STROOCK
SPECIAL BULLETIN

Future of Small Dollar Lending

June 14, 2018

The regulatory stars are aligning for banks and non-banks to expand their offerings of short-term, small dollar credit. A Federal district court judge this week dealt a blow to the industry and Mick Mulvaney's Bureau of Consumer Financial Protection (Bureau) by refusing to stay the August 2019 compliance date for the agency's payday rule. Notwithstanding this ruling, however, the Bureau and Federal banking agencies are primed for collaboration to reverse the Obama administration's discouragement of short-term, high-interest lending. Alert lenders have the opportunity to expand their share of this market with little fear of prescriptive regulations–provided they are vigilant in their business practices to avoid the remaining threat posed by State authorities and private litigants, as well as the Federal Trade Commission (FTC) and the Department of Justice (DOJ).

Future of the Payday Rule

The Bureau's October 2017 rule imposed highly prescriptive requirements on payday loans, vehicle title loans, and certain installment loans, including requirements that lenders conduct a comprehensive assessment of borrowers' ability to repay both these short-term loans and their other financial obligations. Under new leadership in 2018, the Bureau declared an interest in reconsidering the rule, but did not take any step toward reconsideration. Acting Director Mulvaney instead advocated use of the Congressional Review Act (CRA) to undo the rule, emphasizing that it provided a better vehicle than Bureau action.

In April 2018, the Community Financial Services Association of America Ltd. and the Consumer Service Alliance of Texas filed suit in Texas Federal district court to challenge the payday rule. Following the failure of the CRA attempt to rescind the rule, the Bureau joined these two trade groups in late May 2018 to move for a stay of both the lawsuit and the rule's compliance date, citing the agency's plan to reconsider the rule. In a brief order issued on June 11, 2018, the court stayed the lawsuit but denied all other aspects of the joint motion. While the parties likely will appeal this ruling, the industry can ill afford to wait for a judicial resolution while the rule's August 2019 compliance date remains looming.

The pressure is on for the Bureau to release a timely notice of proposed rulemaking. It could issue a narrow notice with the primary purpose of staying the compliance date. To make real changes and survive legal challenge, however, the Bureau must provide sound legal bases for (a) reconsideration of the rule and (b) proposal of a revised rule, laying out a framework for robust comments and evidence to support any modification. With consumer advocates vehemently proclaiming the Bureau's five-year process for data gathering and development of the 2017 rule, as well as the courts' rigorous review of agencies' regulatory reversals (witness the trials of the Federal Communications Commission's Net Neutrality rule), the notice of proposed rulemaking must lay a firm foundation for any changes. Small dollar lenders seeking relief thus must provide the Bureau with ammunition for an evidence-based reconsideration of the rule, incorporating a thorough cost-benefit analysis (including the impact on the availability of credit for cash-starved consumers).

Opportunities for Small Dollar Lending

In the meantime, the Bureau and the Federal banking agencies have been working on reversing the Obama administration's discouragement of short-term, high-interest credit offerings in the broader market. The Bureau has reclassified as "inactive" previous plans to conduct rulemakings targeting overdraft offerings on checking accounts and defining "larger participants" in the market for personal loans, including installment loans and vehicle title loans, that would be subject to the Bureau's supervisory examination.

Banks also are getting the green light from their Federal prudential regulators to pursue small dollar lending. The 2013 supervisory guidance issued by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), severely limiting the offering of deposit advance products (DAPs), had largely driven out depository institutions. Banks remained skeptical after the Acting Comptroller rescinded the OCC guidance in 2017, especially in light of the potential for adverse action by the Bureau.

In May 2018, Comptroller Otting issued an OCC bulletin with the explicit intent to encourage bank offerings of short-term, small dollar loans. The OCC bulletin focused on encouraging installment loans which typically have terms of two to twelve months, in contrast to the loans under the payday rule which typically have terms of 45 days or less. Importantly, while the OCC bulletin and its core principles for responsible lending posed no conflict with the Bureau's existing payday rule, both Otting and Mulvaney have stated an intent for their agencies to collaborate to remove regulatory obstacles to small dollar lending. With Jelena McWilliams now confirmed as Chair of the FDIC, that agency likely will come onboard as well, including rescinding the restrictive 2013 DAP guidance.

While extensive work and time will be required for payday lenders to obtain definitive relief from the Bureau's payday rule, we anticipate that other small dollar lenders will be able to develop new offerings largely free from fear of highly prescriptive Federal regulation. The OCC bulletin's reference to compliance with applicable state laws and its statement that "the OCC views unfavorably an entity that partners with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)" caused some industry consternation. But OCC officials have clarified that there is no intent to disfavor legitimate bank/non-bank partnerships, such as those between banks and FinTech entities. And Federal regulators under the Trump administration have not been shy to assert Federal preemption. As further discussed below, they also are particularly eager to support FinTech innovation in this space.

Rigorous Review of Practices

The increasingly hospitable Federal regulatory environment does not mean that the industry can be lax in compliance efforts. Although the shackles of prescriptive rules will be removed for most offerings, financial institutions' business practices will be heavily scrutinized by both State and Federal authorities, as well as private litigants.

The States are committed to fighting preemption and filling the widening void they perceive in Federal consumer financial protection. Small dollar lending, auto lending and online lending are high on their priority list. While some States are adopting new laws and regulations, the most immediate threat to the industry comes from the States' supervisory and enforcement channels. States are deploying resources, from establishing new consumer financial protection units within State Attorney General offices and regulatory agencies, to organizing multi-state efforts. Financial institutions must ensure that their business practices survive scrutiny not only under State laws, including State prohibitions against unfair and deceptive acts and practices, but also under the Dodd-Frank Act provisions which State Attorneys General are empowered to enforce.

In addition to the States, the FTC and DOJ also continue to aggressively pursue alleged fraud and deception claims, and they are placing a priority on scouring financial activities on mobile and online platforms, popular channels for the marketing, origination and servicing of short-term credit offerings. This enforcement emphasis may appear at odds with the Trump administration's deregulatory agenda and regulators' assertions of support for FinTech innovation – from the OCC's FinTech charter initiative (to be clarified later this summer) to the Bureau's elevation of the Office of Innovation to report directly to the Director and its effort to create a FintTech "regulatory sandbox" in collaboration with the Commodity Futures Trading Commission (CFTC). The parallel regulatory and enforcement activities, however, merely reflect the determination of both Federal and State authorities to stake out their turf in the FinTech space.

Finally, while this bulletin focuses on the impact of Federal and State authorities, it is important to note that the industry also faces substantial uncertainty regarding the scope of liability presented in private litigation, given continuing shifts in the legal framework for class actions.

As financial institutions take advantage of the opportunities created by the dismantling of the Obama administration's restrictions on short-term, small dollar lending, they must be attentive to the need for rigorous legal review of their business practices, including each step in their consumer interactions and digital transition. Vigilant institutions will be the ultimate winners, capitalizing on the opening to expand their share of this market sector so recently facing the threat of extinction.

The attorneys of Stroock's Financial Services Litigation, Regulation & Enforcement Group are well positioned to answer any questions you may have about financial regulation, investigation, litigation and related issues.

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