Rent-To-Own Industry: A Closer Look at the Implications of Expansion of RTO Kiosk Model; Analysis of Senator Casey Letter to CFPB and FTC

Updated Outlook

Relative to other small dollar lenders, RTO has solid legal protection. The Rent-To-Own (RTO) industry currently enjoys relatively solid legal protection compared to the payday, installment, and title industries, which are all set to be hit with stiff regulations from the CFPB later this year.

However, enhanced scrutiny, at a minimum, is on the horizon. Two recent developments—a pointed letter from Senator Bob Casey, and an aggressive industry push into kiosks—present risk to the sector and must be monitored to understand whether or not the RTO industry will be subject to regulation, oversight and enforcement by the CFPB or opportunistic State AGs. Further, should small dollar lenders face margin pressure or significant drops in utilization from new CFPB rules, affected lenders could look to enter the RTO kiosk model as a way to provide a credit-like product to a familiar demographic, potentially driving up competition in the space.

Quick Look at Casey Letter and Risks Related to Kiosk Model

Senator’s letter calls for focus on RTOs at CFPB, FTC. Senator Robert Casey recently called on the CFPB and FTC to closely monitor the RTO industry to ensure that adequate safeguards are in place to protect the growing number of low-income consumers that rely on RTO financing as an alternative to traditional credit. Senator Casey also requested that both agencies describe the tools currently at their disposal to protect RTO consumers as well as any limitations on their authority to address issues in the RTO market.

Significance of Casey letter. Senator Casey’s letter is a significant development because it thrusts RTOs into the spotlight, after the industry avoided regulatory scrutiny at the federal level for many years. Stakeholders should note that letters from Senators carry significant weight with agencies and that a letter from Senator Markey to the FTC led to an investigation into Herbalife and the MLM sector, which had previously received lax oversight. The inquiries contained in Casey’s letter will likely require the CFPB to reveal its views regarding the Bureau’s jurisdiction over RTOs and potentially open the door for the FTC to reexamine whether the consumer protection issues in the RTO industry warrant further scrutiny.

Kiosk model likely to become focus. Any regulatory scrutiny triggered by Senator’s Casey letter will likely lead to an examination of the rapid expansion of the kiosk model. From a legal risk standpoint, the kiosk model creates new sales practice and disclosure issues and bears a greater resemblance to traditional credit.

For this article we reviewed recent regulatory filings, earnings calls, and investor presentations for Rent-A-Center (RAC) and Aaron’s, the two largest players in the RTO industry. We also conducted interviews with a number of industry stakeholders.

In-depth: Analysis of Senator Casey’s Letter

The CFPB will have to address the RTO industry. In 2012, a CFPB spokesperson stated that the Bureau had “reviewed the rent-to-own industry generally” to monitor the impact of industry practices, but had not reached any conclusions regarding whether to take any action. Since that time, the CFPB has not brought any enforcement.
actions against RTOs or offered additional insight into its views on the industry. Consumer advocates that we spoke with believe that RTOs, while not a top priority, are certainly on the CFPB’s radar. The advocates speculated that the CFPB could potentially shift its focus to RTOs once the small-dollar loan rule is finalized or if the Bureau identifies significant consumer harm.

The RTO industry and some industry observers have asserted that RTOs are not subject to the CFPB’s jurisdiction premised on the theory that RTO agreements fall outside the definition of “financial products” under Dodd Frank. In contrast, one industry advocate that we interviewed contested the notion that the RTO industry “is somehow immune” from the CFPB’s jurisdiction. In order to respond to Senator Casey’s inquiries, the CFPB will almost certainly have to reveal whether it believes it has jurisdiction over RTOs.

**Casey letter could push FTC to reexamine the RTO industry.** The FTC has authority to bring enforcement actions against RTOs for engaging in unfair and deceptive business practices, but has only done so on one occasion in an action against Aaron’s for allegedly using privacy-invasive software. During hearings before the House Financial Services’ Subcommittee on Financial Institutions and Consumer Credit in July 2011 regarding potential federal regulation of RTO agreements (the “RTO hearings”), FTC Deputy Director Charles Harwood testified that RTOs were not an agency priority due to the lack of consumer complaints or other indications of consumer harm.

According to Mr. Harwood, of the approximately 1.1 million total complaints that the FTC received in the year preceding his testimony, only several hundred related to RTOs. However, Mr. Harwood noted that if the FTC observed a rise in complaints or received other indications of consumer harm, the agency would take a closer look at the industry. “If we were to see a pattern of fraud or deception or consumer injury with regard to the conduct of rent-to-own members, we would likely choose to focus more of our resources on the industry,” Mr. Harwood testified. We believe that Senator Casey’s letter could provide the FTC with a basis to reexamine whether current RTO business practices are causing harm to consumers even in the absence of significant customer complaints.

**In-depth: Continued Expansion of Kiosk Model and Potential Regulatory Implications**

**Potential regulatory hooks related to kiosk model.** The kiosk model presents at least three potential regulatory issues. The first issue relates to the nature of the representations and adequacy of disclosures at the point of sale in kiosk transactions. Kiosk customers are unique because they have already made a decision to purchase the merchandise and often have no previous experience with RTO financing. As a result, one potential area of concern could be how the kiosk transaction is presented to consumers at the point-of-sale and whether standard RTO disclosures are adequate. According to Marceline White, Executive Director of the Maryland Consumer Rights Coalition: “It is a bait-and-switch? Are kiosk customers entering into the transaction thinking that they are purchasing merchandise when in reality they are actually renting?”

A second potential issue could be whether the nature and growth of the kiosk model will kindle debate regarding whether RTO agreements should be treated as credit sales instead of leases. The kiosk model specifically targets retail consumers seeking to purchase on credit, but who do not qualify for standard retail credit financing. As noted previously, RAC and Aaron’s have reported that between 70 and 80 percent of kiosk customers purchase the rented merchandise. As a result, the purpose and outcome of the kiosk model bears an increased resemblance to credit, but is regulated like a lease. “The concern is that kiosk customers are more clearly using RTOs as a substitute for credit, but are not receiving APR disclosures typically required under TILA for credit transactions,” said Professor Dee Pridgen, the Carl M. Williams Professor of Law & Social Responsibility at the University of Wyoming. “Without APR disclosures, kiosk customers will not realize the true cost associated with renting to own.”

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A third potential issue relates to the CFPB’s pending small dollar-loan rule. As noted in our recent report, the rule is likely to lead to a sharp drop in profitability for covered loans (payday, installment, and title loans). In our view, companies that are likely to be significantly impacted by the small-dollar rule could look to move into the RTO sector because it is currently subject to less stringent regulation and because of the familiar customer demographic.

RAC aggressively expanding Acceptance Now business. RAC’s Acceptance Now business segment operates kiosks inside traditional retailers. Customers that are turned down for traditional retail credit are referred to an Acceptance Now kiosk in order to “save the sale”. Approximately 50% of retail customers that are directed to Acceptance Now kiosks enter into a rental-purchase agreement to acquire possession of the merchandise on a RTO basis. Notably, between 70 and 80 percent of Acceptance Now transactions result in ownership (“keep rate”), which is substantially higher than the 25% keep rate in RAC’s RTO stores.

Although RAC has operated kiosks within retail partners’ locations for nearly a decade, Acceptance Now has experienced substantial growth in recent years. In September 2009, RAC’s VP of Public Affairs indicated that RAC had only established kiosks in a handful of retail stores and did not view the kiosk model as central to the company’s core mission. However, as evidenced by the chart below, the Acceptance Now segment has experienced rapid growth since 2009 – the segment represented 21% of the company’s total revenue in the first three quarters of 2014:

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<tr>
<th>Year</th>
<th>Acceptance Now Revenue</th>
<th># of Kiosks</th>
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<tbody>
<tr>
<td>2010</td>
<td>$18M</td>
<td>384</td>
</tr>
<tr>
<td>2011</td>
<td>$193M</td>
<td>750</td>
</tr>
<tr>
<td>2012</td>
<td>$343M</td>
<td>966</td>
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<tr>
<td>2013</td>
<td>$502M</td>
<td>1,325</td>
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<tr>
<td>Q1-Q3 2014</td>
<td>$624M</td>
<td>1,359</td>
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RAC has indicated that it intends to expand the segment by increasing the number of retail partners as well as the number of locations with the company’s existing partners. The continued growth of the Acceptance Now segment will be critical for RAC to offset declining sales at RAC’s traditional retail stores, which resulted in the company closing 150 stores during the second quarter last year.

Aaron’s expanding into virtual RTO Market. In April 2014, Aaron’s established a strong foothold in the virtual RTO market when it acquired Progressive Financial Holdings. At the time of the acquisition, Progressive operated over 15,000 virtual kiosks in 46 states. Unlike RAC’s Acceptance Now kiosks, Progressive’s virtual kiosks are integrated into the point of sale, allowing the retailer to execute the transaction without referring customers to a separate location. Notably, Aaron’s has also indicated that the keep rate for its virtual kiosk transactions is between 70 to 80 percent, which is higher than the 50 percent keep rate for its traditional RTO stores.

According to Aaron’s 3rd quarter regulatory filing, Progressive accounted for approximately 26 percent of Aaron’s year-to-date revenue. During the 3rd quarter earnings call, a company official indicated that Aaron’s “expect[s] Progressive to become a larger part our overall business as we add new retailer relationships and grow existing ones.”

RTO Snapshot
# Federal Regulation of the RTO Industry

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<tr>
<th>Reasons RTO Industry May Face Enhanced Regulatory Oversight and Enforcement</th>
<th>Reasons RTO May Avoid Enhanced Regulatory Oversight and Enforcement</th>
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| **Legal/Market Factors**  
- The nature and rapid growth of the kiosk model presents potential sales practice and disclosure issues and bears a greater resemblance to traditional credit.  
- CFPB small dollar rule may push affected lenders into less regulated RTO market. | **Legal/Market Factors**  
- The ability to terminate RTO agreements at any time lowers risk of borrowers falling into endless cycles of debt and hurts aggressive regulators’ ability to classify RTO transactions as credit. |
| **Political Factors**  
- Senator Casey recently sent a letter to the CFPB and FTC imploring both agencies to take a closer look at the RTO industry. | **Political Factors**  
- Numerous attempts to enact federal RTO legislation have failed.  
- 47 states and DC have already enacted legislation governing RTO agreements.  
- The RTO industry has enjoyed significant political influence in Congress and likely benefits from a shift to Republican control of both the House and Senate |