

Insights: Alerts

Key Takeaways From the CFPB's Final Rule On Payday, Vehicle Title, and Certain High-Cost Installment Loans

October 10, 2017

Written by Gary R. Bronstein, Christina M. Gattuso, Edward G. Olifer,

On October 5, the Consumer Financial Protection Bureau (CFPB or Bureau) released its long-anticipated final rule on small dollar lending, which covers payday, vehicle title, and certain high-cost installment loans.¹ The final rule establishes 12 C.F.R. Part 1041, which creates consumer protections for certain consumer credit products, and follows the CFPB's June 2016 issuance of a proposed rule.

Highlights

Along with providing consumer protections governing the underwriting of covered short-term and longer-term balloon-payment loans — including payday and vehicle title loans — the rule also contains disclosure and payment withdrawal attempt requirements for covered short-term loans, covered longer-term balloon-payment loans, and certain high-cost covered longer-term loans.

In one of the most significant differences from the proposal, the Bureau is not, at this time, finalizing the ability-to-repay determination requirements proposed for certain high-cost installment loans, but it is finalizing those requirements as to covered short-term and longer-term balloon-payment loans.

The CFPB also made other changes to the rule in response to the more than one million comments received on the proposed rule. These changes include adding new exemptions for certain loans from the underwriting criteria prescribed in the rule if they have specific consumer protections. The Bureau also streamlined components of the full-payment test and refined the approach to the principal-payoff option.

Scope of the Rule

The rule applies to two types of covered loans.

First, it applies to short-term loans that have terms of 45 days or less, including typical 14-day and 30-day payday loans, as well as short-term vehicle title loans that are usually made for 30-day terms and longer-term balloon payment loans.² The underwriting portion of the rule applies to these loans. The Bureau had proposed parallel underwriting requirements for high-cost covered longer-term loans. However, at this time, the Bureau is not finalizing the ability-to-repay portions of the rule as to covered longer-term loans other than those with balloon payments.

Second, certain parts of the rule apply to longer-term loans with terms of more than 45 days that have (1) a cost of credit that exceeds 36 percent per annum; and (2) a form of “leveraged payment mechanism” that gives the lender a right to withdraw payments from the consumer’s account.³

The payments practices part of the rule applies to both categories of loans.⁴ The rule excludes or exempts several types of consumer credit, including:

- loans extended solely to finance the purchase of a car or other consumer good, in which the good secures the loan;
- home mortgages and other loans secured by real property or a dwelling if recorded or perfected;
- credit cards;
- student loans;
- non-recourse pawn loans;
- overdraft services and lines of credit;
- wage advance programs;
- no-cost advances;
- alternative loans (similar to loans made under the Payday Alternative Loan program administered by the National Credit Union Administration);
- and accommodation loans (loans made by a lender who makes 2,500 or fewer covered short-term or balloon-payment loans per year and derives no more than 10 percent of its revenue from such loans (these are usually small personal loans made by community banks or credit unions to existing customers or members)).⁵

Ability-to-Repay Requirements & Alternative Requirements for Covered Short-Term Loans

The rule identifies it as an unfair and abusive practice for a lender to make covered short-term or longer-term balloon-payment loans without reasonably determining that the consumers will have the ability to repay the loans according to their terms. The rule prescribes requirements to prevent this practice and thus the specific harms to consumers that the Bureau has identified as flowing from the practice, including extended loan sequences for a substantial population of consumers.

- **“Full-Payment” Test/Ability-to-Repay Determination.** A lender, before making a covered short-term or longer-term balloon-payment loan, must make a reasonable determination that the consumer would be able to make the payments on the loan and be able to meet the consumer’s basic living expenses and other major financial obligations without needing to re-borrow over the ensuing 30 days.⁶ For payday and auto title loans that are due in one lump sum, full payment means being able to afford to pay the total loan amount, plus fees and finance charges within two weeks or a month. For longer-term loans with a balloon payment, full payment means being able to afford the payments in the month with the highest total payments on the loan. The rule also includes a cooling off period, which will prohibit a lender from making a covered short-term loan to a consumer, who has already taken out three covered short-term or longer-term balloon-payment loans within 30 days of each other, for 30 days after the third loan is no longer outstanding.

- **Principal-Payoff Option/No Ability-to-Repay Determination.** In the alternative, a lender is allowed to make a covered short-term loan without meeting all the specific underwriting criteria set out above; as long as the loan satisfies certain prescribed terms, the lender confirms that the consumer meets specified borrowing history conditions, and the lender provides required disclosures to the consumer.⁷

Payments Practices Requirements

The rule identifies it as an unfair and abusive practice for a lender to make attempts to withdraw payment from consumers' accounts in connection with a short-term, longer-term balloon-payment, or high-cost longer-term loan after the lender's second consecutive attempt to withdraw payments from the accounts from which the prior attempts were made have failed due to a lack of sufficient funds, unless the lender obtains the consumers' new and specific authorization to make further withdrawals from the accounts.⁸ The rule requires that lenders must provide notice to consumers when the prohibition has been triggered and follow certain procedures in obtaining new authorizations.

In addition, a lender is required to provide a written notice under certain specified conditions, including when the lender first attempts to withdraw payment for a covered loan from a consumer's checking, savings, or prepaid account, or before the lender attempts to withdraw such payment in a different amount than the regularly scheduled payment amount.⁹

Additional Requirements

The rule requires lenders to furnish to provisionally-registered and registered information systems certain information concerning covered short-term and longer-term balloon-payment loans at loan consummation, during the period that the loan is an outstanding loan, and when the loan ceases to be an outstanding loan.¹⁰ A lender also is required to establish and follow a compliance program and retain certain records.¹¹

Effective Date

Most of the rule takes effect 21 months after it is published in the *Federal Register*, although certain provisions necessary to implement the consumer reporting components of the rule (specifically § 1041.11), will become effective 60 days after publication in the *Federal Register*.

Key Takeaways & Implications for Other CFPB Activity

- **Continued Use of the Ability-to-Repay Standard.** This final rule highlights how the ability-to-repay/ability-to-pay requirement has become a benchmark for the Bureau. This marks yet another context, in addition to credit cards and mortgages, in which certain consumer financial services and products are subject to an ability-to-repay/ability-to-pay standard.
- **Use of UDAAP Rulemaking Authority, including the "Abusive" Standard.** The Bureau issues these regulations primarily pursuant to its authority under section 1031 of the Dodd-Frank Act to identify and prevent unfair, deceptive, or abusive acts or practices. This marks the first rulemaking, in which the Bureau has invoked its rulemaking authority to prohibit "abusive" acts and practices. The Bureau has concluded that there is some indication based on limited legislative history that Congress also intended the Bureau to use the authority under section 1031(d) of the Dodd-Frank Act to address payday lending through the Bureau's rulemaking, supervisory, and enforcement authorities. The rule identifies it as an

unfair and abusive practice for a lender to make covered short-term or longer-term balloon-payment loans, including payday and vehicle title loans, without reasonably determining that consumers have the ability to repay the loans according to their terms. For the same set of loans along with certain other high-cost longer-term loans, the rule also identifies it as an unfair and abusive practice to make attempts to withdraw payment from consumers' accounts after two consecutive payment attempts have failed, unless the consumer provides a new and specific authorization to do so.

- **Breadth of Rulemaking Scope.** All lenders who regularly extend credit are subject to the CFPB's requirements for any loan they make that is covered by the rule. This includes banks, credit unions, nonbanks, and their service providers. Lenders are required to comply regardless of whether they operate online or out of storefronts and regardless of the types of state licenses they may hold. These protections are in addition to existing requirements under state or tribal law.
- **Payments Practices.** The prohibition against a lender withdrawing payment from a consumer's account after two unsuccessful attempts is a novel development. Regulated entities in other markets should take note of the Bureau's concerns about the fees that can accrue as a result of multiple failed attempts to collect payment.
- **Balancing Consumer Protection & Access to Credit.** This final rule reflects the tension that can exist when the Bureau tightens protections in ways that can impede access to credit for consumers that may have few or fewer credit options — especially the unbanked or underbanked. In its final rule, the Bureau notes that consumers may experience reduced access to new loans, be prevented from rolling loans over or reborrowing shortly after repaying a prior loan, may only be able to borrow smaller amounts or with different loan structures, and may find the process of obtaining a loan more time consuming and complex.
- **Accommodations for Companies Seeking to Provide Innovative Access to Consumers' Wages.** We note that the rule excludes from coverage some new "fintech" innovations, such as certain no-cost advances and programs to advance earned wages when offered by employers or their business partners. Some of these companies are part of the "fintech" wave. Some are developing new products as an outgrowth of businesses focusing mainly on payroll processing, for example, whereas others are not associated with consumers' employers, but rather are focused primarily on devising new means of advising consumers about how to improve their approach to cash management. This accommodation may be an attempt to accommodate innovation in the industry that poses little to no consumer risk. The Bureau states that it has "consistently expressed interest in encouraging more experimentation in this space," but also cautions that "nothing prevents [it] from reconsidering these assumptions in a future rulemaking if there is evidence that such products are harming consumers."
- **Further Agency Regulatory & Supervisory/Enforcement Action is Likely.** While the final rule does not apply ability-to-repay protections to all of the longer-term loans that would have been covered under the proposal, the CFPB is conducting further study to consider how the market for longer-term loans is evolving and the best ways to address concerns about existing and potential practices that may arise as the market responds to the reforms prompted by this new rule. Additionally, the rule operates as a floor leaving state and local jurisdictions to adopt further regulatory measures (whether a usury limit or other protections) as appropriate to protect consumers. The states that do not authorize payday loans will not be affected by this rule. To date, the Bureau has pursued public enforcement actions against more than 20 small-dollar lenders, including brick-and-mortar storefront lenders, online lenders, and vehicle title lenders (as well as pawn lenders, which are not covered under the rule). A number of these actions have been resolved, but some remain pending in the courts at this time.

- **Uncertainty Lies Ahead.** The final rule likely faces a potential vote to repeal it in Congress through the Congressional Review Act (CRA). According to public reports, litigation under the Administrative Procedure Act and other legal grounds is likely. In addition, CFPB Director Richard Cordray is in the waning months of his term, which is set to expire in July 2018 (unless he chooses to leave earlier). A new CFPB director selected by President Donald Trump could have a different view of this rulemaking and seek to scale it back prior to when the rule is scheduled to take effect in 21 months.¹²

¹ Consumer Financial Protection Bureau, Payday, Vehicle Title, and Certain High-Cost Installment Loans (Oct. 5, 2017), available at http://files.consumerfinance.gov/f/documents/201710_cfpb_final-rule_payday-loans-rule.pdf.

² See § 1041.3(b).

³ See id.

⁴ See id.

⁵ See § 1041.3(d).

⁶ The lender must verify the borrower's net income, debt obligations (through a national consumer report and a consumer report from a "registered information system"), housing costs (through a national consumer report or the consumer's written statement of monthly housing expenses), and basic living expenses. It also must project the consumer's residual income or debt-to-income ratio, in order to determine if the borrower can repay the obligation.

⁷ Among other conditions, under this alternative approach, a lender is allowed to make up to three covered short-term loans in short succession, provided that the first loan has a principal amount no larger than \$500, the second loan has a principal amount at least one-third smaller than the principal amount on the first loan, and the third loan has a principal amount at least two-thirds smaller than the principal amount on the first loan. In addition, a lender is not allowed to make a covered short-term loan under the alternative requirements if it would result in the consumer having more than six covered short-term loans during a consecutive 12-month period or being in debt for more than 90 days on covered short-term loans during a consecutive 12-month period. These loans cannot be offered to borrowers with recent or outstanding short-term or balloon-payment loans. The principal-payoff option also is not available for loans for which the lender takes an auto title as collateral.

⁸ This prohibition on further withdrawal attempts applies whether the two failed attempts are initiated through a single payment channel or different channels, such as the automated clearinghouse system and the check network.

⁹ The notice must contain key information about the upcoming payment attempt and, if applicable, alert the consumer to unusual payment attempts. A lender is permitted to provide electronic notices as long as the consumer consents to electronic communications.

¹⁰ To be eligible to become a provisionally registered or registered information system, an entity must satisfy the eligibility criteria prescribed in the rule. The rule provides for a registration process that will allow information systems to be registered, and lenders to be ready to furnish required information, at the time the furnishing obligation in the rule takes effect. Consumer reports provided by registered information systems will include a reasonably comprehensive record of a consumer's recent and current use of covered short-term and longer-term balloon-payment loans. Before making covered short-term and longer-term balloon-payment loans, a lender is required to obtain and consider a consumer report from a registered information system.

¹¹ In particular, a lender is required to retain the loan agreement and documentation obtained for any covered loan or an image thereof, as well as electronic records in tabular format regarding origination calculations and determinations for a short-term or longer-term balloon-payment loan, and regarding loan type and terms.

¹² For example, in a different context, Labor Secretary Alexander Acosta has sought to alter the U.S. Department of Labor's fiduciary duty regulation put into place under the Obama Administration.

Related People



Gary R. Bronstein

t 202.508.5893

gbronstein@ktslaw.com



Christina M. Gattuso

t 202.508.5884

cgattuso@ktslaw.com



Edward G. Olifer

t 202.508.5852

eolifer@ktslaw.com