PUBLICATION

Heard At The Country Music Hall Of Fame: CFPB Director Performs In Nashville

July 17, 2014

Among the displays offering tribute to Reba and The Man in Black, Richard Cordray and some of his fans at the CFPB held a public hearing at the Country Music Hall of Fame in Nashville on March 25, 2014. Rather than the typical cowboy hat and boot-clad tourists that normally frequent the Hall, the shelter from the cold, rainy day outside protected throngs of well-dressed citizens who came to hear who the CFPB intended to save next.

Mr. Cordray led off the tense discussion by reading a prepared speech announcing the results of the CFPB's follow-up research study on payday lending, released by the CFPB that day. He indicated that the CFPB had chosen Nashville for the release on account of the prevalence of payday lenders both in Nashville and surrounding states. Since most of the crowd represented management and employees of the financial industry, he was at least correct about his immediate surroundings that day.

Mr. Cordray then began to give statistics and related two stories of customer abuses among his stated 12 million customers using payday lenders (one was about "Alice in Pennsylvania," despite the fact that Pennsylvania has outlawed payday loans for years), but he did state that it was important to encourage small loan products as long as "the markets for those services are fair, transparent and competitive." As this phrase was repeated a number of times during the hearing, it was encouraging to the industry representatives. Mr. Cordray indicated that the payday loan industry, in particular, had been developed to meet the short-term, emergency financial needs of consumers who intended to repay the loans from their next paycheck.

Most of the statistics Mr. Cordray quoted from the study were directed at the fact that many of these short-term loans turned into long-term loans. For example:

- For about half of initial payday loans, borrowers are able to repay the loan with no more than one renewal.
- One in five (20%) initial loans are made in loan sequences that involve seven or more loans, and fees "eclipse the actual payday loan itself."
- He gave what seemed a conflicting statistic stating that 4 out of 5 (80%) payday loans are rolled over or renewed within two weeks and roughly half of all loans are made in loan sequences lasting 10 or more loans in a row. (Of course, if you add up all the loans of one borrower in a sequence, rather than counting the number of borrowers or sequences as he did in the statistic above, it is easy for him to make the numbers look much worse than what the study was showing. This 80% rollover statistic was the one quoted in all the national and local media outlets and has been misinterpreted by the media.)
- In states requiring a 14-day "cooling off" period, renewal rates are nearly identical.

As a result of these statistics, Mr. Cordray said that payday loans had turned into a "revolving door of debt" and a "slippery slope toward a debt trap." He stated that the efforts of the CFPB would be to prevent this "perpetuating sequence." He took pride in the CFPB's initial efforts to fine a couple of large companies for unfair and deceptive practices and for the new guidelines which had been released on military lending. The CFPB is working on issuing new rules for payday lenders. He concluded that he did not intend to eliminate the payday lending industry, but just to eliminate some of these concerns raised by the study.

After Mr. Cordray spoke, a panel was seated, which included representatives of the payday industry, consumer groups and regulators. Each person had an opportunity to speak before the floor was opened to questions from the audience.

The consumer groups reiterated many of the "abuses" in the payday lending industry and cited additional examples. One of the representatives seemed to prefer that the industry be terminated altogether. One suggestion was to require the lender to determine the ability of the borrower to repay the debt and review credit reports and financials on the borrower. This particular representative indicated her belief that the industry fought this requirement because the payday lenders depended upon the inability of the borrowers to repay so that the lenders could then clean out the borrowers' bank account through electronic funds transfers. She called payday lending "debt trap loans." Another consumer group spokesperson stated that the industry and its state legislative efforts were an attempt at "a systematic dissembling of state usury laws."

Industry representatives on the panel stated that they encourage state regulation and plan to adopt best practices for their industry. Tennessee actually was the first state to adopt such statutory requirements, and the industry trade groups have worked with legislators in 36 states to adopt laws. They indicated that many of the abusive examples given during the hearing were in states where laws had not been passed. They also indicated they were appalled by the bank regulatory efforts to stop the commercial banking industry from offering small loan products, since the payday industry representatives felt that more competition was actually good for the industry and helped control abuse. Even the U.S. Postal Office's Service's consideration of offering small loans was welcome (which, by the way, is also supported by former CFPB advisor and current Democratic Senator Elizabeth Warren). Statistics were quoted that 93% of payday borrowers intelligently weighed the risks of taking out these small loans and that 95% had indicated that they were very satisfied with the product.

Finally, Paige Marta Skiba, a Vanderbilt professor who represents the Center for Responsible Lending and who has conducted studies on payday lending, discussed her research and the "unrelenting demand for small dollar credit." While many payday borrowers ultimately file for bankruptcy, those persons using these services typically are in the bottom 20% of credit scores and have already incurred credit card and mortgage delinquencies. She stated that many of the mechanisms adopted by states to try to control the industry were not effective. Information disclosures were too complicated to understand and did not really address the issues anyway. Financial literacy was very expensive and was not being sought out by those who needed it the most. Limitations on the number of loans or cooling-off periods between loans "makes no difference in the probability of whether people default on their loans." While she did not offer a solution to the abuses, she did conclude that banning payday loans would place these borrowers in an even worse situation.

When the hearing was opened for public comment, most of the comment was made by industry employees, who obviously supported payday lending and gave many examples of their very happy customers. Their major point was to let the consumer decide what products they want. Many members of the audience wore badges that said "My Credit, My Decision." Comments from consumer advocates reiterated the high cost of loans, how the loans were designed to create a long-term cycle of debt, and how the loans ignore the borrower's ability to repay.

The lesson learned from this hearing as well as other recent actions of regulatory authorities is that the business uncertainty caused by inconsistent actions of the government regarding the small loan business is limiting credit. On the one hand, Mr. Cordray praises efforts to meet the demand of short-term financial needs of Americans, but then he continues to chastise the payday industry as if all participants are bad apples. Commercial bankers, especially community bankers, are used to similarly lumping everyone in one basket, which increased in intensity during the most recent economic crisis. The CFPB seems to be resorting to more restrictions on the industry, which will lead to less credit being made available, rather than allowing the industry to proceed with its efforts towards implementing best practices.

Efforts of other government agencies are similar. The U.S. House Oversight and Government Reform Committee released a staff report on May 29, 2014, concluding that the Justice Department's "Operation Choke Point" was aimed specifically to "choke out" payday lending companies that the Administration considers "high risk" or otherwise objectionable, despite the fact they are legal businesses. By threatening federal investigation, Justice and other regulatory agencies have forced banks to do their bidding without any judicial or other check on their power.

Various state attorney general actions and other bank regulatory efforts to detach the commercial banking industry from the payday lending industry are well reported. Attempting to destroy an industry by cutting off their access to the legal free market banking system will only drive more shady characters and shady methods into the industry, which is what Mr. Cordray and others are trying to prevent. In the May 2014 report published in the CFPB's Supervisory Highlights referencing the payday and other nonbank industries, the CFPB encourages entities to "proactively make any necessary changes to prevent violations of law and consumer harm," even though this indirect guidance is based upon "violations reported [to] have been found at a small number of institutions."

Some government officials do get it. Debbie Matz, Chairman of the National Credit Union Administration, stated in April, while approving an application by a federal credit union to expand its micro loan business to low income residents, that credit unions may offer a payday loan alternative with a lower cost and with some restrictions in place. The FDIC is encouraging a pilot program for banks to offer a deposit advance product, but there has been little buy-in, especially when the FDIC, OCC and Federal Reserve each have issued new restrictions on small dollar loans and have been so critical during the examination process that most banks have gone in the other direction of offering fewer such products or exiting the business totally.

Nobody threw physical paper or stones at the CFPB hearing in Nashville, there were no placard-carrying protesters, and there was general civility in the room. As everyone left the auditorium to go back to work, we could hear Hank on the background speakers still singing "these silver tears you're sheddin' now is just interest on the loan."