Consumer Finance Monitor (Season 3, Episode 33): The CFPB's Payday/Auto Title/High-Rate Installment Loan Rule: A Look at the Uncertain Road Ahead

Speakers: Alan Kaplinsky and Jeremy Rosenblum

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers and the industry. I'm your host today, Alan Kaplinsky and I'll be moderating today's program. I am the Practice Group Leader of the Consumer Financial Services Group at Ballard Spahr. For those of you who want even more information about the topic we'll be discussing today or any other consumer finance topic, don't forget to consult our blog, which is also shares the name Consumer Finance Monitor with our podcast.

Alan Kaplinsky:

We've been doing our blog since 2011 when the CFPB got stood up and there is a lot of content there. We covered almost on a blow-by-blow basis whatever the CFPB is up to. But during the Trump administration, we've started covering not just the CFPB, we really do cover the waterfront when it comes to consumer finance. We also regularly host webinars on subjects that should be of interest to those of you in the consumer finance industry. So if you want to subscribe to our blog, you just log on to the blog and you can self subscribe. If you want to get on our list for webinars, you should email us at ballardspahr.com. Our podcasts are available on any podcast platform that you tend to use.

Alan Kaplinsky:

So we have a what I think is going to be a very interesting show today. The topic we're going to talk about is something that has consumed the CFPB for almost since its inception and that is, well, what were they going to do, if anything, about dealing with payday lending? There had been certainly at the time of enactment of Dodd Frank, there was very much a focus and a concern about the industry. The industry got singled out in Dodd Frank because payday lenders were one of the groups that were automatically subject to supervision by the CFPB. Fairly early on, but apparently maybe not early enough when you look back at the history the CFPB and what it did in the area of small dollar lending, they started looking into the industry.

Alan Kaplinsky:

I can't think of a better person to really tell us the story of the CFPB and its connection to payday lending and then it later morphed into more than just payday lending, but nobody better to tell us that story and bring us up-to-date than my longtime colleague and friend Jeremy Rosenblum. Jeremy is a Partner at Ballard Spahr. He co chairs the Consumer Financial Services Group with me. He has really followed the payday lending industry since its inception, was there really at the birth of the industry and has represented a lot of companies engaged in that business or related businesses and really understands that business inside and out. So first of all, Jeremy, a very warm welcome to you today.

Jeremy Rosenblum:

Thank you Alan. Glad to be here.

Alan Kaplinsky:

We'll lay a foundation before we get to what's going on right now. But in 2017, Richard Cordray, the then director of the CFPB, issued a final rule pertaining to small dollar lending. And as I recall the events, he did it as one of the last things from a regulatory standpoint that he accomplished before he resigned as Director of the CFPB to go back to Ohio to run for governor. Could you tell us or summarize for our listeners what was in that final rule and what impact it would have had on the industry if it had ever gone into effect?

Jeremy Rosenblum:

Sure Alan. Richard Cordray was no fan of payday lending. I think it's fair to say that he was viscerally hostile to the industry and his rule reflected that. There were two principle components. There were ability to repay, also known as Mandatory Underwriting Provisions. These rules applied to all consumer loans of 45 days or less and to longer term consumer loans that had balloon payment features, that is the possibly of payments that were twice other payments in the payment stream. Interestingly, the coverage of these provisions was not limited to small loans, but could apply to very substantial loans. That's really just a drafting flaw I think rather than anything else, but these provisions required covered lenders to do elaborate underwriting of the covered loans and very expensive verification requirements as to income, obligations and the like. They were basically designed to ensure that consumers were able to repay their obligations and still have funds available for other financial needs.

Jeremy Rosenblum:

The expectation was that these, and the CFPB acknowledged this, that these loans would have led to the demise of a very, very substantial portion of the industry, 70% or more of the industry. That was one aspect of the rule. There was also the adoption of so-called payment provisions. These applied to the same loans and also applied to longer term loans that did not have a balloon payment feature, but had an APR exceeding 36% and had a so-called leveraged payment mechanism. This was basically a method of accessing the consumer's bank account, whether through an ACH authorization, a post-dated check, a card authorization or other mechanisms. These payment provisions basically said that after a consumer has missed two straight payments that the lender has to go back and get an exclusive reauthorization for payment and then they had elaborate notice requirements associated with them.

Jeremy Rosenblum:

Two comments on the provisions. The ability to repay provisions, I mentioned had elaborate verification requirements. It's interesting that these verification requirements exist because the definition of unfairness in Dodd Frank excluded situations where the consumer is reasonably able to avoid injury. One would think that the verification of consumer statements should not be necessary when the consumer can simply tell the truth and accurately describe their obligations and income sources and so on. And by the same token, the payment provisions identified as the injury that the CFPB sought to avoid, that consumers would be subject to non sufficient funds charges or overdraft charges on their bank accounts when they were surprised by an initiation of another payment after they had already missed two payments.

Jeremy Rosenblum:

And again, the notice requirements simply had very little connection with the identified injury, the so-called unfairness that the CFPB was trying to address.

Alan Kaplinsky:

Yeah. So Jeremy, just going back to the ability to repay provisions, for our listeners who aren't all that familiar with or may not be that familiar with the payday lending product, are you saying that generally there is no underwriting of that product, that anybody who wants to can get a loan if it's legal in the state where they reside? It's just as simple as going into the store and buying toilet paper.

Jeremy Rosenblum:

It's not so easy to buy toilet paper these days Alan.

Alan Kaplinsky:

Maybe that was the wrong example.

Jeremy Rosenblum:

But I think it's fair to say that there are obstacles both in buying toilet paper and in obtaining a payday loan, so of course there was underwriting of these loans that lenders are not in the business of making loans that will not be repaid, but the combination of high interest rates and the access to the consumer's bank account that was characteristic of payday loans did mean that credit was much more available in the form of a payday loan than it would have been otherwise available. The consumers who were obtaining these loans were simply unable, for the most part, in getting credit from banks. Banks are not interested in making loans of $500 or less or at least for the most part, are uninterested in that. We're seeing some interest in payday loan substitutes from the banking industry, but mainstream banks [inaudible 00:12:41] in the industry was formed were not interested in small loans of this type.

Alan Kaplinsky:

I take it, and correct me if I'm wrong here, but there was no Congress did not... CFPB did not impose any kind of usury cap on the payday lending industry, what they said was, "You've got to jump through some additional hoops before you can make a loan to an individual." What the industry came back with is, "Yeah, but in order to jump through those hoops, there's a lot of cost involved to the industry and therefore our profit margin is going to get very narrow or get eliminated altogether, even though we charge high interest rates." Is that sort of... get to the sum and substance of the economics of the problem?

Jeremy Rosenblum:

Well, the rules would have drastically cut back on consumers who would qualify for loans and they would have imposed huge costs in terms of verification so that for most of the industry, except perhaps for large players who offer other services, such as check cashing, money transmission and the like, most of the industry would not only have had profit margins compressed, but profits eliminated entirely. Going back to the question of the CFPB simply imposing usury limits on payday loans, I'm quite sure that if that had been an available option to the CFPB at the time, it would have done just that, but there is a provision of the Dodd Frank Act that explicitly prohibits the CFPB from enacting usury limitations on loans.

Alan Kaplinsky:

Right. Right. So Jeremy, the rule was originally scheduled to go into effect in August of last year and it didn't go into effect. Describe to our listeners what happened to prevent that?

Jeremy Rosenblum:

Well, two things. First, with the change of administration and Director Cordray's replacement by then acting Director Mulvaney, Mr. Mulvaney, Director Mulvaney, announced fairly early in his tenure in that role that he had serious reservations about the payday rule and the Mandatory Underwriting Provisions and suggested that a cancellation or rescission of those Mandatory Underwriting Provisions was under active consideration. And then second, two industry trade groups initiated a lawsuit in Federal District Court in Texas seeking to have the payday rule declared invalid under the Administrative Procedure Act and the Constitution and seeking to enjoin implementation of the rule.

Jeremy Rosenblum:

In that lawsuit, ultimately, the court stayed the litigation, but also stayed implementation of the rule and that stay has remained in effect since I think sometime in 2018 to the present date.

Alan Kaplinsky:

And yeah, as I recall, what about every six months a status report would get filed with the Judge and the CFPB and the Trade Associations would agree on a further extension by virtue of the fact. As I recall, not so much other than basing the request for an extension on the fact that there was a case pending before the Supreme Court that was going to deal with the Constitutionality of the CFPB. It had much more to do with the fact that the CFPB intended to issue a new rule at some point and that that might moot all or part of the lawsuit. Am I right? That was the theory.

Jeremy Rosenblum:

I think both of those elements combined to keep the stay in place. There is no question that the court... The court, as I see it, was not really enthusiastic about the rule and has been happy, I think, to kick the can down the road a little bit. The lawsuit challenging the Constitutionality of the CFPB, of course, was key here because the rule was adopted by a Director at a time when the statute provided that he could not be, or she, he at the time of course, could not be discharged without cause. That is the Constitutional infirmity that the Supreme Court just found in the structure of the CFPB and the Seila law case. The court in the Texas litigation I think clearly was waiting for some clarification for the Supreme Court on whether it was dealing with a Constitutional rule or not.

Alan Kaplinsky:

Okay. And now getting back to the rule making itself, as I recall, you were absolutely right. Mulvaney, fairly early on, did some jaw boning about the rule, but during his tenure, he didn't do anything formally. Am I right? He didn't propose any change to the rule. I guess he was the Director when that litigation got filed in Texas, but it really didn't... nothing formally happened until he left and that didn't occur until Kathy Kraninger was named the new Director and got confirmed by the Senate right?

Jeremy Rosenblum:

I suspect that research and analysis was performed under Acting Director Mulvaney's reign, but you're correct that no formal proposal to amend the rule was made until Director Kraninger was appointed and confirmed.

Alan Kaplinsky:

Yeah. It's sort of funny. This is just a footnote to what we're talking about. I would guess if you were to ask Richard Cordray what his biggest regrets are of his tenure at the CFPB, he would probably say... There are probably two things. One, that he didn't get an arbitration rule done earlier in his tenure. And second, he didn't get a payday lending rule done earlier in his tenure because if he had, it might have very well gone through. I mean, there still would have been a legal challenge and it's hard to say how that would have come out, but I know it's a complicated issue and it takes time. You can't do it overnight, but it seems like both the Directors Cordray and Mulvaney probably should have jumped on this rule making a lot earlier than they appear to.

Jeremy Rosenblum:

Well, rule making is not such a simple process and doing it right is not easy. I'm not saying that Director Cordray did it right with respect to either arbitration or payday lending, not so much the timing on arbitration. He got his rule adopted and it was overturned by Congress under the Congressional Review Act and I don't know if that was really a timing question so much as just a political problem.

Alan Kaplinsky:

Well, I say it became a political problem because at one point, I guess during the first two years of Obama's tenure, the Democrats controlled the House and the Senate.

Jeremy Rosenblum:

I will grant you that if he had come into office and adopted an arbitration rule very early in his tenure without doing serious research, then he probably would have survived the Congressional Review Act, but would have been more exposed to litigation threats. I was going to add a third regret that undoubtedly Director Cordray had, I'll-

Alan Kaplinsky:

You'll keep that to yourself.

Jeremy Rosenblum:

I will keep that to myself.

Alan Kaplinsky:

Yeah. All right. Good. Good. So the Seila Law Opinion that you mentioned came down for the Supreme Court. The Supreme Court held that the management structure of the CFPB was unconstitutional by creating a single director who is removable only for cause. The Supreme Court remedied that constitutional infirmity by redlining the for cause language in Dodd Frank with the net result being that the President, whoever he or she might be, would have the right, with or without cause, to remove whoever might be the Director of the CFPB. What the Supreme Court left unanswered however was a very important question that they remanded to the Ninth Circuit. That is, well, okay, well what about the civil investigative demand that was the original act taken the CFPB. They had issued a CID to a law firm and the law firm resisted compliance with the CID based on its argument that it was unconstitutional.

Alan Kaplinsky:

CFPB filed a lawsuit against the law firm challenging... basically saying that they had to comply and the defense to the law firm was, "No I don't. The CFPB is unconstitutional." That issue got remanded. There are two other cases, one in the Ninth Circuit... No, one in the Fifth Circuit, one in the Second Circuit, All American Check Cashing and RD Legal Funding that now also we're going to have to deal with the question of what's the impact of Seila Law on the enforcement actions that were taken by the CFPB in those two cases? So getting now to this rule making, Seila Law comes down and nothing happens in the Texas lawsuit for maybe a month or so. And then what happened with... A status report recently got filed. Am I right?

Jeremy Rosenblum:

Well, Alan, there has been another critical development that I don't think we discussed yet and that is that the CFPB adopted a rule very recently that rescinded the Mandatory Underwriting Provisions of the 2017 rule and left intact without any modification the Payment Provisions of the 2017 rule. As things now stand, and this is still nonplussed, there are no Mandatory Underwriting Provisions in the current rule and the Payment Provisions remain in place. This is tied in with the almost simultaneous adoption by the Supreme Court of its Decision in Seila Law and both the Mandatory Underwriting Provisions and the Payment Provisions, whether the Mandatory Underwriting Provisions come back into the law somehow and whether the Payment Provisions are excised from the law are both open questions as things now stand.

Jeremy Rosenblum:

This started first with the repeal of the Mandatory Underwriting Provisions. It is a virtual certainty the CFPB action in rescinding these provisions will be challenged by blue state Attorney Generals or Backing Commissions and/or self styled consumer advocates. There will be litigation attacking the validity of the rescission rule making by the CFPB. And also, the rule rescinding the Mandatory Underwriting Provisions due to the timing of the adoption late in... relatively late in the Trump first term, potentially late in his administration period, the next Congress after the election will have the opportunity under the Congressional Review Act, almost for sure, to adopt a resolution disapproving the repeal of the Mandatory Underwriting Provisions, if it chooses to do so.

Alan Kaplinsky:

And Jeremy, if that were to happen, are you saying that the Mandatory Underwriting Provisions would spring back into life?

Jeremy Rosenblum:

I think that probably would be the result of a Resolution of Disapproval approved by both Houses of Congress and the President. That will be the new Senate, the new House and the new President. If all three of those bodies are controlled by the Democrats, I think it would be highly likely that the disapproval will be given under the Congressional Review Act and-

Alan Kaplinsky:

Yeah. But let me just interrupt you for a second, isn't it going to take more than just simple control of the Senate by the Democrats? Aren't they going to have to have 60 Democrats in the Senate in order for it to be filibuster proof?

Jeremy Rosenblum:

Well, Alan, you knew the answer to that question.

Alan Kaplinsky:

I figured I'd throw you a softball.

Jeremy Rosenblum:

The answer is that resolutions under the Congressional Review Act if enacted within 60 legislative days of the Congress receiving notice of regulatory action are not subject to filibuster. Now of course, there's an open question whether filibuster will survive a Democrat control of the Congress at all. But certainly under the Congressional Review Act, if action is taken promptly enough there will not be the possibility of a filibuster in the Senate.

Alan Kaplinsky:

Yeah, but here we are in August. 60 days is two months right? August, September. How do you see this thing extending into late January? I guess it's January 1, the new Congress, or January 2nd, the new Congress will reconvene. That's a lot more than 60 days away from now. What is the-

Jeremy Rosenblum:

Well, it's not 60 calendar days, Alan, it's 60 days when Congress is in session and people will be back home campaigning and the Senate and the House will have many, many days when they are not in session before the end of the year. The way it works out, I think, as I calculated based on the current proposed schedule, it looks like there may only be 56 days prior to the end of the year.That assumes that Congress is going to remain in session for the all the days on the current and calendar. It wouldn't be shocking if it recessed for longer periods than in the current schedule.

Alan Kaplinsky:

So actually, strategically, if you're, and we're talking politics now, the Republicans who support what Kraninger did would probably... it would be wise to get a CRA vote taken this year. If they know they either have enough votes in the Senate to kill the resolution or if they know that Trump would veto the resolution if it were passed, wouldn't it be a good idea to get this thing taken care of sooner rather than later? Delay is not going to be helpful here.

Jeremy Rosenblum:

That's a very interesting idea Alan and I simply don't have the kind of working experience with the Congressional Review Act to know whether that strategy would succeed. First, I don't know whether there's the political appetite to do that. And second, I mean, there are other important things going on that command some Congressional attention. But in addition, I don't know

whether, one, failure under the Congressional Review Act to disapprove a rule permanently insulates the rule form override under a subsequent potential resolution's approval.

Alan Kaplinsky:

So you're saying they might be able to get more than one bite of the apple maybe?

Jeremy Rosenblum:

I don't know, but that strikes me as possible. And I should say that in the situation [inaudible 00:34:11] when both House of Congress are under Democrat control and Joe Biden is President, there may be worse things that would happen to the payday industry and the consumer lending industry than disapproval of the repeal of the Mandatory Underwriting Provisions. I mean, there's been [furmat 00:34:35], for example, for a 36% national usury cap. And of course, if that legislation gets adopted, then the payday industry is gone.

Alan Kaplinsky:

As well as a lot of other types of consumer lending I might add. It won't be just payday. That would be absolutely devastating to the wider consumer finance industry and devastating to consumers because at that point, the only place where a lot of people are going to be able to get loans is on the deep, dark web and they won't be at the legitimate interest rates.

Jeremy Rosenblum:

There would be a radical contraction of credit if there was a 36% APR cap.

Alan Kaplinsky:

So you mentioned, Jeremy, that there's likely, assuming the CRA challenge doesn't work, the consumer advocates have got certainly the ability to challenge, let's call it payday loan rule number two. They, I guess, are fine with the payment part of it, but they would challenge the repeal of the underwriting or the ability to repay provisions. Would you expect that lawsuit to get combined with the lawsuit that is in Texas already between the trade associations and the CFPB or do you think that will be a separate lawsuit altogether?

Jeremy Rosenblum:

My expectation would be a separate lawsuit. I think the parties hostile to the repeal of the Mandatory Underwriting Provisions are likely to look around and find a venue that they consider to be as favorable as possible, somewhere-

Alan Kaplinsky:

You think they would go venue shopping? Do you think that... That sounds unseemly?

Jeremy Rosenblum:

I would do it if I were them. I think that's almost a certainty.

Alan Kaplinsky:

I would think a Federal Court in California might be a fairly good place for them to be. Very recently in an unrelated matter, three state AG's sued the Comptroller of the Currency challenging its newly adopted anti-Madden Rule. They didn't file in DC, they filed in Northern District of California. So clearly, there will be venue... And I agree with you. They're not going to want to be in Texas combined with that other lawsuit. I would hope that there would be an attempt to send that lawsuit wherever it got filed to Texas so that it's all in front of one judge. It makes sense from the standpoint of efficiency. And actually, I know you said earlier you thought the judge had a preelection to find in favor of the industry. They didn't seem to be that friendly toward the Payday Lending Rule.

Jeremy Rosenblum:

No. No. No. Alan, I did not say that. What I said was that I thought that the court was happy to kick the can down the road to avoid deciding the issue. I don't think the court has really-

Alan Kaplinsky:

No, they haven't.

Jeremy Rosenblum:

Evidenced whether he believes there is merit or is not merit in the challenge to the Payday Rule.

Alan Kaplinsky:

Yeah. That lawsuit, even though it's been pending now since 2018, for three years, it's not really gone very far. In fact, I don't even think the CFPB has filed a Response to the Complaint. They haven't filed either a Motion to Dismiss or an Answer. The plaintiffs, the trades, did file a Motion for Preliminary Injunction. I don't think that ever got responded to. I think after all that happened, the parties entered into this Joint Motion to Stay and the thing has been stayed. Right?

Jeremy Rosenblum:

Well, that's right. And the stay pretty much has the same effect as a preliminary injunction.

Alan Kaplinsky:

So you now have to give advice to a client. I'm a client and I call you Jeremy. I'm in the payday lending business. I'm really worried about the Payment Provisions. I ask you, when is it going to go into effect or is it ever going to go into effect? What do you think Jeremy and should we be getting everything ready now to comply with this rule so that if, God forbid, it does go into effect, we'll be ready to pull the trigger?

Jeremy Rosenblum:

Well, I'm reminded of the line in the Clint Eastwood movie, "Well, do you feel lucky punk? Do you?" I mean, and it's basically a question of risk and appetite for risk. There are very, very serious legal arguments that the trade groups have in opposition to the Payment Provisions as they currently exist. To my mind, some of the challenges that the industry can and will assert should get a favorable reception from the court. However, we know that the CFPB will defend the Payment Provisions right now for the remainder of the Kraninger term. And if Kraninger is replaced in a Democratic administration, all the more so by her replacement. The problem is if the lawsuit is unsuccessful and the Payment Provisions... the stay is lifted and Payment Provisions go into effect, then a company that has not taken the steps to prepare for the advent of the Payment Provisions is really in a horrible position.

Jeremy Rosenblum:

They cannot comply with an existing CFPB rule with respect to core elements of their product and that's a big risk to take. It's really a quandary because it is not simple to make the operational and programming changes that the Payment Provisions, as they're currently constituted, would require. It's no small undertaking. This is for companies who are already under severe financial stress with the COVID-19 pandemic and other developments in industry. It's a very difficult decision where reasonable people will take different approaches depending largely on their risk appetite and the resources that they have available to devote to compliance.

Alan Kaplinsky:

Yeah. What I've heard from a few people is, well, even worse case scenario, the Payments Provisions withstand attack, that the judge is going to be kindhearted and is going to realize that it's going to take a while for companies to come into compliance

and he'll give the industry ample time. Sounds a little bit to me like... While you quoted Clint Eastwood, maybe I can quote... I think it was Tennessee Williams, "Depending upon the kindness of strangers." Right?

Jeremy Rosenblum:

And was Tennessee Williams recommending that course of action? Look, we have a number of clients who have actively prepared for the Payment Provisions who are well down the road towards putting compliance procedures in place and they will be able to get their houses in order in whatever time that the court allows. Should the court provide a very substantial amount of time, if and when it decides to lift the stay, absolutely. Will it? That's a much different question. The court could conclude that the industry has had plenty of time. Of course, the industry has had plenty of time during the period when there was good reason to believe that the Payment Provisions might be overturned through either rule making or the court action. I don't think that's a good reason to adopt the short period, but there are just no guarantees in life and there's certainly no guarantees in Federal District Court.

Alan Kaplinsky:

Right. Okay. Well, I'm sure Jeremy we'll have further occasion to be talking about this rule as time goes on and we see what happens with the Texas lawsuit, the election, the Congressional Review Act override. And by the way, just one quick last point, am I right that if Congress tries to override the rule, they can't do it piecemeal? They can't say we want to override the repeal of the Underwriting Provisions, but we're perfectly content with the Payment Provisions, so we don't want to override that.

Jeremy Rosenblum:

Well no, I think that's exactly what will happen.

Alan Kaplinsky:

Oh, you do?

Jeremy Rosenblum:

The rule that will be subject to override is the rule rescinding the Mandatory Underwriting Provisions. There was basically no action taken with respect to the preexisting Payment Provisions. So no, any override will apply solely to the Mandatory Underwriting Provisions and have no impact whatsoever on the Payment Provisions.

Alan Kaplinsky:

Well, just to mention one thing though you're right, but the CFPB did ratify the Payments Provisions. That much I recall.

Jeremy Rosenblum:

I guess could Congress separately challenge the ratification of the Payment Provision? Sure, but I think that was a separate rule making and therefore would not be caught in an attack on Mandatory Underwriting Provisions per se.

Alan Kaplinsky:

Okay. Well Jeremy, thank you very much for coming here today and being our guest on our podcast and really shedding a lot of light on a very murky subject and a complicated one and it's... I feel badly for not only people in the industry, but for consumers who rely upon the product. This cloud has been hanging over the industry now for such a long period of time and we're still... It seems like we're not much better off than we were in terms of there being some clarity. It just seems to get murkier. Well, thank you again.

Jeremy Rosenblum:

Well, thank you for having me on.

Alan Kaplinsky:

Make sure you visit our website, www.ballardspahr.com, where you can subscribe to our show, either on our website or you can do it on Apple Podcasts, Google Play, Spotify or whatever your favorite podcast platform may be. And again, a reminder, don't forget to check out our blog, consumerfinancemonitor.com for daily insights about the consumer finance industry. We will be covering in detail, as we have for years, the rule making that we discussed today, as well as a lot of other important areas. Our podcast, we have a new show each week and it generally gets released on Thursday, except for a couple of holidays. We issue about 50 a year. So with that, I want to thank all our listeners for downloading and listening to our podcast today. Thank you again.