***The Consumer Finance Podcast*: 1071 Rule Status**
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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, co-leader of Troutman Pepper's Consumer Financial Services regulatory practice, and today I'm going to be talking about the current state of play for the compliance state under the CFPB's final Small Business Data Collection rule, promulgated under section 1071 of Dodd-Frank. But before I get into that topic, let me remind you to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget about our other podcasts. We have the *FCRA Focus* all about credit reporting, *Unauthorized Access*, which is our privacy and data security podcast, *The Crypto Exchange* about everything relating to crypto, and *Payments Pros*, which is all about the payments industry. Those are all available on all popular podcast platforms. So check them out. And speaking of those podcast platforms, if you like this podcast, let us know. Leave us a review on your podcast platform of choice and let us know how we're doing.

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The Texas Bankers Association was the lead plaintiff in that case against the CFPB, seeking a preliminary injunction against the 1071 rule on the basis of, among other things, dependency of the constitutionality of the CFPB before the Supreme Court in the *Community Financial Services Association v. CFPB* case, which was argued on October the 3rd, and which we expect a decision from the Supreme Court in sometime this term that is before the end of next June.

So the court entered an injunction on July the 31st, but limited its injunction only to those entities that were the plaintiffs in the lawsuit and the members of those entities who were associations. And so for a number of months we had a situation where the rule was stayed as to some banks, but no non-banks and no banks who weren't members of the various trade associations that were the plaintiffs in the lawsuit. This spurred a flurry of activity from small business lenders who were not going to be covered by the court's injunction. So you had a number of things happen. First, you had a number of trade associations attempt to intervene in the case so that their members could receive the benefit of the injunction as well. And you had a number of entities and associations writing letters to the CFPB asking the Bureau to basically give all small business lenders the benefit of the injunction so that there will be a level playing field for the small business lending community as a whole.

And there'd be uniformity and certainty for when the rule would go into effect market-wide. The Bureau did not agree to those requests, and so it came to a head in the court hearing, The Texas Bankers Association case. So after several sets of trade associations and other plaintiffs intervened, they not only asked for the injunction to be provided to their members, but also that the court issue a blanket injunction covering all small business lenders nationwide. And the federal court actually finally did that at the end of October. The court entered a nationwide injunction covering all small business lenders and essentially saying that both the implementation and enforcement of the 1071 rule would be stayed pending the outcome of the Supreme Court's decision in the CFSA case. Now notably, the federal court's injunction, even as it had been entered in July and as it's been extended in October, not only puts off the mandatory compliance dates of the 1071 rule, but does so for an additional period equal to the length of the injunction.

So we don't know when the injunction is going to end because we don't know when the Supreme Court will decide the CFSA case, but during the time that the injunction is pending, the deadlines that are set forth in the 1071 rule itself, which for example for the largest small business lenders would've required compliance beginning in October of 2024, are being stayed. We don't know how long they'll be stayed because we don't know when the Supreme Court case will come out, but they're being stayed right now. That is unlike, for example, an injunction that was issued by a federal court in Kentucky in another similar case, which only prevented the CFPB from enforcing the rule prior to the Supreme Court decision. And the court in that case even observed that it didn't really matter because a decision was expected from the Supreme Court prior to even the earliest of the compliance dates called for in the 1071 rule, which isn't until October of 2024.

So now we have the small business industry with a level playing field again, and once the Supreme Court case is decided one way or the other, we will presumably have a known start date for the compliance with the small business data collection rule. I think that raises two related issues. One, for small business lenders, especially those in that largest tier that have the earliest compliance date set in the rule at October 2024, the question becomes, "Well, can we just put our pencils down and stop working since we have the benefit of a stay?" And I think from my standpoint, the answer to that is no. It's not advisable to do that. In fact, one of the consistent themes among the larger small business lenders and their trade associations was that the implementation period provided by the Bureau in the final 1071 rule wasn't long enough for them to code the systems and establish the policies and procedures and set up the monitoring and do the testing and all the other things that are necessary to gather and submit small business application data under the 1071 rule.

Well, if that's the case that that period of time was insufficient, then we now have more time. And so I think if that time is necessary in order to get all those things set up, it seems intuitive to me that that largest tier of small business lenders would continue their setup efforts to comply with the rule, even not knowing when the final compliance date will be, but knowing they'll need all the time that they can get to set up everything and get it working in order to comply with the rule when it presumably does become effective after the stay expires in some way. That's one question that I think it's important to get an answer out to. The other question that's come up on a number of occasions since the federal court injunction was entered has to do with what I call the “free look” period under the 1071 rule.

And the rule says that starting one year prior to the mandatory compliance date, an entity can optionally request and gather the demographic information required by the 1071 rule, even though it's not yet obligated to do so. And the CFPB provided this as a one-year period for small business lenders to basically test out their methods of gathering the information, during the application process, their backend systems for gathering and separating the data behind the firewall, and then for putting it into the LAR for submission to the CFPB all without the obligation to do any of those things being present. That's why I call it the “free look” period, because small business lenders can test out their operations and figure out what's going on both from the standpoint of gathering the data and avoiding discouragement under the rule, but also to have the data available to look at it from a fair lending standpoint prior to being required to send anything to the CFPB.

So the question comes up, if the implementation date, the compliance date for the rule is going to be stayed some indefinite period of time by a result of the federal court's injunction in Texas, can we take advantage of the “free look” period based on the original compliance date of say, October 2024, or do we need to wait for one year prior to the new compliance date? And that's a question that doesn't have a clear answer in the text of the rule because if you look at the provision in the 1071 rule, it basically says that you can start collecting the data on a voluntary basis one year before the compliance date specified in the previous subsection of that same section of Reg B, and those are the ones that have the specific dates in it. So if you read that, you would think, "Well, maybe I can start one year prior to October 2024," which would already be in place now.

On the other hand, you've got a federal court having enjoined the rule, and you know that gathering demographic information from applicants is illegal under the Equal Credit Opportunity Act unless there's some specific act of Congress that permits you to do so like HMDA and now the 1071 rule. And so I think with the rule subject to an injunction, it would worry me that the collection of that demographic data would be illegal under Reg B because the legal justification of the 1071 rule isn't there because its enforcement has been enjoined by the federal court in Texas. So my own view is that the “free look” period is probably not something that the large small business lenders would want to take advantage of right now because of that uncertainty about whether or not it would be legal to collect that information given the injunction. So I think we're going to have to wait for our “free look” period until the federal court's injunction expires, which of course will be triggered when the Supreme Court decides the CFSA case.

And of course, depending on how the CFSA case comes out, because if the Supreme Court held that the CFPB were unconstitutionally funded and affirmed the Fifth Circuit's decision in CFSA, then maybe there wouldn't be a 1071 rule at all following that ruling. But we'll have to see what the Supreme Court thinks of that issue when it comes out.

So for now, I think the bottom line message is that certainly for the largest of the small business lenders, it's good that we have a uniform stay that will delay the implementation date of the 1071 rule, but use that time wisely to build the systems and do the testing and monitoring, both from the standpoint of data collection and discouragement, but also from a fair lending standpoint. Even if you can't gather data, there's lots of fair lending reviews that we can do of small business lending operations prior to the time any data has to be collected, and it would be a great investment of everybody's time to do that prior to the rule coming into effect. So I urge everybody to use the extra time to do those things. And I think probably from my standpoint, the “free look” period is something that we should wait on until the federal court does something one

way or the other with its injunction. With the injunction in place now, I'm not sure it's a great idea to take advantage of the “free look” period.

That's the update that I wanted to give you today about the 1071 rule. Obviously, we're going to continue to watch this as it unfolds. You'll see us report about it on the blog, and you'll probably hear about it on the podcast when major developments happen with respect to 1071. For now, let me thank you for listening to today's episode and remind you again to visit and subscribe to our blogs where we will be reporting about this, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And why don't you also visit us at troutman.com and add yourself to our Consumer Financial Services email list? That way we can send you copies of the alerts that we send out from time to time, as well as invitations to our industry only webinars that we conduct. And again, keep our mobile app in mind. It's a great one-stop shop for all of our thought leadership content. You can find it under Troutman Pepper in either App Store, and of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.