11 FEBRUARY 2019

Height Commentary

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Payday Lending

CFPB Payday Revision Positive For Lenders

THE TAKEAWAY

Enova International (ENVA), FirstCash, Inc. (FCFS), and auto title lenders will benefit from the Consumer Financial Protection Bureau's (CFPB) proposed payday lending rule revisions. The agency is proposing to rescind the ability-to-repay (ATR) requirement in its entirety, in line with our expectation. This includes debt-to-income (DTI) and residual income assessments, cooling-off periods, and caps on the number of rollovers. The payday lending rule would have reduced payday loans by an estimated 55-62%, payday industry revenues by 71-76%, and auto title industry revenues by 89-93%. The proposed revisions would prevent these projected declines in lending and associated revenues from occurring. The comment period is open for 90 days and will close in early May, and we expect the revisions to be finalized in late 4Q19 to early 1Q20. In addition, the CFPB proposed extending the August 19, 2019 compliance date to November 19, 2020.

Conclusion. The CFPB's proposal is positive for payday and auto title lenders. These businesses will remain largely intact once the rescission of the ATR requirement is finalized.

ATR eliminated entirely. The CFPB proposed rescinding five sections (Figure 1) of its final payday lending rule (sections 1041.4, 1041.5, 1041.6, 1041.10, and 1041.11) and modifying one other (1041.12).

Section 1041.5 covers the ATR requirement and the CFPB proposed rescinding the entire section. This would eliminate all payday, auto title, and short-term balloon loan underwriting requirements. Lenders would not have to verify income or major financial obligations, calculate DTI or residual income, estimate living expenses, get a credit report, make a reasonable determination of repayment, or ensure that borrowers could make all financial payments for 30-45 days following repayment of the loan. The 30-day cooling off period and limitations on rollovers are included in the section and would be rescinded under the proposal. Since the proposal eliminates the ATR requirement, there is no need for the alternative payday loan product (Section 1041.6) and this section

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would also be rescinded. The CFPB is also proposing to eliminate the credit reporting requirements, registered information systems, and certain compliance and record retention requirements.

Figure 1. Payday Lending Sections Subject to Proposed Revision

Section 1041.4 Identification of unfair and abusive practice.

Section 1041.5 Ability-to-repay determination required.

Section 1041.6 Conditional exemption for certain covered short-term loans.

Section 1041.10 Information furnishing requirements.

Section 1041.11 Registered information systems.

Section 1041.12 Compliance program and record retention.

Source: CFPB.

Rationale for proposed revisions. The CFPB determined that the impact of the rule should not just withstand judicial review under the Administrative Procedures Act, but also should be based on robust and reliable analytics given that the rule as finalized would restrict access to credit for consumers and have a devastating effect on the payday and auto title lending industries. This would include causing 2,400 payday lenders and 800 auto title lenders defined as small business potentially going out of business.

The proposal states that under the Dodd-Frank Act, the CFPB “shall have no authority . . . to declare an act or practice abusive in connection with the provision of a consumer financial product or service” unless the act or practice takes unreasonable advantage of (1) a consumer’s lack of understanding of the material risks, costs, or conditions of the product or service; or (2) a consumer’s inability to protect the interests of the consumer in selecting or using a consumer financial product or service. The proposal addresses the shortcomings in the analysis used in the final rule to determine that extending a short-term loan was an unfair and abusive practice if the lender did not reasonably determine a consumer's ATR.

To support the revisions, the proposal addresses the use of Professor Ronald Mann's study titled *Assessing the Optimism of Payday Loan Borrowers*. The study concluded that "most borrowers expected that they would continue borrowing for some time after the initial loan" and "the borrower’s predictions about their future repayment behavior, although imperfect, are surprisingly accurate." The CFPB determined that for borrowers whose loan became extended for long periods of time, their inability to accurately determine when they would be able to repay the loan is what caused them financial harm. The proposal stated Professor Mann observed that the Bureau had made “substantial use” of his study but described the Bureau’s use of the work as “inaccurate and misleading,” and deemed the Bureau’s summary of his work “unrecognizable.”

In addition, the study only included one lender that operated in five states. The limited study did not account for how other lenders operated or the repayment expectations of other consumers. The CFPB highlighted "there are clear limitations to the Mann Study which the Bureau now believes undermine the reliability and probative value of the Bureau’s interpretation of the limited data it received from Professor Mann as the main basis for the Bureau to make findings concerning consumer awareness of potential outcomes from taking out payday loans from payday lenders throughout the United States."

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The final rule also incorporated the results of a Pew Charitable Trusts study titled *Payday Lending in America: How Borrowers Choose and Repay Payday Loans*. This study found that 37% of borrowers have felt that faced with a difficult financial situation that they would take a payday loan on pretty much any terms offered. This result was used to support the CFPB's determination that many payday and auto title borrowers were not aware of other potential options and would take out a short-term loan regardless of the terms. The proposal noted that this finding ignored the consumers and their options in the 17 states and the District of Columbia where payday lending is prohibited. The proposal also includes data from another Pew Charitable Trusts report titled *Payday Lending in America: Who Borrows, Where They Borrow, and Why*. This study "found that if payday loans were not available, borrowers would cut back on expenses (81 percent), delay paying some bills (62 percent), borrow from friends or family (57 percent), or pawn personal property (57 percent)." This data was supported by a Federal Reserve study titled *Report on the Economic Well-Being of U.S. Households in 2017* that found consumers facing an emergency expense of $400 would borrow from friends or family (26%) or sell something (19%). Only 5% stated that would use a payday loan to cover the expense.

Based on the limitations of the data used to support the final rule's determination of an unfair and abusive act as well as the additional studies on consumer's knowledge of alternatives to payday lending, the CFPB is proposing to rescind Section 1041.4, which is the primary component used to support the need for the ATR requirement.

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COMPANIES MENTIONED IN THIS REPORT

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