



2005 Market Street, Suite 1700      215.575.9050 Phone  
Philadelphia, PA 19103-7077      215.575.4939 Fax

901 E Street NW, 10th Floor      202 552 2000 Phone  
Washington, DC 20004      202 552.2299 Fax  
[www.pewtrusts.org](http://www.pewtrusts.org)

August 15, 2011

Ms. Peggy Twohig  
Assistant Director, Nonbank Supervision  
Consumer Financial Protection Bureau  
Washington, DC 20036

RE: CFPB Docket No. CFPB-HQ-2011-2, Defining Larger Participants in Certain Consumer Financial Products and Services Markets (Comment on Proposed Rules)

Dear Ms. Twohig,

The Pew Financial Security Portfolio, a part of the Pew Health Group, includes two projects engaged in research related to the consumer financial products and services markets discussed in the Consumer Financial Protection Bureau (CFPB) proposed rule on defining larger participants in certain markets. The Safe Small Dollar Loans Research Project develops research-based policy solutions to address predatory lending practices that stifle consumer access to transparent and safer forms of borrowing. The Safe Checking in the Electronic Age Project is reviewing prepaid cards and other alternatives to traditional checking accounts with a focus on what new consumer safeguards may be appropriate.

We appreciate the CFPB taking comments on its proposed rules. Based on our research and analysis, we submit the following comments on the larger participant rule.

Sincerely,

Nick Bourke  
Project Director  
Safe Small Dollar Loans Research Project  
(202) 552-2123  
[nbourke@pewtrusts.org](mailto:nbourke@pewtrusts.org)

Susan Weinstock  
Project Director  
Safe Checking in the Electronic Age Project  
(202) 540-6598  
[sweinstock@pewtrusts.org](mailto:sweinstock@pewtrusts.org)

The larger participant rule will delineate both the consumer financial markets in which the CFPB has supervisory authority and also which participants—covered persons under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010—are subject to this supervision.<sup>1</sup> This presents an important opportunity for the CFPB to bring clarity to and level the supervisory playing field in markets for nondepository consumer products. Supervision will allow the CFPB to conduct examinations and gather information to monitor these markets and ensure compliance with federal consumer financial laws.

Based on work at the Pew Health Group on small dollar loans and checking accounts, we urge the CFPB to issue an initial rule broadly covering nondepository markets. Within these markets, coverage of individual participants under the larger participant rule should permit comprehensive supervision by the CFPB. The CFPB's supervisory authority must be broader than its rulemaking authority because examination of the market informs rulemaking needs.

The comments here reflect conclusions that we have drawn based on Pew Health Group research and analysis. Our silence on other products and issues addressed in the Notice and Request for Comment does not indicate a position that these areas should be excluded from the larger participant rule.

## **I. Covered Markets**

In the Notice and Request for Comment, the CFPB poses the question of which consumer financial product or service markets should be included in the initial rule on larger participants. Based on our research and analysis of the markets for small dollar loans and checking accounts, as well as our review of prepaid products as substitutes for these products, we urge the CFPB to articulate broad supervision authority over consumer credit and stored value transactions. To elucidate this authority, the CFPB should broadly define the covered markets and then specifically name any exceptions. By generally covering all nondepository products that include credit and all nondepository savings or stored value mechanisms, the larger participant rule will allow the supervisory authority of the CFPB to follow a product and type of activity wherever it may lead. The rule should provide the CFPB with uniform examination capacity—one reaching across product type, marketing channel, and underlying state license or corporate structure—to cover larger participants in nearly all consumer lending and stored value product areas.

*A. The CFPB should supervise all credit and stored value products, regardless of structure, label, or form.*

To gather information enabling well-tailored and responsive rulemaking, the CFPB must be able to supervise consumer financial products regardless of how any specific product is defined.

While the Dodd-Frank Act gives the CFPB authority over payday loan markets, the larger participant rule should provide examination authority over any part of the small dollar loan market, even if it falls outside of an eventual payday loan rule. Experiences in jurisdictions using narrower product definitions illustrate the need for comprehensive market coverage. In these jurisdictions, only certain products must comply with usury rate caps or structural requirements. Here, financial services providers innovate to offer product types that fall just outside the border of regulation; therefore, the CFPB must be able to supervise beyond the scope of its rulemaking activity as well.

For example, following the expiration of legislation authorizing payday loans in Arizona, many payday lenders reopened under the state's Motor Vehicle Time Sales Disclosure Act to provide small dollar loans secured by first or second liens on a motor vehicle.<sup>2</sup> Similarly, after the Talent-Nelson Amendment and subsequent regulations imposed a 36 percent APR cap on closed-end small-dollar loans of up to 91 days to military personnel, payday lenders began offering 92-day loans or defining their payday loans as open-end credit.<sup>3</sup> If the CFPB had issued regulations that limited the payday lending market in each of these circumstances and did not have coverage of the auto title or 92-day cash advance markets under the larger participant rule, it would be unable to continue supervising the resulting small dollar loan market.

In addition to covering mortgage products, education loans, and payday loans, the CFPB has asked for comment on what other products should be immediately included in its nondepository supervision program. The larger participant rule should provide examination authority over all prepaid products.

A checking account is the most common financial product and prepaid cards are becoming a more frequent checking account alternative.<sup>4</sup> The Federal Reserve's data show that in 2009 over \$140 billion in transactions were made using prepaid products.<sup>5</sup> Research by MasterCard predicts that the total market for network-branded prepaid cards will be \$385 billion in 2015.<sup>6</sup> Among underbanked users of prepaid cards, 49 percent use the cards for day-to-day purchases and 20 percent use them to withdraw cash.<sup>7</sup> These are the two core functions of a debit card and such research demonstrates that prepaid cards are commonly used as checking account alternatives.

While federal bank regulators have historically had ample authority to regulate checking accounts, currently, many aspects of the prepaid industry are unsupervised and state laws are inconsistent.<sup>8</sup> In addition, federal protections for prepaid cards lag behind protections for checking accounts.<sup>9</sup> Unbanked consumers who use prepaid cards should be afforded the same protection as those with traditional transaction accounts. Thus, prepaid cards and other alternatives to checking accounts should be supervised by the CFPB in its initial rulemaking.

In the request for comment, prepaid cards are defined to include "general purpose reloadable open-loop payment cards, non-reloadable open loop payment cards, closed-loop gift or store cards, electronic benefits transfer cards and payroll cards." Even if all of these products were included, the rule would not be broad enough to protect consumers. Limiting the market to prepaid "cards" ignores the known emerging market of mobile accounts and disregards the possibility of further innovation.<sup>10</sup> Therefore, the market the CFPB includes in its initial larger participant rule should be all products outside of the traditional banking industry used for storing value or performing transactions.

The types of market changes delineated above have the potential to create significant consequences for people and their communities, and may frustrate the intent of state and federal regulators to control short-term, small dollar lending and prepaid products. Accordingly, it will be necessary to ensure that the CFPB has the authority and flexibility to supervise beyond the scope of its rulemaking in order to keep pace with innovations in the market.

*B. The CFPB should supervise providers in all types of marketing channels.*

To supervise the consumer credit and stored value markets effectively, the CFPB must be able to supervise financial services providers regardless of the type of marketing channel utilized and must be able to do so in a uniform manner.

The importance of being able to cover providers equally is made evident by the rise of online small dollar lending. At the state level, consumer loans obtained in-person at a storefront are not always subject to the same regulations as consumer loans obtained online. In Ohio, a borrower may obtain a 14-day cash advance loan at a storefront for up to \$1,000 at 311 percent APR; the same borrower may obtain a 14-day cash advance loan for up to \$1,500 at 676 percent APR if that loan is taken out online.<sup>11</sup>

Further, merchants who market and sell prepaid products—like card issuers—have significant control over disclosures and are responsible for complying with federal laws.<sup>12</sup> Therefore, CFPB supervisory authority should cover the marketing mechanism for these products as well as the card issuers.

By defining markets for consumer financial services to encompass all marketing channels, the CFPB may exercise the same supervisory authority in online, in-store, and emerging markets equally and therefore be equipped with the information and insight necessary to help ensure consistency and consumer confidence in all corners of the industry.

*C. The CFPB should supervise providers regardless of underlying state license or corporate structure.*

To prevent gaps in regulation on the basis of nominal differences between financial services providers, CFPB supervisory authority should cover all providers regardless of how any particular corporation is licensed or structured.

State laws for small dollar loan products provide a patchwork of regulation. In some instances, these regulations offer disparate treatment of very similar products issued by lenders registered under different state laws and leave some entities in the lending process unsupervised.

Ohio, for example, sought to end predatory payday lending in the state by enacting a maximum 28 percent APR on payday loans. However, the legislation covered only licensed payday lenders. Following enactment of the legislation, payday lenders in the state continued doing business providing cash advance loans by registering under alternative state licenses, including one authorizing a “credit service organization.” Small dollar loans remain legally available in the state at rates mirroring the cost of payday loans prior to the rate cap.<sup>13</sup> Cash advance companies have followed similar strategies to escape regulatory oversight in other states, such as Texas.<sup>14</sup>

The issue of corporate structure is also important for stored value products. Issuers and merchants of prepaid products must have the same scrutiny as depository institutions to ensure compliance with applicable laws. For example, Comdata is one of the largest issuers of prepaid cards, but because it is not a bank, it is not currently supervised for compliance with federal banking laws.<sup>15</sup>

The CFPB should avoid such gaps in supervision and articulate examination authority covering all lenders regardless of how they may be registered at the state level. Similarly, a nondepository issuer of a stored value card should be subject to the same degree of scrutiny as a federally-insured depository institution issuer of a stored value card. Additionally, the CFPB should account for all participants in the lending process, including both service providers and intermediaries in the scope of examination. All entities that participate in the provision of credit should be on a level playing field.

The larger participant rule enables the CFPB to supervise consumer markets by requiring reporting from market participants. A broadly drafted rule that captures all nondepository credit and nondepository

stored value products will enable the CFPB to gather the data necessary to promote effective and responsive rulemaking and enforcement actions under federal consumer finance laws.

## **II. Determining Larger Participants**

In addition to establishing the scope of its supervisory authority, the CFPB must determine which covered persons within the consumer financial products and services industry may be examined as a larger participant. Here, understanding of market nuances is essential. We urge the CFPB to delineate criteria for determining who is a larger market participant that reflect the distinctions between the particular markets in which covered persons operate. Such definitions will allow the CFPB to address diffusion and overlap between market sectors, to respond to innovative products and practices, and to discourage superficial data manipulation by participants to avoid regulation. The CFPB should have examination authority over the entirety of consumer lending markets and consider individual market participants within the particular space they occupy. Based on our analysis of small dollar loans markets, we recommend four specific distinctions the CFPB should consider in determining whether a particular participant is a larger participant in its market, and we also encourage the CFPB to explore additional procedures.

First, the CFPB should consider participants within the specific market for the particular product or service type offered. While the examination authority of the CFPB should broadly cover all consumer loans, the markets for each type of loan product must be considered independently. A one-month, single-payment loan is functionally different from a six-month installment loan. Loans that do not require any form of security are functionally different from loans requiring security. Similarly, different forms of security—whether an auto title or a cash deposit—define unique product categories in the marketplace. Defining larger participants within the scope of narrowly-drawn markets reflecting particular product types will allow the CFPB to supervise the market for innovative credit products even if the lenders dominant in the innovative activity do not meet larger participant thresholds in more traditional lending markets. By establishing its right to supervise early adopters of new product types, the CFPB will avoid hindering market innovation while ensuring consistency in supervision and promoting consumer confidence among all parts of the industry.

Second, the CFPB should consider market participants within their particular marketing channels. This marketing channel criterion permits the CFPB to distinguish between lenders who market their products online from those who market their products through a physical storefront. Under this definition, lenders that provide consumer loans online but do not have a storefront presence in a particular geographic area may still be larger participants in that market for online loans.

Third, the CFPB should account for types of service provider and companies that fulfill different roles in the lending process. To determine the size of various actors in the consumer lending markets, the CFPB should create distinct evaluations for financiers, service providers, and intermediaries. This criterion would treat lead generators that collect consumer information and sell it to lenders as distinct from the loan originators. Thus, while all participants in the lending chain should be covered—from lead generators to loan servicers—the size of each should be measured within the market for the particular role it plays.

Fourth, the CFPB should consider as larger participants all covered persons operating in legally ambiguous circumstances, such as interstate lending. For example, a lender in State A that markets and

issues high-cost small dollar loans to residents of State B where high-cost lending is not permitted would be a de facto larger participant in the market covering State B residents. Regardless of their size in the state of origin, financial services providers that reach across state lines or pursue alternative marketing channels to access borrowers outside of the provider's home state create unique circumstances that must be subject to CFPB supervision.

### III. Registration of Covered Persons

The CFPB should require registration of all covered persons. In the past, organizations like The Pew Charitable Trusts have been able to conduct research on financial products that have a major impact on the everyday lives of consumers.<sup>16</sup> We have been able to effectively collect data on credit cards and checking accounts through publicly available channels.<sup>17</sup> Unfortunately, many other consumer financial products and services do not allow for such research because the businesses are not nearly as open about their products. Under the Dodd-Frank Act, the CFPB may require registration of covered persons that provide financial products.<sup>18</sup> This authority should be used to ensure compliance with the law and to provide data that allow the CFPB and other organizations to effectively study financial markets.

This registration process can be a boon for consumer finance research if it is publicly accessible. At the same time, registration does not need to be a burden on businesses. The CFPB can limit what information must be provided to lessen any burden on covered persons.<sup>19</sup> In addition, registration should not be a matter of endorsement or providing a "seal of approval" from the CFPB and any use of registration as a marketing tool should be strictly forbidden. The registration process should be used only for the purposes of keeping track of covered persons and allowing organizations inside and outside of government access to vital data that will likely further important research. Registration will allow for better research and monitoring of markets to determine what levels of supervision are necessary.

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We thank the CFPB for this opportunity to comment on the proposed larger participant rule and look forward to continuing to work with you as the rule is developed and implemented. As always, we are available to discuss these comments or any other aspect of our work at any time.

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<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 12 U.S.C. § 5481(6) (a "covered person" means "(a) any person that engages in offering or providing a consumer financial product or service; and (b) any affiliate of a person described in subparagraph (a) if such affiliate acts as a service provider to such person."). *Id.* at § 5514(a).

<sup>2</sup> Arizona law permits auto title loans, "secondary motor vehicle finance transactions" under state law, at a monthly finance rate of 17 percent per month, Ariz. Rev. Stat. §44-291. *See*, for exploration of auto title lending in Arizona, Jean Ann Fox, "Driven into Debt: CFA Car Title Loan Store and Online Survey," Consumer Federation of America (November 2005), available at [http://www.consumerfed.org/pdfs/Car\\_Title\\_Loan\\_Report\\_111705.pdf](http://www.consumerfed.org/pdfs/Car_Title_Loan_Report_111705.pdf). Accounts of auto title lenders in the state are available through online searches for auto title loans in Arizona and news reports, including, for example, KNXV-TV, "In Arizona, Title Loan Fast Money Can Mean Very High Interest Rates," ABC15.com (July 21, 2011) available at [http://www.abc15.com/dpp/news/local\\_news/investigations/in-arizona.-fast-money-can-mean-very-high-interest-rates](http://www.abc15.com/dpp/news/local_news/investigations/in-arizona.-fast-money-can-mean-very-high-interest-rates).

<sup>3</sup> The Talent-Nelson Amendment to the John Warner Defense Authorization Act of 2007 limits permissible APR and requires extended payment periods on loans to members of the armed forces. 10 U.S.C. § 987; 32 C.F.R. § 232.3. *See*, for example, on innovation following implementation of the Talent-Nelson Amendment, *see*, *Comments of Center for Responsible Lending, Consumer Federation of America, Customers Union of U.S., Inc., National Association of Consumer Advocates, and National Consumer Law Center on Request for Comments 72 Federal Register 73336-7* (December 27, 2007) DOD-2006-OS-0216 (February 25, 2008), available at [http://www.responsiblelending.org/payday-lending/policy-legislation/congress/MIL\\_DOD\\_08\\_MLA\\_CommentsFinal-2\\_23.pdf](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/MIL_DOD_08_MLA_CommentsFinal-2_23.pdf); United States Department of Defense, "Report on

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Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents” (July 22, 2008), available at <http://www.dccuc.org/PDF%20Files/Senate%20Report%20Final.pdf>.

<sup>4</sup> Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore, “Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances,” Federal Reserve Board - Division of Research and Statistics (February 2009), available at <http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf>.

<sup>5</sup> 76 Fed. Reg. 43394, 43395.

<sup>6</sup> Philip Keitel, “Federal Regulation of the Prepaid Industry: Costs, Benefits, and Changing Industry Dynamics,” Federal Reserve Bank of Philadelphia (April 8-9, 2010), available at <http://www.philadelphiafed.org/payment-cards-center/events/conferences/2011/C2011-Federal-Regulation-of-Prepaid-Card-Industry.pdf> (MasterCard’s prediction includes the U.S. and Canada).

<sup>7</sup> Synergistics Research Corp., “Competing for Underbanked Relationships” (March, 2011) (Synergistics reported that the sample size of underbanked users of prepaid cards was 73 individuals out of a total of 236 underbanked individuals. Underbanked consumers were defined as those “having a checking or savings account, but no other depository, savings, or investment services.”).

<sup>8</sup> E.g., Phillip W. Bohl, Kathryn J. Bergstrom, and Kevin J. Moran, “Prepaid Cards and State Unclaimed Property Law,” 27 Franchise L.J. 23 (Summer 2007), available at <http://www.gpmlaw.com/uploadedFiles/Resources/Publications/Bohl-Bergstrom-Moran-Franchise-Law-Journal-Summer-2007.pdf>; Craig J. Knobbe, Nathan J. Cook, and Lynne M. Hanson, “The New Federal Gift Card Regulations,” 30 Franchise L.J. 181 (Winter 2011), available at [http://www.ballardspahr.com/alertspublications/articles/~-/media/Files/Articles/2011-03-16\\_New\\_Federal\\_Gift\\_Card\\_Regulations.ashx](http://www.ballardspahr.com/alertspublications/articles/~-/media/Files/Articles/2011-03-16_New_Federal_Gift_Card_Regulations.ashx).

<sup>9</sup> Regulation E, 12 C.F.R. § 205. See also, Gail Hillebrand, “Before the Grand Rethinking: Five Things to do Today with Payments Law and Ten Principles to Guide New Payment Products and New Payments Law,” 83 Chi.-Kent L. Rev. 769 (2008).

<sup>10</sup> E.g., Forbes.com, “Visa Inks Pair Of Deals With Eye On Mobile” (June 2011), available at

<http://www.forbes.com/2011/06/09/visa-announces-two-deals-aimed-at-mobile-transactions-marketnewsvideo.html>.

<sup>11</sup> E.g., see, Check ‘n Go “Ohio Cash Advance Rates and Terms,” available at <http://www.checkngo.com/resources/state-center/oh.rates>.

<sup>12</sup> 12 C.F.R. § 205.20.

<sup>13</sup> Ohio Rev. Code Ann. 13 § 1321.40; David Rothstein, “New Law, Same Old Loans: Payday Lenders Sidestep Ohio Law,” Policy Matters Ohio, (September 2009), available at

[http://www.cohhio.org/pdf/Fact%20Sheets%20and%20Reports/NewLawSameOldLoans2009\\_1.pdf](http://www.cohhio.org/pdf/Fact%20Sheets%20and%20Reports/NewLawSameOldLoans2009_1.pdf). Examples of in-store loans available in Ohio include a \$200, 14-day cash advance loan from Advance America for 353 percent APR and a \$200, 14-day cash advance loan from Check ‘n Go for 350 percent APR. Online cash advance loans marketed by both companies and available to Ohio have rates exceeding 676 percent. See, Advance America, “Fees and Terms for Loans in Ohio,” available at <http://www.advanceamerica.net/apply-for-a-loan/fees/OH> and Check ‘n Go, “Ohio Cash Advance Rates and Terms,” available at <http://www.checkngo.com/resources/state-center/oh.rates>.

<sup>14</sup> Tex. Fin. Code Ann. § 393.201.

<sup>15</sup> The Nilson Report, Issue 975, p. 9 (July 2011); Comdata, “Who we are,” Comdata.com, available at

[http://www.comdata.com/comdata/about\\_us\\_who\\_we\\_are.jsp](http://www.comdata.com/comdata/about_us_who_we_are.jsp).

<sup>16</sup> Pew Health Group, “Two Steps Forward: After the Credit CARD Act, Credit Cards are Safer and More Transparent — But Challenges Remain” (July 2010), available at

[http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit\\_Cards/PEW-](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit_Cards/PEW-CreditCard%20FINAL.PDF?n=1231)

[CreditCard%20FINAL.PDF?n=1231](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit_Cards/PEW-CreditCard%20FINAL.PDF?n=1231); Pew Health Group, “Hidden Risks: The Case for Safe and Transparent Checking Accounts” (April 2011), available at

[http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe\\_Banking\\_Opportunities\\_Project/Pew\\_Report\\_HiddenRisks.pdf](http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Banking_Opportunities_Project/Pew_Report_HiddenRisks.pdf).

<sup>17</sup> *Id.*

<sup>18</sup> 12 U.S.C. § 5514(b)(7).

<sup>19</sup> *Id.*