

The Consumer Financial Protection Bureau and Payday Lending Examinations

The Consumer Financial Protection Bureau (CFPB), created under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, has made payday lending a regulatory priority for 2012. On January 19, 2012 the CFPB officially began the examination of the payday lending industry by hosting a field hearing in Birmingham, Alabama.¹ At the hearing a number of questions were raised, including:

- Does the impact of payday loans and deposit-advance products vary by the type of consumer?
- Who is helped and who is harmed by deposit-advance and payday products?
- Does the answer vary depending on whether the product is provided by a storefront, a bank or online?
- How are small-dollar loans and products marketed?

On April 23, 2012 the public comment period of this transcript ended. The CFPB received over 500 comments, including those from various trade associations, payday lenders and individuals. The comments and transcript are posted on the CFPB's website.²

Earlier this spring the CFPB officially started its examinations of payday lenders and their affiliates. Formal investigations and enforcement proceedings are likely to follow.

These actions are aimed at both ensuring compliance with existing federal consumer protection laws and helping the CFPB to evaluate whether any "unfair, deceptive, or abusive acts or practice" (which the agency refers to as UDAAP) is occurring. Statements from the CFPB's director and others indicate that while the CFPB may not initially use its rulemaking power to decide which payday lending practices are acceptable or to create safe harbors, the CFPB may instead utilize its enforcement authority to create federal precedents about what practices it considers unfair or abusive. This makes it difficult for payday lenders to ensure compliance.

This publication is a brief discussion of the challenges payday lenders may face under such heightened scrutiny by the CFPB and steps to take in anticipation of an examination.

¹ CFPB Director Richard Cordray and the CFPB Panel, which included Raj Date, Deputy Director (Chair); Peggy Twohig, Assistant Director for the Office of Nonbank Supervision; Gail Hillebrand, Associate Director for Consumer Education & Engagement; and Patrice Ficklin, Assistant Director for the Office of Fair Lending and Equal Opportunity, among others

² Request for Comment on Payday Lending Hearing Transcript (Regulations.gov; Docket ID: CFPB-2012-0009):
<http://www.regulations.gov/#!docketDetail;dct=PS;rpp=25;so=ASC;sb=organization;po=100;D=CFPB-2012-0009>

In The Matter of: A Field Hearing on Payday Lending, January 19, 2012,
http://files.consumerfinance.gov/f/201201_cfpb_transcript_payday-lending-field-hearing-alabama.pdf

“Abusive” Practice

In its examinations the CFPB is interested in any unfair, deceptive act or practice the payday lender may be engaged in as a potential violation of the Dodd-Frank Act. The CFPB further clarifies that a lending practice is considered “abusive” if it:

“(i) materially interferes with a consumer’s ability to understand the product or service or (ii) takes unreasonable advantage of the consumer’s lack of understanding, inability to protect his or her interests, or unreasonable reliance on a covered person to act in the interests of the consumer.”³

At this time the CFPB offers no guidance on what activities fall into this category or actions it might take to curtail such abusive practices. Unless the agency changes its current stance, payday lenders may not learn the answers to these questions except through expensive enforcement proceedings.

CFPB’s Rulemaking Authority

After the comment period, the CFPB’s director can issue rules that may regulate certain aspects of payday lending. Under the Dodd-Frank Act, any such regulations would create a national baseline – state laws on the subject would be preempted except for those that were stricter than the CFPB’s rules. The CFPB could also affect payday lending by creating new implementing regulations for the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Fair Credit Reporting Act and the Truth in Lending Act.

CFPB Examination Process

The CFPB is currently conducting examinations of payday lenders both to evaluate their compliance with federal law, including their systems that monitor compliance, and to gather data on current industry practices. The CFPB has published two comprehensive manuals for examiners. Both are accessible on the CFPB’s website. The first manual, *Supervision and Examination Manual*, focuses on the examination procedures, developed under the auspices of the Federal Financial Institutions Examination Counsel (FFIEC).⁴ The second manual, *CFPB Examination Procedures: Short-Term, Small-Dollar Lending*, focuses specifically on payday lender examinations, including five broad subjects: 1) marketing, 2) origination, 3) loan rollover, 4) collections and 5) third-party relationships. The examinations may include review of broad categories of documents.⁵ Payday lenders should be aware that CFPB enforcement lawyers may accompany CFPB examiners during examinations.

Prior to an examination, a payday lender will receive a written notice from the CFPB alerting it that it has been identified for examination. The examinations begin with a request that the lender produce various materials, and continue with on-site examinations that can include interviews with employees, customers and management. While reviewing the payday examination manual may be useful to payday lenders facing an examination, there is no guarantee that its recommendations will be followed by individual examiners. Aside from informal negotiations with the examiner, there is no process for objecting to any portion of an examination. Lenders should expect that their procedures for ensuring compliance with federal consumer protection laws and their compliance with those laws will be closely examined.

³ CFPB Supervision and Examination Manual, pg. 52

⁴ CFPB Supervision and Examination Manual: http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/supervision_examination_manual_11211.pdf

⁵ CFPB Examination Procedures: Short-Term, Small-Dollar Lending: <http://files.consumerfinance.gov/f/2012/01/Short-Term-Small-Dollar-Lending-Examination-Manual.pdf>

At the end of the examination, the CFPB will provide the payday lender with a confidential risk assessment report detailing the potential for the payday lender to cause consumers to suffer any legally cognizable injury, including invasion of privacy, through violations of federal consumer protection laws. The payday lender cannot share these confidential reports outside of its employees, parent companies and agents.

Privileged Documents in Government Investigations

Many courts have held that voluntary disclosure to a government agency, even pursuant to a formal investigation, will waive the attorney-client and work-product privileges. Though the CFPB asserts that privileged documents are not exempt from its examinations, it is unclear whether disclosure would waive privilege. The CFPB has proposed a rule stating that the privilege will “not [be] affected by disclosure to the CFPB,” but it is not clear whether this would be enforceable against third parties in state court. A bill dealing with this privilege problem is making its way through Congress (passing the House on March 26, 2012), but its provisions may not apply to non-banks and might also be challenged in state courts. Payday lenders faced with a demand for privileged documents should consult with counsel on this issue to ensure the privilege is not waived as to third parties.

CFPB Investigations

CFPB investigations will be more limited in scope. Investigations may be conducted with other regulators and may have many features of an SEC or FTC investigation. An investigation begins when the CFPB issues a demand that identifies the federal consumer protection law that it believes the payday lender has violated, and the target must provide a sworn response and discovery. Individuals interviewed during an investigation have the right to counsel and can maintain the attorney-client privilege. The target of an investigation can also petition to set aside the demand. Investigations can close without further action, or can result in an enforcement action in federal court, in state court or in the agency’s own administrative adjudication process.

Freedom of Information Act (FOIA). The agency has stated that information gathered during investigations will be non-public, but information from investigations will be subject to the FOIA. Exemption 8 to the FOIA exempts information “contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.” This exemption should apply to information disclosed in a CFPB examination (though the CFPB has so far declined to publicly take this position, creating some worries). However, the CFPB’s interim final regulations explicitly provide that documents obtained during its investigations are open to FOIA requests. The agency can also disclose the existence of an investigation to any third-party during the investigation itself.

CFPB Enforcement Actions

If the CFPB decides that a payday lender is not in compliance with federal consumer law, it can initiate actions in federal or state court. The agency can also use its own internal adjudicatory procedure, which is modeled on the SEC’s approach. These adjudications contain some of the procedural trappings of a lawsuit, but lack many protections for the target entity. While the agency will have already conducted an examination or investigation to gather the needed materials, the rules do not generally allow the target entity to conduct discovery, such as depositions or interrogatories. And even though the target of an action has only 14 days to file its answer, the regulations state that extensions of time are “strongly disfavored.” The hearing officer has significant discretion in making decisions, but the agency’s director has final say over all decisions.

If the agency determines there is a violation of federal law (or the agency’s own rules and orders), the hearing officer has the power to rescind or reform contracts, issue injunctions, order a regulated entity to refund money or take other affirmative actions, and can impose significant monetary

penalties. An administrative proceeding can result in civil penalties of US\$5,000/day for violating federal consumer laws, US\$25,000/day for a reckless violation or US\$1,000,000/day for a knowing violation. These powers are significantly greater than those enjoyed by other regulators.

Next Steps

While the CFPB defines what are “abusive” practices, payday lenders and their compliance officers can take specific steps to lower the chance of becoming the subject of an enforcement action:

- Lenders should stay abreast of the CFPB’s regulations and any investigations, enforcement proceedings or lawsuits filed by the CFPB or other regulatory agencies (like the FTC).
- Thorough procedures to ensure compliance with federal law are more important than ever.
- Lenders should ensure that compliance is properly documented.
- Lenders should pay particularly close attention to their collection practices (and the practices of any third party they utilize) and to online lending practices.

Payday Examinations in the UK

Payday lenders should also be aware that the UK Office of Fair Trading (OFT) is conducting a similar examination of the payday industry, payday lenders and their affiliates. While the OFT’s examinations are separate from the CFPB, the two agencies are, no doubt, watching one another’s progress. Our UK Financial Services Litigation Practice is actively monitoring the OFT, as such examinations and subsequent rules may impact Squire Sanders’ payday lender clients that have interests in the UK and European countries governed by UK law.

For more information on the OFT and its examination of payday lenders in the UK, please visit the Financial Services Litigation page on Squire Sanders’ website:

<http://www.squiresanders.com/financial-services-litigation>. For more information on the CFPB and payday lending examinations, investigation and enforcement, please contact:

Amy L. Brown
Washington DC
+1 202 626 6707
amy.brown@squiresanders.com

Mark C. Dosker
San Francisco, CA
+1 415 954 0210
mark.dosker@squiresanders.com

Pierre H. Bergeron
Cincinnati, OH
+1 513 361 1289
pierre.bergeron@squiresanders.com

Traci H. Rollins
West Palm Beach, FL
+1 561 650 7256
traci.rollins@squiresanders.com

Brian A. Cabianca
Phoenix, AZ
+1 602 528 4160
brian.cabianca@squiresanders.com

Martha S. Sullivan
Cleveland, OH
+1 216 479 8425
martha.sullivan@squiresanders.com