices.

Through supervisory examinations, Bureau examiners can assess whether the institution is taking its obligations seriously, and whether it has a culture of compliance that tries to prevent harm in the first instance. Supervision can uncover inattention to compliance and other internal controls that, if unaddressed, might lead to future violations. Moreover, where an examination uncovers legal violations, the Bureau does not hesitate to direct the institution to remediate the violation. The Bureau also publishes reports of its findings in a manner that preserves the confidentiality of the institutions in question while helping industry limit risk to consumers and comply with Federal consumer financial law.

The Dodd-Frank Act authorizes the CFPB to supervise payday lenders, regardless of their size, and to conduct periodic examinations to assess compliance with the requirements of all of these federal consumer financial laws and obtain information about compliance systems or procedures. The Bureau is actively engaged in doing so. For example, last summer the Bureau reported that it had "observed one or more entities" engaged in payday lending using deceptive collection letters to collect on payday loans in violation of the Dodd-Frank Act. The Bureau reported that in response to the examination findings, the entity or entities are ensuring that their collection letters do not contain deceptive content. The Bureau also reported that it had "observed one or more entities" using debit card numbers or ACH credentials, which consumers had not validly authorized the lenders to use, to collect amounts due in violation of EFTA and the Dodd-Frank Act. The Bureau further reported that in response to these examination findings, the entity or entities are ceasing the violations and remediating impacted borrowers.

The Bureau is committed to using supervision effectively and efficiently to increase compliance with the law and prevent consumer harm, including when it comes to payday lenders.

Holding Bad Actors to Account through Enforcement

Supervision is valuable to increasing compliance among those who want to follow the law, but enforcement remains an essential tool because there will always be bad actors who do not comply with the law. Enforcement can foster compliance, deter unlawful conduct, help prevent consumer harm, and right wrongs.

Enforcement is and will remain a key part of the Bureau's current efforts to protect consumers in connection with small dollar loans. Over the past year, the Bureau has initiated five public enforcement actions involving payday lenders -- including two since the start of 2019. In these cases, the payday lenders allegedly made disclosures which violated TILA; engaged in deceptive advertising in violation of the Dodd-Frank Act; failed to provide privacy notices as required under the GLBA and Regulation P; and engaged in unfair, deceptive, or abusive collection practices. In each of these cases, the Bureau entered into a consent order which prohibited the payday lenders from engaging in the same or similar practices in the future, and, in four of the five cases, required that the lenders pay civil money penalties.

In addition to bringing these new cases, in the past year the Bureau obtained final judgments against payday lenders in two other, previously-filed cases. In one of those cases, several individual defendants were permanently barred from the industry and forfeited $14 million in assets. In the other case, which involved entities based outside of the United States, the defendants were enjoined from advertising or originating loans or collecting on any of their existing loans.

These payday loan cases are testament to the agency's commitment to use its enforcement tool to take decisive action against wrongdoers and send a clear message to the marketplace that should deter unlawful behavior and support a level playing field.

The Bureau's Pending Rulemaking Proceedings

Let me now turn to the Bureau's use of its rulemaking authority to protect consumers in connection with small dollar loans. Under Section 1031 of the Dodd-Frank Act, the Bureau has the authority to issue rules to identify and prevent unfair, deceptive, or abusive acts and practices in small dollar lending. Section 1031 sets forth specific elements that the Bureau must find before determining that acts or practices are unfair or abusive. In addition, under Section 1032 of the Dodd-Frank Act, the Bureau also has the authority to issue rules mandating disclosures so that consumers can understand the costs, benefits, and risks of small dollar loans.

It is also important to recognize the limits of the Bureau's rulemaking authority. Section 1031 of the Dodd-Frank Act requires that the agency focus on acts and practices related to consumer financial products and services, not on the products and services themselves. Notably, Section 1027(o) of the Dodd-Frank Act expressly precludes the Bureau from imposing a usury limit, including on small dollar loans, which limits the agency's authority to regulate based on price.

In November 2017, using its Dodd-Frank Act rulemaking authority, the Bureau published in the Federal Register a rule (the 2017 Final Rule) to regulate payday, vehicle title, and certain high-cost installment loans. The 2017 Final Rule addressed two discrete topics. First, the Rule contained a set of provisions with respect to the underwriting of covered short-term and longer-term balloon payment loans. I will refer to these as the "Mandatory Underwriting Provisions" of the 2017 Final Rule. Second, the 2017 Final Rule contained a set of provisions, applicable to the same set of loans and also to certain high-cost installment loans, establishing requirements and limitations with respect to certain attempts to withdraw payments on the loans from consumers' checking or other accounts. I will refer to those as the "Payment Provisions" of the 2017 Final Rule.

The Mandatory Underwriting Provisions in the 2017 Final Rule rest on a determination that it is an unfair and abusive practice within the meaning of the Dodd-Frank Act to make covered short-term and balloon-payment loans without reasonably determining that the consumers will have the ability to repay the loans according to their terms. Based on that determination, the 2017 Final Rule requires lenders to follow a detailed set of underwriting provisions and related practices in conjunction with such loans. The 2017 Final Rule also provides an exemption from these Mandatory Underwriting Provisions for small dollar loans that satisfy a set of conditions designed primarily to ensure that the loans do not result in long-term consumer indebtedness. The Bureau found that these Mandatory Underwriting Provisions would result in a decrease of between 51 and 52 percent in the number of payday loans consumers take out and a reduction in revenue of between 67 to 68 percent and found that there would be a decrease of between 89 and 93 percent in the number of short-term vehicle title loans consumers take out and approximately the same in revenue. The 2017 Final Rule further found that those consequences would lead to contraction in the number of payday lenders and vehicle title lenders of similar magnitude at least for stores that do not have substantial revenue from other lines of business.

Since issuing the 2017 Final Rule, the Bureau has come to have serious doubts as to whether the appropriate legal standards were applied and whether the evidence was sufficiently robust and reliable to support the Bureau's determination that small dollar lenders engage in an unfair or abusive act or practice if they make loans without making a reasonable determination that consumers can repay them. Accordingly, on February 6, 2019, the Bureau issued a Notice of Proposed Rulemaking or "NPRM" which proposes to rescind the Mandatory Underwriting Provisions.

The NPRM specifically explains the Bureau's reasons for preliminarily determining that the approach to interpreting and applying the statutory unfairness and abusiveness standards should be revisited. The 2017 Final Rule determined that failing to make a reasonable determination of a consumer's ability to repay was unfair and abusive, reasoning, among other things, that because consumers did not know their specific individualized risk of harm from such a practice, they therefore could not reasonably avoid the harm associated with it and did not understand the material risks of the practice. The Bureau is concerned that it may have applied problematic standards for unfairness and abusiveness, and that the unfairness and abusiveness standards should not be construed to require that consumers know their own specific individualized risk of harm, but rather that they need to know enough about the risk of harm to take reasonable steps to avoid it. The Bureau is similarly concerned that the 2017 Final Rule relied on a problematic approach to determining whether any consumer injury resulting from the practice was outweighed by countervailing benefits from the practice (principally in the form of consumer credit access) and, relatedly, whether lenders engaged in the practice took "unreasonable advantage" of consumers.

The NPRM also explains the Bureau's reasons for preliminarily determining that the evidence underlying the identification of the unfair and abusive practice in the Mandatory Underwriting Provisions of the 2017 Final Rule is not sufficiently robust and reliable to support that determination. The Bureau generated, compiled, and received extensive factual information during the rulemaking process which led to the 2017 Final Rule. The Bureau has robust and reliable information on many factual issues implicated in that rulemaking. However, the rulemaking record has very limited information bearing on consumer understanding and expectations regarding small dollar loans, including how long consumers who take out small dollar loans anticipate they will be in debt. This was critical to the 2017 Final Rule's analysis of unfairness and abusiveness. The rulemaking record also has very limited evidence regarding whether consumers lack the ability to protect themselves in the selection and use of these products. The Bureau is concerned about relying on such a limited evidentiary basis to impose mandatory underwriting requirements with dramatic and long-lasting effects on the market for small dollar loans, including the ability of consumers to obtain access to them. The NPRM seeks public comment on whether the rulemaking record on these factual issues was sufficiently robust and reliable.

Concurrently with issuing this proposal to rescind the Mandatory Underwriting Provisions, the Bureau issued a second NPRM proposing to delay the mandatory compliance date for those provisions (the Delay Proposal). The Bureau did so in order to allow time for an orderly rulemaking process to conclude before the 2017 Final Rule imposes irreparable harm in the form of significant compliance costs and a significant and irreversible contraction of the market and restriction in credit access, all of which would, in turn, undermine effective reconsideration of the Rule.

Importantly, neither the Rescission Proposal nor the Delay Proposal affects the compliance date for the Payment Provisions of the 2017 Final Rule. Under the terms of the 2017 Final Rule, those provisions are scheduled to take effect on August 19th of this year. I would note, however, that a federal district court has issued a stay of the compliance date for the entire 2017 Final Rule and none of the provisions can take effect while that stay is pending.

The comment periods on the Rescission and Delay Proposals have now closed. The Bureau received 145 comments on the Delay Proposal and as of May 13, 2019, had received more than 150,000 comments on the Rescission Proposal. We are evaluating these comments in determining how to move forward with respect to the 2017 Final Rule.

The Bureau is in the midst of these rulemaking proceedings, and I am sure you will understand that I cannot comment on the Bureau's internal and on-going deliberations about them. I can assure the Subcommittee, however, that the Bureau approaches the public's comments with an open mind and will carefully review them before reaching any conclusions. I also can assure the Subcommittee that the rulemaking process will be transparent with all communications with stakeholders about the merits of the proposal reflected in the rulemaking record, consistent with the Bureau's ex parte policy.

Chairman Krishnamoorthi, Ranking Member Cloud, thank you, and I look forward to answering your questions.