# Consumer Finance Monitor (Season 3, Episode 40): CFPB's Exam Findings Related to Short-Term Small-Dollar Lending in Summer 2020 Supervisory Highlights

Speakers: Chris Willis, John Culhane, and Jason Cover

Chris WIllis:

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, Chris Willis, and I'm the deputy practice leader of Ballard Spahr's Consumer Financial Services Group, and I'll be moderating today's program.

Chris WIllis:

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Chris WIllis:

Today, I'm joined by two of my colleagues, John Culhane and Jason Cover, who are two of our expert regulatory lawyers. And we're going to be talking about the provisions in the recent edition of the CFPB Supervisory Highlights that deal with short-term, small dollar lending. John and Jason, welcome to the podcast and thanks for being here today.

Chris WIllis:

And Jason, let me start with you. What were some of the things that you thought were notable as it relates to short-term, small dollar lending in this most recent Supervisory Highlights that the Bureau just released?

Jason Cover:

Thanks, Chris. There were essentially six highlights of which four were deceptive practices and two were truth and lending advertising violations. The first one, and I think this is something we see quite frequently when we diligence companies for our clients involved in application process for a storefront lender, where one could go online and complete a partial application, which was then transmitted to the store and the customer would have to ultimately go to the store to originate that loan. The CFPB found that it was a deceptive act or practice to represent on a website or in mailed advertising that the consumer could apply for a payday loan online in that fashion.

Jason Cover:

The hook is essentially that you've kind of drawn the customer in and they've spent all this time and given you all their information, and what looks like a loan you could ultimately originate, but in fact, you later have to drive or walk to the storefront. Again, this is something we see quite frequently. And I think the question then is, can a lender that is a storefront operator, can they still make applications in this fashion? Or rather is the issue the way that this particular lender or these particular lenders disclose that at "Apply online here, originate today"? Or could one with clear and conspicuous disclosure still start these pre-application applications, if you will?

John Culhane:

I'll jump in and comment. My take on the CFPB's report was that they weren't so much objecting to the process, or a bifurcated process, as they were objecting to the way that that process was described in the payday lender or payday lenders' marketing materials, both on its website and materials that it mailed to prospective clients. I think you could with an appropriate disclaimer, at least as far as we can tell from this report, you could with an appropriate disclaimer have this kind of process. What I found actually that was interesting was that they didn't seem to object to online applications from borrowers who would be interested in these loans. Chris, maybe you could comment on that because I know we have that issue come up from time to time?

Chris WIllis:

Yeah, it's been a worry that we've sort of talked among ourselves about, the idea that if you require a product to be originated via an online application, are you somehow discriminating against or treating unfairly people who don't have access to the ability to do an online application? They wouldn't have a computer or a mobile device that could do it, assuming you can do it with a mobile device. And we've worried principally about whether that might be an ECOA problem, potentially creating a disparate impact based on age.

Chris WIllis:

But thus far, even though we've been talking about that issue for some years now, I don't think we've seen any evidence of any regulatory concern around that issue. We haven't seen the CFPB raise it in enforcement or in supervision that we know of. We haven't seen any public statements that seem to suggest it's a problem. I think here where you see the CFPB examining this online application issue and not raising that, it's just more of the same sort of non-story on what we would sometimes refer to as this digital divide issue.

Chris WIllis:

Jason, what else was notable to you in the supervisory highlights?

Jason Cover:

Sure, Chris. The second issue at hand was a deceptive practice around representation stating no credit checks, and I think John will speak to that.

John Culhane:

Yeah, let me jump in and say a little bit about that. The CFPB objected to, again, one or more payday lenders advertising on websites through social media and other advertising, presumably that would have been direct mail, that their product was available with no credit check. And according to the CFPB, in fact, that lender or those lenders was or were using consumer reports from at least one credit reporting company.

John Culhane:

What's interesting about this is that we don't really get much detail, as is often the case with the Supervisory Highlights, as to what was going on here. We don't know if there really was detailed underwriting using credit reports, if the lender or lenders were accessing credit reports to look for knockout criteria, or even if they were using credit reports as part of a customer identity verification process. What we do know is if you say "no credit check", then that's got to be what it is, no credit check. You can't then access consumer reports as part of your underwriting process.

Jason Cover:

John, I would say this is also a question we get not infrequently. You've kind of alluded to this, but the question is always, "Well, it's not a consumer report" or "It's not a credit score. We're using a boutique bureau. It's not one of the big three. It's a 'soft pull'," and some of these various iterations of the same. And I think there's some real risks there if folks aren't careful with how they make that statement, as opposed to a no credit check product. All of these things have the potential, I think, to elicit a similar response from the CFPB.

John Culhane:

Yes, I agree. It's very likely that one or more of those practices were observed by the CFPB. Because although they say that reports were being obtained from at least one credit reporting company, they don't say national credit reporting company, for example, and they don't really describe the operations of the credit reporting company. It could very well have been obtaining reports of some sort from an entity that's a credit reporting company under the Fair Credit Reporting Act, but not one of the big three or not an entity that we typically think of when we think of credit reporting companies.

Chris WIllis:

The bottom line, gentlemen, I think is that a credit check is a credit check, regardless of where you get it, even if it's not from one of the three national CRA's. Even a boutique credit check is still a credit check.

John Culhane:

Yes, probably any use of third-party information is going to be problematic if you're saying "no credit check".

Chris WIllis:

Yeah. Jason, what's the next issue you'd like to share with the audience?

Jason Cover:

Sure, so the next two I would combine together as they were both deceptive threats involved in question letters. This is a subject probably near and dear to Chris's heart for those of you who have spoken to him on these issues. But the bottom line is I think many of us know that a practice in the collection world is you can't make threats in collection-related materials if you don't actually plan to follow through on them. I think the classic one is, "We will sue you or we will place you with a third party debt collector," or something like that if you don't actually do any of those actions.

Jason Cover:

But here the issue was, and again, it's somewhat unclear whether this was the same or different or multiple lenders, but essentially the first issue was collection letters that involved a threat of asset seizure or lien placement if the consumer didn't make payments. And the second one was a threat to assess late charges or late fees if the consumer didn't make a payment.

Jason Cover:

I think I personally find that the first one the most interesting. We have a lot of clients that make online title loans. And I think as many of you probably would understand, most of our online clients have no desire to repossess something in person. They are not a storefront lender or a retail lender for a reason, and they don't want to incur those additional costs.

Jason Cover:

The question then is, if you were an online lender, you have to be very careful in drafting your collection letters in relation to any sort of securitization or security interest you might have. And I think there's a second issue here too in that some states the fee authority actually directly relates to the ability to take a title in a car or another asset. There is this additional issue of, are you just obtaining the security interest essentially for the fee authority and does it then become a sham? It kind of interrelate to interlinks to this issue.

Jason Cover:

And I guess I neglected to add that there was one other issue here, and the CFPB asserted that some of these consumers may have been exempt from the lien or from the seizure under state law. They leave that nebulously aside as we're not sure what that means, but there's several issues that could potentially be at play here. I think this is a very interesting highlight.

John Culhane:

Yeah, I agree, and I think that highlight is actually something of sort of more general applicability. The suggestion that if you are sending a collection letter out indicating that there will be a lien placement or an asset seizure, that you then have to identify in some fashion at some level of detail the forms of property or assets that would be exempt in your situation is really troubling and challenging for secured lenders, because it seems to almost envision a state-by-state disclosure of exempt property on the back of the collection letter.

Jason Cover:

John, just on the topic of the late fees changing slightly here. I think I would have thought as to a loan agreement, if someone contracts for the late fee and the lender later decided to waive the late fee or just had a common practice of not charging the late fee, that I just always kind of felt like a regulator would... We should probably document the way things actually work, but I never thought a regulator would probably take issue with a client not charging a fee. But do you think this impacts that analysis, or do you think this should solely be related to the collection letter sphere?

John Culhane:

Well, I think this probably is just dealing with the collection letter, but the other issue as you've noted was the threat to assess a late fee when in fact the creditor's practice was not to assess late fees, and seemingly to never assess late fees. Although, again, it's always hard to tell what the actual practices were. But this seems, to me, to really be the CFPB objecting to a practice of providing for fees in your agreement that you never assess, and then somehow getting to the collection stage and threatening or asserting that you may collect those fees in the collection context. If you're providing for fees that you don't actually assess in your agreements and saying something like, "We may assess a late fee," but you never do it, you need to take a close look at your collection letters because they shouldn't be saying anything about the collection of late fees.

Chris WIllis:

Agree with you guys, that it's really more the collection communication that creates the problem rather than perhaps the existence of a fee in an agreement that isn't enforced. I would have a hard time thinking that's going to result in a UDAP claim. But certainly sending a collection letter or making a call saying, "If you don't pay by X, you're going to get a late fee," and then no late fees ever imposed, that seems like a classic UDAP problem to me.

John Culhane:

Absolutely.

Chris WIllis:

What else should we talk about with respect to the Bureau's observations here in the Supervisory Highlights?

John Culhane:

There's some advertising issues. Jason, you want to say a little bit about?

Jason Cover:

Sure. There's two alleged violations of Regulation Z, and I think they seem to be interrelated as they both involve one or more lenders advertising free loans to new customers. The first of these is a triggering term violation. And here the CFPB said that free is a finance charge, and finance charges as we know are triggering terms requiring disclosure of the triggered terms under

Regulation Z, and that the lender failed to do so. John, I think you might have some thoughts on this. I'm not sure this matches everyone's expectations.

John Culhane:

Well, yeah, I think we'll say a little bit more about what the terms of the product might actually have been when we get to the other assertion of an advertising violation, namely that the advertised product wasn't actually available. But this by itself, on its face, looks like the CFPB is asserting that a statement that a loan is free or that there are no finance charges somehow in and of itself is a trigger term. That's the equivalent of saying "zero finance charges" and therefore you've set an amount of a finance charge, and the amount of any finance charge is a trigger term which then triggers a requirement to disclose the annual percentage rate using that term and the terms of repayment over the full loan. And in a credit sale, it also requires a disclosure of the amount or percentage of a down payment.

John Culhane:

If that's the position the CFPB is taking, it's a very aggressive position given that there's a comment in the commentary specifically related to this requirement that says, "Statements that there are no particular charges for credit," and the example is no closing costs, "Statements that there are no particular charges for credit are not trigger terms." It seems a bit of a stretch to then go and say that a statement that there are no charges somehow is excluded from that exception, but that could very well be where we are here.

John Culhane:

We've had clients have to deal with examiners arguing that a 0% rate is somehow is a trigger term, and maybe this is a similar argument in that vein. I think that's just wrong as a matter of law, but we'll have to watch for that and see if it pops up.

John Culhane:

Now, you had an interesting point, Jason, about whether there really was or might've been a finance charge in these transactions. And it relates to that other assertion that the advertised product wasn't really available and what might actually have been going on here. Can you say a little bit more about that?

Jason Cover:

Sure. The second, or I'm sorry, the final item here or the second part of this prong essentially states that the creditor advertised credit terms that it didn't actually offer. And when you get into the meat of this, I think it kind of relates to the way payday loans work. What the CFPB says is, "This lender offered free loans for one week."

Jason Cover:

For those of you that aren't familiar with payday loans, generally how this works is, I mean, it's kind of in the name, right? We try to align the pay date with the due date. Someone who gets paid on a weekly basis, there's probably no problem here because it's a one-week free loan. And then for everyone else, if you're a bi-monthly, if you're biweekly, if you're a monthly payment, you essentially have that free week, but you likely aren't able to make payment then so it forces you into a rollover transaction.

Jason Cover:

And I think as we all know from all of the payday loan rule-related materials, that the CFPB has always been very concerned with rollovers in general. I somewhat wonder if this is really a free loans equal triggering term. Or this is related to the fact that for all intents and purposes, maybe some of the, or most of the people that applied for these loans ultimately would have a finance charge because they either had to rollover the loan or they had to obtain a loan for a longer term.

John Culhane:

Yeah, that seems to be a very logical conclusion, and let's hope that's the case. Because the other, I think, conclusion you might draw from this is that you can't advertise that a loan is free if the way it's free is that you pay it off early. That free relates to the making payments as required over the term of the loan. And if you don't say more, it's not enough to say that's free. It's sort of a deferred interest kind of product that couldn't be advertised as a free loan.

Chris WIllis:

Well, I seem to recall that the use of the word "free" has historically drawn a lot of attention in advertising by the Federal Trade Commission. That they seem to exhibit a very heightened sensitivity to the use the word "free" in advertising, similar to what you're describing from the CFPB here. I viewed these as kind of consistent. What do you guys think?

John Culhane:

I think that's the case. Yeah, I think the bank regulators historically have done the same thing. That if something's free, it's really got to be free. No strings attached. No charges.

Jason Cover:

And I think this ties in also with claims of no fees or no hidden fees or things like that. All of these things require great care if you're going to use them in advertising, and need to be substantiated.

Chris WIllis:

Jason and John, thank you very much for sharing your insights today about payday and auto title lending provisions in the last Supervisory Highlights. And to our audience, thank you for tuning in and be sure to visit us at our website ballardspahr.com, where you can subscribe to our show in Apple Podcasts, Google Play, Spotify, or your favorite podcast platform. And don't forget to check out our blog, consumerfinancemonitor.com for daily insights about the financial services industry. If you have any questions or suggestions for our show, just email us at podcast@ballardspahr.com and stay tuned each Thursday for a great new episode. Thank you all for listening.