Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

Barnett Sivon & Natter P.C.
ATTORNEYS at LAW
WASHINGTON, DC

Ability to Pay and Limits on Transfer Attempts: The CFPB's Payday Loan Rule*

Katie Wechsler

October, 2017

On October 5, 2017, the Consumer Financial Protection Bureau (CFPB) released its final Rule on Payday Loans, Auto Title Loans, Deposit Advance Products, and Longer-Term Loans with Balloon Payments (Payday Rule). The rule was issued under CFPB's authority to prohibit unfair, deceptive or abusive acts or practices.[1] This article reviews the key provisions of that rule. In short, for certain loans, the Payday Rule requires lenders to assess a consumer's ability to repay, provide certain information about loans to registered information systems, and limit the number of times it attempts to debit a consumer's account for payment.

Covered Loans

The Payday Rule applies to three types of loans: Covered Short-Term Loans, Covered Longer-Term Balloon-Payment Loans, and Covered Longer-Term Loans (collectively, Covered Loans).[2] These loans, whether closed-end or open-end credit, are considered Covered Loans (and thus subject to the Rule) only if they are made to a consumer primarily for personal, family, or household purposes.[3]

<u>Covered Short-Term Loan</u>: A Covered Short-Term Loan is a loan with a term of 45 days or less (requiring the borrower to pay the full amount within 45 days or for loans with multiple advances, requiring the consumer to pay any advance within 45 days).

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

[1]The rule also is being issued under CFPB's authority to issue rules regarding disclosures and requiring nonbank lenders to maintain reports and records.

[2]As detailed below, some provisions of the Rule apply to all types of Covered Loans while some provisions only apply to certain types of Covered Loans.

[3]Creditors can rely on the Truth in Lending Act's Regulation Z and its commentary for determining the primary purpose of a loan

Covered Longer-Term Balloon-Payment Loan: A Covered Longer-Term Balloon-Payment Loan requires the consumer to either repay the entire balance (or an advance) in a single payment more than 45 days after consummation, or repay the loan through at least one payment that is more than twice as large as any other payment.[4]

Covered Longer-Term Loan:[5] A Covered Longer-Term Loan is one in which: (1) the cost of credit exceeds 36% per year;[6] and (2) the lender or service provider obtains a leveraged payment mechanism, which is a right to initiate a transfer of money, through any means, from a consumer's account to satisfy an obligation on a loan (i.e., the ability to "pull" funds from the consumer's account). Initiating a single immediate payment transfer at the consumer's request (i.e., a "push" transaction from the consumer to the lender) is not a leveraged payment. A lender or service provider does not initiate a transfer of money from a consumer's account if the consumer authorizes a third party, such as a bill pay service, to initiate a transfer of money from the consumer's account to a lender or service provider.

Exclusions: The Payday Rule does not apply to the following:

(1) Certain purchase money security interest loans;[7]

(2) Real estate secured credit;

(3) Credit cards;

(4) Student loans;

(5) Non-recourse pawn loans;

(6) Overdraft services and lines of credit;

(7) Wage advance programs;

(8) No-cost advances;[8] and

[4] A loan with multiple advances in which paying the required minimum payments does not fully amortize the outstanding balance by a specified date and the amount of the final repayment at such time could be more than twice the amount of other minimum payments also is a Covered Longer-Term Balloon-Payment Loan.

[5] The Rule does not apply to other longer-term loans as originally proposed; however, the CFPB is continuing to study how best to address concerns about existing and potential practices in those markets.

[6] The cost of credit is measured at the time of consummation for closed-end credit. For open-end credit, the cost of credit is measured at the time of consummation and, if the cost of credit at consummation is not more than 36%, again at the end of each billing cycle. If in a billing cycle there is a principal balance of $0 and the lender imposes a finance charge, the open-end credit is deemed to have a cost of credit that exceeds 36%. Once an open-end line of credit has met this threshold (cost of credit exceeds 36%), it is considered a Covered Loan for the duration of the plan.

[7] Credit extended for the sole and express purpose of financing a consumer's initial purchase of a good when the credit is secured by the property being purchased.

[8] Advances of funds that constitute credit if the consumer is not required to pay any charge or fee to be eligible to receive or in return for receiving the advance, provided that the entity advancing the funds warrants that it has no legal or contractual claim or remedy against the consumer based on the consumer's failure to repay and the entity will not engage in any debt collection activities or report it to a consumer reporting agency.

(9) Accommodation loans.[9]

The Rule also conditionally exempts "Alternative Loans" from the Rule. An Alternative Loan is a Covered Loan that satisfies several conditions including a loan term of 1-6 months, a loan amount between $200 and $1,000, and it cannot result in the consumer being indebted on more than 3 Covered Loans in the last 6 months. Federal credit union's Payday Alternative Loans (PAL loans) are considered Alternative Loans.

Underwriting

Ability-to-Repay

Under the Payday Rule, a lender cannot make a Covered Short-Term Loan or a Covered Longer-Term Balloon-Payment Loan, unless the lender first makes a reasonable determination that the consumer will have the ability to repay the loan.[10] The lender must conclude that the consumer can make payments for major financial obligations, make all payments under the loan, and meet basic living expenses during the shorter of the loan term or 45 days after consummation,[11] and for 30 days after having made the highest payment under the loan. The lender can use either the consumer's debt-to-income ratio or residual income for this determination.

A determination of ability to repay is not reasonable if it relies on an assumption that the consumer will obtain additional consumer credit to meet his obligations. Evidence that a lender's determinations of ability to repay are not reasonable may include a lender's default rates, re-borrowing rates, patterns of lending across loan sequences, evidence of delinquencies, and patterns of non-covered lending made shortly before or shortly after consumers repay a Covered Short-Term Loan or Covered Longer-Term Balloon-Payment Loan.

Verification and Documentation

The lender must obtain a consumer's written statement of the amount of the consumer's net income and amount of payments required for the consumer's major financial obligations. The lender also must obtain verification evidence of the income and financial obligations (such as pay stubs and a consumer report).

Additional Underwriting Limitations

Prior to making a Covered Short-Term Loan or a Covered Longer-Term Balloon-Payment Loan, a lender must obtain and review information about the consumer's borrowing history from the records of the lender and its affiliates, and from a consumer report obtained from a registered information system.

[9] Loans made by a lender that has made 2,500 or fewer Covered Loans in the current calendar year and 2,500 in the preceding calendar year and the lender derived no more than 10% of their receipts from covered loans.

[10] Note that the ability-to-repay provisions do not apply to Covered Longer-Term Loans.

[11] For a Covered Longer-Term Balloon Payment Loan, this period is the calendar month in which the highest payment is due.

A lender must comply with a 30-day cooling off period before making a Covered Short-Term Loan or Longer-Term Balloon-Payment Loan, if the consumer has already taken out three Covered Short-Term Loans or Longer-Term Balloon-Payment Loans that were outstanding within 30 days of each other.

Conditional Exemption for Certain Covered Short-Term Loans

The Rule provides for an exemption from the ability-to-pay requirements for a Covered Short-Term Loan that meets several requirements including that the loan amount be no greater than $500, the loan is closed-end and not secured by a vehicle, and the consumer cannot have certain outstanding, recent or subsequent Covered Loans.

Payment Transfer Attempts

A lender cannot make more than two attempts to withdraw payment from a consumer's account for a Covered Loan unless the lender obtains the consumer's new and specific authorization to make further withdrawals from the accounts.[12] The purpose of this prohibition is to ensure consumers are not repeatedly charged with lack of sufficient funds fees related to repeated attempts by a lender to satisfy a payment obligation. A payment transfer is a lender-initiated (not consumer-initiated) debit or withdrawal of funds regardless of the means. No later than six business days prior to initiating the first payment withdrawal or an unusual withdrawal from a consumer's account, a lender must provide a payment notice.

Information Furnishing

Lenders must furnish certain information to "registered information systems" about each Covered Short-Term Loan and Covered Longer-Term Balloon-Payment Loan it makes. The information that must be furnished includes a unique identifier for the loan, information to identify the consumer, the type of Covered Loan, the loan date, the principal amount borrowed or credit limit, and the amount due on each payment date. The lender must update the information as necessary while the loan is outstanding. When the loan ceases to be outstanding, the lender must provide the date as of which the loan ceased to be outstanding and whether all amounts owed in connection with the loan were paid in full.

To be a registered information system, an entity must apply to the CFPB and meet several conditions, including possessing the technical capability to receive information the lenders must furnish with standards to facilitate the timely and accurate transmission and processing of that information, maintaining federal consumer financial law compliance and information security programs, submitting independent assessments of those programs, and consenting to being subject to CFPB's supervision.

[12] Note that the payment provisions apply to all types of Covered Loans – Covered Short-Term Loans, Covered Longer-Term Balloon-Payment Loans, and Covered Longer-Term Loans.

Compliance Program and Recordkeeping

A lender making Covered Loans must develop and follow written policies and procedures reasonably designed to ensure compliance with the Payday Rule.

A lender must retain evidence of compliance with the Payday Rule, including the loan agreement, credit report, verification evidence, leveraged payment mechanism obtained, and authorization of payment transfers, for 36 months after the date on which a Covered Loan ceases to be an outstanding loan.

Anti-Evasion

A lender cannot take any action with the intent of evading the Payday Rule. If the lender's action is taken solely for legitimate business purposes, it will not be considered a violation of this provision. However, if a consideration of all relevant facts and circumstances reveals the presence of a purpose that is not a legitimate business purpose, the lender's action may be a violation of this provision. This provision has the potential to expand the scope of the applicability of the Payday Rule.

Effective Date

The Payday Rule is effective 21 months after publication in the Federal Register, except the provisions regarding application and registration of information systems which are effective 60 days after publication in the Federal Register.

Katie Wechsler is an associate with the law firm of ***Barnett Sivon & Natter, P.C.***