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CFPB Credit Stance Has Broad Specialty Finance Implications

By Jeffrey Naimon and Joshua Kotin (December 11, 2020)

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The Consumer Financial Protection Bureau issued an **advisory opinion**[1] at the end of November that could compel specialty-finance companies — including those offering income-share agreements, litigation funding, merchant cash advances and earned wage access products — to take a fresh look at whether their products are in fact subject to certain federal consumer protection laws.

While the CFPB's Nov. 30 opinion is designed only to clarify which earned wage access plans fall outside Regulation Z's definition of "credit," it also more generally establishes an analytical framework potentially applicable to a host of alternative financial products — products that federal and state regulators until this point have generally not considered loans, and therefore, not subject to laws and regulations governing licensing, pricing and disclosures.

The opinion applies only to the Truth in Lending Act and Regulation Z, but is certain to have broader consequences, in particular with respect to the CFPB's jurisdiction, and its authority to bring claims under anti-discrimination laws or to prohibit unfair, deceptive, or abusive acts or practices.

The CFPB's Framework for Analyzing Credit

The earned wage access program that the CFPB's opinion addressed is one in which a third-party provider contracts with an employer to advance the employee's wages that have already accrued; the employee makes no payment, voluntary or otherwise, to access those funds, and the advanced wages are deducted from the employee's next paycheck.

As part of the arrangement, the provider may not retain a legal or contractual claim or remedy against the employee in the event of a failed or partial payroll deduction.

In concluding that the earned wage access program is not credit, the CFPB required the following factors be present:

- There is no debt. The earned wage access program enables the employee to access wages they have already earned, and to which they are entitled. Thus, the employee is not taking on liability in exchange for obtaining a specific sum of money.

- There is no independent obligation to repay. Relying on existing commentary regarding borrowing against the accrued value of an insurance policy or pension account, the CFPB indicated that credit has not been extended because the consumer is, in effect, receiving their own money. There is no independent obligation to repay because, to qualify as an earned wage access program under the advisory opinion, the provider must agree not to retain a legal or contractual claim in the event of nonpayment through a payroll deduction.

- Limitations on collection. The CFPB concluded this is unlike a credit transaction because the provider will not engage in debt collection activities or report the transaction to consumer reporting agencies.

- No charge to the employee. To fit within the earned wage access program, the employee cannot pay interest or other fees, meaning that the provider's recovery will not increase with the passage of time.

- No credit reports. Providers will not, under the earned wage access program, pull credit reports or obtain credit scores on individual employees or otherwise assess employee credit risk.

Nonloan products under state law may now be considered an extension of credit under federal law.

Although there is no uniform definition across the states regarding what financial products are loans, or credit, there are consistent themes. In many states, a purchase and sale agreement can operate in a manner similar to a loan, but will not be considered one as long as the consumer has no absolute obligation to repay the purchase price.

For example, the newly constituted California Department of Financial Protection and Innovation reiterated in a recent settlement[2] that a merchant cash advance agreement in which the business agrees to receive a lump-sum payment in exchange for the sale of future revenue is typically not considered a loan.

This new framework set forth by the CFPB could also encourage states to take more expansive views regarding what products come under lending laws in their state.

The bureau's advisory opinion recognizes that whether the agreement creates a contingent repayment obligation may be one part of this credit analysis. However, it also sets forth a number of additional factors that alternative financial service providers will need to consider when assessing whether they are extending credit for purposes of federal law.

A product considered credit under Regulation Z is likely credit for purposes of other federal consumer protection laws.

Throughout the alphabet soup of consumer protection laws, there are at least three critical definitions of credit:

- Truth in Lending Act and Regulation Z: "Credit" means the right to defer payment of debt or to incur debt and defer its payment.[3]

- Equal Credit Opportunity Act and Regulation B: "Credit" means the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor.[4]

- Dodd-Frank Act: "Credit" means the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase.

Given these similarities, the CFPB could apply the same framework for determining whether a person is extending credit for purposes of not only Regulation Z, but also Regulation B and the Dodd-Frank Act. Under the ECOA and Regulation B, entities offering nontraditional credit products that nevertheless constitute credit would need to comply with federal anti-discrimination laws, and likely need to establish fair lending programs to manage such risks.

Notably, the ECOA and Regulation B apply to consumer and commercial credit. As for the Dodd-Frank Act, entities that offer credit are subject to CFPB jurisdiction and, critically, the CFPB's enforcement authority to take action against those entities engaging in unfair, deceptive, or abusive acts or practices.

The CFPB's advisory opinion may have consequences for alternative financial services providers.

Entities offering financial products and services as something other than a loan under state law requirements likely consider themselves to operate outside of the ambit of federal laws regulating lending products. In light of the CFPB's new guidance, however, these entities should:

Review product terms and conditions.

Companies should review their product agreements in light of the bureau's test for what constitutes an extension of credit. Companies that structure their products as a purchase and sale agreement but seek additional security from their customers may be at higher risk of extending credit under the bureau's analysis. Adjusting certain terms and conditions in existing agreements could mitigate the risk that a particular company is offering credit.

Review customer communications and operations.

The factors set forth by the bureau suggest that certain operational practices, or customer communications, could indicate that a financial product is actually a loan. For instance, although credit reports can be used for a variety of reasons, obtaining a credit report makes it more likely the CFPB will consider the product a loan. Similarly, companies should review all scripts and marketing materials to ensure that products are not described as loans.

Assess compliance with federal laws and regulations.

Companies determining that they are likely to be extending credit under the bureau's new framework should swiftly assess their potential legal obligations. Those that determine they may be subject to the requirements of ECOA and Regulation B should create a fair lending policy and supporting fair lending program to manage fair lending risk.

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[1] https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-

bureau-finalizes-advisory-opinions-policy-and-announces-two-new-advisory-opinions/.

[2] https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/11/Consent-Order-Allup-Finance-LLC.pdf.

[3] 12 C.F.R. § 1026.2(a)(14).

[4] 12 C.F.R. § 1002.2(j).