Written Statement for the Record

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Committee on Financial Services

Rent-a-Bank Schemes and New Debt Traps:

Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps.

February 5, 2020

Chairwoman Waters, thank you for holding this hearing and inviting me to testify on how rent-a-bank schemes undermine the roles of states in protecting consumers.

My name is Monique Limón. I serve in the California State Legislature as an Assembly Member and Chair of the Committee on Banking and Finance. During my time as Chair, I have prioritized the issue of small-dollar consumer lending and have introduced bills dealing with short-term payday loans, consumer installment loans, auto title loans, and loan brokers. My primary focus as Chair has been to learn about these markets by evaluating data from our state regulator and meeting regularly with lenders, consumers, and consumer law experts. My goal in this work has been to identify areas where consumer outcomes can be improved and work to advance legislation to strengthen consumer protections.

Overview of High-Cost Consumer Lending in California

Since the mid-1990s, California has taken a permissive stance on lending products marketed to nonprime consumers. Despite a longstanding state law that caps interest rates on loans smaller than $2,500 at about 30%, the Legislature enacted a law in 1996 that permits payday lenders to charge around 400% for short-term loans of $300.[1] Although the payday loan industry markets its product as a solution to emergencies or one-time cash shortfalls, it is clear that the industry relies on heavy repeat borrowing to generate profits. According to data provided by payday lenders in California, 70% of industry revenue, or nearly $300 million annually, is generated from borrowers who take out seven or more payday loans each year.[2] With such high rates of repeat borrowing of high-cost loans, it is not surprising that academics have found that access to payday loans causes an increase in personal bankruptcy filings.[3]

Over the last decade, many payday lenders began to market larger and longer-term installment loans to California consumers. Because of the state's interest rate ceiling of about 30% for loans smaller than $2,500, lenders pushed borrowers to loans of $2,500 or more, where interest rates were not regulated. CashCall, a high-cost lender, is credited with pioneering this approach.[4] CashCall experimented with various interest rates until it found a profitable breakeven at 135% in 2009. Triple-digit interest rates allowed CashCall to operate a profitable business model even though its model assumed a default rate of 35-40%.[5] As investors and competitors witnessed CashCall's profitability in spite of high default rates, copycat business models entered California.

Since CashCall showed that the model could be profitable, more than a dozen large lenders began to offer similar products in California. As more lenders entered the market, rather than

[1] http://www.leginfo.ca.gov/pub/95-96/bill/sen/sb_1951-2000/sb_1959_bill_960830_enrolled.html

[2] See page 25: https://dbo.ca.gov/wp-content/uploads/sites/296/2019/08/CA-Payday-Loans-Annual-Report-2018-FINAL-8-8-19.pdf

[3] Paige Marta Skiba & Jeremy Tobacman, 2019. "Do Payday Loans Cause Bankruptcy?," Journal of Law and Economics, University of Chicago Press, vol. 62(3), pages 485-519

[4] https://www.latimes.com/projects/la-fi-reddam-cashcall-loanme/

[5] The information about CashCall's business model was provided by CashCall Chief Financial Officer Delbert Meeks in a 2013 court filing as part of a class action lawsuit against the lender (Case No. C 08-03174 MEJ).

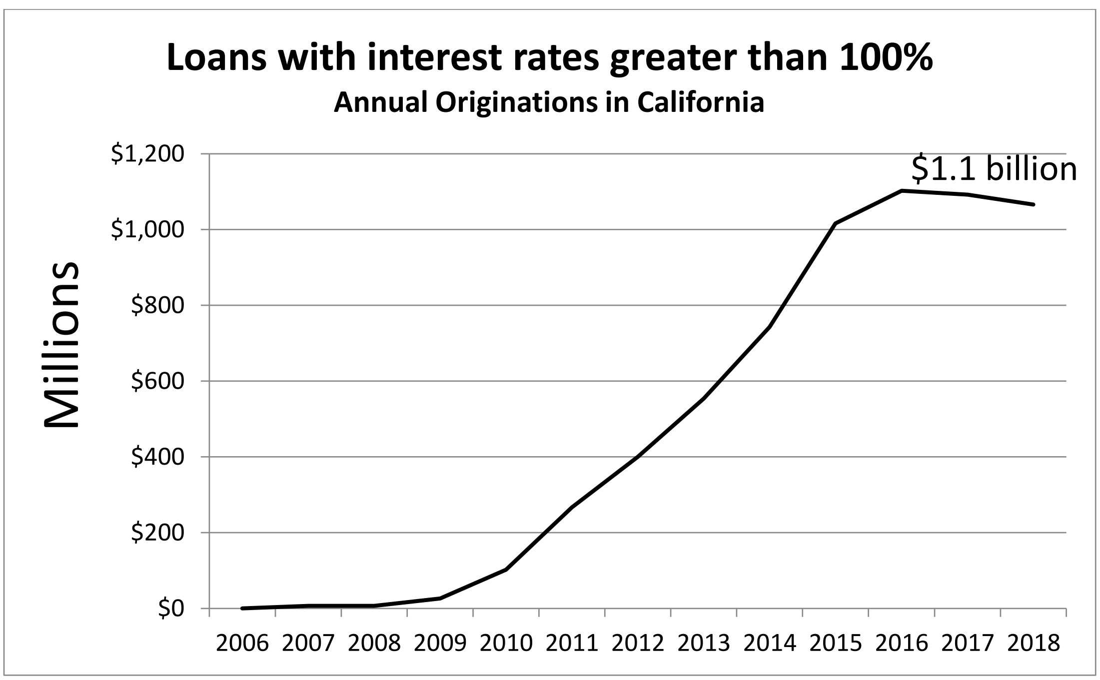
competition driving prices down, interest rates continued to climb, with rates higher than 200% becoming commonplace. Figure 1 below provides example loan terms that were posted on lenders' websites on 3/24/2019. The websites advertised the "quick," "easy" availability of these products.

Figure 1

Lender	Loan Amount	Loan Term (months)	Monthly Payment	Total Repayment	APR
Advance America	$2,550	24	$449	$10,782	206%
Check'n Go	$2,600	9	$612	$5,508	218%
Elevate	$2,600	16	$483	$7,726	224%
LoanMe	$2,600	47	$388	$18,255	184%
SpeedyCash (aka CURO)	$2,600	42	$281	$11,806	132%

By 2015, lenders were originating more than $1 billion of triple-digit interest rate loans in California each year.[6] For a product that was nearly nonexistent at the beginning of the Great Recession, the growth rate is stunning, as shown in Figure 2 below. In 2018, high-cost installment lenders generated more than $1 billion in interest and fee revenue from California borrowers, more than double the $400 million earned from short-term payday loans.

Figure 2



[6] https://calmatters.org/politics/2019/05/will-california-crack-down-predatory-lending-pink-slip-loans/

Triple-digit Interest Rates Push Consumers to Financial Ruin

Loans with triple-digit interest rates harm consumers for two primary reasons. First, high interest rates make a loan less affordable, often causing the borrower's monthly payment to be double or even triple the amount of a similarly structured loan with an interest rate of 36% or less.[7] High monthly payments substantially increase the probability that a borrower will fall behind on her loan, whether due to volatility in her income or due to an unexpected expense that depletes her monthly budget, and eventually default.

Second, high interest rates reduce the incentive for a lender to underwrite loans by reasonably evaluating a borrower's ability to repay. This system of misaligned incentives fosters an economically inefficient segment of the credit market, wherein a lender can remain consistently profitable despite a large portion of its customers defaulting on their debts.[8]

Data from California lenders show that high-cost loans fail borrowers at a very high rate. Four large high-cost lenders submitted their loan data to a third-party consulting firm that produced a report on borrower outcomes in California.[9] This report, which was funded by a high-cost lender, showed that 38% of high-cost loans went into collection status.[10] The report also found that 22% of the loans analyzed were refinanced. Assuming some portion of those refinanced loans were ultimately sent to collections, the actual default rate based on the individual borrowers is even higher than 38%.

Data provided by lenders to the state banking regulator support the conclusions of the report. Figure 3 displays a table of charge-off rates from several large lenders based on their lending activity in California in 2017 and 2018. While charge-off data is not perfectly comparable between lenders or over time, the data provide insight on the magnitude of the problem in California. Figure 4 displays a chart comparing how these default rates compare with other financial products. Note that the default rate on high-cost installment loans is nearly four times as large as the default rate for subprime auto loans in California over a similar period.[11]

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[7] A two-year, $2,600 loan with a 36% interest rate requires a monthly payment of $154. Table 1 cites monthly payments for a loan of the same size and term to be $449, or 2.9x the monthly payment of a 36% loan.

[8] This system of misaligned incentives is clearly explained and analyzed in a National Consumer Law Center report that can be accessed here: https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.

[9] The report's conclusions are summarized here: http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201920200AB539#

[10] In mandated lobbying disclosures, CURO reported paying over $50,000 to Ankura Consulting Group, who published the report. See page 5 here: http://cal-access.sos.ca.gov/PDFGen/pdfgen.prg?filingid=2418444&amendid=0

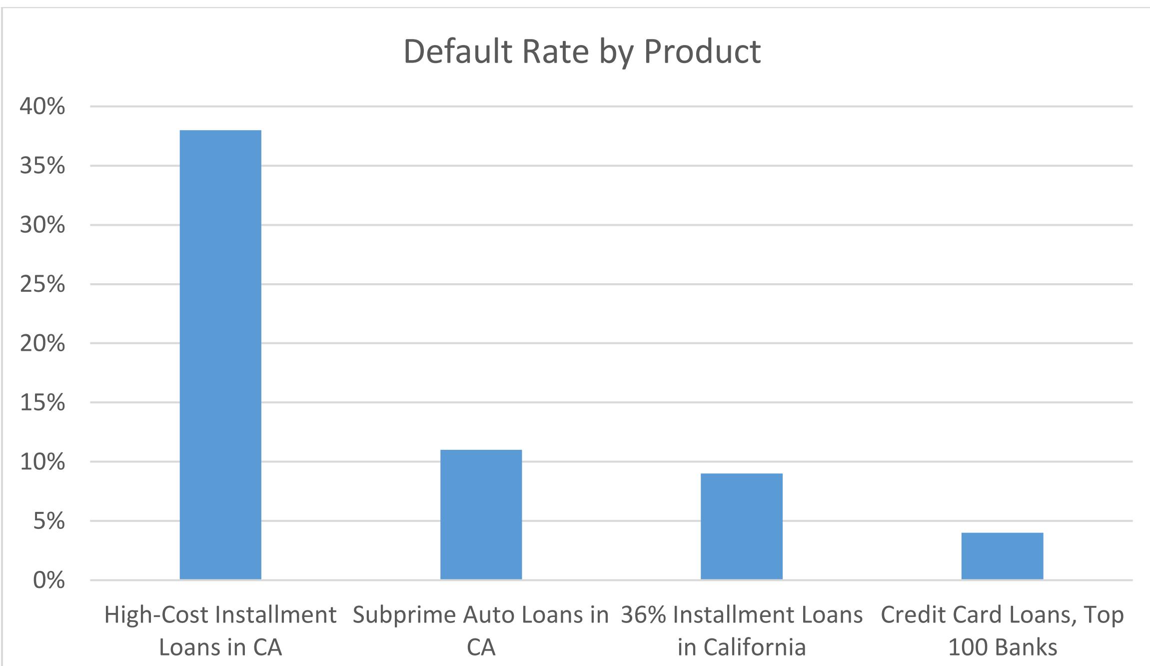
[11] Data for subprime auto loans were collected from credit bureaus by Urban Institute and published here: https://apps.urban.org/features/debt-interactive-map/?type=auto&variable=autoopen_pct&state=6

Figure 3

Lender	2017			2018		
	Active Loans 12/31/17	Charged-off Loans	Default Rate	Active Loans 12/31/18	Charged-off Loans	Default Rate
Elevate Credit	26,741	18,383	41%	21,109	16,542	44%
Enova	18,923	18,621	50%	22,567	22,948	50%
LoanMe	46,445	24,839	35%	46,445	24,839	35%
Title Max	10,092	3,707	27%	12,301	7,227	37%

* Default rate is number of charged-off loans divided by the sum of active loans and charged-off loans

Figure 4



Loan charge-offs represent a tax-deductible business expense for a lender, but signal an impending crisis for borrowers and their families. Lenders assign the amount owed to debt collectors or sell the loan off in the secondary market to a debt buyer. The consumer's credit score is negatively affected, and they are subject to aggressive collections practices, which can ultimately result in their car being repossessed, their paycheck garnished, their bank account closed, and even bankruptcy.

History of California Legislature's Attempts to Reform High-Cost Loan Markets

Efforts to curb high-cost lending in California accelerated in the state legislature over the past three years. Prior to 2017, bills that sought to limit fees, interest rates, or payday loan transactions failed to advance in the legislative process. By 2017, two important factors helped to motivate reform efforts.

First, Members of the Legislature became more aware of the growing number of Californians burdened by high-cost loans and defaults. Data provided by the state financial regulator allowed Members to quantify the problem. Stories of individual borrowers' struggles were documented in the media, and Members heard from constituents harmed by high-cost loans. Additionally, religious leaders, community activists, and consumer organizations amplified concerns to legislators across the state.

Another important factor that buoyed reform efforts was the growth of affordable credit options offered by lenders serving nonprime and traditionally underserved consumers. Some lenders leverage large datasets to assess risk for consumers without credit scores or with credit scores that do not accurately reflect their ability to repay a loan. Other lenders leverage technology to reduce the cost of acquiring customers and servicing loans. The emergence of affordable options for nonprime consumers helped to allay concerns of legislators who had previously assumed that reform efforts would cut-off access to credit.

Legislators introduced several bills in 2017 and 2018 with varying approaches in how to address high-cost lending. Unlike previous efforts, these bills advanced out of committees and some even passed one house of the Legislature. None of the bills, however, made it through the entire legislative process. Two bills failed to receive adequate support when a majority of legislators deemed interest rate caps of 19% and 24% overly restrictive. Other bills failed to gain adequate support because they failed to cover the full range of loans affected by triple-digit rates. While not successful, the deliberation around the 2017 and 2018 bills helped to inform a comprehensive solution that could earn broad support.

2019 Effort Succeeds on Balanced Approach and Strength of Coalition

Last year, I introduced Assembly Bill 539, the Fair Access to Credit Act, to address the issue of unconscionable interest rates and the subsequent high default rates that jeopardize the financial well-being of over 100,000 California families each year. Assembly Bill 539 proposed the following changes to California's lending laws, applicable to loans of $2,500 - $10,000.

- Establish an interest rate ceiling of 36% plus the Federal Funds Rate.
- Set a minimum loan term of one year and maximum loan term of five years.
- Prohibit prepayment penalties.

When thinking about the right approach, I considered establishing underwriting standards, rather than a rate cap, to ensure that lenders were evaluating a borrower's ability to repay. In conversations with lenders, I learned that statutory underwriting standards could stymie innovation and reduce competition in the space. Many lenders actually preferred the clear rules of the road that a reasonable interest rate cap would bring, compared to the Legislature telling them how to make loan approval decisions. Additionally, an interest rate cap is easier to enforce from a regulatory perspective. The regulator can easily review marketing materials, Truth in Lending disclosures, and the loan agreement to evaluate a lender's compliance with the law.

Lender support was a key component in advancing Assembly Bill 539, but the effort could not have succeeded without the broad coalition of consumer advocates who worked to pass the bill. The coalition was spearheaded by Californians for Economic Justice, which brought together leading voices in local governments, religious communities, civil rights groups, and antipoverty advocates to support the bill. The coalition supporting the bill also included veterans groups who were concerned that the Military Lending Act only protected active duty members and their families, labor organizations who were concerned that high-cost loans harmed blue-collar workers, and economic development organizations who knew that high-cost loans eroded wealth in communities struggling against decades of discriminatory policies.

This broad coalition of supporters helped to deliver strong bipartisan support to advance the bill to the Governor. The bill passed on a 60 – 4 margin in the State Assembly and a 30 – 5 margin in the State Senate, with over 40% of Republicans voting "aye" on the bill. The bill was signed by the Governor and became law on January 1, 2020. The support for Assembly Bill 539 shows that consumer protections and regulating high interest rates is a truly bipartisan objective.

- Republican Assemblymember Jordan Cunningham, a co-author of the bill, stated that he was "proud to support AB 539 to cap unreasonable interest rates on consumer loans and protect people from predatory lenders. All of the world's major religions have rules against usury, or the charging of exorbitant interest rates, because it harms communities and families."[12]
- Democrat Assemblymember James Ramos, another co-author, stated that "high-cost payday lenders are inflicting financial harm on vulnerable families, charging sky high interest rates that can put families in worse positions than before they took out a loan. The Fair Access to Credit Act of 2019 will put a cap on these high interest rates and allows families to utilize these services for emergency funds without getting locked into drawn out, expensive repayments schemes that will harm their financial well-being."[13]
- Republican Senator Ling Ling Chang stated, "I proudly voted for AB 539, which cracks down on high-interest predatory lenders. A 200% interest loan isn't morally sound -

[12] https://www.facebook.com/AsmCunningham/videos/361011628099697/
[13] https://a40.asmdc.org/press-releases/20190916-ramos-co-authored-predatory-lending-bill-heads-governors-desk

especially when these predatory practices disproportionately impact veterans and vulnerable families."[14]

High-cost Lenders Declare Intent to Evade California Law via Rent-a-bank Schemes

After Assembly Bill 539 cleared major legislative hurdles, the executive teams of three publicly-traded, high-cost lending companies – Elevate Credit, Enova, and CURO – began their attempts to allay investors' concerns that California's reform efforts would negatively affect their companies' financial results. All three corporations controlled subsidiaries that held licenses from the state of California to make consumer loans, but those licenses required the lenders to follow state laws, including limitations on loan charges. If Assembly Bill 539 became law, these companies would not be able to make loans with interest rates that exceed the new cap.

In the summer of 2019, executives at the three companies told investors during quarterly earnings calls that they were exploring the use of bank partnerships to make loans that perpetuated the high-cost and high-default model that the California Legislature specifically acted to stop.[15]

- David Fisher, CEO of Enova, boldly claimed on July 26, 2019, that Enova would "likely convert our near-prime product to a bank-partner program, which will allow us to continue to operate in California at similar rates to what we charge today." Fisher went on to state, "In terms of the conversion to a bank program, we give up a couple about percentages -- a couple percent of margin to the bank partner, but other than that it's largely like-for-like. And again, I think given the increased opportunity in California from all the subprime instalment lenders that will leave the State, the storefront guys that won't be able to compete. And again, the subprime title lenders who are really impacted by this bill, such a large opportunity for NetCredit. Happy to -- almost happy to pay those couple of points of margin to capture that opportunity."
- Jason Harvison, CEO of Elevate Credit, revealed on July 29, 2019, that Elevate "expect[s] to be able to continue to serve California consumers via bank sponsors that are not subject to the same proposed state level rate limitations… the effective yield that we are looking at on the product would be very similar to what we have on the market today. So we think the impact would be minimal and this transition would be pretty seamless." In other words, Harvison was communicating that Elevate would continue to make loans at similar triple-digit rates in California.
- Don Gayhardt, CEO of CURO, stated on August 2, 2019, that CURO continues "to work on a number of new product and partnership opportunities that could give us the ability to serve our California customers with larger, longer-term loan products."

[14] https://chang.cssrc.us/content/july-2019-newsletter
[15] https://www.nclc.org/issues/ib-rent-a-bank.html

The companies' plans to partner with banks in attempts to evade state interest rate caps did not come as a surprise. Enova and Elevate have been engaged in rent-a-bank schemes around the country for some time. Enova partners with Republic Bank, a state chartered bank from Kentucky, to originate loans that exceed rate caps in some states.[16] Elevate partners with both Republic Bank and FinWise Bank, a state chartered bank from Utah, to evade state consumer protection laws.[17] Likewise, CURO had been publicly discussing its plans to forge bank partnerships with Meta Bank, a nationally chartered bank, for more than a year.[18]

After Assembly Bill 539 was signed into law, I sent letters to the CEOs of all three companies.[19] In those letters, I informed them of the new consumer protections that the California Legislature established on a broad, bipartisan basis. I let them know that I was aware of their plans to evade the law and that I would be working to ensure that our state enforcement agencies carried out the intent of the bill.[20] I concluded by asking them to serve California consumers exclusively with loans that comply with the interest rate protections established by our state laws.

The new law went into effect on January 1, 2020. As of February 2, 2020, it does not appear that any of the three companies were yet offering products in California at rates above 36%. During Enova's earnings call on January 29, 2020, however, CEO David Fisher said that there are "opportunities both within the AB 539 law, but *also kind of outside of it* [emphasis added] for us to roll out additional compliance products in California, which we hope to do this year." The other companies may disclose more about their plans in the coming weeks. CURO is scheduled to report earnings on February 6, 2020, and Elevate Credit is scheduled to report earnings on February 10, 2020.

In addition to the three companies' plans, at least two privately-held companies appear to be breaking California law today. LoanMart is marketing auto title loans through a rent-a-bank scheme with Capital Community Bank, a state chartered bank out of Utah.[21] LoanMart represents that its annual interest rates range from 60% - 222%, indicating that none of its loans comply with California's rate cap.[22] Similarly, OppLoans is marketing loans of 160% to California consumers through a rent-a-bank scheme with FinWise Bank.[23]

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[16] https://www.netcredit.com/rates-and-terms/arkansas - showing that Enova offers loans through Republic Bank with interest rates up to 99.99% in Arkansas, despite the state capping interest rates at 17%.

[17] https://www.risecredit.com/frequently-asked-questions and https://www.elastic.com/FAQs/

[18] https://www.businesswire.com/news/home/20180430006202/en/CURO-MetaBank%C2%AE-Announce-Agreement-Offer-Consumers-Innovative

[19] https://www.sacbee.com/news/politics-government/capitol-alert/article238501288.html

[20] https://www.americanbanker.com/news/stern-warning-to-lenders-mulling-end-run-around-california-rate-caps?feed=00000152-a2fb-d118-ab57-b3ff6e310000

[21] https://www.800loanmart.com/about-us-contact-us/ - see bottom of page

[22] https://www.800loanmart.com/title-loans-faq/ - under "What interest rates does LoanMart offer?"

[23] https://www.opploans.com/rates-and-terms/#california

Rent-a-bank Schemes Threaten Balanced and Deliberative Legislative Solution

If left unaddressed, rent-a-bank schemes undermine state laws that have been established to protect consumers. This problem is not unique to California. The OppLoans and FinWise scheme appears to evade twenty-four states' rate caps, both in states where legislatures passed laws and in states where voters overwhelmingly approved rate caps through ballot initiatives.[24] States have a longstanding interest in protecting their consumers, and rent-a-bank evasions that seek to undermine the will of democratically elected representatives are a threat to states' sovereign powers.

Rent-a-bank schemes not only threaten consumer protections and state sovereignty, but the schemes also undermine the role of prudential banking regulators. In common originate-to-hold models, the FDIC and OCC have the ability to monitor the loan performance of a bank's balance sheet over time, and the agencies have the authority to provide supervisory guidance to ensure that banks are making lending decisions that support the safety and soundness of the banking system. In rent-a-bank models, however, the agreements between the bank and high-cost lender are predicated on the bank offloading the risk of the loan immediately after origination. Such arrangements may temporarily hide the risky behavior of banks, but the bank may later bear liability for the role it plays in facilitating these schemes.

Rent-a-bank Schemes Represent Rogue Behavior, and Not All Bank Partnerships Are Bad

Of the 4,000 banks supervised by the FDIC, only a small handful of banks facilitate rent-a-bank schemes. Similarly, of the thousands of state-licensed lending companies across the country, only a small percentage are seeking out and forging relationships with banks in order to originate high-cost loans. Yet these few entities are effectively evading consumer protection laws in dozens of red and blue states across the country. In addition to putting millions of consumers at risk of high-cost loans and associated defaults, rent-a-bank schemes place a burden on state enforcement agencies that choose to bring cases against such companies.

Before I conclude my testimony, I want to be clear that not all bank partnerships are bad for consumers. Bank partnerships that provide products where the interests of lenders and borrowers are aligned can be a healthy part of the financial system. We have seen responsible innovation from companies that successfully leverage technology to improve underwriting, lower the costs of providing credit, and ultimately give consumers better options than were previously available. To the degree that responsible companies partner with banks to extend their reach and provide healthy, affordable credit options, I am not asking for the federal government to stand in the way. Relatedly, if fintech companies can help banks to better serve their existing customers, I want to foster a regulatory environment that permits healthy relationships.

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[24] https://www.nclc.org/issues/issue-brief-stop-payday-lenders-rent-a-bank-schemes-november-2019.html

As a fundamental test, I believe that bank partnerships that involve consumer credit should be premised on the bank following the FDIC's 2007 guidance on offering affordable small-dollar loans. Among other consumer protections, the guidance encourages banks to offer small-dollar credit with APRs no greater than 36%.[25] As another testament to the truly bipartisan nature of this issue, the guidance was issued under the leadership of Chairwoman Shelia Bair, a Republican appointed by President George W. Bush.

Federal Government Can Solve This Problem

States like California will fight against rent-a-bank schemes that seek to undermine state consumer protection laws, but the federal government should also address this issue. Through legislative or administrative action, the federal government should advance solutions that protect state sovereignty, protect consumers, and create a fair and competitive credit market with all lenders playing by the same rules.

One approach that the federal government should take is establishing a national cap on interest rates. I support the establishment of a national rate cap around the 36% standard. In order to be effective, the cap must apply to all classes of lenders, banks and nonbanks alike. In addition to capping rates, it is also important for proposed legislation to consider various fees and charges assessed by the lender. In line with the 2007 FDIC guidance, any origination fees should bear a direct relationship to the costs of originating a loan.

In parallel with efforts to establish a national rate cap, Congress should work with or compel the FDIC to stop supervised banks from facilitating evasion of state consumer protection laws. I urge Chairwoman McWilliams to establish an enforceable regulation that clearly states that bank partnerships cannot offer consumer credit products with APRs above 36%. A clear standard will serve to protect consumers and will give potential bank partners easy-to-understand rules about the types of products that they can develop with banks, allowing them to focus on new ways to design and innovate products that serve consumers. A clear standard will also foster a fair and competitive credit market by aligning the incentives of borrowers and lenders and by establishing a shared understanding among all lenders of the rules of the road.

Chairwoman Waters and Members of the Committee, thank you for bringing attention to this issue. While states will continue their work to protect consumers, I am hopeful that Congress and our federal banking regulators will step up to their responsibility in eradicating rent-a-bank schemes and supporting a healthy credit market for consumers and lenders alike.

[25] https://www.fdic.gov/news/news/financial/2007/fil07050a.html