PAYDAY LOAN RULE FINALIZED: "ABILITY TO REPAY" REQUIREMENTS NARROWED, BUT CHALLENGES AND RISKS LOOM LARGE

Date: 17 October 2017

Financial Services Alert

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On October 5, 2017, the Consumer Financial Protection Bureau (the "CFPB") released its final rule targeting what it refers to as "payday debt traps" (the "Rule"). Among other things, the Rule will require lenders to make "ability to repay" determinations before offering certain types of loans, including payday loans, auto title loans, and longer-term loans with balloon payments. Failure to undertake an appropriate underwriting analysis to assess a consumer's ability to repay will constitute an "abusive and unfair practice." Industry participants will have approximately 21 months from publication of the Rule in the Federal Register to comply. As set out herein, the scope of the Rule is less expansive than expected, but its requirements present significant challenges and risks for industry participants.

THE PROPOSED RULE[1]

The CFPB's proposed rule, first released on June 2, 2016, sought to supervise and regulate certain payday, auto title, and other high-cost installment loans (the "Proposed Rule").[2] The Proposed Rule addressed two types of loans: "short-term" loans and "longer-term, high-cost" loans (collectively, the "Covered Loans").[3] "Short-term" loans included loans where a consumer would be required to repay substantially all of the debt within 45 days.[4] "Longer-term, high-cost" loans were broken down into two categories. The first category included loans with a contractual duration of longer than 45 days, an all-in annual percentage rate of greater than 36%, and either lender access to a leveraged-payment mechanism, such as a consumer's bank account or paycheck, or a lien or other security interest on a consumer's vehicle.[5] The second category of longer-term, high-cost loans was comprised of loans with balloon payments of the entire outstanding balance or a payment at least twice the size of other payments.[6] The Proposed Rule sought to render it an abusive and unfair practice under the Consumer Financial Protection Act for a lender to extend any of these Covered Loans without analyzing the consumer's ability to fully repay.[7]

Following the June 2016 release of the Proposed Rule, the CFPB received over 1.4 million comments, the largest volume of comments ever received for a CFPB rule proposal.[8] In part, commenters argued that the concerns that the CFPB sought to address were not relevant to all longer-term, high cost loans.[9]

THE FINAL RULE

The Rule will codify the CFPB's determination that it is an abusive and unfair practice to extend credit without completing the ability-to-repay analysis, but only for lenders offering short-term loans ("Covered Short-Term

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Loans") or longer-term loans with balloon payments ("Covered Longer-Term Balloon-Payment Loans"). The Rule departs from the Proposed Rule most dramatically in that it does not extend the ability-to-repay requirements to other longer-term, high-cost loans.[10] Given the extensive commentary provided with regard to such loans, the CFPB determined to "take more time to consider how the longer-term market is evolving and the best ways to address practices that are currently of concern and others that may arise"[11] following the implementation of the Rule.[12]

As to "Covered Short-Term Loans"[13] and "Covered Longer-Term Balloon-Payment Loans,"[14] the Rule mandates that lenders make a reasonable determination that the customer has the ability to repay the loan before extending credit.[15] This determination includes verifying, through reliable records or certain reporting systems, a consumer's monthly income, monthly debt obligations, and housing costs, while forecasting the consumer's basic living expenses.[16] Despite extensive requirements regarding the information that a lender must assess and verify in order to determine a consumer's ability to repay, the Rule provides little guidance as to how industry participants can practically and meaningfully implement such an individualized and fact-intensive analysis for loans of this nature, which consumers typically need in short order.

The Rule also includes several exemptions from the ability-to-repay requirements. Covered Short-Term Loans, for example, can be offered without an ability-to-repay determination if, among other requirements, the principal balance does not exceed $500 and the loan does not include a security interest in a vehicle.[17] Lenders extending less than 2,500 Covered Short-Term Loans or Covered Longer-Term Balloon-Payment Loans per year, with less than 10% annual revenue from such loans, are also exempt.[18] The CFPB believes such loans, which are typically made by community banks or credit unions to existing customers, pose less risk to consumers and, thus, do not require a full ability-to-repay test.[19] Employers and other entities offering wage or no-cost advances may also be exempt under certain circumstances.[20]

WHAT'S NEXT?

Absent congressional action to block it, the Rule will take effect 21 months after it is published in the Federal Register. Industry participants now face the tough task of formulating policies and procedures to implement underwriting models that will satisfy the Rule's mandatory, but vague, ability-to-repay requirements, while maintaining financial and practical viability for both lenders and consumers. Whether Covered Loans can reasonably be offered consistent with the Rule's ability-to-repay analysis is the big question and one that will likely lead to significant disputes once lenders begin compliance efforts.

Notably, neither the Rule itself nor the Consumer Financial Protection Act (which prohibits "abusive" and "unfair" actions) provides for a private right of action for consumers to bring individual or putative class claims for failure to conduct an adequate ability-to-repay analysis. Rather, the greatest potential risks of liability for industry participants that run afoul of the Rule are likely to come from two sources: (1) CFPB enforcement actions; and (2) claims under state unfair and deceptive acts and practices ("UDAP") statutes, which may be brought by consumers and/or by state attorneys general. While the potential scope of liability is uncertain at this stage, it is reasonable to expect that creative consumer attorneys will find ways to plead individual and putative class claims

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against industry participants based on alleged insufficient practices and procedures in determining ability-to-repay. Monitoring and engagement as this area develops will be critical to understanding the potential risks.

[1] For more information regarding the CFPB's proposed rule, please see the K&L Gates Alert "Payday Loans Under Attack: The CFPB's New Rule Could Dramatically Affect High-Cost, Short-Term Lending."
[2] *See* CFPB, Payday, Vehicle Title, and Certain High-Cost Installment Loans (proposed June 2, 2015), http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf.
[3] *Id*. at 170, 173.
[4] *Id*. at 170-172.
[5] *Id*. at 173.
[6] *Id*.
[7] *Id*. at 1135, 1148.
[8] 12 C.F.R. Part 1041, Payday, Vehicle Title, and Certain High-Cost Installment Loans, Bureau of Consumer Financial Protection, https://www.consumerfinance.gov/documents/5666/201710_cfpb_final-rule_payday-loans-rule.pdf, at 150.
[9] *Id*. at 246.
[10] *Id*. at 147.
[11] *Id.*
[12] These other types of longer-term, high-cost loans do not escape the Rule unscathed. Defined as "Covered Longer-Term Loans" (12 CFR 1041.3(b)(3)), they include loans that do not meet the definition of Covered Short-Term Loans or Covered Longer-Term Balloon-Payment Loans, have a total cost of credit above 36%, and allow the lender to automatically withdraw payment through a leveraged payment mechanism. Such Covered Longer-Term Loans are subject to other aspects of the Rule, such as the provisions making it an unfair and abusive practice to withdraw funds from a consumer account for repayment on a Covered Loan under certain circumstances. *See* 12 C.F.R. § 1041.7.
[13] 12 C.F.R. § 1041.3(b)(1).
[14] *Id.* at (b)(2). Exempt from the Rule are certain purchase money security interest loans, real estate secured credit, credit cards, student loans, non-recourse pawn loans, overdraft services and lines of credit, wage advance programs, no cost loans, and alternative loans meeting certain conditions. 12 C.F.R. § 1041.3(d).
[15] 12 C.F.R. § 1041.5(b).
[16] 12 C.F.R. § 1041.5(c).
[17] 12 C.F.R. § 1041.6.
[18] 12 C.F.R. § 1041.3(f).
[19] CFPB Payday, Vehicle Title, and Certain High-Cost Installment Loans, https://www.consumerfinance.gov/documents/5666/201710_cfpb_final-rule_payday-loans-rule.pdf, at 298–99.
[20] 12 C.F.R. § 1041.3(d).

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