CFPB Outlines Payday Loan Rule

I. Background & Overview

The CFPB held a field hearing on payday lending March 26 in Richmond, Va., where it announced the details of the payday loan rule that it is considering proposing. Although the outline of the rule provided by the CFPB is not a formal notice of proposed rulemaking, it is referred to in this *Alert* as the "proposed rule." While the hearing and the rule nominally target traditional short-term, small-dollar lending that is commonly referred to as "payday lending," the scope of the proposed rule would more broadly cover vehicle title loans, deposit advance products, and certain high-cost installment loans and open-end loans. The rule outlined by the CFPB is complex and would have a significant impact on the small-dollar, short-term lending market.

In articulating the basis for the proposed rule, CFPB Director Richard Cordray said:

> Today we are taking an important step toward ending the debt traps that plague millions of consumers across the country. Too many short-term and longer-term loans are made based on a lender's ability to collect and not on a borrower's ability to repay. The proposals we are considering would require lenders to take steps to make sure consumers can pay back their loans. These common sense protections are aimed at ensuring that consumers have access to credit that helps, not harms them.

II. Rulemaking Timeline & Process

The CFPB published an outline of the proposed rule in preparation for a Small Business Review Panel (SBRP) that must be held as the next step in the rule-making process. Unless the CFPB certifies that a proposed rule will not have a significant economic impact on a substantial number of small businesses, the Regulatory Flexibility Act of 1980, 5 U.S.C. §§ 601 et seq., requires the CFPB to convene and chair a SBRP pursuant to rules prescribed by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA). Since the proposed rule would likely have a significant economic impact on a substantial number of small businesses, SBREFA requires that the CFPB convene a SBRP to consider the impact of the proposed rule and obtain feedback from representatives of lenders and other small businesses that would be subject to the rule.

The SBRP will likely be convened in late April or early May with a report from the SBRP being issued within 60 days after that. The CFPB will then proceed with writing the rule. It is anticipated that the CFPB will issue a formal notice of proposed rulemaking by late summer or early fall 2015. The CFPB usually provides 90 days to comment on a proposed rule, and so the comment period will likely close by the end of 2015 or first quarter of 2016. A final rule would then be expected by summer 2016, with an effective date one year from issuance of the final rule. If this timetable holds and there is no delaying litigation, the final rule is likely to become effective in the summer of 2017.

III. Scope of Proposed Rule

The scope of the proposed rule would cover the following types of consumer credit products:

- Short-term credit products with contractual durations of 45 days or less (Covered Short-Term Loans); and
- Longer-term credit products with an all-in annual percentage rate in excess of 36 percent where the lender obtains a preferred repayment position by either obtaining
  - access to repayment through a consumer's account or paycheck, or
  - a non-purchase money security interest in the consumer's vehicle (Covered Longer-Term Loans).

While different requirements apply to short-term and longer-term credit products covered by the rule, together they are referred to as "Covered Loans."

IV. Requirements of Proposed Rule

The proposed rule under consideration provides separate requirements for Covered Short-Term Loans and Covered Longer-Term Loans. For each category of Covered Loan, the CFPB has proposed two alternative regulatory approaches that lenders may choose between: either prevention or protection. Under the prevention requirements, lenders would be required to determine a consumer's ability to repay before extending credit. Under the protection requirements, lenders would generally be restricted in the credit terms they could offer to consumers.

A. <u>Covered Short-Term Loans</u>

Covered Short-Term Loans would include credit products like traditional payday loans with a single payment, short-term vehicle title loans, open-end lines of credit where the credit plan is to terminate within 45 days or the credit is repayable in full within 45 days, and multi-payment loans where the loan is due in full within 45 days. Lenders offering Covered Short-Term Loans would have to comply with either the "Prevention Requirements" or the "Protection Requirements" described below, but not both.

1. Prevention Requirements

The Prevention Requirements for Covered Short-Term Loans would require lenders to make a reasonable good-faith determination prior to extending credit that the consumer can repay the loan when due. For each Covered Short-Term Loan, lenders would have to verify the consumer's income, "major financial obligations," and borrowing history using third-party records. "Major financial obligations" would include such obligations as housing payments, car payments, and child support payments. Using this information, the lender would then have to make a determination whether the consumer has the ability to repay the loan after covering other major financial obligations and basic living expenses.

The proposal would also create a rebuttable presumption that the consumer lacks the ability to repay an additional Covered Short-Term Loan taken out within 60 days of a prior outstanding Covered Short-Term Loan, thus creating a so-called 60-day "cooling off period." For a second and third Covered Short-Term Loan made in a sequence within this 60-day period, the lender would need to separately determine that the consumer has the ability to repay each loan.

To overcome this rebuttable presumption, the lender would have to verify that the consumer's financial circumstances have improved sufficiently to demonstrate that the consumer has the ability to repay the loan. After three Covered Short-Term Loans in a sequence, the proposed rule would create a conclusive presumption that the consumer lacks the ability to repay. In such circumstances, a lender would be prohibited from making a fourth Covered Short-Term Loan to that consumer until a 60-day cooling-off period had elapsed after maturity of the third Covered Short-Term Loan.

2. *Protection Requirements*

Instead of complying with the Prevention Requirements described above, a lender may alternatively comply with the Protection Requirements for Covered Short-Term Loans. The Protection Requirements would include screening and structural requirements for the credit product.

The screening requirements would require the lender to do all of the following:

1) Verify the consumer's income;
2) Verify the consumer's borrowing history;
3) Report use of the loan to all applicable commercially available reporting systems;
4) Verify that the consumer does not currently have a Covered Loan outstanding with any lender;
5) Verify that the consumer has taken out no more than three such "alternative loans" in a sequence (with a sequence including any loan taken out within 60 days of having a prior loan outstanding), and has not completed a three-loan sequence of "alternative loans" from any lender within the past 60 days;
6) After repayment of the third loan in a sequence, neither the lender nor any of its affiliates can extend additional credit, whether or not a Covered Loan, to the consumer for a period of 60 days;
7) Verify that the loan would not result in the consumer receiving more than six covered short-term loans from any lender in a rolling 12-month period; and
8) Verify that, following completion of the contractual loan term, the consumer will not have been in debt on Covered Short-Term Loans for more than 90 days in the aggregate during a rolling 12-month period.

If the screening requirements described above are satisfied, the lender could extend credit to the consumer that meets the following structural requirements:

1) The amount financed does not exceed $500;
2) The Covered Short-Term Loan has a contractual duration of 45 days or less with no more than one finance charge for this period;
3) The consumer does not provide a security interest in a vehicle as collateral for the Covered Short-Term Loan; and
4) The loan is structured to "taper off the consumer from indebtedness" on Covered Short-Term Loans. To satisfy this tapering off requirement, the CFPB is considering requiring either that: (a) lenders provide a "no-cost off-ramp" for consumers unable to repay the debt after the third loan

in a sequence; or (b) lenders reduce the principal amount of subsequent loans so that the debt amortizes over three loans.

B. Covered Longer-Term Loans

Covered Longer-Term Loans are credit products with an all-in annual percentage rate in excess of 36 percent where the lender obtains a preferred repayment position by either obtaining (1) access to repayment through a consumer's account or paycheck, or (2) a non-purchase money security interest in the consumer's vehicle. A key aspect of the definition of Covered Longer-Term Loans is the meaning of "account access." According to the CFPB's outline of the proposed rule, account access would include a post-dated check, an ACH authorization, a remotely created check authorization, an authorization to debit a prepaid card account, a right of setoff or to sweep funds from a consumer's account, and other methods of collecting payment from a consumer's checking, savings, or prepaid account, as well as a payroll deduction. A credit product would be considered a Covered Longer-Term Loan and would be subject to the proposed rule if the lender obtains account access before the first payment on the loan, imposes a contractual obligation to provide account access, or incentivizes account access.

Lenders offering Covered Longer-Term Loans would also have to comply with either the Prevention Requirements or Protection Requirements described below, but not both.

1. Prevention Requirements

Similar to Covered Short-Term Loans, the prevention requirements for Covered Longer-Term Loans would require lenders to make a reasonable good-faith determination prior to extending credit that the consumer can repay the loan when due. To satisfy this ability-to-repay requirement, a lender would have to verify the consumer's income, major financial obligations, and borrowing history using third-party records. Using this information, the lender would then have to make a determination whether the consumer has the ability to repay the loan after covering other major financial obligations and basic living expenses.

This ability-to-repay determination for Covered Longer-Term Loans would apply to lenders making a Covered Longer-Term Loan, including refinancing of certain loans into a Covered Longer-Term Loan. Specifically in the refinancing context, the proposed rule would impose a rebuttable presumption that a consumer lacks the ability to repay a Covered Longer-Term Loan where circumstances exist indicating that the consumer lacked the ability to repay the loan that is being refinanced. The presumption would be triggered with respect to the extension of the term of any existing loan or the issuance of a new loan during the term of a preexisting loan if:

1) The consumer was, at the time of the refinancing, delinquent or had recently been delinquent on a payment under the loan being refinanced;

2) The consumer stated or otherwise indicated that he was unable to make a scheduled payment under the loan being refinanced or that the loan being refinanced was causing financial distress;

3) The refinancing provides for the consumer to skip (or pay a lesser amount than) a payment that otherwise would have been due under the loan being refinanced, unless the refinancing provides for a substantial amount of cash out to the consumer; or

4) The loan being refinanced is in default.

The rebuttable presumption would apply in any transaction where the new loan is a Covered Longer-Term Loan and the prior debt, whether a Covered Loan or not, was made by the same lender or its affiliates. In addition, this rebuttable presumption would apply to any transaction where the new loan is a Covered Longer-Term Loan and the debt being refinanced is a Covered Loan from any lender.

In such circumstances where a rebuttable presumption of the consumer's inability to repay exists, in order to extend credit, the lender would have to verify that the consumer's financial circumstances have improved sufficiently to demonstrate that the consumer has the ability to repay the loan.

Finally, for purposes of refinancing and reborrowing, the proposed rule would treat Covered Longer-Term Loans with a balloon payment in the same manner as Covered Short-Term Loans.

2. Protection Requirements

Instead of complying with the Prevention Requirements described above, a lender may alternatively comply with the Protection Requirements for Covered Longer-Term Loans. The CFPB has proposed to allow lenders to make two types of Covered Longer-Term Loans under the Protection Requirements. Similar to the Protection Requirements for Covered Short-Term Loans, the requirements for each of these "alternative" Covered Longer-Term Loans would be comprised of both screening and structural requirements.

a. PAL-Type Loans

The first type of "alternative" Covered Longer-Term Loan would be a loan generally satisfying the requirements of the Payday Alternative Loan (PAL) program under the National Credit Union Administration's regulations.

With respect to screening requirements, the lender would need to verify the consumer's income and determine that the loan would not result in the consumer having more than two Covered Longer-Term Loans under the PAL-type alternative requirement from any lender in a rolling six-month period.

If these screening requirements are satisfied, the lender could extend credit to the consumer that meets the following structural requirements:

1) The loan has a principal of not less than $200 and not more than $1,000;

2) The loan has a maximum term of six months;

3) The lender charges no more than a 28 percent annualized interest rate plus an application fee of no more than $20 reflecting the actual costs of processing the application; and

4) The lender fully amortizes the loan over no fewer than two payments.

b. Maximum PTI Loans

The second type of "alternative" Covered Longer-Term Loan would be a loan with payments below a 5 percent payment-to-income ratio that satisfies certain other conditions.

The screening requirements would include the following:

1) Verify the consumer's income;

2) Verify the consumer's borrowing history;

3) Report use of the loan to all applicable, commercially available reporting systems;

4) Verify that the consumer has no other covered loan outstanding and has not defaulted on a covered loan within the past 12 months; and

5) Verify that the loan would result in the consumer being in debt on no more than two such loans within a rolling 12-month period.

If the screening requirements described above are satisfied, the lender could extend credit to the consumer that meets the following structural requirements:

1) The periodic payment due on the loan is no more than 5 percent of the consumer's expected gross income during this same period;

2) The loan is a closed-end loan repayable in at least two substantially equal payments over no fewer than 45 days;

3) The loan has a maximum duration of no more than six months; and

4) The lender charges no fees for prepayment of the loan.

C. Payment Collection Restrictions

In addition to the restrictions on Covered Loans described above, the CFPB is also considering two restrictions on lender collection practices when lenders access a consumer's checking, savings, or prepaid account.

First, the proposed rule would require lenders to provide consumers with three business days advance notice before submitting a transaction to the consumer's bank, credit union, or prepaid account for payment. This notice would include disclosures about the imminent payment collection, such as payment amount.

Second, the proposed rule would limit unsuccessful withdrawal attempts. The proposal would prohibit lenders from attempting to collect a payment from a consumer's account after two consecutive payment attempts have failed. After that, the lender would have to obtain a new authorization from the consumer.

V. Resources

- Outline of the proposals under consideration
- Factsheet summarizing the proposals under consideration
- Factsheet summarizing the SBRP process
- List of questions for SBRPPP

This *GT Alert* was prepared by **Gil Rudolph, Brett Kitt, Scott Sheehan** and **Peter Cockrell.** Questions about this information can be directed to any member of Greenberg Traurig's **Consumer Financial Protection Bureau (CFPB)** team of professionals:

➢ Gil Rudolph | Co-Chair, Financial Regulatory & Compliance | +1 202.530.8575 | rudolphg@gtlaw.com

➢ Brett Kitt | Financial Regulatory & Compliance | +1 202.533.2359 | kittb@gtlaw.com

- Scott Sheehan | Financial Regulatory & Compliance | + 1 713.374.3543 | sheehans@gtlaw.com
- Michael Sklaire | Financial Services Litigation & Regulation | +1 703.749.1308 | sklairem@gtlaw.com
- Andy Berg | Financial Services Litigation & Regulation | +1 202.331.3181 | berga@gtlaw.com
- Michele Stocker | National Chair, Financial Services Litigation | +1 954.768.8271 | stockerm@gtlaw.com
- Jennifer Gray | Financial Services Litigation & Regulation | +1 310.586.7730 | grayjen@gtlaw.com
- Brian Schulman | Financial Services Litigation & Regulation | +1 602.445.8407 | schulmanb@gtlaw.com
- Jacob Bundick | Financial Services Litigation & Regulation | +1 702.792.3773 | bundickj@gtlaw.com
- Alan Slomowitz | Government Law & Policy| +1 202.533.2318 | slomowitza@gtlaw.com
- Patrick Anderson | Government Law & Policy | +1 202.331.3100 | andersonp@gtlaw.com
- Thomas McKee | Litigation | +1 703.749.1300 | mckeet@gtlaw.com
- Michael Lawrence | Litigation | +1 310.586.7719 | lawrencem@gtlaw.com
- Peter Cockrell | Financial Regulatory & Compliance | +1 202.530.8517| cockrellp@gtlaw.com

Albany
+1 518.689.1400

Amsterdam
+31 (0) 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Delaware
+1 302.661.7000

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0) 203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 (1) 55 5029 0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

New York
+1 212.801.9200

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul∞
+82 (0) 2 369 1000

Shanghai
+86 (21) 6391.6633

Silicon Valley
+1 650.328.8500

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv^
+972 (0) 3 636 6000

Tokyo¤
+81 (0)3 3216 7211

Warsaw~
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900