

# PUBLICATION

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## New Risks for Payday Lenders Under Dodd-Frank

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) imposes sweeping regulations on nearly all aspects of consumer lending. In addition to establishing these new rules, Dodd-Frank also created the Consumer Financial Protection Bureau (CFPB) to enforce them. While most of the CFPB's regulatory authority applies to all consumer lenders, certain provisions apply only to specific types of non-depository creditors, including payday lenders. The result is the CFPB's new power to regulate payday lenders, as well as the ability to levy substantial penalties on those who violate federal consumer financial law. Payday lenders need to become familiar with the new regulations in order to implement procedures to protect themselves.

### The CFPB's Regulatory Power Over Payday Lenders

Under Dodd-Frank, the CFPB has been granted the authority to punish any unfair, deceptive or abusive act or practice by a seller of a consumer financial product. Dodd-Frank broadly defines an "abusive act or practice" as one that:

- (1) Materially interferes with the ability of a consumer to understand a consumer financial product or service, or
- (2) Takes unreasonable advantage of:
  - a. A consumer's lack of understanding of the material risks of the product.
  - b. The consumer's inability to protect his or her own interest in using the product.
  - c. The consumer's reasonable reliance that the provider of the product would act in the interest of the consumer.

The CFPB's examinations procedures for the payday lending industry suggest several ways in which payday lenders may violate this standard, including a lender's failure to disclose check cashing fees, material terms of a financial product or the consumer's rights regarding payment. Because of Dodd-Frank's all-encompassing definition of "abusive acts," payday lenders will likely face increased scrutiny over their products. Such lenders should create procedures to ensure compliance with these disclosure requirements.

### The CFPB's Supervisory Power over Payday Lenders

To help the CFPB investigate and identify suspected violations of federal consumer financial law, Dodd-Frank gives the CFPB broad supervisory powers over payday lenders. Under Dodd-Frank, the CFPB is required to collect reports and conduct examinations of payday lenders for the purpose of (1) ensuring compliance with federal law, (2) obtaining information about the payday lender's procedures to prevent violations, and (3) detecting risks to consumers created by the products offered by payday lenders. In addition, the CFPB can create rules requiring payday lenders to generate, provide or retain records to assist in the supervision. The CFPB even has the authority to impose background checks on principals, officers, directors and other personnel of the payday lender to ensure that such lenders are "legitimate entities." Failure to respond to the CFPB's request for information can result in a court order for contempt.

### The CFPB's Enforcement Power over Payday Lenders

The CFPB's role does not end at supervision; if it detects a violation of federal consumer financial law, it has the power to impose substantial penalties on the offender. The CFPB generally has two levels of enforcement power: cease and desist orders and civil penalties. If the CFPB discovers a violation, it may send a letter ordering the suspected offender to cease and desist the offending behavior. If the suspected offender does not respond within 30 days, the order automatically becomes effective.

The CFPB also has the authority to bring a civil action against a suspected offender in the District Court of the district where the offender is located. Damages may include restitution, payment of damages, return of money or property, and public notification regarding the violation. In addition, the Act also imposes substantial civil penalties for violations of federal consumer financial law. These penalties are as follows:

- (a) For any violation, a fine of up to \$5,000 for each day that such violation continues.
- (b) For a reckless violation, a fine of up to \$25,000 for each day that such violation continues.
- (c) For a knowing violation, a fine of up to \$1,000,000 for each day that such violation continues.

## **Conclusion**

The CFPB will undoubtedly attempt to snare payday lenders under the expansive "abusive acts and practices" prohibition. If it finds evidence of such practices, or any other violation of consumer financial law, it will impose substantial penalties that most small, non-traditional lenders cannot afford to pay. Payday lenders should implement procedures, such as periodic monitoring reviews by management or a regular independent compliance audit, to ensure that they are making the necessary disclosures, preserving all loan documentation and minimizing the risk of violating these new regulations.