SPECIAL ALERT: CFPB RELEASES OUTLINE OF PROPOSED RULE FOR PAYDAY, VEHICLE TITLE, AND SIMILAR LOANS

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On March 26, the CFPB announced that it is considering proposing a rule to "end payday debt traps" and released several related documents, including a fact sheet and an outline of the proposal that will be presented to a panel of small businesses pursuant to the Small Business Regulatory Enforcement Fairness Act (SBREFA). The proposal sets forth ability to repay requirements for "short-term" and "longer-term" loans, and then provides alternative options for lenders to provide both types of loans in lieu of complying with the general ability to repay requirements.

Under the SBREFA process, the CFPB first seeks input from a panel of small businesses that likely will be subject to the forthcoming rule. A report regarding the input of those reviewers is then created and considered by the CFPB before issuing its proposed rule.

Scope of Products Covered

The SBREFA outline suggests that the proposal would cover two categories of loans:

- "Covered short-term loans," which include consumer loans with a contractual duration of 45 days or less; and
- "Covered longer-term loans," which include credit products with an "all-in" APR of 36% or more where the lender either (a) "obtains a preferred repayment position" through "access" to the consumer's account (e.g., by means of a post-dated check, ACH debit authorization, or similar methods) or (b) has a non-purchase money security interest in the consumer's vehicle.

The CFPB specifically stated that it is considering a broader definition of APR than TILA's definition and that this may include fees and ancillary products, suggesting that it may use the military annual percentage rate defined in 32 C.F.R. Part 232 as a measure of this "all-in" APR.

Ability to Repay Requirements for Covered Short-Term Loans

The proposal would impose different requirements on "covered short-term loans" and "covered longer-term loans." For short-term products, lenders would be required to evaluate the consumer's ability to repay the loan by the due date. As part of this, lenders would be required to obtain and verify information about the consumer's income, "major financial obligations" (such as housing payments, other debt obligations, child support, and possibly utility payments and medical expenses), and the consumer's borrowing history with respect to other covered short-term loans. The lender would need to obtain documentation of the consumer's income, verify major financial obligations using third-party records, and determine the consumer's borrowing history with respect to covered short-term loans by checking its own records (and the records of any affiliate) and by checking a commercially available reporting system. Based on the verified information, the lender then would be required to determine that the consumer could repay the loan after meeting his or her major financial obligations and necessary living expenses.

Furthermore, for refinances of covered short-term loans, the proposal would create a rebuttable presumption that the consumer is unable to repay the new extension of credit if the new extension of credit has a "similar" payment structure. To rebut this presumption, the lender would need evidence of a change in the consumer's circumstances indicating the ability to repay (e.g., evidence of a pay raise) and would need to comply with the verification and ability to repay requirements for an initial loan. The presumption also would cover any new loan made within 60 days of a prior covered short-term loan. After the third loan in a sequence, the presumption regarding the consumer's inability to repay would be conclusive. Self-certification of a change in circumstances would not be permitted.

<u>Alternative Requirements for Covered Short-Term Loans</u>

The CFPB's proposal also contains "alternative" requirements. A lender could extend a covered short-term loan without complying with the ability to repay requirements described above if the lender complied with certain screening requirements and structural limitations. The screening requirements are:

- Verification of the consumer's income;
- Verification of the consumer's borrowing history and reports use of the loan to all applicable commercially available reporting systems;
- Confirmation that the consumer does not currently have a covered loan outstanding with any lender;
- Confirmation 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;
- Refusal by the lender (or any affiliate) to extend additional credit to the consumer after the third loan in a sequence, whether or not a covered loan, for a period of 60 days;
- Confirmation 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
- Confirmation 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.

Furthermore, the following structural limitations would apply:

- The amount financed may not exceed $500;
- The loan must have a contractual duration of 45 days or less with no more than one finance charge for this period;
- The consumer must not provide a security interest in a vehicle as collateral for the loan; and
- The loan must be structured to "taper off the consumer from indebtedness on such loans."

With respect to the "taper off" requirement, the CFPB is considering two options:

- The first alternative would require the lender to reduce the principal amount for each loan in a three loan sequence. For example, if the initial loan were for $300, the second loan in the sequence could be for no more than $200, and the third loan in the sequence could be for no more than $100.

- The second alternative being considered is a “no cost extension” of the third loan in a sequence where the lender would be required to permit the consumer to repay the third loan in a sequence at no additional cost over four additional installments.

Ability to Repay Requirements for Covered Longer-Term Loans

The proposal would impose ability to repay and underwriting verification requirements for covered longer-term loans that are similar to the requirements for short-term covered loans with certain exceptions. Specifically, in connection with refinances and new loans within 60 days of a prior covered loan, different rules apply depending on the prior covered loan. If the prior covered loan was a covered longer-term loan without a balloon payment, then no presumption of the consumer’s inability to repay applies unless:

- The consumer was, at the time of the refinancing, delinquent or had recently been delinquent on a payment under the loan being refinanced;
- The consumer stated or otherwise indicated that he or she was unable to make a scheduled payment under the loan being refinanced or that the loan being refinanced was causing financial distress;
- 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
- The loan being refinanced is in default.

In those cases, the lender would need to obtain evidence of a change in circumstances, similar to a covered short-term loan.

If the prior covered loan was a covered longer-term loan *with* a balloon payment (defined as a payment more than two times the regular payment) or a covered short-term loan (or either if there are multiple covered loans in the prior 60 days), then the same presumptions of the consumer’s inability to repay discussed above in connection with covered short-term loans also would apply.

Alternative Requirements for Covered Longer-Term Loans

Similar to covered short-term loans, the CFPB’s proposal also contains “alternative” requirements for covered longer-term loans that would substitute for compliance with the ability to repay requirements described above. The CFPB is considering two alternatives: (i) loans made pursuant to the NCUA’s Payday Alternative Loan Program, and (ii) loans with periodic payments below a specified payment-to-income ratio. The former would involve the following screening requirements and structural protections:

- The lender applies “minimum underwriting standards” and verifies the consumer’s income;
- The loan has a principal of not less than $200 and not more than $1,000;
- The loan has a maximum term of six months;
- The lender charges no more than a 28 percent annualized interest rate and an application fee, reflecting the actual costs of processing the application, of no more than $20; and
- The lender fully amortizes the loan over no fewer than two payments.

The CFPB further stated that it is considering the following additional requirements:

- The lender verifies the consumer's borrowing history and reports use of the covered loan to all applicable commercially available reporting systems;
- The consumer has no other covered loan outstanding;
- The loan would result in the consumer having no more than two such loans during a rolling six-month period; and
- The loan has a minimum term of 45 days.

Some additional protections also would apply if the lender holds a deposit account in the consumer's name.

Alternatively, the CFPB is considering allowing lenders to offer covered longer-term loans without complying with the ability-to-repay requirements described above if the loan meets the following requirements:

- The lender verifies the consumer's income;
- The lender verifies the consumer's borrowing history and reports use of the covered loan to all applicable commercially available reporting systems;
- The consumer has no other covered loan outstanding and has not defaulted on a covered loan within the past 12 months;
- The loan would result in the consumer being in debt on no more than two such loans within a rolling 12-month period;
- The periodic payment due on the loan is no more than 5 percent of the consumer's expected gross income during this same period;
- The loan is a closed-end loan repayable in at least two substantially equal payments over no fewer than 45 days;
- The loan has a maximum duration of no more than six months; and
- The lender charges no fees for prepayment of the loan.

The CFPB also noted that it is considering a requirement to provide disclosures to consumers explaining the requirements for covered longer-term loans.

<u>Restricted Collection Practices</u>

For both short-term and longer-term covered loans, the CFPB's proposal also contains two restrictions on collection practices. First, the proposal requires the lender to provide written notice before each lender-initiated attempt to collect payment from a consumer's checking, savings, or prepaid account. This notice must contain the following information and must be provided at least three (3) business days in advance of each payment collection attempt and no more than seven (7) business days before payment is due:

- The "exact" amount and date of the upcoming payment collection attempt;
- The payment channel through which the attempt will be made;
- A break-down of the application of payment amount to principal, interest, and fees (if applicable);
- The loan balance remaining if the payment collection attempt succeeds;

- The name, address, and a toll-free phone number that the consumer can use to reach the lender; and
- For payment collection attempts made by check, such as a post-dated signature check or remotely created check, the check number associated with the payment attempt.

Finally, the proposal limits the number of times a lender may attempt to collect payment on a covered loan from a consumer's account, including a checking, savings, or prepaid account. After two consecutive failed attempts to collect payment, a lender would be prohibited from using any authorization it has at the time to make additional payment attempts on the loan. This restriction would apply to both delinquent payments and payments that are due in the future. However, the lender could obtain a new authorization from the consumer after hitting this cap and use the subsequently-granted authorization to collect future payments. The CFPB noted that it is considering whether to propose additional requirements to ensure that any new authorization was obtained freely, such as a disclosure indicating that the prior payment attempts have failed and that, if the consumer provides a new authorization, the consumer may incur further NSF and other fees in the event that future payment attempts fail.

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Questions regarding the matters discussed in this Alert may be directed to the lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

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