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KEYS TO UNLOCKING VALUE IN US CONSUMER FINANCIAL SERVICES

CONTENTS

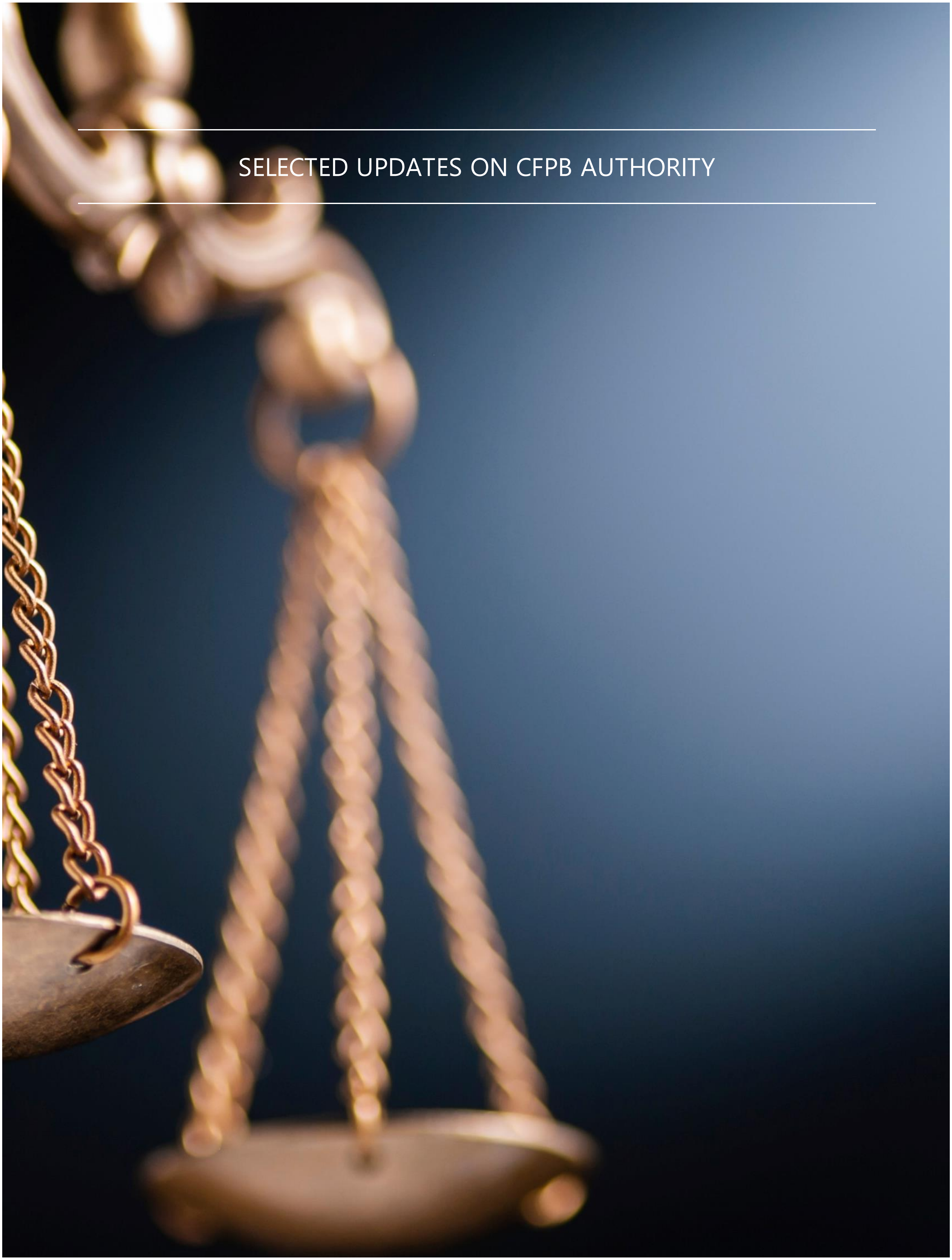
INTRODUCTION

As we enter 2025, the primary and secondary markets for consumer and small business financial assets remain robust. Like last year, many new securitization issuances are planned for the first quarter, and financial services companies continue to expand their existing offerings and innovate new products.

Nonetheless, navigating the rapidly evolving regulatory environment remains a top priority for those in the consumer and small-business financing space. A new federal administration presents the possibility of significant pivots in regulatory priorities; simultaneously, states position themselves to continue expansion of regulatory regimes into new products, or to take the reins on aggressive enforcement as federal regulators potentially step back. These conditions have impacted many of the consumer fintech assets typically offered by or through fintechs, and securitized or financed through private credit. Given this context, it is no surprise that some of the more esoteric corners of this market are having a field day while others are struggling.

In the pages that follow, Mayer Brown colleagues unpack these unique market dynamics, leveraging decades of experience in the industry to offer insight on the current landscape. This compilation of articles (presented as they were originally published, as examples of the kinds of Legal Updates you may expect from the firm) explores pivotal themes and asset classes, including CFPB authority, bank-partnership lending models, auto financing, buy-now pay-later (BNPL), credit cards, earned wage access, small business financing, and solar and home improvement financing. Clients expect us to help them stay ahead in the fast-evolving market, which requires a keen understanding of the forces shaping the markets, the ability to navigate potential challenges, and an appetite for innovation. In this compilation, we'll help you tap into all three by providing actionable insights to unlocking value in US consumer financial services.

SELECTED UPDATES ON CFPB AUTHORITY



CFPB ISSUES ORDER ESTABLISHING SUPERVISORY AUTHORITY OVER NONBANKS

By Christa L. Bieker, Tori K. Shinohara, and Joy Tsai
March 05, 2024

On February 23, 2024, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") published an order establishing supervisory authority over a small-loan consumer finance company, using a Dodd-Frank Act provision that allows the Bureau to supervise certain nonbanks that it has reasonable cause to determine pose risks to consumers (the "Order"). The Order represents the CFPB's first publicized use of this authority in a contested case.

The Order provides insight into how the Bureau views its authority to designate certain nonbank entities for supervision. In this Legal Update, we summarize relevant aspects of the Bureau's supervisory authority, and highlight key takeaways from the Order.

CFPB'S SUPERVISORY AUTHORITY

In addition to its broad powers to enforce enumerated federal consumer financial laws, one of the CFPB's core authorities is its power to supervise and examine certain entities. The Bureau has authority under the Dodd-Frank Act to supervise large (i.e., over $10 billion in assets) banks, thrifts and credit unions. The CFPB also has authority under the Dodd-Frank Act to supervise nonbank entities that fall into the following five categories:[1]

- Covered persons[2] who offer or provide origination, brokerage, or servicing of mortgage loans or loan modification or foreclosure relief services in connection with such loans;
- Covered persons who offer or provide a consumer a private education loan;
- Covered persons who offer or provide a consumer a payday loan;
- Covered persons who are "larger participants" of a market for other consumer financial products or services as defined by rule;[3] and
- Covered persons who the Bureau has reasonable cause to determine are engaging, or have engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.

Supervisory authority allows the CFPB to examine entities to gain information about their activities and processes, and to assess their compliance with federal consumer financial law. Supervisory examinations typically result in a Supervisory Letter drafted by the Bureau detailing its findings and recommendations, primarily in the form of Matters Requiring Attention ("MRAs"). Depending on the Bureau's findings, an

[1] 12 U.S.C. §§ 5514, 5515. The CFPB also has the authority to supervise certain service providers to supervised entities. *Id*.
[2] A covered person is defined as "any person that engages in offering or providing a consumer financial product or service." *Id*. § 5481(6). Certain affiliates of a covered person are also covered persons.
[3] The CFPB has conducted rulemakings to define thresholds for entities subject to supervision in the markets of consumer reporting, debt collection, student loan servicing, remittances, and auto loan servicing.

examination could lead to a referral to enforcement or a supervisory Memorandum of Understanding ("MOU").

REASONABLE CAUSE TO DETERMINE AN ENTITY POSES RISKS TO CONSUMERS

In 2022, after conducting an assessment of its supervision program, the CFPB announced that it planned to invoke its largely unused authority to supervise covered persons it has reasonable cause to determine are engaging, or have engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.[4] The Bureau explained that this authority allows the CFPB to be agile and supervise entities that may be outside of its existing supervision program.[5]

The CFPB has promulgated procedural rules governing the process of deciding that it has cause to determine an entity poses risks to consumers.[6] Specifically:

- A CFPB initiating official may issue a Notice of Reasonable Cause ("Notice"), indicating that the Bureau may have reasonable cause to determine that the respondent is a nonbank covered person engaging in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.[7]
- Within 30 days of service of the Notice, the respondent may file a written response rebutting the Bureau's contention.[8] The response may include a request for a supplemental oral response. The respondent may also voluntarily consent to the Bureau's authority. If the respondent does not file a response within the 30-day window, the rule provides that it waives the right to do so.
- Within 45 days of receiving the response (or within 90 days of issuance of the Notice, if a respondent requested to present a supplemental oral response), the Associate Director for Supervision, Enforcement, and Fair Lending is to recommend whether there is reasonable cause for the CFPB to determine that the respondent is engaging or has engaged in conduct that poses risks to consumers that should result in an order subjecting the respondent to the Bureau's supervisory authority.[9]
- The Associate Director submits this recommendation to the Director, who then makes a final determination within 45 days to fully adopt, modify, or reject the recommended determination.[10] The rule states that the Director's decision constitutes final agency action subject to judicial review under the Administrative Procedure Act.[11]

[4] Consumer Financial Protection Bureau, "CFPB Invokes Dormant Authority to Examine Nonbank Companies Posing Risks to Consumers," April 25, 2022.
[5] *Id.*
[6] *See* 12 C.F.R. Part 1091.
[7] 12 C.F.R. § 1091.102.
[8] *Id.* § 1091.105.
[9] *Id.* § 1091.108.
[10] *Id.* § 1091.109.
[11] *Id.* § 1091.109(d).

- If the Director determines that a respondent is subject to the Bureau's supervisory authority under this rule, the respondent may petition for termination of this authority no sooner than two years from the date of the order and annually thereafter.[12]
- The Director will decide whether an order will be publicly released, in whole or in part.[13] The rule provides that the Bureau will not disclose information that would be exempt from disclosure under certain provisions of the Freedom of Information Act, or if the Director determines there is other good cause not to release the information.

TAKEAWAYS FROM THE ORDER

In the Order, the Bureau explains why it has reasonable cause to determine that the company at issue, an installment lender, is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services. Below are a few key takeaways from the Order.

- "**Reasonable Cause to Determine**:" The Order emphasizes the fact that the Bureau only needs to have a "reasonable cause to determine" that the covered person's conduct poses risks to consumers. According to the Bureau, this standard is a "relatively lenient burden of persuasion," and stands in contrast to a preponderance of the evidence standard or a clear and convincing standard. This is an important point for entities to keep in mind as they weigh the risks and benefits of contesting a supervisory notice.

  The CFPB explains that this lower standard is appropriate, given the "relatively limited impact" of the supervisory determination on an entity. However, given the burden of responding to examination requests—which routinely require the production of voluminous amounts of data, documents, and information, and the fact that examinations can lead to MRAs requiring changes to business practices or to a supervisory MOU or enforcement action—we suspect that many institutions would not agree with the Bureau's view that being supervised has a "relatively limited impact."

- **Determination Based Largely on Consumer Complaints**: The Order makes clear that the CFPB's risk determination was largely based on consumer complaints collected through the CFPB's complaint system. The company at issue argued that unverified complaints were not sufficient to designate it for supervision. The CFPB rejected this argument, noting that the Dodd-Frank Act states that a risk determination may be "based on complaints," and does not qualify that the complaints must be verified. Further, the CFPB reasons that supervision will allow the CFPB to look more closely at the merits of the complaints.

  This underscores the importance of reviewing complaints in the CFPB's complaint system to identify potential risks that might factor into a supervision determination.

- **Nature of Business Contributed to Determination**: While the Order relies heavily on consumer complaints, it also emphasizes that the company at issue routinely refinances its loans, including delinquent loans. The Order states that one of the main concerns when Congress passed the Dodd-Frank

[12] *Id.* § 1091.109(b)(4).
[13] *Id.* § 1091.115(c)(2).

Act surrounded products and services that allowed creditors to profit from borrowers who are unable to pay their loans.

- **Reputational and Litigation Risk**: Although the CFPB clarifies that the Order does not constitute a finding that the entity has engaged in any wrongdoing, the Order does not come across as innocuous. Instead, it largely reads as a litany of concerns about the company. For example, the CFPB states that it has "reasonable cause to the determine" the entity does not adequately explain to consumers that certain insurance coverage is optional, that it engages in excessive harassing and coercive collection practices, and that it furnishes inaccurate information to consumer reporting agencies, among other concerns. This type of public release could increase litigation and reputational risk, and is another important factor for entities to consider if they receive a Notice and are determining whether to contest it.

The Order serves as an important reminder that nonbank entities— including fintechs—that currently are not supervised by the Bureau may nonetheless come under CFPB supervisory authority through a risk determination. Moreover, it provides key insights into how the CFPB is viewing this largely unused authority.

THIRD CIRCUIT HOLDS SECURITIZATION TRUSTS CAN BE SUBJECT TO CFPB ENFORCEMENT AUTHORITY

By Barbara M. Goodstein, Steven M. Kaplan and Tori K. Shinohara
March 22, 2024

In a long-awaited decision, the Third Circuit handed the Consumer Financial Protection Bureau ("CFPB" or "Bureau") a victory in the *National Collegiate Student Loan Trust* litigation that could have wide-reaching implications for market participants in the consumer financial services industry. In its March 19, 2024 opinion, a three-judge panel held that: (1) the National Collegiate Student Loan Trust entities ("Trusts") are "covered persons" subject to the CFPB's enforcement authority under the Dodd-Frank Act because they "engage" in consumer financial products or services—i.e., student loan servicing and debt collection; and (2) the CFPB did not need to ratify the underlying action before the statute of limitations had run despite the constitutional deficiency within the Bureau when the action was initiated.[14]

BACKGROUND ON NCSLT LITIGATION

By way of background, the Trusts are 15 special purpose Delaware statutory trusts. From 2001 to 2007, the Trusts acquired and provided financing for over 800,000 private student loans with a principal amount of more than $15 billion through the issuance of approximately $12 billion in investor notes. In 2017, the CFPB sued the Trusts in federal court alleging that the Trusts, through the actions of their servicers and sub-servicers, engaged in unfair and deceptive debt collection and litigation practices. Along with the complaint, the CFPB filed a purported consent judgment that the CFPB represented to the court had been executed by the defendants. After various Trust-related parties intervened, the district court denied the CFPB's motion to enter the consent judgment, finding that the attorneys who executed it on behalf of the defendant Trusts were not authorized to do so by the proper Trust parties.

Subsequently, after the Supreme Court held that the CFPB's structure was unconstitutional because it was headed by a single director removable by the President only for cause, the district court dismissed the CFPB's case without prejudice, holding that the CFPB did not have the power to bring the case when it did due to its constitutional structural defect. After the CFPB's case was dismissed, three important things happened. First, the agency filed an amended complaint. Second, the Supreme Court decided *Collins v. Yellen*, which addressed the validity of the Federal Housing Finance Agency's actions while that agency was headed by a single director removable only for cause. Third, the CFPB's case against the Trusts was re-assigned to a new judge.

In December 2021, that new judge denied renewed motions to dismiss the case, making two key rulings in the process. First, the court ruled that *Collins* changed the law and held that "an unconstitutional removal restriction does not invalidate agency action so long as the agency head was properly appointed," unless it can be shown that "the agency action would not have been taken but for the President's inability to remove

[14] *CFPB v. Nat'l Collegiate Master Student Loan Trust et al.*, No. 22-1864 (3rd Cir. March 19, 2024).

the agency head." Applying that standard, the district court found that the removal restriction did not impact the CFPB's decision to bring and continue litigating its case against the Trusts.

Second, the district court ruled that, at least at the motion to dismiss stage, the CFPB had properly asserted claims against the Trusts. Various Trust parties that moved to dismiss the case had argued that the CFPB could not properly assert claims against pass-through securitization trusts because such trusts are not "covered persons" under the Dodd-Frank Act. The Dodd-Frank Act provides that the CFPB can only seek to enforce prohibitions against unfair, deceptive and abusive acts and practices ("UDAAP") against "covered persons," a term defined as anyone who "engages in offering or providing a consumer financial product or service." The Dodd-Frank Act does not, however, authorize a private right of action against "covered persons."

The Trust parties argued that as special purpose entities with no employees the Trusts could not "engage" in providing a consumer financial product or service and the only proper defendants are the entities that do so directly (in this case, the servicers and sub-servicers). Relying on dictionary definitions of the term "engage," the district court held that by contracting with others to service and collect student loans, which the court described as "core aspects of the Trusts' business model," the Trusts had "engaged" in those acts and were thus covered persons subject to the CFPB's enforcement authority.

The Trust-related parties then moved to certify both these issues—the CFPB's authority to bring the action notwithstanding its constitutional defect and whether the Trusts are "covered persons" subject to the Dodd-Frank Act's UDAAP prohibitions—for interlocutory appeal. In February 2022, the district court certified both issues for interlocutory appeal and stayed the case pending the resolution of that appeal. In May 2023, the case was argued before a three-judge panel of the Third Circuit.

THE TRUSTS ARE "COVERED PERSONS" SUBJECT TO CFPB ENFORCEMENT AUTHORITY

In its March 19, 2024 opinion, the court first analyzed the plain language of the statute and found that Congress clearly intended trusts to be included as "persons" under the Dodd-Frank Act. Similarly, the court found that consumer financial products and services include "extending credit and servicing loans" and that the Trusts themselves acknowledged that they were formed to acquire private student loans, issue securitized notes and provide for the servicing of the loans, among other activities. Thus, according to the court, the Trusts "unambiguously" fall within the statute. Therefore, the primary statutory question at issue was whether the Trusts "engage" in consumer financial products or services. According to the court, "[i]f they do 'engage,' they are covered persons under the [Dodd-Frank Act]; if they do not, they do not fall within the purview of the [Dodd-Frank Act]."[15]

Because the Dodd-Frank Act's legislative history does not define the term "engage," the court looked at how this term has been applied in earlier cases. The court cited to earlier Supreme Court precedent, holding that that word "engaged" means "occupied," "employed" or "involved" in something.[16] It also noted that this interpretation is consistent with colloquial and legal dictionaries defining "engage" and that the

[15] *Id.* at 25.
[16] *Id.* at 27.

definition has remained consistent over time. The court then looked to the trust agreements for each Trust, noting that the agreements themselves state the purpose of the Trust is to "engage in" activities that include entering into trust-related agreements for the "administration of the Trusts and servicing of the Student Loans." The court concluded:

> *The Trust Agreement's purpose indicates that the Trusts engage in both student loan servicing and debt collection. As such, the Trusts fall within the purview of the [Dodd-Frank Act] because they "engage" in a known "consumer financial product or service" and are necessarily subject to the CFPB's enforcement authority.*[17]

CFPB RATIFICATION WAS NOT REQUIRED

The court then turned to the constitutional question of whether Bureau ratification of the underlying action was required before the statute of limitations expired. The Trusts argued that the underlying suit needed to be ratified by the CFPB's Director before the statute of limitations expired because it was initiated while the agency's structure was unconstitutional and that this creates a "here-and-now injury."[18] The CFPB argued that ratification was not necessary under the *Collins* decision because the Bureau's director was properly appointed, and the problematic statutory provision did not cause harm to the Trusts.

The court opined that "actions taken by an improperly insulated director are not 'void' and do not need to be 'ratified' unless a plaintiff can show that the removal provision harmed him."[19] With respect to harm, the court declined to find a link between the removal provision and the Trusts' case. Instead, the court agreed with the district court and found that the underlying action likely would have been brought regardless of a president's authority to remove the CFPB's Director because the Bureau's litigation strategy has been consistent across five directors—four of whom were removable at will. The court was not persuaded that the Trusts suffered an actual "compensable and identifiable harm."[20] Thus, the court concluded, "There is no indication that the unconstitutional limitation on the President's authority harmed the Trusts."[21]

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Market participants should carefully examine trust and related documents to attempt to reduce the risk that they could be covered persons under the Dodd-Frank Act.

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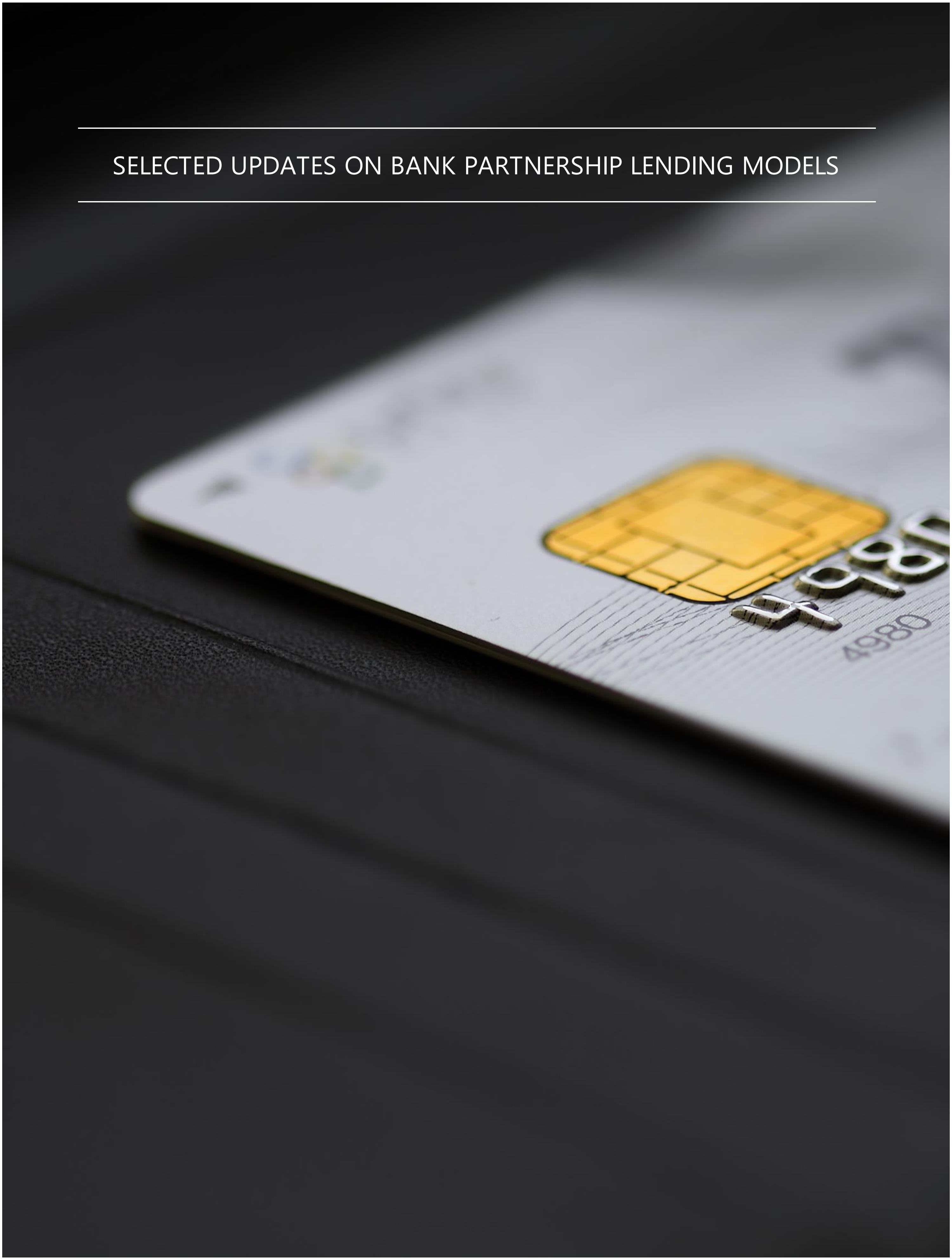
[17] *Id.* at 32.
[18] *Id.* at 32.
[19] *Id.* at 33.
[20] *Id.* at 37.
[21] *Id.* at 38.

SELECTED UPDATES ON BANK PARTNERSHIP LENDING MODELS



SIGNIFICANT "TRUE LENDER" CHANGES TO WASHINGTON CONSUMER LOAN ACT NOW EFFECTIVE

By Krista Cooley and Francis L. Doorley
July 25, 2024

Washington recently enacted significant changes to its Consumer Loan Act that may bring certain nonbank loan marketers and program managers within its scope. The Consumer Loan Act requires a license to make consumer loans of any dollar amount that bear a finance charge, including both mortgage and non-mortgage loans. In addition to requiring non-exempt lenders to obtain a license in order to make consumer loans, the Consumer Loan Act also imposes a maximum finance charge limit of 25% APR on these consumer loans. However, prior to June 6, 2024, the Consumer Loan Act did not require a license to solicit, broker, arrange, or purchase non-mortgage consumer loans.

Senate Bill 6025, titled the “Predatory Loan Prevention Act,” was signed by Governor Jay Inslee and took effect on June 6, 2024. Senate Bill 6025 amends the Consumer Loan Act to incorporate “true lender” provisions that, as a matter of law, re-characterize certain non-exempt entities as the lender of consumer loans with APR exceeding 25%. The “true lender” provisions seek to apply the Consumer Loan Act’s licensing requirement and finance charge limitations, among other compliance obligations, to certain loans originated through partnerships between exempt lenders such as banks or depository institutions and nonbank marketers, program managers, and other third parties.

The new “true lender” provisions apply to non-exempt entities if:

- The non-exempt entity acts as an agent or a service provider or in a similar capacity for an exempt lender (such as a bank) related to a consumer loan with an APR that exceeds 25%; and
- Either of these is true: (i) the non-exempt entity holds, acquires, or maintains the predominant economic interest in the loan or (ii) the totality of the circumstances indicate that the non-exempt entity is the lender and the transaction is structured to evade the requirements of the Consumer Loan Act.

If these conditions are met, then the non-exempt entity is considered to be the party that made the loan, as a matter of law, for purposes of determining whether the loan complies with the licensing and other compliance obligations contained in the Consumer Loan Act.

With Senate Bill 6025 taking effect, the Consumer Loan Act now provides that it is also a violation of the law for a person to “[e]ngage in any device, subterfuge, or pretense to evade the requirements of this chapter including, but not limited to, making, offering, or assisting a borrower to obtain a loan with a greater rate of interest, consideration, or charge than is permitted by [the Consumer Loan Act].”

Last, if a transaction violates the Consumer Loan Act’s requirement that a person hold a license to “engage in any activity subject to” the Consumer Loan Act, the amended Consumer Loan Act provides that:

- If the loan is not a residential mortgage loan, the loan is void and unenforceable.
- If the loan is a residential mortgage loan, all non-third-party fees charged in connection with the origination of the loan, other than interest, must be refunded to the borrower.

With these amendments, Washington joins Connecticut, Hawaii, Georgia, Illinois, Maine, Minnesota, Nevada, New Hampshire, and New Mexico as states that have adopted some form of a "true lender" provision that applies certain licensing and/or compliance obligations to some or all consumer loans that are marketed, arranged, or originated through partnerships or arrangements with nonbank entities.

DIDMCA OPT-OUT UPDATE—DISTRICT COURT CONSTRAINS COLORADO OPT-OUT

By Eric T. Mitzenmacher
June 20, 2024

On June 18, state-chartered banks and their fintech partners received welcome news in ongoing litigation challenging the scope of Colorado's opt-out from the interest exportation regime established by the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA). The US District Court for the District of Colorado issued a preliminary injunction prohibiting state officials from enforcing state-specific interest limitations against any member of the plaintiff associations—the National Association of Industrial Bankers, American Financial Services Association and American Fintech Council—with respect to any loan not "made" in Colorado, where "made" means that the lender is located and conducts certain key loan-making functions.

Under DIDMCA, state-chartered, FDIC-insured banks have the authority to "export" the interest-related requirements of their home or, in certain cases, branch office (host) states when lending elsewhere (the "Interest Exportation Authority"). This authority preempts state regulation with respect not only to numeric usury caps and aspects of state law material to the calculation of the maximum permitted rate, but also to limitations on various fees considered "interest" under Federal banking law (e.g., origination fees, late fees, NSF fees, etc.).

DIDMCA provides states the ability to "opt-out" of the interest exportation regime, however. Specifically, the Interest Exportation Authority ceases to apply in any state "on the date . . . on which such State adopts a law . . . which states explicitly and by its terms that such State does not want the [Interest Exportation Authority] to apply with respect to loans made in such State[.]" Iowa and Puerto Rico have had longstanding opt-outs, and, Colorado enacted an opt-out last year that is set to become effective July 1, 2024. Other states initially opted-out of the interest exportation regime but later repealed their opt-outs.

The scope of DIDMCA opt-outs depends on where a loan is "made." Proponents of broad opt-outs, including state legislators, regulators and enforcement agencies in Iowa and Colorado, have taken the position that a loan is made, or at least can be deemed to be "made" depending on the underlying facts, in the state in which the borrower is located at the time the loan is originated.

In advance of the effective date of the Colorado DIDMCA opt-out, a coalition of financial industry associations sued the Attorney General of Colorado and the Administrator of the Colorado Uniform Consumer Credit Code, the two officials who would enforce state interest limitations, to prevent their application of the opt-out to out-of-state banks making loans to Colorado residents. In the context of a motion for a preliminary injunction, the District Court's June 18 ruling addressed both procedural issues regarding standing and ripeness, as well as the substance of the opt-out.

As initial procedural matters, the court determined that the plaintiff associations had standing because they represented members threatened by potential enforcement of preempted interest rate limitations or administrative costs and losses associated with compliance with preempted laws, and that the matter was ripe for consideration by courts notwithstanding that it raised questions about the validity of the opt-out in a pre-enforcement context in which the challenged state officials had not yet brought specific claims against banks or loan programs.

The court then assessed the substance of the DIDMCA opt-out regime itself. Drawing from the text of the DIDMCA provision, as well as by reference to other federal banking law provisions regarding lending activity, the court concluded that "making" a loan was an activity conducted by the lender, such that a loan is made in the state in which the lender is located or conducts core loan-making activity. The court rejected arguments by the defendant Colorado officials and an amicus brief submitted by the FDIC that a loan could be made in both the state in which the lender was located and the state in which the borrower was located. The court differentiated verbs commonly referring to actions taken by lenders with respect to loans, including "making," from those commonly referring to actions taken by borrowers, such as "receiving" or "obtaining;" and it distinguished precedent cited by the defendants and FDIC suggesting loans, just as any contact, could be made (in the sense of "entered into") in multiple states as relating to inapposite considerations of constitutional jurisdiction rather than DIDMCA's particular use of the term "made."

Having resolved both the procedural and substantive aspects in favor of the plaintiffs, the court then granted plaintiffs' motion for a preliminary injunction. The preliminary injunction is an initial step suspending enforcement during the pendency of the litigation based on the plaintiffs' likelihood of success on the merits and the damage enforcement of the DIDMCA opt-out beyond appropriate boundaries would have on plaintiffs' members. Unlike more fact-intensive litigation, however, it is not clear that much additional process will be necessary at the District Court level for a permanent injunction to be entered (and, thereafter, subject to potential appeal by the Colorado defendants). Moreover, while the injunction is applicable, on its face, solely to members of the plaintiff associations, we have seen recent litigation (specifically, litigation regarding the effectiveness of the CFPB's "1071" small business data collection rule) in which similarly limited preliminary injunctions were later expanded to cover all potentially affected persons.

SELECTED ASSET CLASS UPDATES: AUTO FINANCING

CFPB SUPERVISORY HIGHLIGHTS TARGET CERTAIN AUTO LENDING AND SERVICING PRACTICES

By Kris D. Kully and Jeffrey P. Taft
October 14, 2024

For the most recent edition of Supervisory Highlights, the Consumer Financial Protection Bureau focused on examiners' findings in the auto finance sector. Several of these practices were identified by the CFPB in prior Supervisory Highlights. Many of the CFPB's concerns relate to trends in the marketing, sales, financing, and refunds related to add-on products like optional vehicle- or payment-protection, and to consumers' difficulty in cancelling those products or receiving refunds. The Federal Trade Commission and state regulators also have prioritized these areas, and several states have recently passed legislation addressing add-on products (including refunds, cancellation and notification). In several of the findings, the CFPB noted that the failures related to inadequate oversight of service providers, reflecting another recurring theme in CFPB's compliance management expectations.

The CFPB has framed many of these targeted practices as unfair, deceptive or abusive acts or practices ("UDAAP"), which is consistent with certain of the agency's recent consent orders or suits related to auto servicing practices.

In response to the findings, the CFPB generally demanded ceasing the allegedly noncompliant practices, developing policies and procedures to ensure compliance going forward, and in some cases refunding amounts to consumers.

Motor vehicle dealers, auto finance companies, servicers and secondary market purchasers of auto loans should take note of these highlighted practices when evaluating their policies and procedures.

FINDINGS OF ABUSIVENESS

The CFPB notoriously has authority to prohibit certain acts or practices that it deems to be abusive. The agency issued a policy statement in April 2023 providing a framework for analyzing the acts, practices, or omissions of covered financial services providers to determine whether they meet that abusiveness threshold. In this latest set of Supervisory Highlights, the CFPB relies on that framework to assert that certain auto financing acts or practices fall into that category.

Charging for Unwanted Add-On Products: Examiners found that certain auto finance companies contracted with service providers to offer refinancings to borrowers. Those contracts required the provider to secure a minimum number of extended service contracts or other add-on products. To the extent those service providers sold those products without disclosing or explaining that the cost would be included in the refinancings, the CFPB deemed that practice to be abusive.

Charging for Add-On Products on Salvage Title Vehicles: A vehicle may have a so-called "salvage" title if the vehicle has been significantly damaged or otherwise has very little value. States may prohibit such vehicles from being operated on public roads, lenders generally will not provide financing for those vehicles, and contracts for add-on products are generally void in connection with those vehicles. However, the CFPB found servicers suspended their title check process and financed add-on products in connection with salvage title vehicles. In those instances, the consumers paid for add-on protections but did not benefit from the coverage because of the exclusion for salvage vehicles.

Denying or Failing to Appropriately Allow Cancellation of Add-On Products: Several of the CFPB's findings of abusiveness related to auto finance servicers that reportedly denied consumers' request to cancel add-on products in accordance with the contractual terms, or that servicers imposed significant hurdles to cancellation. The CFPB reported that in connection with add-on product contracts that allowed for cancellation with a pro rata refund within the first year, certain servicers denied consumers' cancellation requests or refused to provide refunds. The CFPB also reportedly found servicers that required consumers to make two in-person visits to a dealership to cancel contracts for add-on products, the cost of which had been financed. The consumer had to visit the dealership and meet with the manager, and then had to return in order to receive the refund check. The agency's findings of abusiveness under those circumstances harkens back to its enforcement action against an auto finance company last year. In that case, the CFPB stated that consumers who wished to cancel add-on products were routed to a "retention hotline." The hotline personnel would continue promoting the product until the consumer voiced three affirmative cancellation requests, after which the personnel instructed that cancellation could only be effectuated in writing. If the consumer sent a written cancellation request, the company would provide the refund only as a principal payment on the loan, so the consumer would get no immediate benefit from the cancellation. The CFPB deemed that practice to be abusive.

FINDINGS OF UNFAIRNESS OR DECEPTION

In addition to the CFPB's supervisory findings of abusive acts or practices, the agency found unfair and deceptive ones, too.

Unfair Repossession Practices: The CFPB asserted that certain auto financing servicers erroneously repossessed vehicles when consumers had made payments or obtained extensions, deferments, or loan modifications. This wrongful repossession may occur if the servicers are unsuccessful in canceling repossession orders or in acting on those cancellations. The CFPB also claimed that it found instances of unfair repossession of vehicles when there was no verification of a valid, recorded lien. The CFPB has highlighted the issue of unfair repossessions in a prior compliance bulletin.

Unfair Failure to Provide Refunds on Add-On Products: The CFPB also found that servicers failed to ensure consumers received refunds of unearned premiums for add-on products upon early termination of their auto loans, by either failing to provide the refund themselves or failing to ensure that dealers or administrators provided them. The CFPB also found that certain servicers failed to timely apply refund amounts (highlighting a delay of 664 days in at least one instance) or miscalculated them. The agency explained that upon loan payoff, credit protection products have no further value, and upon repossession or if the vehicle was deemed a total loss, neither credit protection nor vehicle service contracts have value. While some states address pro rata refunds, the CFPB asserts that it is the servicer's responsibility in all states to ensure the refunds are provided.

Unfair Failure to Apply GAP Coverage: Examiners found that servicers collected monthly payments when they knew the GAP waiver would cover the outstanding balance. GAP stands for "guaranteed asset protection," a credit protection product that pays off the financing if the car is totaled or stolen (auto insurance typically only covers the actual value of the vehicle at the time of the loss). The CFPB found that certain servicers continued to collect consumer payments, instead of waiving those payments in accordance with the GAP contract, or the servicers miscalculated refunds upon discovering their error.

Unfair Delay in Providing Title Upon Payoff: Examiners found that servicers' policies are generally to provide title documentation within two business days but in some cases delivery times significantly exceeded that timeline.

Deceptive and Unfair Payment Allocation Processes: The CFPB found that an auto loan servicer's website stated that the consumer's payments would be applied first to the current payment due, including both interest and principal, before applying a payment to outstanding late charges. However, for postmaturity loans, the servicer actually applied payments to the most recent payment due, then to other charges (such as late fees), and then to other payments due, which in certain cases caused the consumer to incur additional late fees.

Deceptive Marketing: Prescreened advertisements marketed rates "as low as" specified annual percentage rates ("APRs"), but consumers in fact had no reasonable chance of qualifying for or being offered rates at or near that level. While the CFPB offers no bright lines for measuring the reasonable accuracy of advertisements (for example, what percentage of consumers must be able to qualify for an advertised rate), the CFPB reported that the lowest interest rate offered to consumers was more than twice the advertised rate, which the CFPB found to be deceptive.

OTHER COMPLIANCE FINDINGS

While the CFPB found that the acts and practices described above ran afoul of unfair, deceptive, or abusive acts or practices ("UDAAP") principles, the examiners also found some more straightforward compliance errors related to Truth in Lending Act ("TILA") disclosures and Fair Credit Reporting Act violations.

Inaccurate TILA Disclosure: The CFPB reminded us that accuracy is paramount when considering TILA disclosures, and that includes disclosing that the car buyer will incur a prepayment penalty when the installment contract does not provide for such a penalty. It also includes identifying the payee for optional products purchased by the consumer in the disclosed itemization of amount financed.

Credit Bureau Furnishing Errors: Examiners found that auto financing servicers furnished credit reporting companies inaccurate information, including inaccurate past due amounts, monthly payment amounts, payment ratings, dates of first delinquency, or payment amounts upon payoff or settlement. Examiners also found that servicers failed to promptly correct and update incomplete or inaccurate information with credit bureaus, in some cases continuing for months to furnish bad information even after identifying the error. (The CFPB has highlighted similar furnishing failures in the past.)

NEW HAMPSHIRE SIGNIFICANTLY AMENDS MOTOR VEHICLE RETAIL INSTALLMENT AND SALES FINANCE COMPANY ACT

By Kris D. Kully and Jeffrey P. Taft
September 12, 2024

On August 2, 2024, New Hampshire enacted legislation that significantly revises its Motor Vehicle Retail Installment Sales Act (the "Act"), effective July 1, 2024.

Unfortunately, that effective date is not a typographical error. The New Hampshire Banking Department apparently tried, during the legislative process, to extend the effective date until January 1, 2025, but that extension did not make it into the enacted bill. While the bill was enacted with an effective date of July 1, 2024, the Department attempts at least to provide assurances that the bill became effective upon signing, and not retroactively. Still, the effective date of the amendments is just one of the topics requiring clarification.

The legislation (House Bill 1243) makes many substantive changes to the Act, particularly to the contractual requirements (including notice that complaints may be filed with the Department), notices of assignment upon transfers, and the scope of its licensing obligation. While the Act, prior to the amendments, required motor vehicle retail installment sellers and sales finance companies in the state to obtain a license, House Bill 1243 amended the definition of "sales finance company" to include any person acting as a lender, holder, assignee, or servicer to consumers under retail installment contracts. Adding to the perplexity of how a person can act as a "holder" or "assignee" to a consumer buying a motor vehicle, the amendments define a "lender" for this purpose to include not just a person that provides the financing for the vehicle, but any legal successor to the rights of the lender. The amendments even supplemented the definition of "person" to specify that trusts are included, as are any two individuals or entities with a joint or common interest. An express exemption from licensing applies under the amendments only to state or federally chartered banks, savings banks, trust companies, credit unions, cooperative banks, or industrial banks, and to bankruptcy trustees servicing existing contracts. While there is an exemption for pledgees of retail installment sales contracts to secure a bona fide loan, there is no express exemption for special purpose entities used in securitization or other similar financing transactions. As of September 12, 2024, however, the Department's website states that securitization trusts established for the purpose of pooling retail installment contracts and reconstituting them into securities are not required to obtain a sales finance company license in the state. While the Department stated further that the licensing requirement will typically be fulfilled by the servicer or other entity responsible for servicing the contracts in the securitization trust, it did not expressly address the licensing obligations applicable in other types of financing transactions or to other types of special purpose entities. We expect that a similar licensing exemption would apply to those transactions and entities, because the servicer would need to be licensed or an exempt entity.

House Bill 1243 also amends the geographical scope of the licensing obligation. While the Act, prior to the amendments, applied the licensing obligation to persons engaging in applicable business in the state, the obligation now applies to any nonexempt person that, in its own name or on behalf of other persons, engages in the applicable business in the state "or with persons located in this state." Neither the Act nor the amendments expressly address what constitutes engaging in business in the state for this purpose. Without further clarification from the Department, the "transacting business" standard for foreign qualification in the New Hampshire Business Corporations Act could be an appropriate basis for determining whether an entity is "engaging in business" in New Hampshire for purposes of the Act.

While the new scope of the licensing obligation is not fully clear, the legislation certainly raises the consequences for guessing incorrectly. The Act previously imposed criminal penalties for failure to obtain a license as required (and continues to do so after the amendments, if done "knowingly"). As if that weren't sufficient deterrence, House Bill 1243 provides that any person that engages in the business of a sales finance company (or retail seller) in the state or with consumers located in the state without first obtaining a license "shall have no right to collect, receive, or retain any principal, interest, or charges whatsoever on any purported retail nonexempt installment contract and any such contract shall be null and void." The amendments also provide that no person shall assist or aid and abet any person in the conduct of business under the Act without a license as required by the Act. With a retroactive effective date of July 1, 2024, the licensing provision and the other substantive changes have understandably sent the New Hampshire automobile financing industry scrambling for answers.

The Department announced that it spearheaded the legislation (but was unable to fix the effective date), and "intends to engage in outreach and education" on the amendments until January 1, 2025. The agency did not, in that announcement, commit to engaging "only" in outreach and education, nor did it describe any efforts to amend the legislation's effective date. However, the Department promises to provide further guidance on an ad hoc basis to any business that reaches out with "compliance challenges." In its August 26, 2024 guidance, the Department described a "no-action" process through which the public may seek further specific guidance. In seeking a response to a no-action request, financial institutions will need to identify themselves and provide detailed and particular facts and circumstances, along with the legal basis for their interpretation. Financial institutions may seek confidential treatment of those requests, which the Department may grant in accordance with the state's Right-to-Know Law and other provisions.

The Department emphasized, though, that any no-action letter or response to a request for such a letter that the Department issues will not constitute legal advice, and its answers to frequently asked questions are intended only as informal guidance.

SELECTED ASSET CLASS UPDATES: BUY-NOW/PAY-LATER (BNPL)

CFPB INTERPRETIVE RULE EXPOSES SOME BNPL PROGRAMS TO CREDIT CARD REQUIREMENTS

By Eric T. Mitzenmacher
May 24, 2024

On May 22, the Consumer Financial Protection Bureau ("CFPB") issued an interpretive rule purportedly clarifying the breadth of the term "credit card" for Truth in Lending Act ("TILA")/Regulation Z purposes in the buy-now/pay-later ("BNPL") context (the "Interpretive Rule"). The clarification asserts that "digital user accounts" that permit consumers to access credit in the course of a retail purchase are "credit cards," subjecting the "card issuer" to certain additional disclosure and substantive obligations under Federal law. The Interpretive Rule would become effective 60 days after publication in the Federal Register. The CFPB is accepting comments on the Interpretive Rule through August 1, 2024, notwithstanding that the Bureau's position is that notice-and-comment rulemaking is unnecessary for its interpretation to become effective.

Under TILA and its implementing regulation, Regulation Z, whether a credit product involves use of a credit card is critical to determining the scope of regulatory requirements. Subject to certain exceptions, non-card products trigger Regulation Z compliance obligations if they bear a finance charge (such as interest or various—but not all—types of fees) or are repayable by written agreement in more than four installments. When a credit card is involved, however: (i) products may fall within the scope of certain Regulation Z compliance obligations even if they lack a finance charge and are repayable in four or fewer installments; and (ii) more substantial requirements, such as ability-to-repay underwriting and limitations on penalty fees (the "CARD Act Requirements"), apply if a product involves a credit card, is structured as an open-end credit plan, and is not a home equity line of credit or an overdraft line of credit accessed by a debit or hybrid prepaid-credit card.

For these purposes, "credit card" means, subject to certain exceptions, "any card, plate, or other single credit device that may be used from time to time to obtain credit." The term is not limited to physical cards, but may also include intangible access devices. Prior to the Interpretive Rule, for example, Regulation Z commentary provided that mere "account numbers" could be "credit cards" if they provided access to an open-end line of credit to purchase goods or services. The Interpretive Rule distinguishes "digital user accounts" from mere account numbers and asserts that at least some such accounts may meet the definitional elements of a credit card—*i.e.*, reusability from time-to-time to obtain credit—particularly when there is a relatively frictionless flow permitting the consumer to access credit through the digital user account to purchase goods or services from online retailers or physically in stores.

While the Interpretive Rule acknowledges that not all digital user accounts are credit cards, it leaves significant ambiguity as to what the structure of a digital user account may be to avoid characterization as a credit card. In particular, it asserts that the fact that each BNPL is separately underwritten and may be denied would not be sufficient to shield an account structure from treatment as a credit card, nor would the fact that consumers' use of the account results in a one-time account number or similar credential that may be used to make a single purchase at an online retailer. It also does not comprehensively address the role the digital user account must play in the retail checkout flow or the level of integration with a merchant's systems that must exist before the account becomes a credit card. Accordingly, treatment of any particular BNPL digital user account may require nuanced, fact-intensive assessment to determine similarities and differences between card and non-card user experiences.

The Interpretive Rule primarily engages with the "core" BNPL product currently offered in the US, which is an obligation bearing no finance charge that is repayable in not more than four installments (typically a down payment followed by three periodic payments). For such a product, even if a credit card is involved, CARD Act Requirements would not apply. That said, potential obligations do include incremental: (i) advertising disclosures; (ii) application/- solicitation and account-opening disclosures; (iii) change-in-terms notifications; (iv) periodic statements; (v) prohibitions on unsolicited issuance of a credit card; (vi) limitations on consumer liability for unauthorized use of the card; (vii) billing error resolution requirements (both substantive and procedural); (viii) rights of the cardholder to assert claims or defenses otherwise running against the merchant against the card issuer instead (also involving both substantive and procedural requirements); (ix) limitations on offset rights; (x) requirements related to prompt notification of returns and crediting of refunds; and (xi) limited payment processing restrictions. Of these, the CFPB's primary focus (based on its initial press release and public statements) seems to be on dispute and refund rights, as well as the provision of periodic statements, though the Interpretive Rule does not set aside any of the requirements that otherwise would be applicable to a card-accessible consumer credit product.

Though the requirements applicable to non-CARD Act credit cards are not as substantive as CARD Act Requirements, they can require nuanced analysis as to which specific sub-requirements apply to credit cards accessing closed-end credit vs. only those accessing open-end lines of credit. Additionally, the party to which the requirements technically apply—the "card issuer"—may be a BNPL provider, a bank partner originating BNPL credit, a payment processor providing an entry point into card or payment networks, or even some combination of the three, depending on the facts of the underlying program; and, even once specific requirements and the party to which they apply are identified, setting up and testing appropriate automation and compliance controls can take time. Particularly in programs implemented through partnerships among multiple (typically bank and non-bank) parties, these considerations already are beginning to generate conversations regarding amendments to consumer-facing and partnership/service provision agreements, build-out of compliance management systems and compliance team capacity, incremental monitoring and testing requirements, and similar issues.

Industry comments may challenge whether guidance absent notice-and-comment rulemaking is appropriate for this particular Interpretive Rule, as well as challenge or seek clarification as to the types of digital user account fact patterns covered by the interpretation. Litigation challenging the Interpretive Rule is also a possibility, though no such litigation has been advanced as of the date of this post.

LICENSING AND REGULATION ON THE WAY FOR BNPL PROVIDERS IN NEW YORK?

By Krista Cooley and Francis L. Doorley
January 2024

In a January 2 press conference, New York Governor Kathy Hochul introduced plans to enact a "sweeping consumer protection and affordability agenda," that include what the Governor characterized as "nation-leading regulations" on the "Buy Now, Pay Later" ("BNPL") financing industry. BNPL products typically allow consumers to finance their purchase of goods and services from merchants or retailers at the point of sale. The BNPL market has grown significantly in recent years, and there is significant variance within this market among the type and structure of BNPL financing products, whether the consumer is charged interest or fees, and the term and maturity of BNPL financing, among other items. Currently, New York requires BNPL providers to obtain a license under the New York Banking Law if they make consumer loans of $25,000 or less with annual percentage rates that exceed 16%, or if they purchase retail installment contracts from merchants that sell goods or services to their customers on credit.

During the press conference, Governor Hochul announced her plan to propose legislation that would, if enacted, require providers of BNPL financing to obtain a license, and would authorize the New York Department of Financial Services to issue regulations imposing compliance requirements on providers of BNPL financing. Although we cannot be certain about the content of any forthcoming legislation or regulations, Governor Hochul indicated that the contemplated BNPL legislation and regulations will "establish strong industry protections around disclosure requirements, dispute resolution and credit reporting standards, late fee limits, consumer data privacy, and guidelines to curtail dark patterns and debt accumulation and overextension." Based on these remarks, it appears that—if New York follows the governor's lead—BNPL providers may become subject to a new licensing requirement and significant substantive compliance requirements. We will continue to follow developments in New York related to the governor's push to regulate BNPL financing.

SELECTED ASSET CLASS UPDATES: CREDIT CARDS

CFPB FINALIZES RULE SIGNIFICANTLY RESTRICTING CREDIT CARD LATE FEES—LITIGATION IMMEDIATELY FOLLOWS

By Eric T. Mitzenmacher, Steven M. Kaplan, Jan C. Stewart, Jeffrey P. Taft, and Joy Tsai
March 18, 2024

On March 5, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") issued a Final Rule that would significantly restrict late fees that consumer credit card issuers may charge from $30 or $41, in most cases, to a mere $8. As finalized, the rulemaking largely aligns with the Bureau's Proposed Rule on the same subject matter issued February 1, 2023, with certain differences described below.

Within two days, however, the Final Rule already faced a challenge to its validity through litigation brought in the Northern District of Texas by a coalition of trade groups including the United States Chamber of Commerce, the American Bankers Association, and the Consumer Bankers Association. The challenge seeks invalidation of the Final Rule on several constitutional, procedural, and substantive bases, as well as a temporary stay of the rule's effectiveness while the suit progresses.

In this Legal Update, we frame the Final Rule within current law, and describe the changes imposed by it, the current litigation against it, and the likely industry implications were the rule to become effective.

LIMITATIONS ON CREDIT CARD LATE FEES UNDER CURRENT LAW

Late fees for traditional consumer credit card accounts are regulated at the federal level by provisions of the Credit Card Accountability Responsibility and Disclosure Act (the "CARD Act," which is an element of the federal Truth in Lending Act ("TILA")) that are implemented by Regulation Z.

Under current regulation, the relevant Regulation Z provisions address "penalty fees" on a basis agnostic to the specific type of fee. A "penalty fee" is any fee imposed on a consumer for violating the terms or other requirements of a CARD Act-regulated credit card account. These include, for example, late fees, non-sufficient funds ("NSF") fees, and over-limit fees.

Each such penalty fee is subject to three distinct limitations.

- First, penalty fees must be set no higher than: (i) specified safe harbor values, currently $30 for an initial violation and $41 for a subsequent violation for credit card accounts,[22] with such dollar amounts subject to automatic annual adjustments for inflation; or (ii) an amount—supported by appropriate analysis updated at least every 12 months—that represents a reasonable proportion of the total costs incurred by the card issuer as a result of the type of violation.[23] Costs that may be considered largely are hard costs, exclusive of credit losses and associated costs such as those related to holding reserves against losses and analytical costs associated with determining whether consumers are likely to violate the

[22] A separate safe harbor of 3% of the delinquent balance on a charge card account that requires payment of the outstanding balance in full at the end of each billing cycle if the card issuer has not received the required payment for two or more billing cycles is not affected by the Final Rule and is not further discussed in this Legal Update.
[23] 12 C.F.R. § 1026.52(b)(1).

account term at issue.[24] In practice, the administrative burden of analysis is sufficient that effectively all consumer credit card issuers impose penalty fees at or below the safe harbor values.

- Second, notwithstanding the safe harbors or analysis-supported fee values, no penalty fee may exceed the dollar amount associated with the violation (e.g., a late fee may not exceed the value of the minimum required payment that was late).[25]
- Third, a card issuer may not impose more than one fee for violating the terms of an account based on a single event or transaction (e.g., attempting to make a required payment with a check that bounces may result in either a fee for the returned payment or a late fee for the minimum required payment not being made, but not both).[26]

CONTENT OF FINAL RULE

The Final Rule would change the fee requirements described above, beginning May 14, 2024, were it to become effective.

In response to comments that the Proposed Rule would impose undue burdens on small card issuers, the CFPB's Final Rule restricting late fees does not apply to "Smaller Card Issuers," which it defines as a card issuer that, together with its affiliates, had fewer than one million open credit card accounts for the entire preceding calendar year. However, if a card issuer and its affiliates had fewer than one million open credit card accounts for the entire preceding calendar year, but then meets or exceeds the one million threshold in the current calendar year, that card issuer will no longer be considered a Smaller Card Issuer as of 60 days after it meets or exceeds the threshold, and will be subject to the late fee restrictions under the Final Rule. Notwithstanding the exemption for Smaller Card Issuers, the Bureau indicates that approximately 95% of card balances would be covered by the Final Rule.

Material amendments likely to be adverse to the interests of card issuers (other than Small Card Issuers) include:

- Reduction of the basic safe harbor limit for late fees for credit card accounts from $30 to $8;
- Elimination of the distinction between first and subsequent violations (violations of the same type that occur during the same billing cycle or in one of the next six billing cycle) for late fee purposes, such that the current $41 safe harbor would no longer apply; and
- Elimination of the automatic annual inflation adjustments to the $8 safe harbor limit, such that the real value of the safe harbor would fall over time unless the Bureau took separate steps to raise the value in any given year.

Instead of relying on the safe harbor limit for late fees, as before the Final Rule, card issuers may still impose fees representing a "reasonable proportion of the total costs incurred by the card issuer" as a result of the violation of the credit card agreement. With respect to that provision, the Final Rule merely clarifies that card issuers must not include any collection costs incurred after an account is charged off in conducting

[24] Official Interpretation to 12 C.F.R. § 52(b)(1)(i).
[25] 12 C.F.R. § 1026.52(b)(2)(i).
[26] 12 C.F.R. § 1026.52(b)(2)(ii).

their cost analyses. That said, given that the cost analysis requires significant procedural and examination burdens, virtually all card issuers have relied on the safe harbor limit historically. Indeed, the Bureau noted in the Final Rule that, from its 2022 analysis of credit card agreements submitted to its database, it has found **no evidence** of **any** issuers using the cost analysis provisions to charge an amount higher than the safe harbor value.

Limited positive news for card issuers beyond the exemption of Smaller Card Issuers includes that, in the Final Rule, the CFPB:

- did not adopt a provision in its Proposed Rule that would have limited late fees to 25% of a consumer's minimum required payment (down from 100% under current law);
- did not impose a new mandatory 15-day grace period before a card issuer may charge late fees, which it had contemplated in the Proposed Rule; and
- mandated the 2024 inflation adjustment for penalty fees other than late fees (or, for Smaller Card Issuers, including late fees), moving the relevant safe harbor values from $30/$41 to $32/$43 for initial and subsequent violations within six billing cycles.

LITIGATION CHALLENGING THE FINAL RULE

Ink barely dried on the CFPB's Final Rule before trade groups sued to delay its implementation and, ultimately, seek its invalidation. In a March 7 complaint filed in the Northern District of Texas (the "Trade Group Complaint"),[27] trade groups raised a series of concerns with the Final Rule and the manner in which it was developed. Each such concern was well-presaged in industry comments submitted in connection with the Proposed Rule, and the limited extent to which the Final Rule varied from the Proposed Rule likely aided trade groups in their ability to bring action quickly.

With respect to particular, substantive statutory obligations imposed on the CFPB's rulemaking in this matter, the Trade Group Complaint takes issue with the Bureau's alleged disregard of statutory standards for evaluating the reasonableness of penalty fees. Specifically, provisions of the CARD Act regarding penalty fee rulemaking required the relevant regulator (initially, the Board of Governors of the Federal Reserve System ("Federal Reserve"), with authority later transferred to the CFPB in 2011) to issue rules establishing standards for assessing the reasonableness and proportionality of credit card penalty fees after consideration of: (i) the cost incurred by the creditor from an omission or violation; (ii) deterrence of omissions or violations by the cardholder; (iii) conduct of the cardholder; and (iv) such other factors deemed necessary or appropriate by the relevant regulator. The CARD Act also granted the regulator discretion to provide for a penalty fee that is presumed to be "reasonable and proportional" to the omission or violation—i.e., a safe harbor value.

The preamble to the Final Rule indicates that the CFPB heavily focused on the cost prong, and received substantial pushback from industry commenters challenging Bureau methodology in calculating costs. Many commenters to the Proposed Rule criticized the CFPB's analysis of the deterrence prong. Several industry commenters asserted that the Bureau did not provide sufficient evidence that the reduced safe

[27] *Chamber of Commerce et al. v. Consumer Financial Protection Bureau*, Case No. 4:24-CV-213 (N. D. Tex. Mar. 7, 2024).

harbor limit would deter late payments, arguing that the ability to make late payments for a fee could be viewed as a credit product, the quantity demanded of which increases when price decreases. In finalizing the rule, the Bureau noted that even if the proposed amount results in an increase in late payments, borrowers may benefit from greater ability to pay revolving debt, though a commenter argued that potential consumer benefit is irrelevant to the Bureau's statutory mandate to consider the deterrence effect. The Trade Group Complaint aligns with such comments, alleging that the Final Rule is unlawful because the Bureau did not sufficiently consider the role that late fees play in "deterrence of omissions or violations by the cardholder."

Additionally, under broader requirements of the Administrative Procedures Act not necessarily specific to the particular subject matter of the Final Rule, the Trade Group Complaint takes issue both with: (i) the arbitrary and capricious manner of the Bureau's decision-making around issues such as estimations of card issuer costs, disregard of deterrent effects, and disregard of post-charge-off collection costs, and (ii) reliance on certain non-public data (specifically FR Y-14M data through which the Federal Reserve collects relatively detailed information regarding banks' credit card and loan portfolios on a monthly basis) that has not, and, based on Bureau intentions, will not, be published. Claims challenging rulemaking as arbitrary and capricious for lack of sufficient analysis are relatively common, but the challenge to use of nonpublic data is more specific to this rulemaking. With respect to publication of data, in particular, the Bureau explained that it considered FR Y-14M data from the Federal Reserve, which includes confidential supervisory information that would not be released in raw form. Commenters, and, ultimately the Trade Group Complaint, essentially frame the limitation on data as an Administrative Procedures Act violation because it deprived the public of a reasonable ability to comment on the Proposed Rule or understand the decisions ultimately reached by the Bureau.

Finally, the Trade Group Complaint raises a challenge to the constitutionality of the CFPB's funding structure similar to that already before the Supreme Court in CFSA v. CFPB (argued in October 2023 and likely to be decided before the Supreme Court's 2024 summer recess).28 The existing case seems likely to resolve that funding claim, though presentation of the claim in the Trade Group Complaint arguably helps tie the challenge to ongoing litigation in a manner that may support a preliminary injunction staying the Final Rule's effective date pending the outcome of *CFSA v. CFPB*, as has been the case for certain other CFPB-related litigation, including ongoing actions addressing the Bureau's 1071 small business credit data collection rule[29] and the Bureau's use of informal guidance, in the form of updates to its Examination Manual, to implement substantive regulation consisting of including anti-discrimination concepts within the CFPB-administered prohibition on unfair, deceptive, or abusive acts and practices ("UDAAPs").[30] A motion for such a preliminary injunction and a brief in support of that motion were filed alongside the Trade Group Complaint on March 7.

[28] *Community Financial Services Association of America, Ltd. v. Consumer Financial Protection Bureau*, Case No. 1:18-CV-295 (W.D. Tex. October 19, 2022).
[29] *Texas Bankers Assoc. v. Consumer Financial Protection Bureau*, Case No. 7:23-cv-00144 (S. D. Tex. October 26, 2023).
[30] *Chamber of Commerce v. Consumer Financial Protection Bureau*, Case No. 6:22-cv-00381 (E.D. Tex. September 8, 2023).

INDUSTRY IMPACT

Given the challenges presented by the Trade Group Complaint, it is possible that the Final Rule may never become effective in its current form. If, however, the Final Rule does become effective (even on a delayed basis), it will likely substantially affect the availability and terms of consumer credit card accounts.

As a first-order effect, dramatic reduction in safe harbor fee values likely will reduce fee revenues and increase delinquency rates for card issuers and investors in consumer card receivables. While fee revenue and deterrent effect reduction could be offset, at least in part for some issuers, through conducting cost analysis to justify higher fees than the safe harbor value, such an outcome seems unlikely given historic reluctance to rely on the cost analysis provisions, the administrative burdens of the analysis itself, and the likelihood that reliance on cost analysis to charge higher late fees would make a card issuer a greater target for regulatory investigation or private actions.

More likely, card issuers may engage in a combination of offsetting behaviors as second-order effects. These may include, for example: (i) increasing top-line numeric interest rates to generate higher revenue on delinquent accounts and serve as a better deterrent; (ii) tightening credit standards, resulting in greater selectivity around credit application approvals and initial credit limit assignments; and/or (iii) more quickly applying after-the-fact protections such as credit limit reductions, line suspensions, or account terminations to delinquent consumers.

Since credit card portfolios are often securitized, there may also be pricing impact on the secondary market. Investors may be concerned with the impact the reduced fee revenue may have on securitization trust metrics such as excess spread, particularly with the recent rising interest rates on issued securitization debt. While the market for credit card receivables is robust enough to handle much of the pricing shock, there may well be some reduction in financing and/or secondary market outlets available to card issuers that could ultimately reduce the availability of card-based credit to at least some portion of the overall consumer population. Moderate-sized card issuers (too large to be exempt from the Final Rule's changes as Smaller Card Issuers, but likely to have somewhat less leverage in the secondary market) and consumers down the credit spectrum seem particularly likely to face adverse impact as a result of the Final Rule—again, if it ever becomes effective in its current form.

PLACEMENT WITHIN THE BROADER REGULATORY CONTEXT—THE CFPB'S JUNK FEE INITIATIVE

The Final Rule is the latest—and potentially most impactful—of the Bureau's moves in its ongoing campaign against "junk fees," through which the Bureau seeks limitations on a variety of consumer-facing charges it deems to be inconsistent with consumer protection objectives.[31] With respect to the Final Rule, CFPB Director Rohit Chopra proclaimed that the Final Rule closed a regulatory "loophole" that major credit card issuers "exploited…to harvest billions of dollars in junk fees" annually.

Other fees the Bureau appears to categorize similarly include, for example:

[31] For a general discussion, see Mayer Brown's March 2023 and February 2024 Legal Updates.

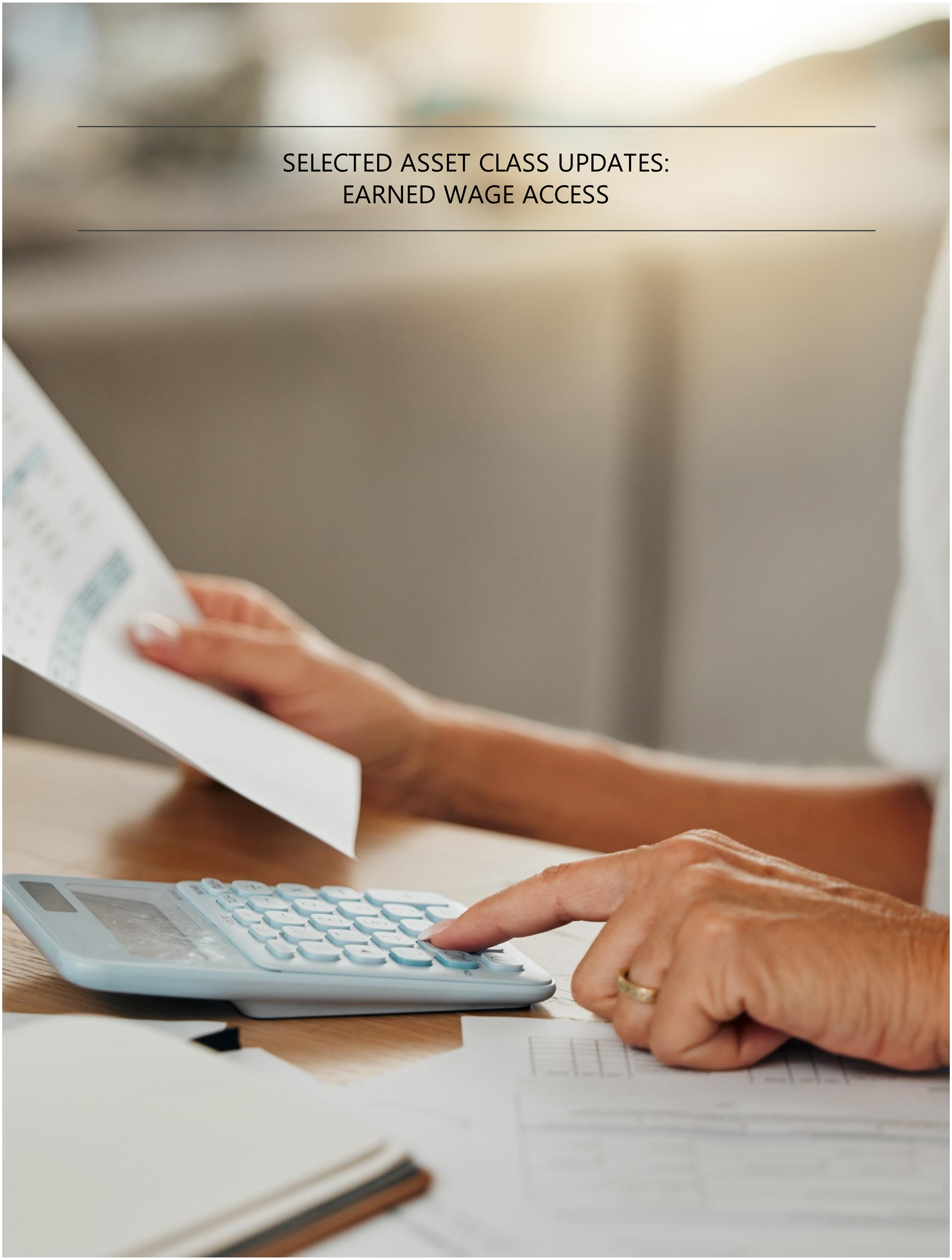
- **NSF Fees**—certain non-sufficient funds (NSF) or returned payment fees on transactions a financial institution declines in real time;
- **Overdraft Fees**—certain fees associated with the extension of short-term overdraft loans in connection with consumer deposit accounts;
- **Customer Service Fees**—including certain fees for provision of paper statements and fees imposed for provision of customer service related to providing basic account information or responding to inquiries or complaints.
- **"Worthless Add-on Product Fees"**—including fees for insurance or similar products charged after an auto loan has been satisfied in full or the protected collateral has been repossessed.

Some of the CFPB's action in the junk fee space has targeted narrow fact patterns under which consumers may receive little or no value from the payment of a fee and/or are denied meaningful access to basic legal or contractual protections without paying; but the Bureau's most aggressive positions—including the Final Rule—expand the reach of its junk fee construct to charges that are both: (i) typical and anticipated for the type of consumer financial product or service at issue, and (ii) core to the framing of incentives around responsible access to and use of such consumer financial products and services.

Late fees, in particular, are also among the most understandable and well-disclosed fees that exist across the consumer financial marketplace and play an important role in incentivizing on-time payments that lower the cost of credit across the industry as a whole and help individual consumers build better credit profiles. Yet, the Bureau positions them as though they are little more than financial institution cash grabs.

While the Bureau has a clear statutory authority and responsibility to establish rules regarding appropriate late fees for consumer credit card products, looping the Final Rule into a broader political campaign against junk fees suggests a more moralized approach than the technical one structured by TILA. In that light, it should be no surprise that the industry views the Final Rule as unwarranted and destabilizing.

SELECTED ASSET CLASS UPDATES: EARNED WAGE ACCESS



THE STATE OF PLAY ON EWA

By Krista Cooley and Francis L. Doorley
February 15, 2024

Like a snowball rolling down a hill, the push to pass legislation to regulate earned wage access (EWA) providers is growing. In June 2023, Nevada became the first state to officially regulate earned wage access providers, and Missouri followed soon after. In the month of January 2024 alone, four states, Arizona (Senate Bill 1273), Florida (Senate Bill 1146), Hawaii (Senate Bill 2664), and Kentucky (House Bill 322) introduced bills to regulate earned wage access providers.

These four bills highlight the differences in how states may be preparing to regulate earned wage access, including with respect to the critical issue of whether earned wage access transactions are considered to be loans or credit. One industry trade association recently wrote a letter to CFPB Director Rohit Chopra noting this "patchwork" approach and urging the CFPB to "engage in a more substantive regulatory endeavor, such as a formal rulemaking," that creates a "clear and consistent regulatory framework" for EWA providers.

We discuss high-level features of each of these four most recently introduced bills below.

ARIZONA

On January 30, 2024, the Arizona Legislature introduced Senate Bill 1273 , which, if enacted, will regulate earned wage access providers and require them to be licensed. Senate Bill 1273 would require "providers" of an "earned wage access service" to obtain a license from the Arizona Department of Financial Institutions prior to doing business in Arizona. A "provider" of earned wage access services does not include a service provider, such as a payroll service provider, whose role may include verifying a consumer's available earnings, unless the service provider is contractually obligated to fund proceeds that are delivered as part of an EWA program. The term also does not include an employer that offers to advance wages or compensation to its employees or contractors prior to a normally scheduled pay date. The Arizona legislation would apply to providers of both employer-integrated and direct-to-consumer earned wage access services.

Senate Bill 1273 would also subject licensed earned wage access providers to disclosure and consumer protection requirements. For example, licensed earned wage access providers would be required to offer at least one reasonable option to a consumer about how to obtain proceeds at no cost and clearly explain how to elect that no cost option, and disclose all fees associated with the EWA program and the consumer's rights under the agreement to the consumer prior to entering into an agreement. If the program solicits "tips" or voluntary gratuities from the consumer, then the provider must clearly and conspicuously disclose to the consumer immediately before each transaction that any tip, gratuity, or other donation amount is voluntary and may be zero. Providers that accept tips or gratuities must also include in their program or service contract with the consumer that any "tips" are voluntary and that whether a consumer tips (or the amount of the tip) does not affect the consumer's eligibility for the EWA program, including with respect to the size or frequency of advances under the program.

Senate Bill 1273 would, if enacted, provide licensed earned wage access providers with a "safe harbor" from Arizona's consumer loan, collection agency, and money transmission licensing laws when offering earned wage access services in compliance with the law, and would also provide that any fees or voluntary tips, gratuities, or donations paid to a licensee are not interest or a finance charge.

FLORIDA

If enacted, Florida Senate Bill 1146 would create Part V of Chapter 560 of the Money Services Business provisions. Part V of Chapter 560 would be titled the "Florida Earned Wage Access Services Act" (the "Act")(Fla. Stat. Ann. 560409 et seq.). The Act would include: (i) definitions; (ii) registration requirements; (iii) provider requirements; (iv) administrative remedies and penalties; and (v) will set forth examples of which transactions are not considered to be earned wage access services.

Senate Bill 1146 would require "providers" of an "earned wage access service" to register with the Florida Office of Financial Regulation prior to doing business in Florida. A "provider" of earned wage access services does not include a payroll provider that is not contractually obligated to fund proceeds that are delivered as part of an EWA program. The term also does not include an employer that offers to advance wages or compensation to its employees or contractors prior to a normally scheduled pay date. The Florida legislation would apply to providers of both employer-integrated and direct-to-consumer earned wage access services. Similar to the Missouri and Nevada laws, Senate Bill 1146 would also enact compliance and disclosure requirements. For example, registered earned wage access providers would be required to allow a consumer to cancel their use of EWA services at any time, without incurring a cancellation fee or penalty. Providers also would be prohibited from sharing any fees, tips, gratuities, or other charges collected from the consumer with an employer; requiring a consumer report or credit score to determine the consumer's eligibility for an EWA program, or accept payment of outstanding amounts via a credit card or charge card.

Senate Bill 1146 specifically provides that EWA programs offered and provided by registered providers in compliance with the law would not be considered as an assignment or sale of wages, a loan, credit, or debt, or money transmission, for purposes of Florida law. In addition, the bill would clarify that the Florida Consumer Finance Act (which regulates and licenses consumer lenders) does not, as a matter of law, apply to any proceeds provided to a consumer pursuant to the Earned Wage Access Services Act, and any voluntary tip, gratuity, or donation paid by a consumer to a registered EWA provider is not a finance charge. If enacted, the Act will become effective on October 1, 2024.

HAWAII

While the Arizona and Florida bills would create a "safe harbor" for earned wage access providers by expressly precluding EWA transactions from characterization as a loan, debt, or credit for purposes of state law, Hawaii's Bill 2664 takes the opposite approach. Bill 2664, which was introduced on January 19, 2024, would amend Hawaii's usury law to categorize earned wage access products as "credit" and subject EWA advances to Hawaii's usury law.

Bill 2664 would amend Hawaii's interest and usury code to re-define a "credit" transaction to include "any sale, assignment, order, or agreement for the payment of unpaid wages, salary, commissions, compensation, or other income, including a tax refund or other expected source of funds, or any portion or amount thereof, whether earned, to be earned, or contingent upon future earnings, that is made in consideration for goods or services, or the payment of funds to or for the account of the person earning or receiving, or potentially earning or receiving, the wages, salary, commissions, compensation, or other income." In addition, while "credit" is currently defined consistent with the federal Truth In Lending Act (TILA) and Regulation Z as "the right to defer payment of debt or to incur debt and defer its payment," Bill 2664 would define "debt" to include any amount that a consumer agrees to repay, regardless of whether the transaction carries recourse to the consumer in the event of nonpayment or requires the payment of any charges or payments.

In addition to capturing earned wage access advances as "credit," Bill 2664 also amends Hawaii's usury law to impose a 12% APR limit on such advances. The bill provides that the calculation of the APR includes not only all charges that are "finance charges" under TILA and Regulation Z, but also "any amount offered or agreed to by a borrower in furtherance of obtaining credit or as compensation for the use of money," and "any fee, voluntary or otherwise, that is charged, agreed to, or paid by a borrower in connection or concurrent with an extension of credit."

Bill 2664 would take effect immediately upon enactment.

KENTUCKY

Kentucky House Bill 332 ("HB 332") was introduced on January 22, 2024. HB 332 does not expressly require licensing or registration of earned wage access providers; instead, HB 332 contains a provision that expressly re-characterizes EWA transactions as loans and imposes fee limitations on EWA transactions.

HB 332 applies to an "earned wage access transaction," which is defined as "[a]n advance of earned wages, salary, commissions, or other compensation for services," or "any other advance or payment in money, funds, or credit in exchange for, or that is secured by, a sale, assignment or order for the payment of earned wages, salary, commissions, or other compensation for services[.]" HB 332 provides that any transaction that meets the definition of an "earned wage access transaction" is a loan as a matter of law, regardless of the means of collection, whether the provider has legal recourse to the consumer in the event of nonpayment, or whether the transaction requires the payment of any charges or payments by the consumer. HB 332 would, if enacted, ban the use of a "tip" model in Kentucky, as the bill would prohibit any person from soliciting or accepting any gift or gratuity in connection with an earned wage access transaction. The bill would also limit the fees and charges that may be imposed on an earned wage access transaction to $3 for the first transaction within a calendar month, $2 on the second transaction within that month, $1 for the third transaction, and would prohibit the charging or receipt of any amount on a subsequent transaction within the same calendar month.

HB 332 provides that it does not apply to consumer loans or deferred deposit transactions that are originated by licensees under the Kentucky Consumer Loan Law or Kentucky Deferred Deposit Transactions Law, as applicable.

A NEW PLAY IN EWA? CFPB ISSUES PROPOSED INTERPRETIVE RULE ON EARNED WAGE ACCESS

By Francis L. Doorley, Eric T. Mitzenmacher, and Jeffrey P. Taft
July 23, 2024

On July 18, 2024, the Consumer Financial Protection Bureau ("CFPB" or the "Bureau") issued a proposed interpretive rule (the "Proposed Rule") purporting to clarify the application of the Truth in Lending Act ("TILA") and Regulation Z to earned wage access ("EWA") programs. Unlike other interpretive rules issued by the Bureau, including the interpretive rule on the application of certain TILA and Regulation Z "credit card" provisions to buy now, pay later products, the Proposed Rule is styled as a proposal and request for comment that will not become effective until after the CFPB considers comments and issues a final interpretive rule. In this blog post, we discuss the important features of the Proposed Rule.

STRUCTURE OF EWA PROGRAMS

Before diving into the Proposed Rule, we briefly remind readers of the basic structure of EWA programs. Earned wage access is a service that allows workers to obtain wages that they have earned, but have not yet been paid, prior to the worker's regularly scheduled payday. EWA programs have grown in popularity in recent years, and many large employers now partner with EWA providers to offer the providers' programs as an employee benefit, with the goal of promoting employees' financial well-being and offering employees access to a lower-cost alternative to payday loans or short-term loans. EWA programs typically do not charge interest, and many do not require the payment of any mandatory fees. Instead, it is common for EWA programs to allow consumers to voluntarily pay a fee for expedited delivery of the proceeds of an advance (although the consumer always may elect to receive an advance for free that is delivered at "regular" speed), and some programs allow consumers to leave a "tip" or gratuity if the consumer so chooses.

As an emerging product, EWA programs present novel financial regulatory issues. The most significant of these issues is the status of an EWA transaction as a non-credit transaction. Regardless of the model, EWA programs typically restrict the amount that can be advanced to a user to the amount of wages that the user has actually earned and has a property right to, and the transaction carries no recourse to the user if the provider cannot recoup the advance. These features differentiate an EWA transaction from a traditional consumer loan. In fact, several states have recently enacted legislation which provides, as a matter of law, that EWAs which are offered in compliance with state law are presumptively not credit for purposes of state lender licensing and usury laws.

THE PROPOSED RULE

The Proposed Rule appears to be a significant step toward the Biden administration CFPB's efforts to regulate EWA programs as consumer credit. Prior to the issuance of the Proposed Rule, the CFPB had taken the position that certain EWA programs likely were not "credit." First, the CFPB's 2017 payday lending rule contained an express exemption for certain "wage advance" or "no cost advance" products. In the preamble to the payday lending rule, the CFPB noted that instances when "an employer allows an employee to draw accrued wages ahead of a scheduled payday and then later reduces the employee's paycheck by the amount drawn" "may not be credit at all." The CFPB specifically noted that "[t]his is especially likely where the employer does not reserve any recourse upon the payment made to the employee other than the corresponding reduction in the employee's paycheck." Next, in December 2020, the CFPB issued an Advisory Opinion which concluded that certain "covered" EWA transactions that met specific criteria set forth in the advisory opinion were not "credit" under TILA and Regulation Z. While the Advisory Opinion, by its terms, did not provide that EWA programs that did not meet the specific criteria were likewise not "credit," it also did not provide that such programs were credit per se. Since then, CFPB officials have stated that they believed the advisory opinion resulted in regulatory uncertainty and noted that the CFPB intended to "clarify" the advisory opinion. The Proposed Rule appears to function as this "clarification"; in the preamble to the Proposed Rule, the CFPB stated that the Proposed Rule is intended to "overturn and replace" the 2020 Advisory Opinion.

TILA applies to a "creditor" that extends "consumer credit." The first issue the Proposed Rule addresses is whether an EWA involves "credit" for purposes of TILA. TILA defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." The Proposed Rule sets forth the CFPB's view that EWA programs are "credit" under TILA, notwithstanding that a typical EWA does not, by its terms, create an absolute and unconditional obligation to repay, because "the consumer incurs an obligation to pay money at a future date." In the CFPB's view, the fact that an EWA transaction is subject to one or more contingencies does not necessarily mean that a transaction is not subject to TILA.

Even if a transaction is "credit" for purposes of TILA, the transaction does not subject a person to regulation under TILA as a "creditor" unless (i) the transaction is repayable by a written agreement in more than four installments; (ii) the "consumer credit" is subject to a "finance charge;" or (iii) the transaction involves use of a "credit card" (broadly defined by TILA to include cards and other physical or virtual access devices that permit a consumer to obtain credit from time to time).

EWA products currently in-market typically do not establish, by written agreement, a schedule of required payments, let alone a schedule involving more than four installments. Additionally, they typically do not involve use of any access device to obtain advances that might reasonably be considered a "credit card." Each of these is a fact-based determination for any given program, but the key trigger for EWAs to be subject to TILA requirements under the [Proposed Rule] would, for most programs, be whether any fee or other monetization of the program would be treated as a "finance charge."

Under TILA, a "finance charge" is defined as "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." The Proposed Rule sets forth the CFPB's view that whether a fee or payment is a "finance charge" is not based solely on a determination of whether payment of the fee was voluntary, but whether a payment that is exacted by the creditor is "substantially connected" to the extension of credit. Although the CFPB appears to acknowledge that voluntary expedited payment fees or "tips" are not charges that are imposed "as a condition" of credit, the Proposed Rule sets forth the CFPB's view that expedited payment fees and "tips" are "substantially connected to the extension of credit," notwithstanding that these payments are voluntary and an EWA may be obtained on the same terms without payment of these amounts, they are nevertheless "imposed" as an "incident to" credit and are therefore "finance charges" under TILA and Regulation Z. The

CFPB stated in a footnote to the Proposed Rule that it believes that a cost may be "imposed" on a consumer even if the cost is not required for the extension of credit.

That being said, the Proposed Rule appears to leave open the possibility that some "tips" nevertheless are not "finance charges" even under the Proposed Rule's broad interpretation of a "finance charge." Instead, the Proposed Rule suggests that the determination of whether a "tip" is imposed as an "incident to" the extension of credit requires a nuanced analysis that can include consideration of whether the provider (i) solicits a "tip" before or at the time of a credit extension (rather than some significant time after it); (ii) labels the solicited payment with a term (such as "tip") that carries an expectation that the consumer will make such a payment in the normal course; (iii) sets default "tip" amounts or otherwise making it practically more difficult for the consumer to avoid leaving a "tip"; (iv) suggests "tip" amounts or percentages to the consumer; (v) repeatedly solicits "tips," even in the course of a single transaction; and (vi) states or otherwise implies, directly or indirectly, that tipping may impact subsequent access to or use of the product.

The scope of the Proposed Rule is limited to interpreting TILA and Regulation Z's application to EWA programs. It does not address whether EWA programs are "credit" under any other federal or state consumer financial regulatory laws, though various federal consumer financial laws and regulations (including the Equal Credit Opportunity Act, for example) incorporate definitions of "credit" reasonably similar to the TILA definition; and it also does not address the treatment of any other products under TILA and Regulation Z, though courts or the CFPB itself could pursue similar treatment of other products involving contingent payment obligation as an extension of the Proposed Rule through additional rulemakings or enforcement activity. The CFPB is also analyzing options for workers to more easily access and permission their payroll data separately from the Proposed Rule, as part of what the CFPB states is an effort to "facilitate more competition for paycheck advance products and other loans."

The application of state and federal consumer financial laws to EWA programs also may be addressed through legislation. The Earned Wage Access Consumer Protection Act, introduced in the U.S. House of Representatives in February 2024, would, if enacted, would exclude EWA transactions offered in compliance with the law from the definition of "credit" (and exclude any voluntary fees, tips, or gratuities paid by the consumer from the definition of a "finance charge") under TILA and Regulation Z. A number of states, including Kansas, Missouri, Nevada, South Carolina, and Wisconsin have recently enacted legislation which offer EWA programs offered in compliance with state law a presumption that the programs do not involve the extension of credit for purposes of state lender licensing and usury laws.

The CFPB will be receiving comments on the Proposed Rule through August 30, 2024. The CFPB intends to publish a final interpretive rule after considering comments received.

SELECTED ASSET CLASS UPDATES: SMALL BUSINESS FINANCING

MISSOURI REGULATES PROVIDERS AND BROKERS UNDER NEW COMMERCIAL FINANCING LAW

By Daniel B. Pearson and Jeffrey P. Taft
September 12, 2024

Missouri has enacted the nation's ninth state commercial finance disclosure law, regulating the providers and brokers of certain commercial financing transactions. Signed by Governor Mike Parson on July 11, 2024, Missouri Senate Bill 1359 enacted the Missouri Commercial Financing Disclosure Law (the "Law"), imposing disclosure and registration requirements for providers and brokers, respectively, of qualifying commercial financing. The Law, which comes a few months after the commercial finance disclosure law Kansas enacted in April, requires providers to disclose, and brokers to register. But providers need not register, and brokers need not disclose. The Law's structure shows that the industry should not expect each new state commercial finance disclosure law to be a carbon copy of the law that came before it, notwithstanding that the laws tend to share many similarities. This summary discusses: the transactions that are subject to, and exempt from, the Law; the disclosure requirements imposed on providers under the Law; the registration requirements applicable to brokers; and details on the Law's implementation, penalties, and effective date.

TRANSACTIONS SUBJECT TO THE LAW

The Law applies to the following business-purpose transactions in amounts of $500,000 or less:

- Commercial loans (secured or unsecured);
- Commercial open-end credit plans; and
- Accounts receivable purchase transactions (i.e., merchant cash advances and factoring).

In addition, the Law exempts the following:

- A depository institution, and an affiliate, subsidiary, and certain service corporations thereof;
- A provider that is a lender regulated under the federal Farm Credit Act;
- A transaction secured by real property;
- A lease;
- A purchase money obligation;
- A transaction of $50,000 or more in which the recipient is a motor vehicle dealer or rental company, or an affiliate thereof;
- A transaction offered by a "captive" company, meaning "a person in connection with the sale or lease of products or services that such person manufactures, licenses, or distributes, or whose parent company or any of its directly or indirectly owned and controlled subsidiaries manufactures, licenses, or distributes;"
- Factoring or purchasing of accounts receivable related to personal injury health care debts;
- A money transmitter licensed in any state;

- A provider that consummates no more than five commercial financing transactions in Missouri in a 12-month period; and
- A commercial financing of more than $500,000.

DISCLOSURE REQUIREMENTS FOR PROVIDERS

The Law requires providers of qualifying commercial financing to disclose the terms of the financing to recipients at or before consummation of the transaction. A provider is defined in a manner consistent with several of the previously enacted commercial finance disclosure laws, as "a person who consummates more than five commercial financing transactions to a business located in [Missouri] in any calendar year." (Oddly, the de minimis threshold applies per "twelve-month period" rather than per calendar year under the exemptions.) A provider also includes an online platform that partners with a depository institution to arrange commercial financing.

Specifically, the Law requires a provider to disclose the following at or before the consummation of a commercial financing transaction:

- Total Amount of Funds Provided: the total amount of funds provided to the business applying for financing;
- Total Amount of Funds Disbursed: the total amount of funds actually disbursed to the business, if less than the total amount of funds provided after accounting for fees and third-party costs;
- Total of Payments: the total amount the recipient will pay to the provider when all payments are made;
- Total Dollar Cost of Financing: the total dollar cost of the financing, defined as the delta between the total of payments and the total funds provided;
- Payments or Estimated Payments: the manner, frequency, and amount of each payment; or, if payments may vary, the manner, frequency, and the estimated amount of the initial payment (with the variable payment methodology to be described in the financing agreement); and
- Prepayment: a statement of whether there are any costs or discounts associated with prepayment, and a reference to the paragraph in the financing agreement that creates the contractual rights of the parties related to prepayment.

For commercial financing facilities involving multiple accounts receivable purchases over time, the provider may disclose using an example based on a total face amount owed of $10,000.

Only one disclosure is required for each transaction, and new disclosures are not required as a result of the modification, forbearance, or change to a consummated transaction.

REGISTRATION REQUIREMENT FOR BROKERS

Brokers must register with the Missouri Division of Finance and obtain a $10,000 surety bond. The registration is effective upon the Division's receipt if the filing is complete and accompanied by the required $100 fee. The registration must be renewed annually by January 31, with the payment of a $50 fee.

The Law defines a "broker" as any person who, for compensation, "obtains a commercial financing transaction or an offer for a commercial financing transaction from a third party that would, if executed, be binding upon that third party and communicates that offer to a business located" in Missouri. A broker expressly excludes a provider, as well as any person whose compensation is not based on the terms of the specific financing offered. As defined, then, a broker arguably excludes a person who obtains an offer of financing for compensation that is not based on the "terms" of the specific offer, even if the broker is compensated. Persons that receive no compensation are not "brokers" under the Law.

Non-exempt brokers will be relieved to learn that the registration filing requirements are minimal. Applicants for a broker registration need only provide:

- The broker's name;
- Any d/b/a name in use;
- The broker's principal office address (which can be outside of Missouri);
- Confirmation of whether any officer, director, manager, operator, or principal of the broker has been convicted of a felony involving an act of fraud, dishonesty, breach of trust, or money laundering; and
- The name and address of a designated agent for service of process in Missouri.

Updates to the information submitted in a registration application are not required until the next renewal.

IMPLEMENTATION OF THE LAW

Missouri's attorney general is authorized to enforce the Law. Violations of the Law are punishable by fines of $500 per violation (capped at $20,000 in aggregate), with additional penalties for violations committed after receiving a notice of violation from the Missouri Attorney General. The Law does not provide for the impairment of any contracts for violations or authorize a private right of action.

The Law takes effect six months after the Missouri Division of Finance promulgates rules to implement the Law, or on February 28, 2025 if the Division does not. We have not seen an indication from the Division regarding whether it intends to engage in rulemaking. Either way, we can expect an effective date in 2025 at the earliest.

KANSAS ENACTS COMMERCIAL FINANCE DISCLOSURE LAW

By Daniel B. Pearson, Krista Cooley, and Francis L. Doorley
June 2024

After months of anticipation (or trepidation), we finally have our eighth state commercial finance disclosure law. Senate Bill 345, the Kansas Commercial Financing Disclosure Act (the "Kansas Act"), was enacted on April 12, 2024, and is set to take effect July 1, 2024. Prior to the Kansas Act, the most recently enacted commercial finance disclosure law was Connecticut's law, enacted last June.

The Kansas Act boasts little in the way of surprises, instead largely following the examples set by the laws of several other states that came before such as Florida and Georgia. The disclosure requirements under the Kansas Act are distinguishable from the prescriptive and complex commercial disclosure requirements contained in the California and New York commercial disclosure laws that inaugurated the wave of commercial financing disclosure legislation, which could mean a comparatively lighter compliance burden for commercial finance providers doing business in Kansas.

SCOPE OF ACT

Once the Kansas Act takes effect, "providers" who "consummate" more than five commercial financing transactions to a business "located" in Kansas in a calendar year will have to provide disclosures to the recipient before, or at the time of, consummating the transaction. Although a provider is generally defined as the person who consummates a commercial financing transaction, a provider specifically includes a platform that has a written agreement with a depository institution to arrange a transaction.

Financers subject to the Kansas Act will not be required to register with the state.

A commercial financing transaction for Kansas Act purposes is a business-purpose loan, open-end credit plan, or accounts receivable purchase transaction (i.e., merchant cash advance) of $500,000 or less.

REQUIRED DISCLOSURES

A provider subject to the Kansas Act must disclose the following to the recipient of financing before, or at the time of, consummation:

- Total amount of funds provided to the recipient;
- Total amount of funds disbursed to the recipient;
- Total of payments made to the provider;
- Total dollar cost of financing for the recipient;
- Manner, frequency and amount of each payment (or estimates if these terms may vary, along with the provider's methodology for calculating variable payments and circumstances where payments may vary); and
- Prepayment costs or discounts.

For a commercial financing facility, under which the provider plans to purchase multiple accounts receivable over time, the provider can disclose based on an example of a possible transaction under the agreement where $10,000 is the total face amount owed.

Only one disclosure need be provided for any commercial financing transaction. A provider does not have to redisclose when a consummated transaction is modified.

EXEMPTIONS FROM THE ACT

The Kansas Act exempts the following providers and transactions:

- A depository institution, its parent, and its owned and controlled subsidiary or service corporation if regulated by a federal banking agency;
- Providers regulated under the federal Farm Credit Act;
- Real estate-secured transactions;
- Leases;
- Purchase money obligations;
- Floorplan financing of at least $50,000 where the recipient is a motor vehicle dealer or rental company or affiliate thereof;
- Transactions offered by a captive finance company (i.e., a company financing the sale or lease of products or services manufactured, licensed or distributed by that company or its parent or affiliate);
- Providers licensed as a money transmitter in Kansas or any other state;
- Providers that consummate no more than five commercial financing transactions in Kansas in a 12-month period; and
- Commercial financing transactions of more than $500,000.

These exemptions are fairly consistent with many of the state commercial finance disclosure laws enacted recently. The Kansas Act's exemptions for a depository institution's subsidiary and parent will be appreciated by some financers given that some earlier laws exempted only a depository institution itself and not related entities.

REGULATION OF BROKERS

Although brokers of commercial financing are not subject to the Kansas Act's disclosure requirements, the law prohibits brokers from engaging in certain acts. A broker may not collect an advance fee for brokering services outside of fees for actual services necessary to arrange a commercial financing application. A broker also may not use any false or misleading misrepresentations, omit any material fact in the offering of broker services, or engage in any other act that would operate as a fraud or deception on any person.

PENALTIES FOR NONCOMPLIANCE AND ADMINISTRATION OF THE ACT

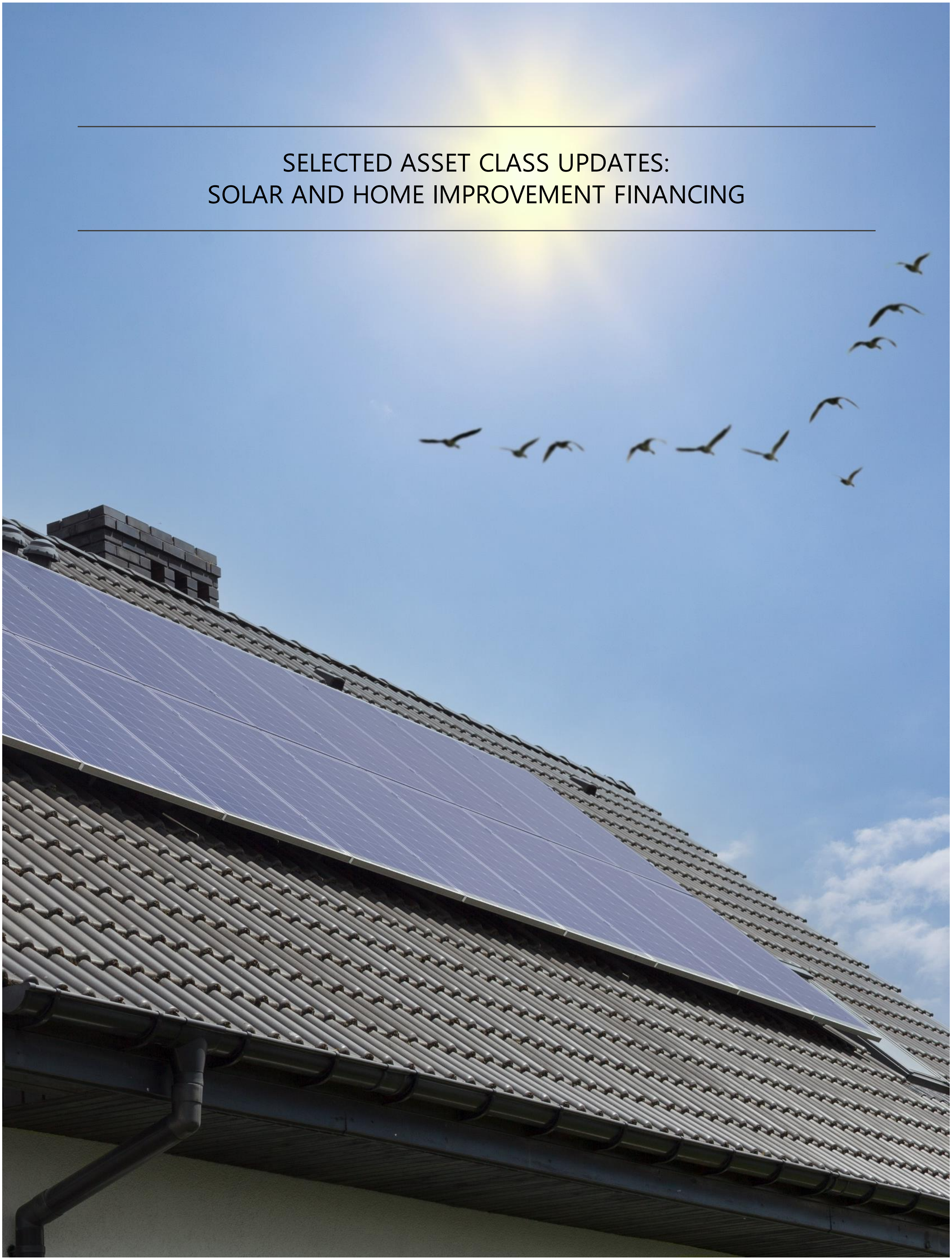
Violations of the Kansas Act are punishable by a civil penalty of $500 per violation, capped at $20,000 in aggregate, with additional penalties for repeat offenders. There is no express impairment of enforceability for a transaction that violates the Kansas Act, nor is there a private right-of-action for harmed recipients of financing.

The Attorney General of Kansas has exclusive authority to enforce the Kansas Act. Notably, the legislation does not expressly direct or authorize the attorney general to promulgate rules or issue guidance to carry out the law. In the absence of disclosure templates or samples, it is possible that providers may end up repurposing the disclosures they have prepared for other states to comply with the Kansas Act.

LOOKING AHEAD

As state legislative sessions begin winding down and governors' signing deadlines approach, we could see any number of the commercial financing disclosure bills currently pending in other states be enacted throughout the spring and summer. Providers of commercial financing should continue to monitor for developments.

SELECTED ASSET CLASS UPDATES: SOLAR AND HOME IMPROVEMENT FINANCING



REGULATORY CLOUDS ON THE HORIZON FOR SOLAR FINANCING? PROGRAMS FACE HEADWINDS, BUT THE FUTURE STILL LOOKS BRIGHT

By Joy Tsai and Eric T. Mitzenmacher

Association (SEIA) reported a 26% average annual growth rate in the overall US solar industry over the past 10 years.[32] While rapid growth in the solar market largely has been a positive for consumers, providers, and investors, 2024 brought a notable uptick in negative press for certain aspects of the industry. Recent developments in complaints, lawsuits, and regulatory inquiries and enforcement initiations will not cool the market entirely, but they present considerations with which market participants will have to grapple in the coming year.

Below, we summarize some of the key regulatory pressures facing the residential solar financing industry. The pressures reflect underlying concerns from regulators regarding consumer misunderstanding of loan pricing, energy cost and tax credit savings, and implications of security interest filings—all heightened by a belief, among certain regulators that some parties selling solar products and services ("Dealers" for the purpose of this summary) use aggressive sales tactics that may place higher pressure on consumers. Regardless of whether any particular regulatory pressure is grounded in firm understandings of applicable law or program-specific facts, regulatory actions in aggregate suggest heightened scrutiny of the residential solar financing industry. Market participants should monitor the increased potential for regulatory action this year, and remain nimble and ready to address.

CONSUMER FINANCIAL PROTECTION BUREAU REPORT

The Consumer Financial Protection Bureau's ("CFPB" or "Bureau") Office of Markets issued a report in August 2024 identifying consumer regulatory risks in the solar financing industry. The report is based on the Bureau's market analysis and consumer complaints and outlines the following potential issues:

Dealer Fees

Solar loans frequently involve "dealer fees" that regulators assert increase the amount of the loan principal above the "cash sale price," which is the price at which the same products and services would be available in the absence of financing programs. These fees represent costs that the Dealers who sell consumers the solar systems pay the lender or sales finance company to be able to offer financing to consumers or to be able to offer particular financing terms. The Bureau asserts that "dealer fees" typically range between 10% and 30% of the cash price and are not disclosed to consumers as part of the annual percentage rate (APR) calculated pursuant to the federal Truth in Lending Act (TILA).

The CFPB's report does not address the relationship between typical "dealer fee" structures and commentary regarding the treatment of "seller's points" under TILA's implementing regulation, Regulation Z. Regulation

[32] "Solar Data Cheat Sheet," SEIA, (Dec. 2024). The "Cheat Sheet" is a publicly available summary of a "US Solar Market Insight" report developed quarterly by SEIA and Wood Mackenzie and offered for purchase.

Z requires disclosure of the "finance charge" and an APR reflecting an annualization of the finance charge. Official Staff Commentary, however, expressly excludes "seller's points" from the finance charge. "Seller's points" include "any charges imposed by the creditor upon the non-creditor seller of property for providing credit to the buyer or for providing credit on certain terms," and commentary indicates they are excluded from the finance charge even if those points are passed on to the buyer in the form of a higher sale price for the financed property.

Some states expressly use the TILA and Regulation Z definitions of "finance charge" and "APR" for licensing and other regulatory purposes; others have case law or guidance connecting state-specific terms such as "interest," "charges," "compensation," or "consideration" for a loan to TILA and Regulation Z concepts. That said, not all states expressly address this issue in their lending or sales finance laws.

Statements Concerning Federal Tax Credits

Homeowners who purchase and install solar panels may receive a 30% Investment Tax Credit (ITC) under current federal tax law, but the consumer's eligibility for tax credits depends on the consumer's federal tax liability. The CFPB reports that many Dealers market solar loans presuming that all consumers will receive the ITC and use marketing materials that present a lower "net cost" to consumers by deducting the federal tax credit from the total loan amount. However, not all consumers are eligible to receive the ITC. The CFPB asserts that presenting the "net cost" may overshadow the true cost of a loan by obscuring the conditionality of tax credits, notwithstanding that some lenders may provide additional disclaimers or disclosures regarding tax credit eligibility during loan solicitation or application processes.

Repayment Structures

Solar loans are often structured so that a borrower's monthly payments will increase after a certain date unless the borrower prepays a percentage of the loan principal (typically 30%, which is the ITC that borrowers are presumed to receive). The CFPB asserts that many borrowers either do not understand this repayment structure or do not qualify for the ITC and therefore do not expect what may be a substantial increase to their monthly payment obligation if they—for any reason—do not make the presumptive prepayment.

Savings Claims

The Bureau asserts that homeowners may receive misleading claims from some Dealers or solar finance companies about energy savings from solar systems—claims based on overstatements related to the future cost of energy or the amount of electricity that the panels will produce, for example. The actual financial benefits from the solar panels vary significantly depending on several factors, including geographic location, system design, and weather.

The Bureau's press release accompanying the report states that the Bureau, along with the Federal Trade Commission (FTC) and other government agencies, intends to target what it deems "abuses" in the solar financing market. Accordingly, the Bureau's report may lead to additional scrutiny of solar finance. While the CFPB report focuses on solar loans, some of the issues highlighted by the Bureau related to savings claims and Dealer sales practices also may apply to solar leases and Power Purchase Agreements (PPAs) that are originated through Dealers. Some may also be relevant in the context of non-solar home improvement financing.

CENTER FOR RESPONSIBLE LENDING REPORT

The CFPB's report comes on the heels of an article issued by the Center for Responsible Lending (CRL), a consumer advocacy organization, titled "The Shady Side of Solar System Financing." The CRL report alleges that some solar financing companies and Dealers engage in practices that violate state or federal law in the marketing, origination, and servicing of solar loans and calls for greater regulation and enforcement activity in the solar loan industry.

The CRL article identified the following practices that the CRL asserts are widespread in the solar loan industry:

- Improper or misleading sales practices with respect to energy savings or tax credits, including the likelihood that consumers will benefit from receiving tax credits
- Poor installation or workmanship
- Underwriting loans without properly assessing a borrower's ability to repay
- Failing to properly monitor installers and customer-facing salespersons
- Installers passing "dealer fees" charged by the lender for participating in the lender's program onto the borrower in the form of a higher sale price for the financed equipment
- Not accommodating borrowers with limited English proficiency by providing translations of contracts or other documents
- Filing UCC-1 financing statements that cloud title on the borrower's property

Some of these issues have formed the basis of the pending lawsuits against solar financing companies by state attorneys general (AGs), and negative press relating to the CRL report and similar consumer advocacy pieces may further increase scrutiny in the space over time.

STATE ATTORNEY GENERAL SCRUTINY

States have entered the residential solar financing fray as well. Their actions have involved increased examination pressure from some state licensing regulators, but state AGs arguably have led the charge on aggressive claims against industry participants. Below, we describe two actions brought by AGs in Minnesota and Connecticut that highlight this trend.

In March 2024, the Minnesota AG filed a lawsuit against four large solar financing companies, alleging that the lenders engaged in deceptive sales practices in violation of the state Consumer Fraud Act and Unfair Deceptive Trade Practices Act. Specifically, the lawsuit alleged that the lenders collected "hidden fees" from borrowers by marketing loan products with low interest rates while their Dealers inflated the cost of solar systems by 10%-30% or more by passing on the dealer fees to consumers. The complaint asserts that these dealer fees are not included in sales proposals describing available financing, are not included in disclosures of financing costs provided by solar lenders, and that the solar lenders do not permit Dealer fees to be identified or explained by underlying Dealers during the sales process. Like the CFPB report, the Minnesota

AG lawsuit does not address the treatment of dealer fees as "seller's points," which may be excluded from the "finance charge" under TILA and Regulation Z.

In October 2024, the Connecticut AG settled a lawsuit with another (now-bankrupt) solar company for $5 million alleging that the company engaged in misleading marketing practices, failed to obtain required permits before commencing work, made misrepresentations concerning tax benefits of installing solar systems, and performed installation without duly licensed agents. In the associated press release, the Connecticut AG stated that the settlement is intended to "set[ ] clear expectations for solar companies operating in Connecticut, including accuracy of disclosures, contract protocols, permitting procedures, and use of licensed contractors. The settlement prohibits use of tablets and phones for signing contracts, and bars signing of contracts on the same day of a salespersons' first visit to a home." The AG's announcement suggests ongoing investigation into solar company practices as well as the importance of Dealer oversight to mitigate compliance risk.

Another lawsuit by the Connecticut AG highlights how the risks presented by alleged Dealer misconduct in solar lending are also applicable to solar leases and PPAs. In July 2024, the Connecticut AG filed a lawsuit against a solar lessor and two of its Dealers, alleging that the Dealers and individuals engaged in unfair or deceptive high-pressure in-home sales tactics for solar leases. The lawsuit cited examples in which a sales agent allegedly forged the consumer's signature on a lease agreement and impersonated the consumer over a verification call, sales pitches in which the agent did not disclose an annual escalator on the lease agreement, failure to provide copies of lease agreements to consumers, and Dealers failing to obtain required local permits prior to system installation.

THE CFPB CROSSES THE FINISH LINE TO REGULATE PROPERTY ASSESSED CLEAN ENERGY FINANCING

By Francis L. Doorley, Steven M. Kaplan, Kris D. Kully, and Joy Tsai

On December 17, 2024, the Consumer Financial Protection Bureau (CFPB or Bureau) issued its final rule (Final Rule) applying certain residential mortgage requirements to Property Assessed Clean Energy (PACE) financing. The CFPB issued the Final Rule in response to the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which required the CFPB to issue regulations applying the Truth in Lending Act's (TILA) ability to repay and civil liability provisions to PACE financing. The Final Rule is materially similar to the CFPB's May 2023 proposed rule and becomes effective March 1, 2026.

BACKGROUND AND REGULATORY SCRUTINY

PACE programs are established by states and municipalities to provide homeowners an alternative to traditional financing for energy-efficient home improvements. A PACE obligor finances home improvements through a special tax assessment on their real property. Repayment of the PACE transaction is secured by a property tax lien that takes priority over existing and future mortgages on the obligor's real property. Although government agencies administer PACE programs, private home improvement financing companies typically originate the transactions, often through door-to-door or point-of-sale contractors soliciting homeowners for their products and services and providing applications and disclosures relating to the PACE transaction.

PACE financing has drawn scrutiny from regulators and consumer advocates. Consumer advocates and regulators argue that there is the potential for contractors to engage in aggressive sales tactics or otherwise unfair, deceptive, or abusive marketing practices, often originating PACE products quickly without considering consumers' ability to repay or understanding of the product. Private financing companies also may face low repayment risk given the super-priority status of the property tax lien. The CFPB's Office of Research Publication has reported that PACE financing caused homeowners' property taxes to increase by an average of $2,700 per year, representing an 88% increase, and that PACE obligors were more likely to become delinquent on their first mortgage than consumers who chose to finance their home improvements through other means. Additionally, the Bureau estimates that the annualized cost for PACE financing tends to be approximately 5% higher than first mortgages, despite their priority status over first mortgages.

This Legal Update summarizes several of the main requirements for PACE financing under the Final Rule.

FINAL RULE

TILA Applicability

TILA and its implementing Regulation Z apply only to transactions that constitute "credit." Previously, Regulation Z's official commentary excluded tax liens and tax assessments from the definition of "credit" so that PACE transactions would not be subject to regulation. The Final Rule amends commentary to TILA's implementing Regulation Z to specify that only "involuntary" tax liens and tax assessments are excluded. Consumer advocates and regulators criticized that exclusion for allowing PACE financing companies to avoid providing disclosures that would be required for standard loan products. In the Final Rule, the Bureau indicates that PACE transactions allow consumers to receive funding for home improvement projects and repay those funds over time in installments, and the fact that the transactions are repaid alongside property tax payments should not change the fundamental nature of the transaction as a loan.

Loan Estimate and Closing Disclosures

Because PACE transactions are credit secured by residential real property, they become subject to mortgage-related requirements under TILA and Regulation Z. The CFPB issued integrated disclosures for mortgage loan transactions consisting of a Loan Estimate and a Closing Disclosure, which are provided as model forms in the Appendix to Regulation Z. The Final Rule requires lenders to provide Loan Estimates and Closing Disclosures to PACE obligors, with certain modifications to the existing forms. The Bureau sets forth model forms in Appendix H-24(H) and H-25(K) of the Appendix to Regulation Z. Fields that are irrelevant to particular PACE transactions may be left blank. Disclosures required under some state laws or those voluntarily provided by some PACE financing companies would not be a substitute for the TILA disclosures.

The CFPB recognized comments from the PACE industry characterizing the disclosure requirements as burdensome given that home improvement projects frequently involve change orders that may require re-disclosure under the Final Rule. However, the Bureau noted that the Loan Estimate and Closing Disclosure help consumers understand their financing options and that the rule only requires re-disclosure post-consummation if an event during the 30-day period after consummation causes the Closing Disclosure to become inaccurate. The Bureau also declined to amend the timing requirements for the Loan Estimate and Closing Disclosures for PACE transactions, indicating that the seven-business-day waiting period between the Loan Estimate and transaction consummation is intended to provide consumers effective advance disclosure of settlement charges and that the three-business-day waiting period following the Closing Disclosure is intended to enhance consumer awareness of the costs associated with the transaction. The Bureau indicated that its prior testing of those forms—although for use with standard mortgage loans—supports their effectiveness in disclosing transaction costs and providing a nationwide waiting period.

Right of Rescission

Regulation Z provides for a three-day right of rescission in a credit transaction in which the lender takes a security interest in the consumer's principal dwelling, with certain exemptions including, but not limited to, a residential mortgage transaction, a refinancing, a transaction in which a state agency is a creditor, and an advance.[33] The three-day right of rescission allows consumers to rescind a transaction within three business days of consummation, delivery of the notice informing the consumer of the right to rescind, or delivery of all material disclosures, whichever occurs last. If the notice and disclosures are not delivered, the right to rescind expires three years after consummation, upon transfer of all of the consumer’s interest in the property, or upon sale of the property, whichever occurs first. Under the Final Rule, a PACE transaction, as a credit transaction secured by real property, would become subject to the three-day right of rescission.

[33] 12 CFR 1026.23.

The Bureau notes that PACE obligors in some states, including California and Florida, already have a three-day right to cancel under state law, so the new requirement is unlikely to impose additional benefits or costs on consumers and PACE providers. However, the right to cancel under state law may start from the date the consumer signs the financing agreement[34] rather than from the date that accurate disclosures are provided under Regulation Z, which may create complication.

Higher-Cost Mortgage Loans

The Home Ownership and Equity Protection Act (HOEPA) amended TILA decades ago to address abusive practices in home equity mortgage loans. HOEPA imposes additional requirements for high-cost mortgage loans, which are mortgage loans in which either (i) the rate of interest is 6.5% greater than the average prime offer rate for a first-lien transaction or 8.5% greater than the average prime offer rate for a subordinate-lien transaction or (ii) the points and fees exceed 5% of the total loan amount for loans under $20,000 or the lesser of 8% or $1,000 for loans over $20,000. The Final Rule will apply HOEPA protections to PACE transactions in the same way those protections apply to non-PACE mortgage loans. The Bureau commented that distinguishing between PACE and non-PACE high cost loans would contravene HOEPA's protections for vulnerable consumers.

However, the Final Rule excludes PACE transactions from the escrow account requirement that otherwise applies to higher-priced mortgage loans. The CFPB determined that requiring escrow accounts—with the related Regulation X requirements for escrow account analyses, statements, and administration of surpluses and shortages—could be confusing in the context of PACE transactions.

Periodic Statements

The Final Rule exempts PACE transactions from the Regulation Z requirement to provide periodic statements. Regulation Z requires creditors, servicers, and assignees of mortgage loans to provide a statement for each billing cycle that contains information such as the amount due, past payment breakdown, transaction activity, contact information, and delinquency information.[35] The CPPB reasoned that consumers would receive information regarding payments and delinquency from their property tax collectors, as well as mortgage servicers if the consumers have a mortgage with an escrow account. The CFPB also declined to address any servicing requirements that apply only to "servicers" as defined by Regulation X because there is not a "servicer" in a typical PACE transaction given that a governmental authority receives payments as part of the consumer's property tax payment.

Ability to Repay Assessment

Regulation Z currently requires a creditor to make a reasonable and good faith determination of a consumer's ability to repay at or before consummation of a covered mortgage loan.[36] A creditor's failure to consider a consumer's ability to repay where required is subject to special enforcement provisions under TILA, including damages equal to the sum of all finance charges and fees paid by the consumer.[37] These

[34] *See, e.g.,* Fla. Stat. § 163.081(6).
[35] *See* 12 CFR 1026.41.
[36] 12 CFR 1026.43(c).
[37] 15 USC 1640(a)(4).

claims are subject to a three-year statute of limitations and may be used as a defense to foreclosure.[38] Attempts to defend against tax foreclosure, which would limit a state government's taxation authority, could potentially present constitutional issues relating to the state-federal taxation power that otherwise would not be present for non-PACE mortgage loans.

Regulation Z requires the creditor to consider specific factors in making the repayment ability determination and verify the information using reasonably reliable third-party records. The Final Rule applies the existing ability-to-repay requirements for mortgage loans to PACE transactions without providing for a qualified mortgage presumption of compliance for PACE transactions. The Bureau determined that it would be inappropriate to provide PACE transactions eligibility for a presumption of compliance with the ability-to-repay requirements, citing the risk of PACE transactions being unaffordable and the lack of incentives for creditors to consider an obligor's repayment ability in the market. With regard to the requirement to consider, in the ability-to-repay determination, the amount of the consumer's payment on any simultaneous loans, the Final Rule adds commentary that a PACE creditor is deemed to know of any simultaneous loans that are PACE transactions if the transactions are included in any existing database or registry of PACE transactions. This comment is intended to address concerns about predatory "loan stacking" and "loan splitting" practices in which a contractor divides a loan into multiple transactions or returns to existing consumers to offer additional PACE financing.

CONCLUSION

The Final Rule as enacted brings about material changes to PACE transactions by sweeping them into the definition of "credit" under TILA and Regulation Z. Many mortgage banking trade associations as well as housing advocacy groups have reacted positively to the Final Rule, characterizing the Final Rule as "a significant step to protect consumers and reduce mortgage delinquencies by ensuring that consumers are both informed of the obligations they are signing up for when they take out a PACE loan and that they have the ability to repay the loan." Meanwhile, the PACE industry has criticized the Final Rule for failing to account for the "unique nature of PACE" as required under the EGRRCPA as well as positive developments in the PACE industry since the CFPB initially drafted the rule.

While the Final Rule could be less susceptible to claims that the Bureau exceeded its authority given that Congress required the Bureau to issue regulations applying TILA's ability to repay and civil liability provisions to PACE financing under the EGRRCPA, the Final Rule could be a target under the Congressional Review Act ("CRA"). The CRA requires agencies to submit final rules to Congress, which may overturn agency rulemaking by issuing a joint resolution of disapproval that is approved by both houses of Congress and signed by the president. The CRA precludes rulemaking with similar substance after an enacted joint resolution of disapproval, consequently it would be difficult to present a CRA challenge without eliminating the underlying EGRRCPA statutory requirement.

[38] 15 USC 1640(k).

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