MAY 10, 2019

# JOINT COMMENT OF TOM MILLER, JR., PH.D. OF MISSISSIPPI STATE AND BEAU BRUNSON OF CONSUMERS' RESEARCH ON THE CFPB'S PROPOSED PAYDAY, VEHICLE TITLE, AND CERTAIN HIGH-COST INSTALLMENT LOANS RULE DOCKET NUMBER: CFPB-2019-0006

**BY ELECTRONIC DELIVERY TO:**

*https://www.regulations.gov*

Kristine M. Andreassen
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May 15, 2019

Dear Ms. Andreassen:

We appreciate 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]

Thomas W. Miller, Jr. is a Professor of Finance and the inaugural holder of the Jack R. Lee Chair of Financial Institutions and Consumer Finance at Mississippi State University. He is also a Senior Affiliated Scholar with the Mercatus Center at George Mason University whose research focuses on small-dollar loans for the Program on Financial Regulation. His current research concerns various aspects of consumer credit and, specifically, small dollar installment loans. He has held positions at Saint Louis University, Washington University in St. Louis, and the University of Missouri, and he has taught in Italy and France. Professor Miller is co-author of *Fundamentals of Investments: Valuation and Management, 8th ed.* and *Derivatives: Valuation and Risk Management.*

Beau Brunson is the Senior Policy Advisor for Consumers' Research, 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.

## I. Introduction

All financial regulations should be grounded firmly in empirical research. The reach of federal rules is too large not to proceed with extreme care and caution, particularly if rules disproportionately affect economically vulnerable Americans.

When the CFPB announced its intentions to revise its small-dollar lending rule, some voices criticized the Bureau's decision, expressing concern that the new rule might enable lending practices that create "debt traps." But many, if not most, criticisms of

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

small-dollar lending fail to ask several key questions about consumers who rely on this industry's products: *who* uses small-dollar loans, *how* do they use them, and *why* do they use them? The 2017 rule, which the 2019 Final Rule would replace, noted that small-dollar loans are "typically used by consumers who are living paycheck to paycheck, have little to no access to other credit products, and seek funds to meet recurring or one-time expenses."[2] Far from solving demand for credit, destroying small-dollar lending would eliminate some of the few options available to millions of consumers, potentially driving them into the arms of less scrupulous lenders. This demand for small-dollar loans would persist even were the CFPB to regulate them out of existence. All this considered, it is our opinion that the 2019 Final Rule is good policy that will benefit consumers.

## II. No Mosaic of Replicable Research Supports the 2017 CFPB Small Dollar Rule

Financial regulations should be developed through thoughtful, deliberative, and objective study. Moreover, the results of this research should be replicable or refutable by researchers using other samples. Ideally, a collection of research results should form the foundation for rule writing.

The CFPB's process in building the 2017 payday rule lacked in scientific method and in empirical rigor. The CFPB laid special emphasis on one study in justifying the 2017 Final Rule's stringent underwriting requirements. As reported in the 2017 rule, the CFPB extrapolated from a 2014 study conducted by law professor Ronald Mann that consumers who typically use payday loans "are not able to predict accurately how likely they are to reborrow."[3] Professor Mann, however, disagreed with the conclusion the CFPB drew from his work. In a public letter submitted to the Bureau, Mann wrote that "it is frustrating that the…discussion of [my] work is so inaccurate and misleading."[4] "The Bureau," he continued, "has stated a commendable intention to found its rulemaking on empirical evidence collected in the academic context. I only wish that the implementation of that statement reflected an even-handed assessment of evidence rather than a distortion of the evidence to suit policies that the Bureau has pre-selected for implementation."

In his study, Professor Mann surveyed about 1,300 customers in five states using various locations of one payday lender. Among other things, he found that about 60 percent of payday borrowers were able to accurately predict how long they would be in debt.[5] Mann found this percent of accurate predictors to be higher than is typically attributed to payday borrowers. The CFPB took the opposite position. The CFPB focused on the 40

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

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

*4 Mann, Ronald J. 2016. "Re: Docket No. CFPB-2016-0025 (RIN 3170-AA40)."*

*5 Mann, Ronald. 2014. "Assessing the Optimism of Payday Loan Borrowers."*

percent who did not accurately predict their repayment time as evidence that a substantial number of payday borrowers take out these loans in ignorance of their own economic circumstances. Moreover, Mann found that many borrowers are rolling over their loans consciously — that is to say, rationally — whereas the CFPB took the position that rolling over loans must be irrational due to its costliness and therefore could not be the "initial intention" of borrowers.

The Bureau admitted its differences with Mann in the 2017 rule: "The Bureau notes that Professor Mann draws different interpretations from his analysis than does the Bureau in certain instances…"[6]

The 40 percent of the payday borrowers who did not accurately predict their repayment time deserves a closer look. The description of the sample breakdown is not readily apparent in the Mann study. However, in the original notice for proposed rulemaking that preceded the 2017 Final Rule, the Bureau states: "…borrowers are very poor at predicting long sequences of loans. Fewer borrowers expected to experience long sequences of loans than actually did experience long sequences. Only 10 percent of borrowers expected to be in debt for more than 70 days (five two-week loans), and only five percent expected to be in debt for more than 110 days (roughly eight two-week) loan [sic], yet the actual numbers were substantially higher. Indeed, approximately 12 percent of borrowers remained in debt after 200 days (14 two-week loans)."[7]

This 12 percent represents about 62 people in the original sample of 1,300 (1,300 × 0.40 × 0.12 = 62.4). These 62 people represent only 4.8 percent of the original sample, a number that does not support the CFPB's claim that "borrowers are very poor at predicting long sequences of loans."

The fact that 60 percent of borrowers in the sample accurately predicted how long they would be in payday debt also deserves some further thought. People who rely on payday loans often have top-line income variability and not many other financial resources. Being able to predict accurately under these financial circumstances is consistent with the notion that many of these borrowers have considerable financial acumen.

The stark contrast of interpretation between Professor Mann and the CFPB over the study's implications indicates that more research on this topic is needed. Mann suggested just this path in the conclusion of his 2014 study, calling for more research examining the rationality of borrowers and surveying of consumer sentiment.[8] Rather than seeking more

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

*7 Notice of Proposed Rulemaking, page 232.*

*8 Mann, Ronald. 2014. "Assessing the Optimism of Payday Loan Borrowers."*

empirical evidence, though, the CFPB wrote a sweeping payday rule by focusing on a small subset of the borrowers from Mann's study.

CFPB interventions are likely to be ineffective at best, and welfare-decreasing at worst, if such interventions are not based in robust empirical evidence.

## III. The Original 2017 Rule Downplayed or Ignored Many of the Rule's Costs

The CFPB's failure to justify the 2017 payday rule based on a thorough analysis of empirical evidence is particularly concerning considering the substantial impact the rule would have on both the consumer loan industry and state law.

According to numbers used by the CFPB, an estimated 12 million Americans use payday loans each year.[9] The Bureau's own supplemental report predicted that, were the 2017 rule to take effect, payday loan volume and revenues would decline between 71 and 76 percent."[10] Yet the 2017 rule claimed, with little apparent evidence, that "short-term loans would still be available in states that allow them to consumers facing a truly short-term need for credit."[11]

## IV. The 2017 Final Rule Usurps State Authority

Equally concerning, it does not appear that the CFPB found that existing laws on small-dollar lending had failed. Small-dollar loans have been regulated by state law for over one hundred years. Every state has enacted laws regulating small-dollar loans. These laws are updated regularly. By overriding these laws without justifying its actions, the CFPB opened itself to criticism of irresponsibly usurping state laws.

## V. Does the CFPB Understand Payday Borrowers?

One of the most troublesome aspects of the public debate surrounding payday lending is the gap in lived experience between those who denounce payday loans and those who use them. Reflecting on the public perception of small-dollar lending, Hillbilly Elegy author J.D. Vance has mused that "Powerful people sometimes do things to help people like me

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

*10 Consumer Financial Protection Bureau. 2016. Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products.*

*11 Consumer Financial Protection Bureau. 2017. Payday, Vehicle Title, and Certain High-Cost Installment Loans. (pg. 424).*

without really understanding people like me."[12] The 2017 rule's ostensible goal was "to help people like" Vance by protecting them from the supposedly consumer-harming lending practices of payday lenders and others, yet it was rife with potential for unintended and unexpected consequences.

Going forward, the questions that need answering aren't really about small-dollar loans or lenders, but borrowers. The glaring and indisputable fact of small-dollar loans is that millions of people use them. Policymakers should, therefore, be asking several questions: Why do consumers use these loans? When do consumers use these loans? Who are the borrowers who use these loans frequently? What would these borrowers do if payday loans suddenly disappeared? In a 2018 article, US News & World Report offered the following alternatives to using a payday loan: a payment plan with current creditors; a personal loan; a payday alternative loan; a credit card cash advance; a paycheck advance; a 401(k) loan; and borrowing from family or friends.[13] Similar alternatives are suggested in articles by Credit.com, Market Watch, and the American Banker.[14] But if these welfare-enhancing alternatives are available to payday consumers right now, why don't they choose them?

Evidence indicates that many payday borrowers do consider alternatives and decide that payday is the best credit option for their situation. In a 2007 survey of payday borrowers, Elliehausen (2009) found that 28.2 percent of borrowers chose a payday loan over alternatives because of the quick and easy process, fast approval, and lack of paperwork.[15] Negotiating payment plans, asking family for credit, or procuring a personal loan from a bank each imposes much greater search and delivery costs on consumers than the ease of a payday loan.

Some might argue that, even if consumers choose payday loans willingly, they still leave better options on the table. This argument is not supported by the facts. Elliehausen's 2007 survey found that 20.8 percent of borrowers chose payday loans over alternatives because they had no other alternative. Indeed, the survey found that, over the last five years, 55.1 percent of payday borrowers had a credit request denied or limited; 59.8

*12 Colangelo, Joe. 2016. "What A Best-Selling Memoir Tells Us About Payday Loans." Forbes. https://www.forbes.com/sites/realspin/2016/09/01/what-a-best-selling-memoir-tells-us-about-payday-loans/#70208900b0c3*

*13 Bond, Casey. 2018. "7 Alternatives to Costly Payday Loans." U.S. News & World Report. https://loans.usnews.com/alternatives-to-costly-payday-loans*

*14 Brinkley-Badgett, Constance. 2019. "8 Smart Low Interest Payday Loan Alternatives." https://www.credit.com/loans/loan-articles/alternatives-to-low-interest-payday-loans/*

*Passy, Jacob. 2019. "For desperate Americans considering a payday loan, here are other options." https://www.marketwatch.com/story/are-you-desperate-and-considering-a-payday-loan-there-are-other-less-dangerous-options-2019-02-08*

*Bourke, Nick. 2018. "Momentum is building for small-dollar loans." https://www.americanbanker.com/opinion/momentum-is-building-for-small-dollar-loans*

*15 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.*

percent of borrowers considered applying for credit but did not because they expected to be denied; and 16.3 percent of borrowers had filed for bankruptcy. In short, there is no guarantee that the majority of payday consumers would qualify for suggested alternatives.

A vitally important question that is seldom addressed is: What are the consequences for the consumers who are denied access to credit? Losing credit access can be especially costly for consumers whose financial situation is “on the edge.” For such consumers, the inability to repair a vehicle needed to get to work, pay a utility bill, or buy food and medicine can have long-term consequences.

Two more questions to consider include: who are the repeat borrowers and why do they take out a series of payday loans over the course of a year? If these loans are debt-traps as the Bureau has claimed, why do some people choose to roll-over payday loans rather than simply default? Default is an option, it should be remembered: These lenders aren’t loan sharks, their rates are supported by the economic principles . Under what circumstances will borrowers walk away? Without knowing all, or even most, of the discoverable answers to these questions, regulation of this industry will inevitably rely on incomplete information and subjective judgments.

As written, the 2017 Final rule requires lenders to determine whether the borrower “would be able to make the payments on the loan and be able to meet the consumer’s basic living expenses…without needing to re-borrow over the ensuing 30 days.”[16] While this requirement sounds reasonable at face value, the CFPB has itself established that basic living expenses are the very thing that many payday loan borrowers seek to cover. Upon implementation, the 2017 Final rule would immediately harm low-income consumers by removing an emergency credit option. Without access to emergency small-dollar credit, where will these borrowers turn?

## VI. Conclusion

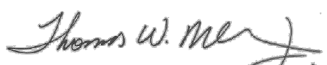
Good, consumer-benefiting, policy requires objective research. Economists at the Bureau, as well as independent researchers, can best inform policymakers by following the scientific method: ask questions, gather data, use widely-accepted research methods, and publish replicable research results.

As the Bureau considers making changes to payday regulations, it needs to incorporate into the final rule independent and critical economic analysis. The stakes are high. Too many people rely on access to small-dollar loans to get the new rule wrong.

*16 Consumer Financial Protection Bureau. 2017. Payday, Vehicle Title, and Certain High-Cost Installment Loans. (pg. 5).*

The CFPB's 2019 decision to revise rules that had been founded on dubious premises is good policy. The onus should be on government regulators to prove products and services cause harm before regulating them — particularly if millions of Americans use them, as they do payday loans. Twisting studies to implement "pre-selected" policies is more likely to generate unintended consequences than enhance consumer welfare. The CFPB's 2019 proposed changes to the 2017 Final rule will keep credit available for some of the most economically vulnerable Americans.

Sincerely,



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