

I. Background

On October 5, 2017, the Bureau of Consumer Financial Protection (“BCFP” or “Bureau”) issued the Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule (“Final Rule” or “Rule”) covering certain short-term loans. Compliance is required by **August 19, 2019**.¹ The Rule applies to lenders, including community banks, and places limitations on the lending practices regarding personal loans such as payday loans, auto title loans, deposit advance products, and certain high-rate installment and open-end loans.

On January 16, 2018, the Bureau announced plans to reconsider the Final Rule.

Applicability to Community Banks

The majority of community banks are likely exempt from the requirements of this Final Rule.

Any community bank that originates fewer than 2,500 covered loans and derives no more than 10% of its revenue from these loans is exempt from the ability-to-repay requirements and record retention requirements.

Loans below 36% annual percentage rate (“APR”) that have a term of at least 46 days without a balloon-payment are not covered in the Final Rule.

Additionally, community banks that make loans to their own customers are exempt from the penalty-fee prevention measures which include a written notice and limited withdrawal attempts, so long as those loans cannot generate overdraft or insufficient funds fees.

II. Scope

Covered Loans

The Final Rule defines covered loans as:

- any short-term consumer credit with a term of 45 days or less,
- any longer-term, balloon-payment consumer loan with a term of more than 45 days if the consumer is required to repay substantially the entire loan balance in a single payment, or if at least one payment is twice as large as any other payment, OR
- any longer-term consumer loan with a term of more than 45 days and without a balloon-payment if:
 - the total cost of credit exceeds an APR of 36%, inclusive of all finance charges as set forth by Regulation Z; and
 - the lender obtains a form of “leveraged payment mechanism” giving the lender a right to initiate transfers from the consumer’s deposit account.

¹ The Bureau expects to issue proposed rules in January 2019 that will address the Final Rule’s compliance date.

For all covered loans, the Final Rule limits certain repeated payment withdrawal attempts from a consumer's deposit account, requires disclosures related to certain withdrawal attempts, and mandates recordkeeping compliance. For short-term credit and longer-term balloon-payment loans, the lenders also have to assess a consumer's ability-to-repay ("ATR"), discussed further, below.

Loans excluded include:

- purchase-money credit secured by the vehicle or other consumer goods;
- real property or dwelling-secured credit if the lien is recorded or perfected;
- credit cards;
- student loans;
- non-recourse pawn loans;
- overdraft services and overdraft lines of credit;
- employer wage advance programs; and
- no cost-advances.

Conditional exemptions from the Rule

In addition to the excluded products listed above, there are other loan products that have conditional exemptions, such as, accommodation loans, alternative loans and principal-payoff loans. In some instances, products are exempt from the Rule's coverage, and in other instances, products have fewer compliance requirements.

Conditional exemption for accommodation loans

"Accommodation loans" are exempt from coverage and are defined as loans made by a community bank and its affiliates which do not exceed 2,500 covered loans in the current and preceding calendar years, and generating no more than 10% its receipts from these loans during the most recent tax year.²

Covered longer-term loans made by a lender that is also the account-holder do not count toward these thresholds, so long as certain conditions are met (see below, "conditional exclusion for certain transfers by account-holding institutions").

Conditional exemption for alternative loans

The Final Rule also provides a conditional exemption for "alternative loans" which are defined as loans that:

- are closed-end;
- have a term between one and six months;
- are between \$200 and \$1,000;
- amortize completely during the term of the loan;

² "Receipts" are defined as "total income" plus "cost of goods sold" as these terms are defined and reported on Internal Revenue Service tax return forms.

- are repayable in at least two payments of substantially equal amounts and due in substantially equal intervals;
- have a maximum interest rate of 28%; and
- have an application fee that does not exceed \$20.

Alternative loans must also meet the following conditions:

- the loan would not result in the consumer having three outstanding alternative loans made by the lender within a period of 180 days;
- no more than one alternative loan is made at a time to a consumer; and
- the lender must maintain and comply with policies and procedures for documenting proof of consumer's recurring income.

Principal-Payoff Loans

Although not exempted from the Rule's coverage, "principal-payoff loans" do not necessitate as many compliance requirements as other covered loans. The Final Rule allows a lender to assist a consumer in paying down the principal balance of an outstanding short-term loan without meeting the ATR requirements, so long as:

- the loan is not secured through a security interest in a motor vehicle;
- the lender ensures the consumer does not take out more than three covered short-term or balloon-payment loans within 30 days of each other or six covered loans during any consecutive 12-month period;
- the first "principal-payoff loan" must be less than \$500, and each subsequent loan must be one-third less than the prior loan; and
- the loan must amortize completely during the term of the loan.

Additionally, principal-payoff loans have specific disclosure requirements. The first loan in a sequence must be accompanied by a disclosure containing the language set forth in Model Form A-1 in Appendix A to the Final Rule. This language includes a warning to the consumer not to take out the loan if it cannot be repaid by the contractual due date, and advises the consumer that any subsequent loans taken out within 30 days of the original loan must be smaller. A third "principal payoff loan" must contain the disclosure set forth in Model Form A-2 in Appendix A to the Final Rule. This disclosure informs the borrower that a 30-day cooling-off period is required after repaying this loan.

Conditional exclusion for certain transfers by account-holding institutions

Generally, a loan with a term of 45 days or more, with a cost of credit that exceeds 36%, and has a "leveraged payment mechanism" is a covered loan and requires certain disclosures and recordkeeping, explained further below in Sections IV and VII. However, the Final Rule conditionally excludes such loans from coverage if the bank making the loan also holds the consumer's account, and the bank does not charge a fee or close the account for insufficient funds or a negative balance resulting from a loan payment.

III. Ability-to-Repay

For short-term and longer-term balloon-payment loans, the Rule requires lenders to undergo an ATR analysis. The BCFP considers it is an abusive practice to make these loans without determining a consumer's ATR and requires that before a lender extends a covered loan, it must determine whether the consumer is able to repay it.

To meet ATR requirements, community banks must assess a consumer's ability to make loan payments while also meeting other major financial obligations, such as basic living expenses, without having to borrow additional funds for 30 days. Under this test, the lender must obtain and verify evidence of the consumer's income and major financial obligations. In circumstances where a lender determines that a reliable income record is not reasonably available, the lender can reasonably rely on the consumer's written statements alone as evidence of income.

The Final Rule permits lenders and consumers to rely on income from third parties, such as spouses, in which the consumer has a reasonable expectation of access as part of the ATR determination, and permits lenders in certain circumstances to consider whether another person is regularly contributing to the payment of major financial obligations or basic living expenses.

Lenders must enforce a 30-day cooling-off period after making a consumer a three covered short-term or longer-term balloon-payment loans in quick succession.

IV. Payment Withdrawal Restrictions and Disclosures

The Final Rule imposes new requirements on a lender's repeated attempts to withdraw payments from a consumer's deposit account with insufficient funds.

First, the Final Rule requires a lender to provide written notice before the first attempt to withdraw a payment, and before subsequent attempts that deviate from the scheduled amounts, dates, or involve a different payment method. Notice must be provided at least three business days prior to any attempt to access the consumer's checking, savings, or prepaid account.

A lender is permitted to provide electronic notices pursuant to electronic communication rules. The notice must contain the same information and language set forth in Model Form A-3 in Appendix A to the Final Rule, including the date on which the transfer will occur, the dollar amount that will be transferred, and the account from which the amount will be transferred.

Second, when two consecutive withdrawal attempts fail due to insufficient funds, the lender must send a consumer rights notice no later than three business days after it receives information that the second consecutive attempt failed. The notice must contain the same language set forth in Model Form A-5 in Appendix A to the Final Rule, including the fact that the lender's last two transfer attempts failed, and that the lender is prohibited from initiating additional transfers without the consumer's new specific authorization to make further withdrawals. This prohibition on additional withdrawal attempts applies whether the two failed attempts are initiated through a single payment channel or different channels, such as the automated clearinghouse ("ACH") system and the check network.

Finally, if a borrower's repayment varies from a regular payment, such as a different repayment date, payment channel or amount, the lender must provide the consumer with a notice that contains the same language set forth in Model Form A-4 in Appendix A to the Final Rule, noting a description of the unusual withdrawal. Remember that a community bank is exempt from this provision if the bank is making the loan also holds the consumer's account, and the bank does not charge a fee or close the account for insufficient funds or a negative balance resulting from a loan payment.

V. Electronic Delivery of Notices

If a consumer consents to receiving disclosures through electronic delivery, the lender may provide the applicable notices through electronic delivery, subject to certain conditions. If the lender uses an electronic delivery channel other than email, such as text or a mobile application, the lender must provide the applicable short notice in substantially the same manner as Model Forms A-6 through A-8 depending on the information requirement.

VI. Registered Information Systems

Lenders, including community banks, subject to the ATR requirements and under the principal step-down option are required to furnish certain loan data to the Bureau's "registered information systems," and to obtain consumer reports when extending covered short-term loans or longer-term balloon payment loans. Reporting must be done at loan origination, updated if changes occur while the loan is outstanding and when the loan is repaid or charged off.

Registered information systems must:

- be able to receive the furnished information;
- be able to generate a consumer report;
- have a federal consumer financial law compliance program;
- have an independent security assessment program performed periodically; and
- be able to comply with the Final Rule.

VII. Record Retention

For all covered short-term or longer-term balloon payment loans originated, lenders must develop and follow policies and procedures to comply with the Final Rule and retain evidence of compliance for thirty-six months. The evidence of compliance must include a copy of the loan agreement and documentation obtained in connection with a loan, such as the lender's projection of a consumer's net income and major financial obligations.