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CFPB Issues Final Rule Rescinding Payday Loan Mandatory Underwriting Requirements

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The Consumer Financial Protection Bureau (the "CFPB" or "Bureau") recently issued a final rule (the "Revocation Rule")[1] that significantly circumscribes the scope of the Bureau's original 2017 Payday Lending Rule (the "2017 Rule").[2] While the 2017 Rule originally was designed to address what the prior CFPB director Richard Cordray described as the "debt trap" caused by short-term consumer loans with a term of 45 days or less repayable in a single installment and longer-term consumer loans with balloon payments (together "covered loans"), the recently adopted Revocation Rule jettisons significant portions of the 2017 Rule intended to address practices previously characterized by the Bureau as "unfair and abusive."

A. Overview of the 2017 Rule

The original scope of the 2017 Payday Lending Rule[3] contained three principal sets of obligations:

- underwriting standards;
- collections requirements (also known as the Payments provisions); and
- reporting requirements.

The underwriting standards in the 2017 Rule were intended to require lenders of covered loans[4] to determine a borrower's ability to repay prior to making a loan (the "Mandatory Underwriting Provisions").[5] The 2017 Rule identified as an "unfair and abusive practice" a lender making a covered loan without "reasonably determining that the consumer will have the ability the repay the loans according to their terms"[6] (the "Identification Provision"). The 2017 Rule further established specific underwriting requirements for these loans, including a requirement to obtain verification evidence of a consumer's income if reasonably available and a report from a national consumer reporting agency (the "Prevention Provision").[7] The 2017 Rule required lenders to furnish information concerning each covered loan to a Registered Information System (the "Furnishing Provisions").[8]

The 2017 Rule also placed restrictions on debt collection attempts, focusing on the initiation of direct withdrawals from consumers' accounts (the "Payments Provisions").[9] The Payments Provisions could result in an unfair and deceptive lender practice to attempt to withdraw payment from consumers' accounts after two consecutive failed attempts due to insufficient funds without first providing a

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consumer with a specific notice and obtaining a reauthorization.[10] Lastly, the 2017 Rule directed lenders to retain records for 36 months after the date on which subject loans were satisfied, and to develop and follow a program to ensure compliance with reporting and retention requirements (the "Recordkeeping Provisions").[11] Information regarding these provisions can be found in our prior *Stay Current* available here.

B. The Impact of the Revocation Rule

Although most of the provisions of the 2017 Rule originally had a compliance date of August 19, 2019, the 2017 Rule has been subject to a number of efforts to delay or roll back the requirements—starting in January 2018 when the Acting Director of the CFPB announced the Bureau's intention to engage in rulemaking to reconsider the 2017 Rule. Then in June 2019, the CFPB issued a final rule to formally delay the August 2019 compliance date for the Mandatory Underwriting Provisions until November 2020.[12] Finally, in February 2019, the Bureau issued a notice of proposed rulemaking to revoke the Mandatory Underwriting provisions, which was adopted in final form as the Revocation Rule.

The Revocation Rule formally revokes the following key provisions under the Mandatory Underwriting provisions:

1. The Identification Provision, eliminating the requirement that a lender must confirm a consumer has an ability-to-repay[13] by examining a consumer's basic living expenses, debt-to-income ratio, and major financial obligations;

2. The Prevention Provision, eliminating the requirement to verify a consumer's income; and

3. The Recordkeeping and Furnishing Provisions specific to the Mandatory Underwriting Provisions.[14]

The CFPB also clarifies that the Bureau will no longer deem the failure to determine a consumer's ability to repay as an unfair and abusive practice. The 2017 Rule also authorized a Registered Information System, whereby lenders would register with the Bureau certain information concerning most loans covered under the 2017 Rule. The Revocation Rule removes this furnishing requirement; lenders will no longer be required to furnish information needed to uniquely identify the loan, specific information about the responsible consumer(s) for the loan, and the loan consummation date for all covered loans. To implement the Revocation Rule, the Bureau also removed certain model forms from its regulations.

Although the Revocation Rule significantly decreased the scope of the 2017 Rule, the Payments Provision of the 2017 Rule remains intact, continuing to make it an unfair and abusive practice for a lender to attempt to withdraw payment directly from consumers' accounts after the lender's second consecutive failed attempt. Moreover, the Revocation Rule retained the requirement for lenders to provide consumers with a written or electronic "payment notice" before making the first payment transfer, and a "consumer rights notice" after two consecutive failed withdrawal attempts. Finally, basic record retention remains in effect from the Mandatory Underwriting Provisions, as lenders must retain, or be able to reproduce an image of, the loan agreement for 36 months after the date on which a covered loan is satisfied. The requirement to retain records for 36 months extends to documentation of the leveraged payment mechanisms, authorization of additional payment transfer, and one-time electronic transfer authorizations. Additionally, the lender must retain electronic records of payments received and attempted payment transfers.

The Revocation Rule is effective 90 days after the date of publication in the Federal Register.

C. *Implications for Lenders and Investors*

While the purpose of the 2017 Rule, like the Bureau itself, was intended to address potential consumer harm, the Revocation Rule essentially maintains the *status quo* in the short-term lending industry, permitting the origination of payday loans without imposing additional obligations on industry participants such as to ensure that a consumer can repay or that extensive processes and procedures must be adopted and maintained to track such loans. For lenders and investors, maintaining the *status quo* should be viewed as bringing certainty to the market, as significant changes and expenses are no longer seen as potential risks on the horizon, particularly those costs associated with compliance with the 2017 Rule and potential penalties for violating the obligations initially imposed by the 2017 Rule.

As one of the Bureau's original purposes was to address abuses in the payday industry, the Revocation Rule neuters attempts to limit payday loans to those consumers that can demonstrate ability to repay. The Revocation Rule will allow payday loans to persist in the market largely unchecked. We note that the Revocation Rule is protective of an industry that has long been viewed as one of the primary impetuses for the CFPB, and therefore the new rule could be viewed as antithetical to the mission of the CFPB. As a result, the industry should not be surprised if future Directors of the CFPB attempt to reinstate or otherwise reformulate the consumer protections that were the hallmark of the 2017 Rule. Thus, the adoption of the Revocation Rule may only provide temporary relief to the industry.

We note that the Revocation Rule also closely follows the May 2020 announcement by the federal financial institution regulatory agencies of principles for offering small-dollar loans in a responsible manner to meet financial institutions customers' short-term credit needs in response to the ongoing COVID-19 pandemic, signifying a shift in the other federal financial regulatory agencies' views on endorsing short-term, small-dollar loans to consumers.

Paul Hastings attorneys actively advise lenders, investors, and parties subject to the CFPB's regulatory authority. Please contact us if you would like to discuss any of these issues in detail.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] Consumer Financial Protection Bureau,12 C.F.R. Part 1041, Payday, Vehicle Title, and Certain High-Cost Installment Loans (issued July 7, 2020) (not yet published in the Federal Register) (available at https://files.consumerfinance.gov/f/documents/cfpb_payday_final-rule-2020-revocation.pdf).

[2] An unofficial redline released by the Bureau of the Revocation Rule against the 2017 Payday Lending Rule can be found here.

[3] *See* 82 Fed. Reg. 54472 (Nov. 17, 2017), Payday, Vehicle Title, and Certain High-Cost Installment Loans; 12 C.F.R. § 1041.4–15.

[4] 12. C.F.R. § 1041.3 (a "Covered loan" means "closed-end or open-end credit that is extended to a consumer primarily for personal, family, or household purposes" subject to certain exclusions and meets the criteria set forth in 12 C.F.R. § 1041.3 (b)(1) or 12 C.F.R. § 1041.3 (b)(2)).

[5] 12 C.F.R. § 1041.5.

[6] 12 C.F.R. § 1041.4.

[7] 12 C.F.R. § 1041.5.

[8] 12 C.F.R. § 1041.10(b).

[9] 12 C.F.R § 1041.7–9.

[10] 12 C.F.R § 1041.7.

[11] 12 C.F.R §1041.11-12.

[12] 84 Fed. Reg. 27907 (June 17, 2019), https://www.federalregister.gov/documents/2019/06/17/2019-12307/payday-vehicle-title-and-certain-high-cost-installment-loans-delay-of-compliance-date-correcting.

[13] Similarly, the CFPB eliminated the "principal step-down exemption" that would have allowed lenders to extend covered loans without an ability-to-repay determination if the principal does not exceed $500 for the first in a sequence of short-term loans.

[14] Consumer Financial Protection Bureau,12 C.F.R. Part 1041, Payday, Vehicle Title, and Certain High-Cost Installment Loans (issued July 7, 2020) 3–4 (not yet published in the Federal Register) (available at https://files.consumerfinance.gov/f/documents/cfpb_payday_final-rule-2020-revocation.pdf).

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