

Consumer Finance Monitor (Season 7, Episode 25): What Banking Leaders Need to Know About the U.S. Supreme Court Ruling That the CFPB's Funding Mechanism is Constitutional Part II

Speakers: Alan Kaplinsky, Rich Andreano, John Culhane, Joseph Schuster, and Kristen Larson

Alan Kaplinsky:

Welcome to the award-winning 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. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel at the Consumer Financial Services Group at Ballard Spahr. And I'm pleased to be moderating today's podcast show.

For those of you who want even more information, either about the topic that we're going to be discussing today or anything else in the consumer financial services world, don't forget to consult our blog Consumerfinancemonitor.com. We've hosted the blog since 2011 when the CFPB became operational, so there's a lot of relevant industry content there. We regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the mailing list for our webinars, please visit us at Ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on whatever platform you may use, be it Apple Podcasts, YouTube, Spotify, or any other podcast platform. And also, please let us know if you have any ideas for other topics that we should cover on our program or other speakers we should consider inviting as guests on our show.

This is part two of a webinar that we did on May 30th entitled "Supreme Court CFPB Funding Mechanism is Constitutional: What Do Banking Leaders Need to Know?"

Let me introduce our speakers. Rich Andreano, who is the chair of our mortgage banking group, John Culhane, no stranger I'm sure to any of you who frequently attend our webinars. And Kristen Larson, in our Minneapolis office and last, Joseph Schuster, who within the past couple of months rejoined our firm after spending several years at Goldman Sachs.

This is what we're going to be covering today. We're going to lead off with John Culhane talking about proposed rulemaking in the fair credit reporting act area. Then we're going to go to Kristen Larson who will talk about the CFPB's proposal for a larger participant rule for payment providers. Then we will go to Joseph Schuster, who will talk about the recently released CFPB Buy-Now-Pay-Later interpretive rule. And then we'll go to John Culhane who will talk about the important implications of the congressional review act and how they may apply to regulations that have already been finalized by the CFPB. And then, finally, we'll go back to Joseph Schuster who will talk about the impact of the CFSA litigation on pending enforcement litigation and what we might expect in the way of CFPB enforcement litigation and investigations moving forward. And with that, I'd like to turn it over to John Culhane.

John Culhane:

So we don't have a proposed rule here. What we have is the initiation of a rulemaking process through the convening of a small business advisory review panel. A couple of important observations here though. The CFPB has been heralding this process as a process intended to remove medical bills from Americans credit reports as if that was the only thing that's going on here. That is not the case. This is an effort to rewrite the Fair Credit Reporting Act through regulation comparable to the effort the CFPB engaged in with the Fair Debt Collection Practices Act when it basically issued a gigantic regulation rewriting the provisions of the Fair Debt Collection Practices Act. A couple of observations about what the CFPB has proposed. This is a privacy rule, so maybe it's not too surprising that the proposals by the CFPB, if you look at them at the macro level, are to expand the scope of coverage, bring more companies within the definition of consumer reporting agency more reports within

the definition of consumer report, narrow the ability to get information by limiting the permissible purposes, in particular the one for obtaining a report with the written instructions of the consumer and the one when a report's going to be used for a legitimate business need.

The other things that are in play are beefing up dispute rights so beefing up consumer protections hereby creating a new category of dispute, a dispute about a systemic issue, which would then obligate a furnisher or a consumer reporting agency to confirm that an issue was systemic and then basically take steps to address it as a systemic issue, correcting the reports of all affected consumers and providing notices to all affected consumers. That provision does not exist in the Fair Credit Reporting Act, it's here being created by the CFPB. And then lastly, at the macro level, beefing up the obligation on the part of consumer reporting agencies to protect the data they have by taking the position that they're liable for any data breaches under the Fair Credit Reporting Act, that any data breach would be a breach of their obligation to protect information. At a high level, that's what's going on.

We'll probably see the rulemaking proceed and we'll have proposed rules maybe in the fall sometime. We don't have any firm deadlines under the rulemaking agendas that the CFPB has released. Will this be challenged? I think it will inevitably be challenged. We'll see Alan's argument about the improper funding of the CFPB resurrected for a challenge. We'll see an argument that through the rulemaking process, the CFPB has exceeded its authority under the Fair Credit Reporting Act and invariably we'll also see a claim that the rules and the decisions made by the CFPB were arbitrary and capricious in violation of the Administrative Procedure Act. Let me stop here and turn it over to Kristen to talk about the CFPB's proposal for a larger participant rule for payment providers.

Kristen Larson:

Thanks John. So this proposed rule came out in November of last year and this gets into the CFPB's attempts to try to expand their supervisory authority over non-bank, similar to what Rich was talking about earlier, but here they're focusing on digital wallets and payment apps that are run by essentially fintech's or non-banks. And what they're trying to do here is they're trying to say you're covered by our regulation if you're providing digital wallets, payment apps, fund transfer apps, P2P payment apps and for consumer payment transactions, and they're saying it's in connection with a consumer payment transaction where you're receiving funds for the purposes of transmitting them or accepting and transmitting payment instructions. And then in terms of the wallet functionality, it's you're storing your counter payment credentials including tokenized payments, you're transmitting your routing and processing that payment. And the interesting thing with this is its expansive view of what funds are. We did do a podcast episode on this earlier if you want to hear more.

And then they also have four categories of exemptions for this. Money transfers that are governed by Reg E, a transfer of funds by a customer that's linked to different forms of funds and they give an example of an exchange of fiat currencies for the purposes of purchasing or selling a security or commodity that's excluded from Reg E and payment transactions conducted for the sale or lease of goods or services or an extension of a consumer credit made using a digital application. The interesting thing here is there was a request by the chair of the House of Financial Services Committee to say, can you reopen the comment period and can you also address these additional issues? They were concerned about, and this came up in one of your questions, it's like, did you really analyze the cost and the impact on competition when you did this? Can you provide some justification and more of your analysis and for the scope of the rule and the impact? It's unclear how this is going to impact the whole digital asset ecosystem, and also looking at what they're trying to do is far beyond what Dodd Frank's scope was, and this is similar to what Rich talked about earlier.

And so we do see some of this stuff being challenged for some of the same reasons we talked about earlier. Next I want to talk a little bit about, this is the personal financial data rights rule, section 1033. And what this is trying to do is give consumers more rights to control and get access to their data. And again, we're expecting this to go into effect later this year. We'll see what happens. It's giving the rights to consumers and third parties to get access and have expanded access under GLBA safeguards rule. And what it does for banks and credit unions is it reduces some of the stickiness because it makes it easier for your customers to take their data and go someplace else. For example, if you're using online bill payment, that's going to be a pain to switch to another provider, but if you can get all that data and easily switch, that might make your banking decision easier.

And we also think that we might see states taking similar approaches here as to what's proposed here and adopting some of their state law rules. If it is enacted, you want to look at all your different policies, look at the ways that you can get customers data. I mean a lot of the data is on systems, you can find a way that you can easily produce the data and share it with the customers to make it readable and absorbable. We also did a podcast on this, but again, this is something that we expect to go in place. I don't know, unlike some of the other rules, I don't know how aggressively people will seek to challenge this, but I think it'll depend on the impact that it could have in terms of operationally and doing the cost. And again, it's going to increase customers movement and switching to other providers, so there is that as well. With that, I'm going to turn it over to Joseph to talk about the new buy now pay later interpretive rule.

Joseph Schuster:

Thank you, Kristen. And this rule, interpretive rule, this is not a proposed rule, this is not a final rule. This is the CFPB saying this is how we interpret TL to be. It came out days after CFSA and it really shows, I think, the temerity and the boldness of the CFPB. Were they waiting for CFSA to come out to issue this interpretive rule? I'm not sure, but this is nothing short of a bombshell and we do have a full webinar that will be dedicated to this, say new requirements, but again, interpretive. And that webinar is July 17th, but that will be too late for a lot of issuers of BNPL because the requirements as a result of this new interpretive rule are massive and the interpretive rule takes effect 60 days from publication. Let me get into a little bit about what it is and why it is a sea change for the industry.

So we have always known that the CFPB was concerned about BNPL, they're concerned about any type of credit. Here we have an offering for consumers that has no finance charge, is repayable in four or fewer installments, and we hear the CFPB talking about that. They don't like products with high finance charges. They don't want people to be caught in cycles of debt. And again, this product, no finance charges, four or fewer payments, the CFPB is nonetheless. And a lot of the companies that issue these products as well offer a lot of benefits to consumers, if consumers need to dispute, if consumers want to move their payment due date, different things, different providers offer. Now the CFPB in this interpretive rule is basically saying that BNPL products are credit cards and that most of the requirements on credit cards apply to BNPL. Specifically, they're saying that if the product is a credit card, I'll get into a little bit of what they're defining as a credit card in the BNPL space, Sub-part B of the Truth and Lending Act applies.

Another sub-part that deals with the pricing of credit, when we were talking about the late fee requirements earlier, are not in Sub-part B. So even though BNPL would be a credit card under this interpretive rule, the dollar amount limitations on late fees would not apply. Some of the things that would apply to credit cards are, and just pull up Sub-part B of Reg Z sometime, it's 1026-5 all the way through 1026-16. You have your general disclosure requirements, account opening requirements, all the way down to advertising requirements. In the middle there, you have billionaire disputes, you have unauthorized use claims, claims of defense in there under 12C claims. So what is a credit card under this rule? A credit card is something where a BNPL provider offers a digital user account. So you can think of a digital user account.

So I go to a retailer and I'm on the checkout page and I log in to my BNPL provider and I take out a new closed end BNPL loan from them. The CFB is saying that that provider of that BNPL loan is a credit card because they are issuing me that digital user account that I can log into and use it to access credit from time to time, similar to how if I swipe a credit card, I'm able to access credit from time to time. Now obviously there are substantial differences between a traditional credit card and a BNPL credit. A traditional credit card is open-end, a traditional credit card I can use and I'm not underwritten for credit each time. A BNPL product is a closed end type of credit and I must be underwritten for each new type of credit that exists with that credit card. A couple of things that are reasons why BNPL providers should be thinking about this rule right now is a BNPL provider could be providing different dispute rights to a person and a couple of BNPL providers even came out after this interpretive rule came out and said, "We are already doing things for consumers."

Well, doing things for consumers, providing dispute rights, providing statements to consumers, providing account opening disclosures, being transparent, that's not enough. This is full compliance with Sub-part B of Regulation Z. There are specific timing requirements for any billing or dispute that's received. There are specific notice requirements for any billionaire dispute that's received. We know with the CFPB that following the spirit of Reg Z and doing something that we believe is friendly for the consumer is not good enough. The CFPB, again, they have taken issue with BNPL. They are trying to compel BNPL here to follow the rules of Reg Z and that credit cards have, and these credit card rules are very detailed, they are very onerous.

They will require a lot of system changes, a lot of disclosure changes for a lot of entities. And like I said, this is an interpretive rule. So it is not something that has a time period before a final rule will be issued. It is effective and compliance is expected within 60 days of publication in the federal register. So it will have massive implications. With that, I think I will turn it back over to John to talk about some additional impacts of the Congressional Review Act.

John Culhane:

Thanks Joseph. So the Congressional Review Act is the Damocles hanging over Rohit Chopra's head at this point. We've speculated that the CFPB is likely to seek to issue as many final rules as possible within the next few weeks to avoid Congressional Review Act challenges during the next Congress. But in fact, it may already be too late because of the way the CRA lookback provision operates. In terms of some of the rules we started our discussion with, the credit card late fee rule, that was sent to Congress a long time ago. Typically, the CFPB forwards rules including interpretive rules like the buy now pay later interpretive rule, to Congress almost the same day that they're submitted to the Federal Register for publication in order to get the clock started as soon as possible. The problem here though is the way the lookback provision in the Congressional Review Act works and it's intended to, when there's a change of administrations, prevent the existing administration from basically going crazy within the last few days and issuing rules right and left that then are binding on the new president and his team.

The way this works, and there's a nice graphic here that we'll get to in a moment that's courtesy of the George Washington University Regulatory Study Center, which by the way does a terrific job of tracking Congressional Review Act developments. Basically, rules that are submitted to Congress within 60 working days prior to the time that Congress adjourns, the congressional session adjourns, are revived for review in the next Congress. So this is really important. If you have a change in the composition of the senate and the house and the presidency so that you have a republican house, a republican senate, and a republican president, or if you just have a conservative house and a conservative senate and a republican president, you have the opportunity for rules to be challenged under the Congressional Review Act. Normally the time period for Congressional Review Act challenge expires 60 working days after the rule is submitted to Congress for review.

But in the case of rules that are submitted towards the end of a congressional session, Congress adjourns, there's this recess, then there's this 15 working day break and all rules that are submitted to Congress in that prior 60 working day period are revived and they're treated as if they have just been submitted to Congress on the 15th working day, which means the Congress now has the full 60-day legislative period in which to review and disapprove of the rules issued during that lookback period. So you may well have resolutions emanating from the House and the Senate. And although President Biden vetoed the congressional override of Section 1071, if there's a change in administrations and there's a second term for President Trump, then it may well be the case that all of the CFPB's rules that are issued from here on are going to be reviewed and submitted to President Trump for consideration.

In terms of when this period started, it's really hard to count legislative days because they're very much susceptible to manipulation by the House and the Senate but some scholars have claimed that this lookback period began on May 20th, others on May 24th, and then some have said maybe it will be as late as June 7th, but the deadline is certainly coming soon. And so as I said, we may well see a rush of CFPB rules over the next week. Let me stop here and turn it back to Joseph to talk about what's happening with all the pending litigation and what we might expect in the way of CFPB enforcement moving forward. Joseph.

Joseph Schuster:

Thank you, John. I will touch on as our last couple of topics here, the litigation that we've seen from the CFPB and where that currently stands, as well as an expected proliferation of new CFPB investigations and enforcement actions and the hiring bench that is happening at the CFPB as a result of that as well. After CFSA Director Chopra issued a statement. The piece that I want to mention is first, the CFPB will be able to forge ahead with our law enforcement work. There were a lot of things that the CFPB came out with immediately after CFSA, but we saw the first thing that Chopra is mentioning and what Chopra has been interested in during the entire time that he has been the director is litigation. He's not shy about bringing cases against entities.

During the pendency of the CFSA ruling, there were at least 14 cases that were stayed. These were in all different stages of litigation. I've included links to a couple of them here. In the Nevada one that I included, this was a stay of a CID. An entity was complying with a CID and the lender filed a motion asking the court to stay the case pending the Supreme Court's decision in CFSA and the court did. The court said it in that case that a brief stay to avoid wasteful and unrecoverable investigation efforts and enforcement proceedings on a matter that may be dismissed pending the Supreme Court's decision is justified. That was in the Nevada Federal District Court. The other case that I have here is a New York Federal Court case. Now this was a joint case by the New York AG as well as the CFPB. So this was an interesting one in that it was stayed, even the New York AG items, which the New York AG items were state violations or alleged state violations that the CFPB was not bringing itself, but the court stayed all of those.

The court in that case stated that the stay would not unduly prejudice the CFPB or the New York AG. They said that the CFSA would clarify the legal issues and may help the defendant avoid unnecessary legal costs, which is true because another thing that the court said is that it was in the interest of the court because if the court denied the stay and adjudicated the motion to dismiss, it would need to decide the constitutional challenges to the CFPB's authority, so they're waiting for the Supreme Court to do that. Additionally, the court said a stay is in the interest to persons not parties to the lawsuit and in the public interest because considerations of judicial economy are relevant to the public interest. So we had a number of these different, and these are the public ones, and we have at least 14 cases that were publicly stayed.

There were also instances where the CFPB stepped away from different matters that it was looking at pursuing as a result of the entity raising that they might raise CFSA, that the CFPB did not want to have as many of these stayed publicly, and so a number of them were stayed privately. And in some of those matters that may have been stayed privately or were delayed privately, we are starting to see action on those again, immediately after CFSA, just like we talked about that the BNPL interpretive rule came out immediately after CFSA. The CFPB was similarly ready to go with these lawsuits, the ones that are public as well as the private instances where the CFPB is pursuing action against different creditors and moving forward with those, whether that is moving forward with CIDs, moving forward with draft consent orders, there is a flurry of activity that is happening as a result of this and these 14 cases are now proceeding as well.

The constitutional challenges to the CFPB will not be challenges that will be important for the cases, but there are other substantive challenges in all of the cases that were stayed. So it will be interesting to see what happens with these. It'll be interesting to see what new cases are filed as well because, and I think that this turns to a little bit of the second piece that I wanted to talk about here, which is the expected proliferation of new CFPB investigations and enforcement hiring. I have a little graph here of the new enforcement actions. Like I mentioned, there was a brief pause delay. The amount of enforcement actions being brought was lower than what it had been a year ago during this time period and even before that. Like I said, the CFPB is not afraid of litigation. The CFPB is very political and we are seeing that with a number of different things, as we talked about with the late fee, moving the late fee from \$30 to \$8 and avoiding [inaudible 01:15:28], in the interest of expediency, really a lot of these things may be to show that CFPB and President Biden are able to accomplish their agenda of...

President Biden has talked about lowering late fees by 75%, the CFPB is pushing forward with that. The CFPB is not afraid of litigation. The CFPB has done a lot, again in the time period since CFSA, we are seeing a lot of that there. So as we think about this, which talks a little bit about the enforcement team hiring binge that is happening. We have seen a number of different statements that talk about increasing the enforcement staff by 50% and creating a fifth litigation team. During a January 30th LinkedIn event, the CFPB announced plans to hire about 75 people in 2024. This is leading to more enforcement action. It is leading to more supervision action. We are seeing things that previously may have stayed in supervision being escalated to the enforcement team. There are now more enforcement teams that are able to handle these things.

Where previously the CFPB might have been willing to negotiate more in the consent order in the enforcement context, the CFPB is being more aggressive in some of these items and the CFPB is willing to file litigation. It's no surprise that the CFPB likes its splashy headlines and I think that they get a lot of those headlines when they file litigation. Again, they're not afraid of following through with that litigation. They are hiring a number of enforcement individuals in order to pursue those. So this raises the question of what should everybody be thinking about in terms of supervision, enforcement, exams, things of that nature. Number one, be prepared for exams. There will be a lot more exams. There is a lot more hiring. The CFPB, I don't want to say they're taking the gloves off because I would argue that they've had their gloves off for a long time however, they

are becoming more aggressive. We can see that in the interpretive rules that they're coming out with. We see that in exams and the things that they are pushing and pursuing.

It does really seem like the CFPB views CFSA as a win. They're using this to re-energize themselves. They're using it to re-energize the individuals within the CFPB to do more hiring to show that the CFPB is really going to make an impact. And the way that they're making that impact, if you will, is really by the challenges that they are pursuing against different creditors, regardless, again, of the type of credit, if it's the NPL that offers credit with no finance charge in relatively few installments or whether it's other types of credit. There has been and will likely continue to be a large focus on repeat offenders. So any entity that has had a previous consent order should very much be on the lookout for future exams. The CFPB, in many instances where there was a previous consent order, they are looking for ways to extend the time period for their monitoring, whether that's through a new consent order or through voluntary extension, things of that nature.

The CFPB very much enjoys being able to monitor every type of entity and we're seeing that through some of the things like what Kristen talked about with digital wallets and different things. So exams are certainly a first one. Be prepared to defend practices based on the regulation itself. Being able to show that a product is beneficial and consumers like that product is no longer enough and arguably it's been something that's been a problem in the past or that the CFPB has raised concerns about. So being able to show, as we think about the BNPL credit card rule, how strictly in compliance with Reg Z and Sub-part B an entity is, is going to be important as there are these exams. And things are being escalated to enforcement that otherwise would have stayed with supervision in the past. So being prepared for those conversations with enforcement should something escalate from supervision is going to be important.

The final piece that I will say here is I think we've seen a little bit of a shift of the different types of entities that the CFPB has gone after. Early on with the CFPB, we saw them really going after entities that they considered bad actors and who were doing something that may have been with respect to... It was clearly on the other side of the law. We've then seen them go after large actors to get the splashier headlines, whether that's a big name bank, some of those types of companies as opposed to the smaller entities. I think we're going to see in this third evolution now with the hiring of the enforcement team and others within the CFPB, both types of entities getting similar attention. Whether it's a small entity, I think there's going to be more supervision enforcement action there and the larger entities, we know that the CFPB wants to and will continue to really focus on those larger entities, either from a first time perspective or whether they're looking at those larger entities from a repeat offender perspective. So stay tuned. Again, there are 14 cases that are going to start proceeding again, and I think we're going to see a lot more new cases and a lot more consent orders. And with that, I will turn it back over to Alan.

Alan Kaplinsky:

I want to thank all of our colleagues for doing a terrific job today. To make sure that you don't miss any of our future episodes, subscribe to our show on your favorite podcast platform, whatever that might be, Apple, YouTube, Spotify, wherever you listen. And don't forget to check out our blog, consumerfinancemonitor.com for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast@ballardspahr.com. Stay tuned each Thursday for a new episode of our show. Thank you all for listening, and have a good day.