



*Advancing Economic Security
and Community Prosperity*

August 15, 2011

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Consumer Financial Protection Bureau
Nondepository Supervision
1801 L Street, NW, Room 513-H
Washington, DC 20036

Re: Docket No.: CFPB-HQ-2011-2

To Whom It May Concern:

I am pleased to submit comments on behalf of Woodstock Institute in response to the Consumer Financial Protection Bureau's notice and request for comments on the development of a rule to define covered persons that will be subject to the CFPB's supervision program as a larger participant of a market for consumer credit. These comments discuss the overlap of the payday loan and consumer finance products in Illinois and the regulatory implications of these distinctions and provide a scan of currently available administrative data in Illinois that could be used to determine market segmentation, suggested criteria to determine market size, and industry aspects that suggest different criteria or thresholds based on market characteristics.

Our comments raise the following issues:

- 1) In many markets, there is little difference between payday loans and some consumer finance products in terms of consumer impact, although the CFPB's authority to write rules, supervise and take enforcement actions considers these products very differently.
- 2) The definition of larger participants in the consumer credit market should take into account market share as well as impact on consumers due to a lack of internal controls or business models that are inconsistent with effective consumer protection. These three criteria should be applied in a way that ensures that consumer credit companies that do not meet market share criteria but have a significant, negative impact on consumers are subject to heightened regulatory scrutiny.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. We conduct research on financial products and practices, promote effective state and federal policies, convene a coalition of community investment stakeholders working to improve access to credit, and help people use our work to understand the issues and develop and implement solutions.

Overlap of payday loan and consumer finance markets

The Consumer Financial Protection Bureau has clear authority to supervise, regulate, and write rules governing payday lenders. The statute does not provide a clear definition of the terms and conditions that establish a specific transaction as a payday loan, rather than a consumer credit loan, however. This has specific implications for consumer protection, since the Bureau will only have supervisory authority only over consumer credit companies that are larger participants. Our experience creating a consumer credit regulatory structure in Illinois has demonstrated that, in many cases, the term payday loan and consumer installment loan are used interchangeably. In some states, payday loans are very short-term loans of about two weeks, carry extremely high rates, are structured as balloon payments, and have payment or collection features that involve post-dated checks or automatic checking account debit. In Illinois, this type of payday loan is extremely rare, and due to increased regulatory oversight of that specific product model, most lenders have chosen to move to the consumer finance company model which allows for longer-term, very high interest rate loans with potentially problematic features.

In 2008, Woodstock Institute analyzed the terms and conditions of loans in default made by companies licensed as consumer finance providers in Illinois and found that over half (54 percent) of surveyed loans were short-term installment loans with many of the same features as traditional, shorter-term payday loans.¹ Principals ranged from \$175 to \$17,247 with a median principal of \$1,397. Interest rates ranged from 5 percent to 1,142 percent with a median interest rate of 95 percent. High-cost, short-term installment loans had a median term of nearly nine months (266 days), typically structured as monthly payments averaging \$168. Refinancing these loans to extend the term or receive additional money was common in this category of loan. In 28 percent of surveyed loans, the lender recorded information relating to the refinancing of the original loan into a new agreement. Of these cases, the median amount refinanced into a new loan was \$577, or 38 percent of the original loan principal and interest. This indicates that borrowers typically refinanced approximately one third of the way through the original loan.

Determining market presence and consumer impact of larger participants

Woodstock Institute considers three factors when determining market presence and the direct impact on consumers in its research on consumer credit market in Illinois and the Chicago region:

1. Market share as measured by number of licenses or number of loans;
2. Negative impact on consumers through a lack of internal controls as measured by regulatory violations or enforcement actions;
3. Flawed business practices, underwriting criteria or collections policies incompatible with effective consumer protection as measured by number of complaints filed with the Circuit Court of Cook County.

¹Feltner, Thomas, and Sarah Duda. *Beyond Payday Loans: Consumer Installment Lending in Illinois*. Chicago, IL: Woodstock Institute, 2009. Web. 12 Aug 2011.

Each of these measures provides a different indicator of consumer impact. Consideration of impact on consumers through a lack of internal controls and consideration of business practices incompatible with effective consumer protection are particularly important criteria. Taken together, these criteria will create a level regulatory playing field that ensures that consumer credit companies that do not meet the market share criteria for determination as a larger participant could at some point in the future be subject to expanded supervision if there are serious abuses that put large numbers of consumers at risk.

- 1. Determining market share** – Illinois law requires that consumer finance companies hold a license for each location where they do business. Number of licenses is a rough approximation of a company's market share, but only in cases where lenders operate a storefront retail model. Business models differ greatly from one company to another – many small consumer credit companies rely on storefront locations to drive loan volume, while other lenders have few locations and drive volume through relationships with large employers of low-wealth employees such as Comcast or the US Postal Service. Looking solely at companies that have traditionally offered consumer installment loans, 84 percent of the licenses are held by the 10 largest companies. However, looking at all companies licensed to offer any type of high-cost short-term credit product, the license share of the top ten companies drop to only 41 percent of licenses.

Recommendation: Larger participant should be defined using number of loans, not number of licenses wherever possible. If the Bureau is constrained by existing state-level public data, the Bureau should seek to segment the market based on product (i.e. long-term high cost payday installment loans, long-term lower-cost installment loans, title-secured loans) and strive to define companies with 5 percent or more of the license share as larger participants.

- 2. Determining companies with significant impact on consumers through a lack of internal controls** – In 2008, 9 percent of licensees were subject to 48 percent of consumer protection violations or enforcement actions. We consider frequent consumer protection violations to be indicative of inadequate internal controls and a signal for the need for heightened supervision and enforcement. The top three companies receiving consumer protection violations received 48 percent of all violations in 2008, but held only a 9 percent share of total licenses. Serious underwriting violations represented 72 percent of all violations, including failures to document income, incorrect disclosures, payment-to-income violations, or failure to produce a signed loan agreement.

Recommendation: Larger participants should be defined to include those companies that demonstrate ongoing, serious internal control problems to ensure that they are subject to increased scrutiny.

- 3. Determining larger participants with significant impact on consumers through business model incompatible with effective consumer protection.** We consider extensive use of court complaints to collect on unsecured credit agreements in default to be indicative of flawed underwriting or other business practices that are incompatible with effective consumer protection. In 2007, 2 percent of licensees filed 52 percent of consumer credit complaints in the Circuit Court of Cook County. In Cook County in 2007, 5,485 cases were filed in the Circuit Court and Woodstock estimates that 28 percent of these cases were for high-cost, unsecured payday installment credit. Five companies represented 52 percent of these cases, but only 2 percent of the licenses.

Recommendation: Lenders that file a significant percent of the total number of consumer finance loan collection complaints be subject to additional oversight as a larger participant in the consumer credit market.

- 4. Period of consideration for designation as a larger participant** –Consumer finance companies licensed in Illinois and offering small consumer loans are required to provide a report and public summary information every two years. The availability of this type of information and existing reporting will vary from state to state, but will provide critical insight as to how consumer credit companies perform in various markets and how their practices impact consumers and could be useful to the CFPB as an indicator of market share or consumer impact.

Recommendation: Determination of a company as a larger participant should be determined on a rolling, multi-year basis and take into account administrative data and reporting availability.

We appreciate the opportunity to comment on the CFPB's notice and request for comments on the development of a rule to define covered persons that will be subject to the Bureau's supervision program as a larger participant of a market for consumer credit.

Sincerely,



Tom Feltner
Vice President

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