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Via E-mail (FederalRegisterComments@cfpb.gov) and Hand Delivery

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

Re: Comments on CFPB Proposal on Payday, Vehicle Title, and Certain High-Cost Installment Loans (RIN 3170–AA40; Docket No. CFPB-2016-0025)

Ms. Jackson, Ladies and Gentlemen:

On behalf of Select Management Resources and its related title lending companies ("Select"), we appreciate the opportunity to comment on the proposed rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans, to be codified at 12 C.F.R. pt. 1041 (the "Proposed Rule"). The Proposed Rule was published by the Consumer Financial Protection Bureau ("CFPB" or "Bureau") in 81 Fed. Reg. 47,864 (July 22, 2016) (the "Release").

Select is one of the earliest members of, and is currently a market leader in, an industry that offers much needed loans to a growing segment of consumers who have limited or no access to other sources of credit. Select's owner opened his first office in 1990 and was an early pioneer in providing non-purchase money loans to consumers secured by their motor vehicles ("title loans"). Select remains one of the largest title loan companies in the United States, operating almost 700 offices in twenty-one states, and has expanded to offer this popular product internationally. Select is one of the

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few, perhaps only, major company that limits itself to making automobile title loans, since Select does not also offer loans commonly referred to as "payday loans."

We write this letter principally to express the view that the Proposed Rule is far too restrictive in multiple respects. As currently drafted, the Proposed Rule will make it extremely difficult if not impossible for Select to remain in business and continue to provide credit to consumers in need of its services. Further, many of the requirements of the Proposed Rule go well beyond the level required to protect consumers against the concerns the Bureau has expressed. Accordingly, we believe that the Bureau should take note of our initial comment below and modify the Proposed Rule in the manner set forth in the succeeding comments.

1. *The CFPB should confirm (or correct) the repossession data in its May 2016 report on single-payment title lending and should put its repossession data in better context.*

Before turning to specific proposals, we wish to comment on two key but somewhat anomalous findings from the CFPB's May 2016 report on Single-Payment Vehicle Title Lending (the "May Report") and its June 2016 supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products (the "June Supplemental Findings"). The June Supplemental Findings report (p. 9) that "[e]ight percent of vehicle title installment loans and over one-in-ten vehicle title installment loan sequences end in repossession." By contrast, the May Report states (p. 23) that "about a third of [single-payment] loan sequences experience a default and one-in-five loan sequences result in the repossession of the borrower's vehicle."

Based on its own repossession experience, Select believes that the multi-company figures from the June Supplemental Findings may be somewhat high. Even if these figures are accurate,

however, Select does not believe that the radically higher repossession rate for single-payment loans from the May Report can be correct. For Select, customers obtaining single-payment title loans, on the one hand, and title installment loans, on the other hand, end up having their vehicles repossessed over the life of the relationship at approximately the same rates. We do not know what leads to the divergent CFPB results but suspect that there may be a methodological flaw in the May Report.

In interpreting repossession levels, it is important to distinguish between borrowers who are *unable* to repay their loans and borrowers who *choose* not to repay. More than half of Select's repossessions result from first payment defaults, where it is unlikely that the consumer found himself or herself unable to make a payment.

As with many if not most companies in the industry, most of Select's loans are non-recourse. In any event, as a matter of practice Select has never pursued any borrower personally for any amount owed to it under the terms of one of its loan agreements. This includes having never pursued any deficiency balance after repossession and sale. Further, Select does not report adverse credit information to any of the nationwide credit bureaus. Borrowers are well aware of these realities.

In the title loan business, there is always the risk that the lender will over-value a vehicle or fail to observe a latent defect. In lieu of expending the time and effort to sell an undesired vehicle, an early payment defaulter knows that he or she can conveniently access cash from a title loan *and* continue driving the vehicle for several months or more before the lender initiates or successfully completes efforts to repossess the vehicle. In many cases where repossession is impossible or impracticable, the borrower can retain possession indefinitely.

Perhaps that is the initial plan of many borrowers or at least a possible option they perceive. Even borrowers who default at a later time in the credit cycle may do so because they perceive that the outstanding loan balance is in excess of the remaining value of their car after further depreciation, mechanical problems or an accident.

In short, it is important for the Bureau to undertake additional research into these issues and to put its repossession information into better perspective. The picture is far more nuanced than it may first appear.

2. *The CFPB should replace the 36% rate trigger (the "Rate Trigger") with a lawful, empirically supported differentiator between fair and unfair longer-term loans.*

Section 1041.9 of the Proposed Rule imposes severe ability-to-repay ("ATR") limitations and requirements on lenders seeking to provide covered longer-term loans to consumers. Section 1041.3(b)(2)(i) of the Proposed Rule sets forth one key definitional element of a "covered longer-term loan"—it must have a total cost of credit (or "all-in APR") exceeding 36%. Otherwise, it is not a "covered longer-term loan" and the burdens of the Proposed Rule do not apply.

We do not believe that the Bureau has a reasonable basis for selecting a 36% Rate Trigger as opposed to a rate trigger nearly an order of magnitude greater. The Bureau has asserted that it selected the 36% Rate Trigger "in order to focus regulatory treatment on the segment of the longer-term credit market on which the Bureau has significant evidence of consumer harm.... The Bureau's research has focused on loans that are typically priced with a total cost of credit exceeding a rate of 36 percent per annum." Release, 81 Fed. Reg. at 47,912.

Respectfully, we have seen no indication that the Bureau has studied installment loans at rates anywhere close to the 36% Rate Trigger the Bureau has chosen. Rather, so far as we can tell, *all*

of the loans studied to date have involved triple-digit annual interest rates, typically in the range of 200%, 300% or higher. Thus, the Bureau has no empirical basis to establish a Rate Trigger at the 36% level.

We recognize that many self-styled consumer groups, a number of state legislatures and Congress in the Military Lending Act have either advocated or imposed 36% usury limits for all or specified types of consumer loans. But state legislatures and Congress, unlike the Bureau, have legislative power and, with it, the right to make inherently arbitrary rate-setting decisions. While the Military Lending Act established a 36% usury limit on consumer loans to military members and their dependents, this determination by Congress does not eliminate the Bureau's obligation to make rules under its "UDAAP" authority to define "unfair," "deceptive" and "abusive" acts and practices, if at all, on the basis of the careful, empirically derived cost-benefit analysis required by Sections 1022(b)(2)(A) and 1031 of the Dodd-Frank Act, 12 U.S.C. §§ 5512(b)(2)(A) and 5531.

This means that, if the CFPB continues to use a Rate Trigger in defining "covered short-term loans,"[1] it should significantly increase the Rate Trigger to a level where its studies and empirical data establish a serious risk of consumer harm—a risk outweighing the consumer benefits of the product.

[1] We do not concede that the Bureau has authority under Section 1027(o) of Dodd-Frank to use *any* Rate Trigger. *See* the October 5, 2016 letter we submitted on behalf of Harpeth Financial d/b/a Advance Financial.

3. *The CFPB should eliminate the verification requirements of the Proposed Rule unless and until it develops a record showing that borrowers are being injured because they are unable to accurately represent their financial circumstances.*

The elaborate verification requirements of the Proposed Rule, proposed 12 C.F.R. §§ 1041.5, 1041.9, will create massive burdens on lenders and inevitably prevent many otherwise qualified borrowers from obtaining credit. By contrast to practices that cropped up regarding residential mortgage lending, so far as we know and so far as the CFPB has indicated, there is no evidence that loan applicants, other than out-and-out fraudsters, have engaged in the practice of submitting inaccurate financial information to title or payday lenders, much less that such lenders have encouraged the practice or themselves falsified applicant information. Nor has the CFPB come forward with data showing that verification of borrower-supplied information will produce materially better underwriting results. Verification requirements in this space are not mandated by Congress.

Undoubtedly, the verification requirements of the Proposed Rule will present particularly acute problems in the Hispanic community, which disproportionately has many undocumented agricultural, food-service, housekeeping, child-care and other workers who are paid off the books and who may be fearful of establishing bank accounts. Such workers have no way at all of satisfying the income verification requirements of the Proposed Rule. We find it ironic that the Bureau would propose a rule that will certainly have a major disproportionate impact on a minority population. A financial services provider that established underwriting guidelines with this kind of disparate impact would be at substantial risk of a Bureau or Department of Justice enforcement proceeding.

In short, there is no current reason to believe that one of the key elements and major burdens of the Proposed Rule has any empirical basis at all. Certainly, the costs to the industry and consumers and the inevitable disparate impacts of the proposed verification requirements outweigh any known

benefits of the proposed verification regimen. Thus, the CFPB is not in a position to find it "unfair" for lenders to make title, payday and high-rate installment loans without verifying consumer financial information. *See* Section 1031(c) of the Dodd-Frank Act, 12 U.S.C. § 5531(c) (providing that the Bureau has "no authority ... to declare an act or practice ... unfair, unless the Bureau has a reasonable basis to conclude" that the "practice causes or is likely to cause substantial injury to consumers ... [which] is not outweighed by countervailing benefits to consumers or to competition"). Nor is there any reason to conclude that non-verification is "abusive" in any way. *See* Section 1031(d) of the Dodd-Frank Act, 12 U.S.C. § 5531(d).

Even if a handful of borrowers were to obtain covered loans through inaccurate financial information, and even if consumer injury is assumed to result from such loans, there would still be no "unfair" or "abusive" practice justifying the Proposed Rule's verification requirements. This is because, for a practice to be "unfair," any consumer injury must not be "reasonably avoidable" by them. *See* Section 1031(c)(1)(A) of Dodd-Frank, 12 U.S.C. § 5531(c)(1)(A). Likewise, to be "abusive," a practice must take "unreasonable" advantage of: (i) the consumer's inability to protect his or her interests in selecting or using a financial product or service; or (ii) the consumer's lack of understanding of the material risks, costs and conditions of a financial product or service.

In light of the limits established by the Dodd-Frank Act on acts and practices the Bureau may define as "unfair" or "abusive," unless the Bureau could show that consumers are somehow unable to provide reasonably accurate financial information when seeking title and payday loans, there can be no basis for the Bureau to reasonably conclude that the burdensome verification requirements of the Proposed Rule are warranted. Accordingly, these requirements should be stripped from the Proposed Rule.

4. *If a lender makes a covered short-term loan but allows the borrower to unilaterally reborrow without any further underwriting, the CFPB should allow the lender to conduct its ATR analysis under the assumption that the borrower will take advantage of the unilateral reborrowing options the lender provides, provided that the lender makes special Truth in Lending Act ("TILA") disclosures under the same assumption and delivers any other disclosures required by the CFPB.*

The CFPB has recognized that many more states authorize short-term payday and title loans than longer-term installment loans. For example, Georgia, Idaho, Mississippi, New Hampshire and Tennessee all authorize short-term single-payment title loans but *not* longer-term installment title loans.[2] At the same time, the Proposed Rule favors covered longer-term loans over covered short-term loans. In order for the CFPB to reconcile these differing approaches and facilitate simultaneous compliance with both federal and state law, we believe that the CFPB should add new provisions to the Proposed Rule.

Specifically, we propose that the CFPB introduce into the Proposed Rule a new "hybrid loan" concept. In form, a "hybrid" loan would be a covered short-term loan. However, the loan would be classified as a "hybrid loan" if the lender, by contract (or perhaps by regular practice)

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[2] *See* Ga. Code § 131(a)(1) (term must initially be for 30 days but may be extended for additional 30-day periods); Idaho Credit Code, §§ 28-46-506(1),(4) (term may not exceed 30 days but lender may automatically refinance the loan so long as it gives written notice within 14 days of the automatic renewal); Miss. Code §§ 75-67-403(h), 75-67-413(3) (minimum term of 30 days with extensions by agreement of parties for thirty-day periods, provided that, on each extension, the borrower must generally reduce the principal amount financed by at least 10% of the original principal amount of the loan); N.H. Stat. §§ 399-A:19I and II (original term limited to one month with up to 10 amortizing renewals authorized); Tenn. Code §§ 45-15-113(a), (d) (loan must initially be for 30 days and may automatically renew for 30-day periods, provided that, beginning with the third renewal or continuation, the borrower must repay at least 5% of the original principal amount plus interest and fees).

allows borrowers to reborrow at maturity,[3] one or more times, without performing any new underwriting, so long as the borrower pays all accrued interest and fees on the loan plus the principal, if any, required by state law or the lender's practice. For a hybrid loan, the lender would be allowed to conduct its ATR analysis on the assumption that the borrower takes advantage of all reborrowing opportunities unilaterally available to the borrower, subject to the requirement that the lender provides special TILA disclosures based on the same assumption and gives any further disclosures (for example, pre-rollover notices) mandated by the CFPB.[4]

Our hybrid loan proposal would allow lenders to comply with state laws requiring repayment of the entire loan in a short period of time. Simultaneously, it would allow borrowers who cannot pass ATR muster on a covered short-term loan to qualify as if the loan obligation were for a covered longer-term loan. In the absence of provisions of the Proposed Rule of this type, many borrowers who could qualify for a covered longer-term loan will be unable to obtain any credit unless the lender and its counsel are somehow able to navigate between the competing requirements of state and federal law.

For some time, lenders, primarily in the online space, have offered loans that look like (and are disclosed as) single-payment loans but provide for automatic renewals and refinancings over a period of months. The problem with these loans (as reflected in the $1.3 billion judgment the FTC

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3 In the Release, the "Bureau uses the term 'reborrow' to refer to situations in which consumers either roll over a loan (which means they pay a fee to defer payment of the principal for an additional period of time), or take out a new loan within a short period time following a previous loan." *See* 81 Fed. Reg. at 47,922. We adopt the same convention here.

4 Of course, these longer-term TILA disclosures could be in addition to the standard TILA disclosures for loans of this type. A focus group process would probably be helpful in determining the optimal disclosure regimen.

just obtained against AMG Financial) is not that they are paid in installments over time but rather that borrowers typically do not receive TILA disclosures consistent with the actual anticipated payment schedule. Our proposal would confront this problem head-on by having the CFPB mandate special longer-term TILA disclosures in order to obtain the benefits of the hybrid loan provisions of the Proposed Rule. These disclosures could even alert the borrower that the lender has conducted an ATR analysis that suggests that the borrower will be unable to repay the initial loan at maturity and will likely need to available himself or herself of reborrowing options the lender provides.

At least three states—Mississippi, New Hampshire and Tennessee—require title loans to be structured formally as covered short-term loans but explicitly contemplate repeated reborrowings in accordance with an amortization schedule specified by statute. Other states require initial structuring of title loans as covered short-term loans and permit reborrowings in the lender's discretion, without mandating any particular amortization schedule. As the CFPB has observed, single-payment loans are regularly extended or refinanced. Accordingly, proposed 12 C.F.R. § 1041.5, which requires lenders to treat short-term loans as if they must be repaid in full on the original maturity date, without reborrowing, thus ignores both the requirements of state law and business reality. Adoption of our proposed hybrid loan concept would harmonize the Proposed Rule with state law and substantially enhance the fairness of the CFPB's required ATR regimen.

5. *The CFPB should scrap proposed 12 C.F.R. § 1041.19, proscribing actions taken "with the intent of evading the requirements" of the Proposed Rule.*

The CFPB has included as Section 1041.19 of the Proposed Rule an unprecedented anti-evasion provision. This provision is inherently vague and overbroad, and would threaten normal

structuring designed to comply with the elaborate requirements of the Proposed Rule. In doing so, it would introduce into the field of consumer financial services law a dangerous new precedent.

The Proposed Rule and associated comments run over 51 triple-columned pages in the Federal Register, with another 300 triple-columned pages of explanatory material. Many of the provisions of the Proposed Rule are designed to protect against loopholes that might otherwise allow lenders to circumvent the central protections of the Proposed Rule. *See,* for example: (1) the broad definition of "short-term covered loan"; (2) the sweeping definition of "covered longer-term loan," which covers loans with an all-in APR anywhere in excess of 36% and a vehicle title or leveraged payment mechanism taken within 72 hours after funding; and (3) the Proposed Rule's elaborate verification requirements. Needless-to-say, these provisions are broad and highly complex and will require intensive and costly legal analysis and operations changes to ensure compliance. Under proposed Section 1041.19, however, lenders will not even have assurance that strict compliance with these detailed requirements will suffice.

A few examples—we could provide many more—demonstrate the problems with the Proposed Rule's anti-evasion provision. Comment 1041.19-3 is an illustrative example of a lender action that is not taken with the forbidden intent to evade the requirements of the Proposed Rule. However, because of the narrow way it is written, it functions in practice as a warning of the potential illegality of conduct that should be entirely lawful.

Comment 1041.19-3 describes a lender that switches from offering a 30-day covered short-term loan product to offering a 46-day product that, we are told, constitutes a covered longer-term loan. The Comment assures us that the new product is not an unlawful evasion under Section 1041.19. However, by reporting as a salient fact that the new product is covered, the Comment

suggests that the lender might be in trouble if the new loan product were designed to fall outside the Proposed Rule, for example because the loan was structured as a "signature" loan without title collateral or a leveraged payment mechanism. At the same time, the Comment provides no guidance whatsoever concerning what kind of signature loan will pass muster.

Is it enough if the loan has a single payment due in 55 days? 90 days? Two payments due over a 90-day period? Twelve monthly payments? Certainly, by structuring the loan as a loan that has a term exceeding 45 days and that lacks one of the key criteria of the "covered longer-term loan" definition, *see* proposed 12 C.F.R. § 1041.3(b)(2)(ii), the lender is seeking to avoid not having to comply with the Proposed Rule. But one person's avoidance is another person's evasion. Is the loan legal? Bottom line: We do not know.

In Comment 1041.19-2i, the CFPB provides an example of a scenario where the lender "may have" acted with the improper intent of avoiding the requirements of the Proposed Rule. In this scenario, the lender again makes a longer-term loan without title security or a leveraged payment mechanism. However, more than 72 hours after funding, the lender "routinely" offers an incentive for the borrower to provide the title collateral or leveraged payment mechanism and borrowers "routinely" agree. Again, the Comment leaves readers guessing as to the proscribed conduct. Is the lender in violation if 30% of borrowers agree? 51%? 95%?

Interestingly, in both these cases, the underlying rationale for the protections of the Proposed Rule frequently will not apply. The CFPB has said in the Release that taking vehicle title or a leveraged payment mechanism allows lenders to obtain a preferred position over other creditors and therefore to lend without a reasonable assurance that they can be repaid at the same time as the consumer makes other required payments. However, if a lender makes a "signature" loan without

strong assurance that it can convert the loan into one with title security or a leveraged payment mechanism, it is exposed to unacceptable credit losses if its underwriting and verification mechanisms are flawed.

And also in both cases, the anti-evasion rule creates undue vagueness. If the CFPB is dissatisfied (or comes to be dissatisfied) with a clear 45-day demarcation between covered short-term loans and other consumer loans, which are only covered by the Proposed Rule when specified definitional criteria are met, it should change the applicable definitions. If it wishes to prohibit a contractual or practical requirement on the consumer to provide title collateral or a leveraged payment mechanism on a post-closing basis, it should explicitly do this. *Cf.* Comment 1005.10(e)(1)-1 to Regulation E ("Creditors may not require repayment of loans by electronic means on a preauthorized, recurring basis. A creditor may offer a program with a reduced annual percentage rate or other cost-related incentive for an automatic repayment feature, provided the program with the automatic payment feature is not the only loan program offered by the creditor for the type of credit involved.").

In a celebrated case, the U.S. Supreme Court has warned against statutory interpretations that would "throw into confusion the complex system of modern interstate banking." *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 312 (1978). The CFPB should not adopt a Proposed Rule that would have this same adverse result. This is especially true when the Proposed Rule, like TILA,[5] is already hypertechnical (and burdensome).

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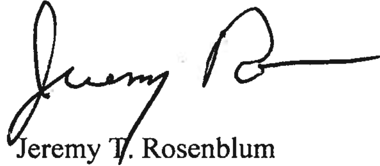
[5] *See Cowen v. Bank United*, FSB, 70 F.3d 937 (7th Cir. 1995) (generally, "hypertechnicality reigns" under TILA).

CONCLUSION

On behalf of Select, we thank the Bureau for the opportunity to comment on the Proposed Rule. Please feel free to contact me with any questions at 215-864-8505 or rosenblum@ballardpahr.com.

Very truly yours,



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