October 6, 2016

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1275 First Street NE.,
Washington, DC 20002.

Docket No CFPB-2016-0025
RIN 3170-AA40

Dear Ms. Jackson,

The Center for Financial Services Innovation (CFSI) is submitting this letter in response to the request for comments on “Payday, Vehicle Title, and Certain High-Cost Installment Loans,” issued by the Consumer Financial Protection Bureau (CFPB) and published on July 22, 2016. Like you, we recognize the important role that access to high-quality financial products plays in helping consumers improve and maintain their financial health. We believe that finance can be a force for good in people's lives and that meeting consumers’ needs responsibly is ultimately good for both the consumer and the provider.

CFSI is a national authority on consumer financial health. We believe that financial health comes about when a consumer’s day-to-day financial systems enable them to build resilience and pursue opportunities. We lead a network of financial services innovators – banks and credit unions, the fintech community, processors, servicers, nonprofits, and community-based organizations – all committed to building higher quality products and services. CFSI informs, advises, and connects our network to seed innovation that will transform the financial services landscape. We see the pain points and the opportunities from both industry and consumer perspectives.

Through our consulting work, our Financial Capability Innovation Funds, and our Financial Solutions Lab, we have fostered innovative products and technologies that improve the financial health of consumers. Our vision is to see a strong, robust, and competitive financial services marketplace, where the diversity of consumer transaction, savings, and credit needs are met by a range of providers offering clear, transparent, and high-quality products and services at reasonable prices.

CFSI is well-steeped in the small-dollar credit (SDC) product landscape. In 2012 we embarked on a set of projects to shed light on the market and the consumer who use these products, to establish quality guidelines, to test the feasibility of these guidelines, and to seed innovation in the SDC market. To build on a foundation of research, we conducted a nationally representative quantitative survey of SDC users and conducted in-depth interview with 30 consumers who used deposit advance, online, and store-front lenders. Our next step was to develop guidelines,
aligned with our Compass Principles to set aspirational industry practices for SDC products, and then to test the feasibility of those guidelines in the market. We also sought to seed innovation in both the non-profit community through our Financial Capability Innovation Fund and our Financial Solutions Lab.

Our comments on the CFPB’s proposed rule are framed primarily around the guidelines in our Compass Guide to Small-Dollar Credit. The Guide defines a high-quality small-dollar loan as one that:

1. Is made with a high confidence in the borrower’s ability to repay
2. Is structured to support repayment
3. Is priced to align profitability for the provider with success for the borrower
4. Creates opportunities for upward mobility and greater financial health
5. Has transparent marketing, communications, and disclosures
6. Is accessible and convenient
7. Provides support and rights for borrowers

In this letter we first provide some overall reactions to the CFPB’s proposed rules with respect to encouraging innovation in credit markets, including a principles versus rules approach that promotes financially healthy outcomes for consumers. Furthermore, we endorse testing a piloting of innovative products via a product sandbox, an approach currently being used by the Financial Conduct Authority in the U.K.

Next we provide specific responses to some of the elements of the rules as proposed by the CFPB:

- Establishing an ability-to-repay (ATR) requirement and potential exemptions to this requirement.
  - We believe in establishing a consumer’s ability to repay without re-borrowing and while still meeting basic needs and financial obligations; however, we think that the implementation could be more guided by principles and allowing for innovations than the proposal suggests.

- Defining cooling-off periods
  - We believe there needs to be support for borrowers when they have trouble repaying; however, if ATR was established, and the consumer does pay off the loan, there is no reason for barriers to subsequent loans.

- Creating registered information systems (RIS)
  - We believe that RISs can prevent loan stacking; however, efficiency and avoiding duplication and unintended consequences will be key elements here.

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See especially the profiles for Ascend and LendStreet.
• Prohibiting unfair and abusive payment practices  
  o The Bureau should research the added cost to industry of changing their ACH protocols for a given product line before creating a rule that is inconsistent with NACHA guidelines. Furthermore, the Bureau should consider harmonizing collection rules across all channels.

**What’s Missing**

Before addressing these issues, we want to point out issues the Bureau did not address that we believe should be addressed. First, we believe that the Bureau should create a national registry of non-bank small dollar lenders, primarily because it’s difficult to enforce a regulation when you don’t know who you are supervising.

Second, our Compass Guide includes a guideline about providing supports and rights for borrowers. The proposed rule is silent on access to servicing, even though the Bureau has been vigilant about servicing in the mortgage and student loan markets. Also, the rule is silent on dispute resolution practices that are reasonable and fair to the consumer. Given the Bureau’s work in the arbitration area, we would like to see the rule include language about transparency in managing disputes.

Lastly, the final rule issued by the CFPB will undoubtedly have a significant impact on the SDC marketplace in ways that cannot fully be anticipated. To ensure the rule’s ongoing relevance and efficacy, the Bureau should build in a periodic review. This would give the CFPB an opportunity to make adjustments in response to indications that “loopholes” are leading to abusive practices or that high-potential innovations are being blocked. Furthermore, a review allows the Bureau to make adjustments to benchmarks that risk becoming ossified otherwise. Currently, the Financial Conduct Authority in the United Kingdom has a two-year review period its high-cost short-term credit rules. While this may be too frequent for the U.S. market, a 3-year period may provide the CFPB with the same flexibility and provide a reason to maintain an ongoing dialogue with the industry and consumer groups about what is working and what is not.

**Encouraging Innovation in Small-Dollar Credit Markets**

Consumers have and will continue to face a number of liquidity challenges for which high-quality small-dollar credit products can be a fitting solution. In our 2012 survey of 1,100 SDC borrowers, we explored and segmented borrowers’ needs and uses of credit. We found a full third of respondents had borrowed to solve for a lack of income, a troubling circumstance which can lead to repeat borrowing or default for borrowers when they don’t have the money to repay their loan. CFSI believes that credit is not always the solution for these consumers. However, the remaining 70 percent were using SDC products as a tool for managing day-to-day liquidity needs, covering unexpected expenses, or making a planned purchase. In these instances, access to safe and affordable credit can be a valuable resource. With millions of adults being shut out of the mainstream credit markets by a subprime credit score⁴ or insufficient credit history⁵,

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⁴ 20% of people with subprime credit scores (June 22, 2016) [http://www.wsj.com/articles/consumers-improving-credit-scores-give-banks-reason-to-cheer-1466587801](http://www.wsj.com/articles/consumers-improving-credit-scores-give-banks-reason-to-cheer-1466587801)
continued innovation will be necessary to find new solutions for safely and efficiently meeting the credit needs of consumers that lack access today.

While the need for small-dollar credit is not going away any time soon, the same may not necessarily be said about access to SDC products. In the U.K., small-dollar lending volumes shrank from “6.3 million in the first half of 2013, to 4.2 million for the same period in 2014, to 1.8 million last year [2015].”6 The Bureau should devise some mechanism for monitoring the availability of credit in U.S markets.

We believe it is critical for the proposed CFPB rule to allow for continued innovation within a framework of sound consumer protection. Lenders will need room to create new products and practices that can safely meet Americans’ credit needs. However, as not all new market developments can be expected to yield positive outcomes for consumers, the CFPB should seek to allow greater flexibility where innovation has the potential to improve borrowers’ financial health. CFSI’s Compass Principles provide a framework for identifying such opportunities by gauging how products effectively embrace inclusion, build trust, promote success and create opportunities for borrowers. As it stands today, the payday loan market certainly fails to live up to these standards; it will be critical for the CFPB rule to promote innovation that meets – and exceeds – these standards. The CFPB should take a number of approaches in its rule to promote positive innovation in the SDC market, including the following recommendations.

**Principles versus Rules**

We encourage the Bureau to consider the relative usefulness of specific rules vs broad, principles-based regulations combined with enforcement procedures. The rate of change in both technology and the financial services and products these technologies enable make “bright line” rulemaking a bit of an anachronism. We realize that in the short run, markets are expecting rules – without clarity, no new entrants will come into the market. But, in the long-run, this approach leaves the CFPB and the market very flat-footed in light of the fact that industry is capable of moving far, far faster than regulators. For example, the Ability to Repay idea moves toward principle-based regulation – however the more the bureau specifies exactly what it means and how to assess it, the more ossified the regulations will get. In contrast, our Compass Guide language of using “the best available underwriting techniques” allows for innovation and adaptation as new technologies become available without painting lenders into the corner.

**Allow for Testing Via a Sandbox**

The CFPB should allow for pilots that would produce more “in-market” data and test the efficacy and consumer impact of innovative models for offering small-dollar credit. The Bureau should permit in-market testing of products outside the rule’s proposed boundaries with

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5 20% of adults with no credit file or an unscorable file (page 12)

oversight and reserve funds that can be used to reasonably compensate consumers who are financially harmed in the testing process. Providers should be allowed to prove that their products are well-built with strong financial health outcomes for consumers without the risk of facing consumer and prudential enforcement actions during the testing period. We believe the protections for providers within such a sandbox would need to be stronger than those currently provided by Project Catalyst.

The marketplace is currently awash with alternative data and technology providers working to create new approaches to effectively underwrite borrowers who lack access to traditional credit products. A number of new FinTech companies are entering the market with new products that take innovative approaches to promoting borrower success and creating opportunities for greater credit access. Having conducted a successful Test & Learn project with SDC providers, CFSI would be happy to work with the CFPB on sandbox initiatives.

Beyond testing products, a sandbox should be used to test out and “right-size” regulatory provisions. For example, a sandbox provides an opportunity to test other loan underwriting proxies such as a 5 percent payment to income ratio or a 6 percent payment to deposits ratio. While we believe the payment-to-income guideline suggested by The Pew Charitable Trusts holds promise as an alternative underwriting strategy, a broader “on the ground” test of the benchmark (should it be 4, 5, or 6 percent?) would allow both the Bureau and the market to identify a clear pathway for lenders to create compliant, efficient and cost-effective underwriting systems. These, in turn, could potentially attract new entrants and encourage broader competition and innovation. Allowing for pilot testing would enable the CFPB to gain additional insight on consumer impact to determine whether alternative models should be included as a permanent exemption.

The CFPB should also utilize testing and industry monitoring to refine benchmarks proposed in the current version of the rule. For instance:

- The appropriate length for “cooling-off” periods
- The maximum number of loans or days in debt within a year
- The 5% cap on default rates required for exempted, non-NCUA longer-term loans

Sandboxes for innovators would not only help encourage entry into the market, but also allow all parties – direct providers, information system operators, third-party data suppliers, and regulators – to refine their understanding of tipping points between successful and unsuccessful loan parameters. A sandbox approach to mutual learning for both regulators and the small-dollar credit industry would address the balance between clarifying elements of the rule and leaving room for meaningful innovation. Furthermore, such in-market testing could inform issues of scalability, efficiency, and quality for consumers. Additional data will help ensure that any benchmarks are drawn tightly enough to ensure consumer protection but also broadly enough to avoid an unwarranted restriction on innovation.
Establishing an Ability-to-Repay Requirement and Potential Exemptions

CFSI has always believed that the loan structure matters; pricing is one element of the structure, but term, the amount of the loan, and aligning payments with cash flow also matter when determining the ATR. CFSI’s number one Compass Guideline is that small-dollar loans are “made with a high confidence in the borrower’s ability to repay.” As a principle, the ability to repay is a familiar one in credit markets. The desired outcome is evident: the consumer is able to pay off the loan. Our Compass Guide’s first core practice under this guideline is to “Use the best available underwriting techniques to ensure a borrower’s ability to repay without re-borrowing and while still meeting basic needs and financial obligations.” What is “best available” in underwriting technology is evolving as financial technology and the effective use of alternative data continue to mature and grow more robust. We believe it is important to allow modeling to validate data elements in the ATR assessment in a cost effective and efficient way.

Building Efficient and Accurate Systems for Validation, and Modeling

We believe the Bureau should establish standards for validation and modeling for elements of the ATR calculation (income, expenses, other credit obligations) rather than the verification standard proposed in the rule. Any such models would need to be fair and not lead to disparate impact. Many who live paycheck to paycheck or lack a strong credit score not only experience income volatility but also earn a significant portion of income in the cash economy, issue and receive informal loans from friends and family, or demonstrate their reliability through the payment of rent or utilities that do not appear on their credit report. This means they often leave an exceedingly thin trail of paystubs, direct deposit bank records, or even tax returns that accurately reflect their income, assets, debt obligations, and ability to repay.

There are several possible ways to mitigate this data challenge – for example, by employing validation or modeled proxies for key metrics such as income or debt obligations. Currently, many lenders use proxy solutions or other third-party alternative data to validate applicant-reported information such as employment status, income levels, and bill payment behavior. Lenders are able to assess the likelihood of applicant information accuracy through the use of indirect ‘big data’ points that add a layer of risk-mitigation by examining secondary factors that predict income or ultimate repayment.

Just as verifiable income data would be very challenging to collect for the small-dollar loan customer base, accurately assessing key expenses would also benefit from allowing modeling and validation. Many basic needs may be paid for in cash or visible only through bank account access to examine checking account outflow. Larger expenses such as housing may be more stable in theory, but volatility of living arrangements, frequent moves, or informal home-sharing with friends and relatives quickly erodes accuracy. In many cases, even when applicants report monthly expenses to the best of their ability, they may estimate incorrectly or fail to anticipate future expense volatility and unexpected expenses. Models could draw from resources such as the BLS Consumer Expenditure Survey or housing data from HUD on rental and mortgage averages to validate, benchmark or systemically adjust self-reported applicant expenses. These models would decrease the time and resources that would otherwise be needed to accurately pin down expenses and obligations. Modeling also can increase consumer loan access by enabling
loans offers around the clock and through mobile banking platforms or ATMs. This level of access would be especially impactful for consumers who do not have regular internet access to borrow online.

The U.K.’s approach to the use of big data for income validation allows for benchmarking applicants and relying on average incomes of larger pools of similar individuals through metrics such as geo-sorting by postal code. Furthermore, loan outcome data can also contribute to model enhancements and the testing of initial assumptions. As additional data are gathered, modeling as a proxy for verification has the potential to increase in effectiveness and efficiency over time, further reducing costs that could be passed on to borrowers. A modeling or validation system that obviates the need for credit report pulls can also save significant resources for providers that support scalable and sustainable loan offerings.

As an alternative to verification, lenders should be able to collect applicant-provided data that third-party suppliers would not otherwise be able to access (such as personal bank account information) to validate other income that is not direct deposited or documented by a pay stub. The science of incorporating third-party data and applicant-supplied data is currently being pioneered by companies such as Yodlee and Neo, and represents innovations in the next wave of data analytics that envisions lower friction and higher mutual benefit for the consumer and providers along the loan supply chain.

A CFSI Compass core practice on underwriting small-dollar loans advises providers and their partners to “Monitor portfolio performance to ensure that most borrowers are using the product as designed, without defaulting or re-borrowing.” Ultimately, any system that uses proxies or models would need to continually track loan outcome metrics to ensure that ATR decisions maintained a high level of accuracy. Models that employ a wide range of data points and continually adjust to real-time shifts in data are able to monitor and respond to loan-performance flaws with precision and efficiency, while helping lenders gain insights into borrower behaviors and predictive characteristics.

Using Default Data as an Underwriting Metric for ATR

The clearest proof of effective underwriting processes should be found in borrower repayment outcome data, rather than by assessing the inputs into the product design alone. CFSI’s Compass guideline is to “Monitor portfolio performance to ensure that most borrowers are using the product as designed, without defaulting or re-borrowing.” Evidence should include an absence of re-borrowing or an extended loan sequence. Given the circumstances that often surround these loans – income volatility, misalignment of payment and cash flows, changing circumstances over longer loan terms – one key indicator for successfully underwriting to an ATR standard is to establish a first-payment default metric, because (absent fraud) it clearly points to a miscalibration in underwriting. Establishing a portfolio default limit (proposed as 5% in the exemption section) should be done only within a “test and learn” framework within our proposed

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7 Data from the U.S. Financial Diaries show that households experience an average of 5 months out of the year in which income is either 25% higher than average or 25% lower than average.  
http://www.usfinancialdiaries.org/issue1-spikes and  http://www.usfinancialdiaries.org/83-charts  -- see charts 2.9 through 2.11
sandbox to establish the most appropriate level. We believe 5% overall may be too low, but without data, it is difficult to know what a more appropriate level would be.

Income volatility also presents the need for a nuanced understanding of loan repayment challenges. Longer term loans come with a higher probability of changes in the financial circumstances of the borrowers. This is especially true for financially unhealthy borrowers – who are by definition living at the margins of borrowing ability. These borrowers may hit a period of unexpected turbulence – such as reduced work hours, illness, or other income disruption – during the course of the loan that impacts their ability to repay the loan. Thus while the ATR was adequate at loan inception, changes in circumstances impact their ability to repay. The Bureau should consider a range of ATR standards that apply across a range of loan terms from very short term (under 45 days) to longer term (18 months or more).

Macroeconomic circumstances will also impact a borrower’s ability to repay, regardless of the quality of the initial underwriting. A national economic crisis or the shutting of a large local employer may impact wide swaths of small-dollar credit consumers. Benchmarking default rates in lender portfolios against industry-wide default rates (versus a “hard-and-fast” 5% as proposed) would help to account for macroeconomic shifts and would better protect consumers from shoddy underwriting standards while also allowing providers to continue to satisfy consumer need for these loans during times of widespread hardship, consistent with prudential supervision.

Given these limitations, we believe the Bureau should set a level of first-payment defaults as the primary indication of poor underwriting rather than defaults across the life of the loan. This first-payment default standard currently is employed in the United Kingdom to assess small-dollar credit outcomes. Furthermore, we believe the Bureau should calibrate the level of first-payment default via a sandbox program. Such pilots would provide data on default indicators to help fine-tune underwriting standards that include the size and lifespan of a loan.

**Right-sizing Re-borrowing and Loan Modification Options**

CFSI’s Compass core practice with respect to repayment challenges is to “Provide support to borrowers when they have trouble repaying.” While we believe the principle-payoff option in the rule is a useful option for loans of $500 or less that fit in the three-month timeframe proposed, loans that are larger or longer could benefit from wider latitude for refinancing and modifications. As noted above, longer loans are correlated with higher income volatility and a greater propensity for unexpected events for borrowers. In turn, borrowers with longer loans may be more likely to benefit from loan modifications or refinancing at a lower rate.

Struggling borrowers need an off-ramp that is structured to help them pay off the loan and avoid a default that would show up on their credit record. Modifications or refinancing that provide for smaller payments over a longer period of time (even if costs exceed 36% all-in) can benefit borrowers. The Bureau should establish – through testing – guardrails such as limits on refinancing fees or limits on how soon after the initial loan and how frequently over the life of a loan such adjustments could take place. The rule could also establish a “tangible net benefit” principle to assure that consumers can take advantage of refinancing with a lower interest rate over a reasonable time.
Pre-Approval and Re-Screening Frequency Requirements

In our 2012 survey, SDC consumers identified quick access and high confidence of approval as the most important attributes for selecting loan products (see footnote #1). Lenders and potential entrants in the market are concerned that the ATR test as proposed will restrict their ability to deliver an efficient and transparent experience for consumers and hinder product economics to a point where they could not make sustainable loans. By gaining clarity on how they can satisfy the ATR requirement, lenders would have greater license to innovate to create compliant and cost-effective application and underwriting approaches that meet consumers’ needs for certainty and speed.

The timeliness of data is an important issue for providers in terms of cost to underwrite accurately and to provide loans conveniently and quickly. In a rules-based approach, when using housing, cost-of-living, debt obligation, or income data that are updated only periodically, the rule should specify how quickly such information would be considered stale and whether – or for what period of time – the income and expense sides of the ATR equation could be considered accurate in the case of subsequent loan applications or refinancing adjustments.

Exemptions

The current rule offers a number of loan structures that would exempt lenders from the ATR test. We believe the CFPB should explore other loan structures that would accommodate higher APRs on loans. Especially for shorter-term loans (for example, loans for 2 or 3 months), the APR as the metric for affordability is flawed.

While the longer-term options provide clear pathways to compliance for lenders to offer products structured with a focus on consumer safety, the proposed interest rate caps may limit their reach. APR restrictions of 28% to 36% will limit lenders’ ability to offer the exempted loan models to riskier borrowers. We believe there is a lot of opportunity for both consumers and lenders for loans priced above 36% when structured fairly. We recognize that lenders could still service those borrowers by charging higher interest rates to compensate for the greater risk. However, they would no longer be exempt from the ATR test, diminishing the likelihood that they will create lower-priced products for riskier or unproven borrowers, especially without some signal from their prudential regulator.

Following implementation of the rule, the CFPB should monitor loan activity to determine if the 28% and 36% rate caps are sufficient to sustain the exempted loan products when they are being offered to non-prime borrowers. The CFPB could also allow for in-market testing and pilots to identify and refine pricing guidelines for exempted products that would allow lenders to sustainably offer them to consumers further down the credit spectrum while creating a competitive market of lower-cost offerings for borrowers.

Enforcement

Lenders see a degree of uncertainty for how they can ensure compliance – both from the consumer protection perspective and from the prudential regulation perspective – with the
proposed rule, creating additional risk for a product category already replete with it. Knowing how the rules will be enforced can actually open up greater space for innovation.

We believe examiners will need to be thoroughly trained to identify allowable underwriting practices, such as when loans can be considered “valid when made” in cases of any five-year retroactive period covered by exams.

More clear delineations of outcomes will help financial institutions, reporting information system companies, and third-party data vendors to better understand where underwriting responsibilities lie, and how they will be required to interface with federal agency requirements and each other as they build data systems and loan products.

Lastly, for financial institutions, lack of specificity in compliance parameters and definitions can leave too much risk of running afoul of standards in ways that cannot be anticipated. Such risk discourages diversified financial institutions, especially depositories, from choosing to move forward with the design and launch of small-dollar credit under the proposed rule’s current provisions.

**Defining Cooling-off Periods**

One of the guidelines in CFSI’s Compass Guide to Small-Dollar Credit\(^8\) is that high-quality credit products should be structured to support repayment. Within this guideline, a core practice for lenders is to “create meaningful safeguards to prevent harmful misuse or overuse of the product.” We encourage lenders to “consider limits on the number of loans in a given period as means to prevent harmful misuse or overuse of the product.” In line with this practice, cooling-off periods can be relevant safeguards that prevent lenders from making new, successive loans that effectively allow consumers to re-borrow the same money from their prior loan. However, the question becomes how can you determine if a successive loan is re-borrowing the same money or truly a new loan? Arguably, if the lender has successfully underwritten the loan with an ATR standard, and the borrower has repaid, the loan was affordable for the consumer. A subsequent new loan even within a 30 day period may not always be clear evidence of unaffordability, especially given the income volatility of many borrowers in this market segment.

As indicated earlier, data from the US Financial Diaries research show that low-to-moderate income households experience an average of 5 months out of the year in which income is either 25% higher than average or 25% lower than average. Being able to access funds during the dips in income is important for these households. Furthermore, these dips do not occur in a tidy “3 months on, 30 days off” pattern (nor in 3 out of 6 months nor 2 out of 6 months patterns). Limiting the number of loans over a 12 month period may be more helpful, but we would encourage the Bureau to test out different cooling off strategies to assure that these work as intended. Furthermore, while a cap on the number of loans a borrower can take out in a year may prevent overuse for some consumers, it may have an unintended, opposite effect for others.

From a behavioral perspective, something such as a limit of 5 loans in 12 months may encourage some consumers to borrow more than they need due to uncertain access.

The Bureau should consider whether cooling-off periods should be waived if borrowers are switching, or even graduating, to a lower-cost, higher-quality loan. To avoid the situation in which lenders switch borrowers to marginally better products to qualify for this waiver, the Bureau should also establish a “net tangible benefit” standard (as mentioned in our discussion on refinancing). We encourage the Bureau to consider testing and experimenting around cooling off periods and limits on the number of loans to determine the right limits that keep borrower out of a cycle of debt but still allow them access to credit when they need it.

Creating Registered Information Systems

We believe the Bureau needs to clarify the purpose of the registered information systems (RIS) in the proposal: is it to provide a real-time view of a consumer’s debt obligations in order to avoid loan stacking or is there also some element of assessing credit quality? If the latter is true, then this raises other questions about potential fair credit reporting inconsistencies and disparate impacts. There are concerns around the potential divide between the borrowers being reported to the major credit bureaus versus these registered information systems, and the perception of this divide. Without guidance there is a huge potential for unintended, adverse consequences.

We believe it is very important for consumers to have the ability to build credit while using products in the RIS. Small-dollar loans can be an on-ramp to building up credit scores; however, we want to avoid instances of use of small-dollar credit as a mark against the credit worthiness of individuals who demonstrate good repayment behavior. Per our Compass Guide, high-quality small-dollar credit products should “create opportunities for upward mobility and greater financial health,” and it is a core practice for lenders to help borrowers “leverage successful repayment into better credit opportunities in the future” and to “help borrowers establish or build credit scores.” However, if the registered information systems are also credit reporting systems, then the intersection of the registered information systems and the three major credit reporting agencies will be critical. There needs to be a way to ensure that such data could not be used against less financially capable borrowers to harm their scores or profiles.

Operationally, we believe it is very important to have efficient systems that allow lenders to prevent loan stacking while at the same time avoiding unnecessary duplication. There is concern around the complexity of reporting to multiple systems (including various state systems), each with a different interface. There are also concerns about credentialing and increased risk of error if lenders are required to furnish data to what could be a half-dozen registered information systems. It may make sense to develop a “report to one, pull a merged report” structure similar to the way credit reporting works in mortgage and other credit markets.

The registered information systems also seem to present a “chicken or the egg” situation – lenders have to check with the RIS before lending, but they can’t report loans until they make them. While we realize that some systems (Clarity, Factor Trust, Veritec) are already operational, it seems the issue of tracking real-time activities – both reporting and verifying loans
– is going to be an ongoing work in progress. The Bureau should provide guidance on how much latitude lenders and the RIS providers will have with respect to timeliness.

Prohibiting Unfair and Abusive Payment Practices

CFSI’s Compass Guide advises to “Provide support to borrowers when they have trouble repaying.” We agree that providing alerts and notices to the borrower can be a strong factor in supporting them, especially where such notices can be real-time, make use of electronic communication channels, and are task-focused.9 These values are further detailed in CFSI’s Compass advice to “Provide customizable alerts and tools that help borrowers manage their debt responsibilities effectively.”

Helping borrowers anticipate, control, and mitigate the damage that can arise from lack of funds available for repayment are key to supporting trouble-free repayment. Giving borrowers notice and lead time to fund an account, or to check for an error or inaccuracy, provides a level of consistency with the borrower’s regular banking experience. Some lenders in the market provide for 24 or 48 hours of forbearance in collections, which may be considered a best practice in the industry.

While we appreciate the “collection plus one representment” proposal for ACH debits, we also realize that many lenders are familiar with the current NACHA rules10 on “collection plus two representements” protocol. The Bureau should research the added cost to industry of changing their ACH protocols for a given product line before creating a rule that is inconsistent with NACHA guidelines.

Where possible, the CFPB should also seek to harmonize its rules with existing requirements instituted by other regulators and governing bodies in the industry and create consistent rules regardless of channels or form factors. This would help to streamline and clarify the regulatory framework for lenders, making it easier to identify opportunities for innovation. It would also make it easier for consumers to know what to expect.

Additionally, any forthcoming CFPB rules for overdraft products should align with the final payday rule to the extent that the Bureau sees overdraft as a credit product. (Here we note that non-sufficient funds fees are rather disproportional to their processing costs. There is an inter-related system of costs for overdraft, NSF, and ACH representments that the Bureau may want to address in the future. The “reasonable and proportional fee” provision in the CARD Act may be a starting point.)


10 NACHA allows one initial debit attempt plus two additional attempts; a good summary of the rule can be found here.
Conclusion

As noted in the title of our research report, small-dollar credit presents a complex portrait in terms of both the borrowers and the lenders. The complexities stem from both the sources of the liquidity issues on the consumer side to the business models on the lender side. Regulators – both those interested in consumer protection and those interested in prudential safety and soundness issues – need to understand these complexities in order to solve for the source of the problems in this market, rather than just dealing with symptoms. While the Bureau has made some important inroads into resolving some of these complexities, we believe there is more work that needs to be done.

There are references peppered throughout this letter to using principles and outcomes (versus rules and inputs) and a regulatory sandbox to test out alternatives and gather data for decision making. While the Bureau’s research team has done an admirable job in several of the Data Points publications related to small-dollar credit, the data often are out of date and are based on older business models. The idea of a regulatory sandbox would be to try out alternative regulatory structures and benchmarks before they become finalized in the rules. This gives the Bureau a chance to test out innovations and derive in-market data-driven solutions to the key issues it’s trying to address. It would be the FDA equivalent of trying out medical products and protocols.

Finally, CFSI recognizes that small-dollar credit products often treat the symptoms of consumer credit issues rather than the cause of those issues. Credit isn't always the right solution and there are other products and policies to reduce people's need to borrow. The U.S. needs policies that might serve as mediators for even needing SDC loans to begin with, such as livable wages, work schedule policies, and family and sick leave policies for hourly and contingent workers. We recognize these are not within the scope of the CFPB, but they will be important elements in resolving the source of the need for small dollar loans. Nonetheless, for many people, SDC can improve financial health by helping consumers manage liquidity or handle emergencies and weather shocks. We want there to be safe, affordable, and accessible products that help people end up better than when they started.

As always, if you have any questions about CFSI’s comments we would be glad to provide answers and clarifications.

Sincerely,

Jeanne M Hogarth
President & CEO
Center for Financial Services Innovation

Jeanne M. Hogarth
Vice President
Center for Financial Services Innovation