# Academic Research Council Meeting

April 8, 2022

Consumer Financial
Protection Bureau

# Meeting of the CFPB Advisory Committees

The Consumer Financial Protection Bureau's (CFPB) Academic Research Council (ARC) met via WebEx at 1 p.m. EST on April 8, 2022.

| ARC members present | CFPB staff present |
| --- | --- |
| Chair Vicki Bogan | Deputy Director Zixta Martinez |
| Mathieu Despard | Jason Brown |
| Eric Johnson | Thomas Conkling |
| Michael Staten | Kristen Evans |
| Anthony Yeazer | Christa Gibbs |
| | Robert Ha |
| | David Low |
| | Lewis Kirvan |
| | Manny Mañón |

## April 8, 2022

### Welcome

**Deputy Director, Zixta Martinez**

**Manny Mañón, Staff Director, Section for Advisory Board and Councils, Office of Stakeholder Management**

**Vicki Bogan, Chair, Academic Research Council**

The Consumer Financial Protection Bureau (CFPB) Section for Advisory Board and Councils Staff Director, Manny Mañón, convened the Academic Research Council (ARC) meeting and welcomed committee members and members of the listening public. He provided a brief overview of the meeting's agenda and introduced Deputy Director Zixta Martinez. Deputy Director Martinez provided remarks on the CFPB's priorities related to Student Lending, Consumer Complaints, and Auto Lending. ARC Chair Vicki Bogan welcomed attendees and explained the advisory committee's mission and expressed her appreciation for being able to serve as Chair of the ARC.

### Student Lending: Student Loan Repayment Suspension Ends Report

**Christa Gibbs, Economist, Office of Research**

**Thomas Conkling, Economist, Office of Research**

**Kristen Evans, Section Chief, Students and Young Consumers, Office of Consumer Education**

During this first session, the Office of Research facilitated a conversation on its research work and findings regarding student lending, specifically concentrating on the CFPB's Student Loan Repayment Suspension Ends Report. Following the presentation, feedback from a research perspective was requested of the Council members.

Multiple members found this report very interesting and thanked the CFPB staff for the presentation. The discussion started around student debt and default. A member said that there was a lot of research done following the last financial crisis looking at student loan default. The member shared that there was an interesting paper in The Journal of Financial Economics that identified that certain types of borrowers that are more likely to default from for-profit institutions and community colleges. The member asked if the CFPB has those types of data, and if so, where one could look at those types of borrowers, indicating that there may be some correlation between some of the risk factors i.e., low income and race. The member further inquired if it would be possible to segment by type of institution that was attended and added that this seems to be present in previous research and identified as those that are at a higher risk. A member said that the unpaid balance or the fraction of the balance that has been paid could be consequential for individuals and that the increase in consumer credit distress is concerning. The member said that it would be interesting to see if the default models work when the pandemic recedes and that maybe a lot of people that have student debt think that it will be cancelled and have the thought of "If you do that, then why should you repay," pointing out this moral hazard. The member said that using a traditional model could in fact document if they got a degree, i.e., pre-pandemic.

Several members highlighted various areas of stress levels. A member inquired as to how some of these signs of increase in stress manifest for non-student borrowers. The member asked about other kinds of borrowers and wondered if they are experiencing the same thing and inquired what there is for a comparison. The member agreed with the prior comments on the Non-Degree Debt (NDD) population, that there is no return on investment as opposed to those who graduated and are out in the work force, getting paychecks and buying consumer goods. The member asked how this group over the past two years compares with this student loan group. Another member said that if the CFPB were to invest in formulating a multi-dimensional index of consumer credit distress, then every time the agency produced a report on a subgroup of all consumers/borrowers, readers could relate the level of their distress in their particular subgroup to the average level of distress of everybody in the economy. The member said that this would be very informative for people.

A member made a comment regarding the NDD population and stated that they have a paper from a colleague Jason Jabbari that can be shared with the CFPB if there is interest. The member said that the paper compares a range of financial difficulties among that population relative to those with some college in debt, those with a college degree in debt, those with college degrees and no debt, and high school students with no debt. The member said that the NDD population comes out worst among those groups. The member added that for future research, researchers should think of the real possibility of those that are at a greater risk in delinquency and default coming out of the deferment period. The member added that it is interesting that during this period we have seen dramatic growth in marketplace lending and that there are big players that offer consolidation and refinance products. The member said that with a federal loan a borrower is waiving certain protections and we need to make sure that the borrowers understand this. The member said that looking ahead, with the Income-Driven Repayment (IDR) process itself, maybe conduct research with the servicers and review how they are prepared with proactive strategies to reach out to borrowers who are in delinquency before they hit default to increase awareness of IDR. The member said that one of the continued struggles is that once you hit default, you have to go through loan rehabilitation which then creates friction.

Regarding the Consumer Credit Panel (CCP), a member asked whether you could find out servicer identity. The member said that it would be interesting to see if there are differences across that and if things change over time. The member stated that there is a lot of student refinancing going on with private companies, they are not dealing with those at risk, but with professional school students with big balances. The member said that taking very low risk but high debt out of the market, i.e., doctors and lawyers, and urged researchers to consider how this could distort the pool.

A member provided feedback regarding outstanding loans and statistics. The member said that where you have a cohort of loans taken out in a given period of time and then many successfully pre-pay, and probably the small ones are dealt with faster than larger ones. The member said that when you take a cross section of loans outstanding you aren't representing the original loan that was indicated and the public doesn't necessarily understand that. The members suggested that trying to communicate that the average stock is not representative of the average loan that was originally endorsed may clear up the public's confusion with the statistics.

## Consumer Complaints throughout the Credit Life Cycle by Demographic Characteristics

**Lewis Kirvan, Consumer Insights Program Manager, Office of Consumer Response**
**Robbie Ha, Director's Financial Analyst, Office of Consumer Response**

During this session, the Office of Consumer Response facilitated a conversation on its work and findings around consumer complaints throughout the credit life cycle by demographic characteristics. This was presented in four demographic characteristic groups (1) Loan Origination (2) Performing Servicing (3) Delinquent Servicing, and (4) Credit Reporting.

Following the presentation, feedback from a research perspective was requested of the Council members.

A member inquired about payday loans and if it was excluded from the research. The member went on to ask multiple questions, including (1) If there is a type of complaint that would be more prominent, such as delinquent servicing from payday loans, and (2) Whether there is a sense of selection bias regarding complaints. The member said that for mortgage related issues, higher income borrowers and certain demographics are more likely to complain. The member said that disempowered communities may feel less able to complain about poor service. The member concluded with a third question: does the CFPB know who is likely to complain more on which type of issue? The member said that researchers need to think about weights and generalizing the findings of the broader population.

A member asked the CFPB staff about a typical loan origination complaint and how it looks. The member went on to talk about the CFPB's comment about giving companies a chance to respond to complaints. The member asked two questions (1) Are companies responding to them directly, and (2) Did they see the response, or are they responding to the consumer? The member said that the most obvious would be to see if the complaint mechanism itself and the fact that companies must respond to it will bring about a significant change in the marketplace over time. The member said that this could potentially signal misunderstanding on the part of consumers, poor service quality, or other issues. The member said that this does sound like a very effective regulatory tool.

A member said that the documentation verification on people with higher incomes can be much larger and much more annoying than people who simply turn in a W-2. The member said that part of this is simply a function of the fact that the nature of your interaction depends upon your financial status. The member added that if we look at the differences between application, credit scoring, and servicing, there are graduate students who might want to have access to the CFPB's data, and this could potentially advance the CFPB's mission. The member suggested the CFPB (1) figure out how to deal with the fact that higher education people and higher income people are more likely to complain, which would show that complaints are not necessarily representative; and (2) that the CFPB conduct a language analysis to measure the rise and fall of complaints against a well-managed company.

A member asked if there is (1) any way to use the complaint data through machine learning that does content analysis to identify patterns for categories of products, and (2) if there are companies that may be manipulating consumer behavioral biases. The member stated that where there is poor product design there are consumers who feel misled and misunderstand product terms and conditions, particularly in the digital space where the average consumer doesn't carefully read the terms and conditions.

A member stated that the scale of what the CFPB is doing is amazing and that some people have been digging deeper into these kinds of models. The member went on to say that the challenge is getting outcome variables and some of these are terribly unstructured and that the easiest thing for the CFPB to do is to think about the outcomes. The member suggested that getting data reliance and clearing up misapprehension using natural language processing would be a great tool moving forward and that it would provide a bunch of variables resulting from the language that was used, demographics, etc. The member said that we need to be thinking about the complaint process itself and get something outside of the database by merging it. The member asked if the CFPB had thought about using multilevel post stratification on this data to address sampling and sentiment analysis.

## Subprime Auto Loan Report

**David Low, Economist, Office of Research**

Throughout this last session of the day, CFPB staff from the Office of Research presented on the CFPB's recent Subprime Auto Loan Report. During the presentation, staff shared findings from the report. Following the presentation, feedback from a research perspective was requested of the Council members.

A member stated that this is a big market which touches millions of consumers a year (for instance there 15 million car sales in the US in 2021, 80% of which are financed). The member said that these are large-scale transactions. The member said that the majority of these car sales entail financial decisions that get wrapped into complicated transactions, so financing and purchase are wrapped in the deal. The member said that the CFPB paper studies differences in interest rates for subprime auto loans by lender types. The member added that the paper provides potential reasons for these differences and future research questions that get at consumer protection implications.

Several members discussed risk-based pricing. A member said that it boils down to understanding the degree of lender aggressiveness and the use of risk-based pricing. The member asked if there are reasons that some lenders choose not to employ risk-based pricing and noted that there is clear market segmentation. The member said that small financiers, such as buy here, pay here lenders have portfolios with borrowers with lower credit scores compared to banks and credit unions. The member added that there is a narrower spread between the interest rates that are charged to delinquent borrowers and rates charged to nondelinquent borrowers. The member said that it suggests there is either less underwriting upfront or less use of risk-based pricing, or both. The member said that lower risk borrowers at those lenders are paying higher rates and are subsidizing higher risk borrowers. The member said that the same effect is apparent if you compare banks and credit unions. The member said that borrowers at both of those types of institutions receive lower rates and are lower risk. The member said that the spread in the rates between delinquent and nondelinquent borrowers at banks is much larger than for credit unions (which have a similar risk pool) and this suggests that there is less application of risk-based pricing by credit unions. A member asked why is there unwillingness to incur the cost of investment in aggressive underwriting or risk-based pricing and said that borrowers are willing to pay a premium to be told yes by lenders and this is explained by consistent marketing from finance companies, particularly small dollar loan companies. The member said that this gets borrowers to reveal their willingness to pay for the "yes premium" as they self-select and that they may have an aversion to being told no. The member said it is about the "why" as to how these practices come about. A member raised the question of whether reducing the premium paid by lower risk borrowers raises the rates that lender have to charge higher risk borrowers or make other adjustment more necessary. The member said this causes higher risk borrowers to be told no or causes them to self-select out of the market because the terms are too onerous. The member asked if we would consider it a problem, if pushing lenders to differentiate their rates according to risks and removing those subsidies requires more of those borrowers to be told no. A member said that how lenders actually deal with high-risk borrowers on the front end is critical to understanding the implications of any fixes for the markets. The member said it is about understanding the market segmentation and what's behind the willingness to employ aggressive risk-based pricing.

A member provided feedback on whether or not the state allows for self-help repossession. The member said that the loss given default is a big deal in the auto lending market. The member said that if there is a relationship between the lender and auto dealer, then there is a price for the automobile, the down payment, the interest rate, and how many vehicles are on the dealer's lot. The member said that the credit market is confounded with other margins.

A member asked the CFPB staff about the CCP, specifically whether the CFPB can survey the CCP, and gather the data as part of other outreach for survey outreach to the CCP.

Multiple members discussed interest rates. A member said that today, the overarching concern is consumer protection. The member said that the paper highlights the mismatch between borrower interest rate and default risk so that some borrowers pay a higher rate than other borrowers who have the same credit/risk profile. A member said that the problem we're trying to address from a policy perspective is that some borrowers pay higher interest rates with some categories of lenders than they would if they went to a different type of lender. A member shared that The RAND Journal of Economics published a paper in 2013 that looked at the subprime auto lenders that got rid of adverse self-selection and had a profitable portfolio without having to change interest rates. A member said that regarding the smaller spread of delinquent and nondelinquent rates with small finance companies, the "yes premium" implies that consumers are paying for less friction in the buying process. A member said that a Pew study focused on the cost structure of payday lending, and it found that a lot of what gets priced into the interest rate are high operating costs. The member asked staff if there is anything in the data to control for or account for poor economies of scale among smaller lenders. A member said that recently in the auto loan market, they've seen an increase in terms i.e., 84-month auto loans. By the end of 2021, over 5% of the market were 84-month auto loans. The member added that there is a differentiation by price/interest rate and by total amount of interest that consumers pay. The member asked if the CFPB is looking at differentiation on this trend of 84-month auto loans by lender types. A member said that with banks and credit unions, the question is if this is a depositor and if dealing with a depositor you may treat them differently. The member stated that rather than a credit transaction, this is a combined transaction and that interest rates are one component of cost. The member said that the CFPB's empirical results are consistent with that—this isn't a credit market, it's a mixed market.

A member complimented the report and stated that one analogy to think about is mortgages and the underserved. Another member shared that Columbia University published a paper on mortgage refinancing and found that lack of trust led people to not take advantage of refinancing. The member said that given the technology for controlling risk, there is potentially less risk for lower credit scores.

A member noted that the emergence of subprime lending markets over the last 30 years has expended access to credit across income risk spectrums. The member said that this is a result of the development of sophisticated risk scoring technology, availability of increasingly accurate data (assembled due to the Fair Credit Reporting Act), which have made models more predictive. The member said that the regulatory freedom to adjust pricing according to risk allowed for this and for wider credit availability.

## Adjournment

Staff Director Manny Mañón adjourned the meeting of the CFPB Academic Research Council on April 8, 2022 at approximately 4:15 p.m. EST.

## Certification

I hereby certify that, to the best of my knowledge, the foregoing minutes are accurate and complete.

Manny Manon

Manny Mañón, Staff Director
Section for Advisory Board and Councils
Office of Stakeholder Management
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Jason Brown

Jason Brown, Assistant Director
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Vicki Bogan

Vicki Bogan, Chair
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