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CFPB Payday Loan Proposals Will Impact Depository Institutions

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In June 2016, the Consumer Financial Protection Bureau ("CFPB") released its long-awaited proposed rules—all 1,334 pages of them—to regulate payday lenders, automobile title lenders and other lenders of small dollar installment credit (the "Proposed Rules").

While the bulk of the criticisms and commentary on the Proposed Rules have come from companies that are in the payday lending and auto title loan business, and that have essentially said that the Proposed Rules would put them out of business, much less attention has been paid to the adverse implications the Proposed Rules would present for depository institutions, particularly smaller banks and credit unions that still routinely offer and make small consumer loans to their customers and members.

This article focuses on how depository institution lenders would be affected by the Proposed Rules if they are enacted, and advocates for a complete exemption for insured depository institutions from these anti-predatory lending regulations.

Insured banks, thrifts and credit unions that have long offered and made small consumer installment loans were never historically a problem from a predatory lending perspective, and these institutions should not now be painted with the CFPB's same "payday lending" brush with which they are addressing nondepository lenders.

Prior to discussing the CFPB's proposal to "federalize" small-dollar consumer lending, it is worth reviewing what the state legislatures have been doing to regulate this area during the past decade. Over 35 states have now passed their own rules and regulations that apply to payday lending and title lending. Like the case in Wisconsin, many state laws require licensing and examination of these lenders by state agencies; it is also true that almost all state laws that have been passed, including Wisconsin's, have included broad exemptions from coverage for insured financial institutions.

Notwithstanding the considerable recent state legislative activity to control perceived abuses in this kind of lending, including the establishment of comprehensive licensing requirements, the CFPB apparently is ready to run roughshod over state efforts and instead impose breathtakingly complex new

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federal requirements for all types of lenders who make "covered loans," including depository institutions.

Covered Loans

The CFPB's proposed rules address three different types of loans, and the requirements under the rules differ based on the loan type:

(a) Covered Short-Term Loans

Typically these are closed-end, single advance loans where the entire amount is due within 45 days of consummation.

Consider the following: A customer of your institution is currently in some financial distress and desperately needs to borrow $1,000 from your institution to pay for some immediate health care and car repair expenses. She would like to borrow from a bank, not an Internet payday lender. Your institution agrees to make the loan and the customer agrees to repay the loan in full in 45 days out of her next three paychecks.

This example would constitute a "Covered Short-Term Loan" under the CFPB's proposed rules, and the related requirements for this type of credit are described below.

(b) Covered Longer-Term Loans

Typically, these will be closed-end, single advance loans where the entire amount of the loan is not repayable within 45 days and in which:

- the "total cost of credit" exceeds 36% per annum;
  and
- the lender obtains a security interest in a motor vehicle;
  or
- the lender obtains a "leveraged payment mechanism" to repay the loan.

(c) Covered Longer-Term Balloon Payment Loans

These are "covered longer-term loans" requiring repayment in a single payment, or where at least one payment is more than twice as large as any other payment.

(d) Excluded Loans

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The CFPB's proposal excludes any real estate secured loans, credit cards, student loans and most "purchase money" security loans.

What Are the New Loan Rules?

Certainly one of the most controversial of the Proposed Rules is the requirement for the lender to complete an "ability to repay" analysis not dissimilar to the process done today to determine if a real estate loan is a "qualified mortgage." It is this requirement that many in the industry have said will lengthen and make the loan application process more expensive, and will cause many financial institutions to exit the "small-loan" business, which today is done most often as a customer accommodation.

Under the proposed rules, a lender cannot make a "covered short-term loan" without first making a "reasonable determination that the consumer will have the ability to repay the loan according to its terms."

To make this ability to repay determination, a lender must reasonably conclude that:

- the consumer's residual income is sufficient to make loan payments and to meet living expenses during the loan term; and
- the consumer will be able to pay for any "major financial obligation" when due, make all payments on the loan and meet basic living expenses for 30 days after the highest loan payment.

Lenders will be required to obtain "verification evidence" of the consumer's claimed income and expenses, which may include receiving a written statement from the consumer about income and expenses. Paystubs or deposit records also should satisfy this verification requirement.
Record keeping requirements would apply.

Requirement to Give Payment Notice

One of the more cumbersome and costly provisions of the Proposed Rules is the requirement for lenders to deliver a notice to consumers in advance of each payment coming from a "leveraged payment mechanism" involving the consumer's account. If the notice is given electronically, it must be provided no earlier than seven and no later than three business days before the payment

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transfer—or no earlier than ten nor later than six days if the notice is mailed.

Electronic Delivery of Disclosures

The Proposed Rules would permit all notices and disclosures to be sent electronically provided the customer consents. Customers also may revoke consent for any reason, meaning, in some cases, lenders will be required to mail all disclosures.

Conclusion

There are obviously many details in the Proposed Rules that cannot reasonably be addressed in this brief summary.

It is critical, however, that community banks, savings and loans, and credit unions all recognize the scope of this proposal, and should be alarmed about this proposed federal regulatory takeover of their small consumer loan programs. Depository institutions and their trade groups should consider filing comments with the CFPB before the Comment Period ends on September 14, 2016, and tell the CFPB to exempt insured depository institutions from coverage under the new rules.

Please call or e-mail Jim Sheriff at 414-298-8413; jsheriff@reinhartlaw.com if you would like to discuss this subject.

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