Banking and
Finance Law Daily

Wolters Kluwer

December 2016

STRATEGIC PERSPECTIVES—CFPB has busy regulatory 2016, but possible end looms

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The Consumer Financial Protection Bureau adopted two major final rules in 2016, one addressing mortgage servicer conduct and the other regulating prepaid accounts. The bureau also proposed rules on permissible predispute arbitration clauses and on short-term or payday loans, and it outlined its ideas for governing third-party debt collections. However, the Republican election victory and a decision by the U.S. Court of Appeals for the District of Columbia Circuit combine to cast doubt on whether the bureau will be able to finalize these rules before presidential or congressional action either restructure it or simply block further action.

Prepaid cards, similar accounts. The CFPB's prepaid accounts rule creates consumer protections and disclosure obligations by amending both Reg. E—Electronic Fund Transfers (12 CFR Part 1005) and Reg. Z—Truth in Lending (12 CFR Part 1026). The Reg. Z amendments arose from the bureau's decision to treat prepaid cards that are linked to overdraft protection features—referred to as hybrid prepaid-credit cards—as extending credit. The rules take effect Oct. 1, 2017 (although the effectiveness of a requirement that account agreements must be submitted to the bureau is delayed an additional year).

The rule extends well beyond stored-value cards or other prepaid accounts, extending consumer protections to:

- traditional prepaid cards, including general purpose reloadable cards;
- mobile wallets;
- person-to-person payment products;
- other electronic prepaid accounts that can store funds;
- payroll cards;
- student financial aid disbursement cards;
- tax refund cards; and
- some federal, state, and local government benefit cards, such as those used to distribute unemployment insurance and child support.

The Reg. E protections are comparable to those associated with credit card accounts. They include requiring that financial institutions offer consumers easy access to information, either through periodic statements or on demand, and error resolution procedures that include provisional credits and a $50 limit on consumer liability for unauthorized transactions (as long as the consumer notifies the institution promptly).

Credit features of hybrid prepaid-credit cards are to offer credit card-like consumer protections. Financial institutions must:

- ensure that consumers have the ability to repay the debt or make required payments before opening a hybrid prepaid-credit card (for consumers under 21, this means assessing their independent ability to repay);
- give consumers regular statements that detail information such as fees, interest rates, the amount borrowed, and the outstanding balance; and
- allow consumers at least 21 days to make required payments before charging a late fee and limiting delinquency fees to what are "reasonable and proportional" to the violation of the account terms.

The rule also endeavors to keep prepaid account and credit features distinct. To do this, it requires that financial institutions must wait at least 30 days after a prepaid account is opened before offering overdraft protection. Also, in addition to requiring 21 days before payment can be demanded, the rule limits an institution's ability to divert funds intended to reload a prepaid account to the repayment of outstanding credit.

Mortgage servicers. The CFPB's amendments to its mortgage servicing rules made broad-based changes to servicer duties relating to force-placed insurance, early intervention and loss mitigation for troubled borrowers, prompt crediting of payments, and periodic statements. The amendments affected both Reg. Z and Reg. X—Real Estate Settlement Procedures (12 CFR Part 1026). Most of the changes take effect Oct. 19, 2017, although some are delayed for an additional six months.

New consumer protections include:

- Borrowers who have brought their loans current under a foreclosure mitigation plan must be accorded the full set of loss mitigation assistance possibilities if another application must be filed.
- A broad definition of "successor in interest" extends loss mitigation protections to persons who receive property on the death of a relative or joint tenant; as a result of a divorce or legal separation; through certain trusts; or from a spouse or parent.
- Special periodic statements and notices must be provided to borrowers who have filed for bankruptcy.
- A requirement that servicers give borrowers a written notice when a loss mitigation application is deemed to be complete.
- A requirement that, in the case of a servicing transfer, the new servicer generally will be bound by the time limits that applied to the former servicer.
- A complete, timely loss mitigation application generally requires a servicer to put foreclosure proceedings or sales on hold until the application is denied or withdrawn or the borrower fails to carry out any resulting mitigation agreement.

The bureau contemporaneously adopted a Fair Debt Collection Practices Act interpretive rule that creates a safe harbor for mortgage loan servicers. The CFPB said that a loan servicer will not be deemed to have violated the FDCPA, under the appropriate circumstances, if it communicates about a mortgage loan with confirmed successors in interest, provides a required early intervention notice to a borrower who has invoked the FDCPA right to demand an end to communication, or responds to a borrower's request for loss mitigation information after the cease-communication right has been invoked.

Short-term and payday loans. Perhaps the most significant pending proposal would restrict payday and other short-term, small-dollar loans. The creation of a new 12 CFR Part 1041—Payday, Vehicle Title, and Certain High-Cost Installment Loans was published on July 22, 2016, and the comment period ended on Sept. 14, 2016.

As can be seen from the proposed regulation's title, a number of loans other than payday loans would be covered. Motor vehicle title loans, deposit advance products, and other high-cost installment or open-end loans would be included. The proposal describes two categories of covered loans: (1) loans with a term of 45 days or less; and (2) loans with terms of longer than 45 days that have an "all-in" annual percentage rate greater than 36 percent and either are repaid directly from the consumer's account or income or are secured by the consumer's vehicle.

Under the proposal, lenders would be required to determine whether a borrower could afford the full amount of each payment when it is due and still meet their basic living expenses and major financial obligations. For short-term loans and installment loans with a balloon payment, that means being able to pay the total loan amount and all the fees and finance charges without having to re-borrow within the next 30 days. For payday and auto title installment loans without a balloon payment, it would mean being able to make all of the payments when due.

Lenders would be able to make covered loans without satisfying the ability-to-repay requirements if the loans meet certain conditions. Consumers could be extended a short-term loan of up to $500 without the full-payment test as part of a "principal payoff option" that is structured to keep consumers from being trapped in debt. Lenders would be barred from offering this option to consumers who have outstanding short-term or balloon-payment loans or who have been in debt on short-term loans for more than 90 days in a rolling 12-month period. Lenders also would be barred from taking an auto title as collateral. As part of the principal payoff option, a lender could offer a borrower up to two extensions of the loan, but only if the borrower paid off at least one-third of the principal with each extension.

The proposed rule also would permit lenders to offer two longer-term loan options with more flexible underwriting, if the loans pose less risk because they meet certain restrictions. The first option would be offering loans that generally meet the parameters of the National Credit Union Administration "payday alternative loans" program, in which interest rates are capped at 28 percent and the application fee is no more than $20. The second option would be offering loans that are payable in roughly equal payments, with terms not to exceed two years, and with an all-in cost of 36 percent or less (other than a reasonable origination fee), as long as the lender's projected default rate on these loans is 5 percent or less. The lender would have to refund the origination fees for any year that the default rate exceeded 5 percent.

Under the proposal, lenders would have to give a consumer a written notice before attempting to debit the consumer's account to collect payment for any covered loan. After two consecutive unsuccessful debit attempts, the lender would be prohibited from debiting the account again without getting a new, specific authorization from the borrower.

Arbitration. Perhaps to the surprise of some, the CFPB did not move to ban all consumer contract predispute arbitration clauses. Rather, it proposed a slightly more limited ban on predispute arbitration clauses that also ban class actions—what Bureau Director Richard Cordray called "gotcha clauses." Under the proposal, an arbitration clause would be required to use specified language to tell consumers explicitly that they cannot be prevented from participating in class actions.

The rule would operate by creating a new 12 CFR Part 1040—Arbitration Agreements. It was formally proposed on May 24, 2016, with a 90 day comment period that closed Aug. 22, 2016. No final rule has yet been adopted.

The proposal was preceded by a study—required by the Dodd-Frank Act—which the bureau characterized as finding that very few consumers bring individual actions against their financial service providers either in court or in arbitration and that class actions provide a more effective means for consumers to challenge problematic business practices. According to the bureau's interpretation of the study results, class actions succeed in bringing hundreds of millions of dollars in relief to millions of consumers each year and cause companies to alter their legally questionable conduct. However, mandatory arbitration clauses allow companies to block class actions.

The study has been controversial, with some critics claiming it revealed that class actions provide little actual relief to consumers. Bills have been introduced in Congress that would prevent the CFPB from adopting a final rule until a new study is completed; however, so far, no such proposal has been passed.

Debt collection. While no rule has yet been formally proposed, the CFPB has outlined much of what it has in mind for enhanced consumer debt collection protection. The plan announced by the bureau would apply to debt collectors that are subject to the Fair Debt Collection Practices Act; consumer protections in the context of creditors collecting for themselves will be addressed separately, the CFPB said.

The proposed consumer protections would cover:

- information integrity;
- communication with consumers;
- notices of rights; and
- dispute resolution.

Information integrity—The CFPB is considering a requirement that debt collectors "substantiate," or have a reasonable basis for, claims that a particular consumer owes a particular debt. Collectors would have to scrub their files and substantiate the debt before contacting consumers. This would include confirming that the debt collector has information such as the consumer's full name, last known address, last known telephone number, account number, date of default, amount owed at default, and the date and amount of any payment or credit applied after default.

Another possibility is requiring a more detailed FDCPA validation notice and a statement of rights that would provide consumers with the information they need to determine whether they owe a particular debt and to navigate the debt collection process.

Communications with consumers—The bureau is considering limiting debt collectors to six communication attempts per week through any point of contact before they have reached the consumer. It would be made easier for a consumer to stop a debt collector from using any specific method of communication or communication at any specific time or place. The CFPB also is considering a 30-day waiting period after a consumer has passed away during which collectors would be prohibited from communicating with individuals such as surviving spouses.

Notices of rights—Debt collectors could be required to include more specific information about the debt in the initial collection notices sent to consumers. This information could include the consumer's federal rights and, if applicable, that the statute of limitations on the debt has passed.

Dispute resolution—The bureau also is looking at ways to make it easier for consumers to contest debts. One possibility being considered is a "tear-off" portion of the initial collection notice that consumers could send back to the collector and that would include options for why the consumer thinks the collection demand is wrong. The tear-off also would allow consumers to pay the debt.

If the tear-off sheet or any other written notice were sent back within 30 days of the initial collection notice, the collector would have to provide a debt report—written information substantiating the debt—to the consumer. The collector would not be permitted to continue pursuing the debt until that report and verification was sent. The consumer also would be able to verbally question a debt's validity at any time, and this would require the collector to have to recheck its files.

If a consumer disputed the validity of the debt, the debt collector would have to stop collection activity until the necessary documentation was checked. Collecting on a debt without having sufficient evidence would be prohibited. In addition, collectors that came across any specific warning signs that the information was inaccurate or incomplete would not be able to collect until the problem was resolved. Collectors also would be required to check the documentation of a debt before filing a collection suit.

If a debt collector transferred debt without responding to the consumer's disputes, the next collector could not attempt collection until the dispute was resolved. The proposals under consideration also outline the information that a collector would have to send when it transferred a debt so that a consumer would not have to resubmit this information to the new collector.

Possibilities for 2017. Any discussion of what could come next from the CFPB must account for the potential effects of the 2016 election and the ongoing *PHH Corp. v. CFPB* litigation. The Republicans maintained their hold on the Congress, and GOP congressional leaders have made clear a desire to replace the Dodd-Frank Act in general and, more specifically, greatly weaken the CFPB. Common congressional demands are to replace the single director position with a five-member

commission that would be comparable to the Federal Trade Commission's structure, subject the bureau to the congressional appropriations process, and restrict the bureau's ability to make new rules.

President-elect Trump is not seen as a friend of the CFPB, and he might accede to congressional actions. Moreover, the ongoing *PHH Corp. v. CFPB* could offer Trump the opportunity to replace CFPB Director Cordray well before the end of his five-year term. In *PHH Corp.*, the D.C. Circuit decided the creation of an independent agency led by a single director who could be removed only for cause violated constitutional separation of powers requirements. The remedy, the court said, was to treat the bureau as an executive branch agency whose director could be replaced by the president at will.

The CFPB's request for an *en banc* rehearing of that decision is pending. If the request is granted, the three-judge panel's decision will be vacated. If not, the bureau will need to hope the Supreme Court will stay the decision during the likely appeal.

It is possible that a CFPB headed by a single, more business-friendly director could undo much of the bureau's regulations and guidance. On the other hand, some have speculated that financial institutions might, in the interests of certainty and consistency, prefer to see the rules remain in place but be enforced with a much lighter touch.

That being said, there are three possibly significant regulatory proceedings the CFPB currently has "teed up." One would be the issuance of a formal debt collection proposal, which likely would be similar to what was contained in the 2016 advance notice. The second would be a final rule on mandatory arbitration clauses.

The third possibility is action on giving consumers better access to the financial information about them that is maintained by companies and requiring better security for that information. In November, the bureau began an inquiry into "how much choice consumers are being given about the use of their records, how secure it is for them to share their records, and to what extent consumers have control over their records." The CFPB's past practices suggest that this is the first step down the road toward either a regulation or, at least, significant new guidance.

Also, the bureau's fall 2016 regulatory agenda noted that it was working on rules that would define larger participants in the markets for consumer installment loans and vehicle title loans, which would make these companies subject to CFPB supervision.

