

# CFPB issues rule regarding payday, title, deposit advance, and certain other installment loans

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On October 5, 2017, the CFPB published its final rule<sup>1</sup> (the “Rule”) addressing payday loans, vehicle title loans, and certain other extensions of credit (collectively, “covered loans”). Among the Rule’s key provisions, it requires lenders to determine a borrower’s ability to repay for “covered short-term loans” and “covered longer-term balloon-payment loans,” but not other covered loans.

Thus, unlike the CFPB’s proposed rule, the Rule does not require an ability to repay determination for longer-term loans that are not balloon loans. For certain covered short-term loans, lenders may provide a principal payoff option in lieu of conducting a full ability-to-repay analysis.

Like the CFPB’s proposed rule, the Rule caps at three the number of covered loans that may be made in quick succession. The Rule also limits certain payment collection practices for all covered loans, including non-balloon loans.

## COVERED LOANS

“Covered loans” under the Rule fall into three categories:

1. “Covered short term loans,” which have a term of 45 days or less
2. “Covered longer-term balloon-payment loans,” which have a term longer than 45 days and must be repaid in a single payment or require at least one payment that is more than twice as large as any other payment
3. “Covered longer-term loans,” which have a term longer than 45 days, a cost of credit exceeding 36 percent, and a “leveraged payment mechanism” granting the lender the right to initiate a transfer of payment from a consumer’s account (but are not a covered longer-term *balloon-payment* loan)

The Rule diverges from the CFPB’s proposed rule by separating “longer-term” loans into two separate categories — those with a balloon payment feature (which, unlike in the proposal, are not subject to the 36 percent rate trigger), and non-balloon loans with a leveraged payment mechanism (which still are subject to the 36 percent rate trigger).

Furthermore, the CFPB contemplated in its proposed rule measuring the 36 percent rate trigger using a standard similar to the Military Annual Percentage Rate under the Military Lending Act.

The Rule, however, more narrowly defines the “cost of credit” to include all finance charges as described in Regulation Z, but “without regard to whether the credit is consumer credit” or “is extended to a consumer,” as those terms are defined in Regulation Z.

Additionally, the Rule excludes several classes of transactions from its scope, including certain purchase money security interest loans, real estate secured credit, credit cards, student loans, overdraft services, non-recourse pawn loans, wage advance programs, and certain no-cost advances of credit.

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Furthermore, the Rule establishes conditional exemptions for certain loans, including exemptions for “alternative loans,” which essentially tracks the features of Payday Alternative Loan products authorized by the National Credit Union Association, and “accommodation loans,” which is intended to address institutions that only occasionally make covered loans to their customers in limited volumes and that principally derive their revenue from other sources.

## ABILITY-TO-REPAY REQUIREMENT DETERMINATION

Under the Rule, it is an unfair and abusive practice for a lender to make a covered short-term loan or a covered longer-term balloon-payment loan without reasonably determining that the consumer has the ability to repay the loan.

The ability-to-repay provision (described as the “full-payment test” by the CFPB in material accompanying the Rule) does not apply to covered longer-term loans — that is, loans with a cost of credit exceeding 36 percent, a leveraged payment mechanism, and no balloon payment provision.



To reasonably determine that a consumer has the ability to repay, the lender must conclude that the consumer can meet all major financial obligations, make payments under the loan, and meet basic living expenses for a particular period of time.

For short-term loans, the relevant time period is the shorter of the term of the loan or the period ending 45 days after the loan is made, and for 30 days after making the highest payment on the loan.

For longer-term balloon-payment loans, the period extends to 30 days after the consumer makes the highest payment under the loan.

The lender can make this determination by estimating the consumer's basic living expenses and considering either the consumer's debt to income ratio or the consumer's residual income.

For an ability-to-repay calculation to be reasonable, the lender must obtain a consumer's written statement identifying the consumer's net income and major financial obligations.

The lender also must take reasonable steps to verify a consumer's income and debt obligations including obtaining reasonably available evidence of the consumer's income and a consumer credit report.

Additionally, the lender must review the consumer's borrowing history from the records of the lender and its affiliates and from a consumer report from any information system that has been registered with the CFPB under the Rule.

The Rule further establishes a "cooling-off period" prohibiting a lender from making a covered short-term loan or longer-term balloon loan to a consumer if the loan would be the fourth in a sequence of consecutive or concurrent loans made to the consumer. New loans are barred while the third loan in a sequence is outstanding and for 30 days thereafter.

Lenders also would be prohibited from making a covered short-term loan or longer-term balloon loan during the period when a consumer has an outstanding covered short-term loan made under the conditional exemption discussed below for loans with a "principal payoff" option, and for 30 days thereafter.

#### **EXEMPTION FOR CERTAIN COVERED SHORT-TERM LOANS WITH A PRINCIPAL PAYOFF OPTION**

For certain covered short-term loans, the Rule also allows lenders to forego the full ability-to-repay determination and instead offer consumers a "principal payoff option."

Under this conditional exemption, a lender still must review the consumer's borrowing history (in its own records and those of its affiliates) and a consumer credit report from an information system registered under the Rule.

The principal payoff option is available for loans up to \$500 where the consumer pays off the loan in a single payment or pays off at least one-third of the initial principal and rolls over

the remaining principal balance into a new loan (up to two subsequent loans are permitted).

The principal payoff option is only available where the consumer has no recent or outstanding short-term or longer-term balloon-payment loans, and such loans cannot be structured as open-ended credit or secured by a vehicle.

The Rule further requires that the lender provide certain disclosures to such consumers in a form substantially similar to the model form provided by the Rule.

#### **PAYMENTS TRANSFERS FOR COVERED LOANS**

For all three types of covered loans, the Rule declares it an unfair and abusive practice for a lender to make a third attempted withdrawal of funds from a customer's account if two prior attempts were denied due to lack of sufficient funds.

A lender may make a third attempt only after obtaining the customer's new and specific authorization to make further withdrawals from a given account. This prohibition generally applies regardless of the means through which the lender initiates the transfer, and thus would include payment mechanisms such as remotely created checks, as well as electronic funds transfers covered by Regulation E.

The Rule also contains certain notice provisions in connection with payments on covered loans. Lenders must provide consumers with a "first payment withdrawal notice," identifying the transfer terms, dollar amount, the consumer account from which funds will be withdrawn, and other information relating to the loan.

Lenders are also required to provide customers with a notice of an "unusual withdrawal" alerting the customer to an upcoming scheduled withdrawal that deviates in dollar amount, withdrawal date, or payment channel from the customer's regular or prior payments.

Finally, a "consumer rights" notice is required if a lender initiates two consecutive failed payment transfers.

#### **INFORMATION REPORTING REQUIREMENTS**

For short-term loans and longer-term balloon-payment loans, the Rule requires lenders to furnish certain loan information to registered "information systems."

The Rule further provides for an application process allowing private entities to seek registration with the Bureau to be an information system for such lender reporting.

The Rule makes clear that the information reported to and obtained from these information systems will be subject to the provisions of the Fair Credit Reporting Act.

#### **OTHER REQUIREMENTS FOR LENDERS OF COVERED LOANS**

Finally, the Rule imposes two other notable requirements on lenders making covered loans:

**Compliance program**

A lender making a covered loan must develop and follow written policies and procedures that are reasonably designed to ensure that the lender complies with the Rule. These policies and procedures must be appropriate for the size and complexity of the lender and its affiliates, and for the nature and scope of the covered loan lending activities.

**Recordkeeping requirements**

The lender must retain evidence of compliance with the Rule for at least 36 months after a covered loan ceases to be an outstanding loan. Furthermore, the Rule requires that specific information be retained regarding (i) the type, terms, and performance of covered shorter-term loans and covered longer-term balloon loans, and (ii) the lender’s payment practices for all covered loans.

These requirements are particularly notable for non-bank lenders making covered loans that are not subject to the CFPB’s supervisory jurisdiction, which may not otherwise be expected to maintain a comprehensive compliance management system.

**EFFECTIVE DATES**

The provisions allowing for the creation and registration of the information systems to receive information regarding covered short-term and longer-term balloon loans are scheduled to take effect 60 days from the date the Rule is officially published in the Federal Register.

All other provisions of the Rule become effective 21 months after the Rule is officially published in the Federal Register.

**RELATED OCC ACTION**

On the same day that the CFPB’s rule was released, the OCC rescinded<sup>2</sup> its 2013 “deposit advance” guidance, which effectively prevented national banks and federal savings associations from offering short-term credit products based on consumer’s deposits.

The Acting Comptroller explained that this step was necessary to avoid “potentially inconsistent regulatory direction and undue burden” and because the guidance may have harmed consumers by “making it difficult for banks to serve consumers’ need for short-term, small-dollar credit” and driving business to “other, lesser regulated entities.”

It is unclear whether the FDIC, which issued similar guidance in 2013, will take similar action.

**IMPLICATIONS AND NEXT STEPS**

It remains to be seen whether the CFPB’s rule might be disapproved by Congress under the Congressional Review Act or challenged in litigation.

Furthermore, since the majority of the Rule does not take effect until after Director Cordray’s term expires, it is possible that the Rule could be modified or withdrawn prior to becoming fully effective.

If the Rule is challenged judicially, this may be important for all institutions subject to the CFPB’s authority to prohibit unfair, deceptive, or abusive acts and practices (“UDAAP”) — not just those making covered loans — because such litigation may establish important precedent for the scope of the CFPB’s UDAAP authority, including both the scope of conduct considered to be a UDAAP and the scope of the agency’s rulemaking authority to identify, prohibit, and prevent UDAAPs.

In the interim, institutions should consider whether they are extending any credit that qualifies as a covered loan under the Rule and is not covered by an exemption. While the Rule is materially narrower than the CFPB’s proposed rule, it nevertheless has the potential to apply to credit beyond payday loans and title loans.

*This article appeared in the October 30, 2017, edition of Westlaw Journal Bank & Lender Liability.*

**NOTES**

- <sup>1</sup> <http://bit.ly/2kstXfK>
- <sup>2</sup> <http://bit.ly/2yIG3Hn>

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