Under the spotlight

Payday ruling could foreshadow marketplace lending regulations

A new CFPB ruling could signal the end of payday lending due to the large regulatory burdens imposed on lenders. The ruling could even be used as a model for approaching marketplace lending regulations.

Immediate implications of the ruling on marketplace lending are unlikely because it will take into account longer-term loans with interest rates of 36% or more. Marketplace loans don't tend to have such high interest rates and they tend to serve different sectors of the market.

However, a pertinent question is whether the CFPB will use the ruling as a template for marketplace lending rulings in future. Jane Luxton, partner at Clark Hill, believes it's possible.

"We could certainly see the CFPB using this approach as a model for marketplace lending regulations. However, given everything else the CFPB has indicated it is pursuing, regulation of marketplace lending is unlikely to happen for another 18 months to two years," she comments.

The impact on payday lenders as a result of this ruling could potentially be devastating, particularly in terms of the swingeing effect on profit margins. Luxton adds: "The burdens of the proposed rule could reduce lending value for payday lenders by 70%, which would result in margins that are unsustainable. As a result, a large number are expected to go out of business."

Marketplace lenders could therefore view this as an opportunity to step into the breach to serve large numbers of underserved borrowers. Tom Brooks, of counsel at Clark Hill, is not so sure.

"In theory some marketplace lenders may view this as an opportunity, but as things stand, it's unlikely. Apart from anything, marketplace lending platforms serve a different market to payday lenders and will most likely not want to lend to the same clientele as payday lenders at the moment," he says.

Marketplace lenders typically focus on prime or near-prime borrowers, unlike the subprime or below-subprime clients of payday lenders.

Added to this, it is perhaps unlikely that marketplace lenders would want to venture into an environment that is CFPB-regulated. Brooks adds, however, that "we've yet to see how marketplace lending will behave in a downturn."

A big concern with the new ruling is the large costs it imposes on lenders, due to the significant regulatory burdens. This is particularly true of the ‘ability to pay’ element of the ruling, which states that payday lenders should determine how able certain borrowers are to repay the loan before providing credit. The cost of this, according to Luxton and Brooks, is far too big for smaller firms and indeed is something that has even prevented banks from entering the small loans market in the past.

Marketplace lenders in theory have been able to capitalise on their theoretically advanced algorithms and technological abilities to efficiently assess a borrower’s ability to repay their loan. They may therefore be more than capable of profitably providing loans, even under the CFPB’s ability-to-pay ruling.

Brooks isn’t so sure. He states: “In theory fintech firms with advanced technological capabilities could pursue a gap in the market here, due to an ability to assess ability-to-pay cheaply and efficiently. But it’s not something we’ve seen so far.”

While the CFPB is unlikely to pursue marketplace lending right now, the nascent sector is certainly in its sights. Brooks suggests that enforcement actions could come into play. The potential of this can already be seen in the fact that the CFPB has started taking complaints from consumers and, as a result, has already issued fines - with some levied on SoFi.

Brooks adds: “One thing that could happen is that the CFPB could regulate through enforcement. Through actions such as fines on operators of platforms, this can set a precedent that leads to other platform operators not pursuing certain practices or indeed changing their existing ones.”

While the future of marketplace lending regulation is uncertain, it is sure to remain under the spotlight. With various other regulatory bodies making enquiries into the transparency and viability of the industry, the CFPB will be monitoring this noise closely.

Brooks concludes: “The various regulators are all looking at marketplace lending from different perspectives. It will be interesting to see what the CFPB’s reaction will be to enquiries done by bodies such as the Treasury or the Californian Department of Business. Their actions might be influenced or guided by those outcomes.”