

THE CONSUMER FINANCE PODCAST: UPDATE ON THE CFPB'S SECTION 1071 FINAL RULE**HOST: CHRIS WILLIS****GUESTS: LORI SOMMERFIELD AND JOE REILLY****DATE AIRED: AUGUST 31, 2023****Chris Willis:**

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Group. And today we're going to be giving an update on what's going on with the 1071 rule given the recent litigation that's been going on with it and what members of the industry ought to do in response to these developments. But before we jump into that topic, let me remind you to visit and subscribe to our blogs, troutmanpepperfinancialservices.com and consumerfinancialserviceslawmonitor.com. And if you like this podcast, don't forget that we have several others. We have the [FCRA Focus](#) all about credit reporting, [The Crypto Exchange](#), all about cryptocurrency issues. We have [Payments Pros](#), which is our most recent podcast all about the payments industry, and our privacy and data security podcast called [Unauthorized Access](#). And all of those are available on all popular podcast platforms.

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So, Lori, Joe, welcome to the podcast again.

Joe Reilly:

Thank you, Chris.

Lori Sommerfield:

Thanks for having us, Chris.

Chris Willis:

So at the end of July, the U.S. District Court for the Southern District of Texas issued a preliminary injunction in joining the CFPB's enforcement of the final 1071 small business data collection rule, but only restricted it with respect to the members of the plaintiff associations who had brought the lawsuit, which was the American Bankers Association, the Texas Bankers Association, and a single particular Texas bank that was the plaintiff in the case. So even though the plaintiffs had requested a nationwide injunction for the whole rule, the court didn't grant that. It only granted relief to the parties that were before it. And of course, the basis for the court's decision was the Fifth Circuit's decision in the CFSA case where the Fifth Circuit held

that the Bureau's funding structure was unconstitutional and therefore that the payday lending rule it had finalized was therefore invalid.

So, the same logic would then apply to the 1071 rule and the court essentially said, well, the Supreme Court is going to hear and decide that case next term. So, it's appropriate to put the 1071 rule on hold at least for these plaintiffs while the Supreme Court decides the CFSA case. So, although the compliance date for the members of these associations is significantly delayed potentially, because we don't expect a decision in the CFSA case until sometime in 2024, maybe not until June of 2024, the injunction doesn't do anything for other small business lenders, and there's a lot of them. So, since that time, there's been a flurry of activity with a lot of other associations seeking to intervene in the case that's pending in the Southern District of Texas, as well as a lot of petitions being made to the CFPB to basically stay implementation of the rule for everybody on equal ground pursuant to the terms of the Texas injunction.

So today we're going to talk about these developments with Joe and Lori and myself and talk about what does it mean and what should entities who are covered by the 1071 rule do whether they're in the current injunction or not in the current injunction. So, let's just start off with talking about what happened in the litigation. So, Joe, let me ask you, the court, as I said, granted this injunction on July the 31st, what does the injunction actually say and what does it mean?

Joe Reilly:

Sure, Chris. Thank you. As you indicated, first of all, the injunction is solely based on the CFSA case. The plaintiffs in the case make some other arguments that we'll talk about later in this podcast, but right now, they asked for this injunction solely on the basis of the concept that the CFPB is unconstitutionally funded. And what the court did is it enjoin the CFPB from implementing and enforcing the rule against the plaintiffs and their members only. Now, that might not necessarily mean very much this time since the earliest compliance date with the rule is not until October of 2024 and as you indicated, the Supreme Court will decide the CFSA case probably long before then, but the court added something else.

The court said that as to these plaintiffs, even if the Supreme Court decides that the CFPB is constitutionally funded, reversing the Fifth Circuit, which would mean that this injunction goes away, the court said that in that case, the CFPB would be required to extend the plaintiffs' and their members' deadlines for compliance with requirements of the rule to compensate for the period stay. So, in other words, if the stay lasts for, say, six months after which the Supreme Court reverses the Fifth Circuit, then the plaintiffs and their members would get an additional six months after their compliance date. Say, that's October of 2024. They'd get an additional six months after that before they would have to comply.

Chris Willis:

So, the court's order takes into account the fact that you don't just flip a switch and start complying with 1071. You've got to do a lot of building and planning to do it, which is why the implementation date was phased by the CFPB in the first place. Now, as I mentioned, the plaintiffs in the case weren't just being selfish. They didn't ask for an injunction just for themselves, they asked for one that would cover all lenders nationwide. Why didn't the court do that?

Joe Reilly:

So, the court didn't give very helpful reasoning, but I think there were two reasons why the court didn't grant the nationwide injunction. One important reason is that the CFPB argued against it. In the CFPB's briefs, the CFPB said, court, even if you decide to grant an injunction, we think the injunction should be limited to the plaintiffs and their members. I think the CFPB did that because the CFPB really wants its rule to go into effect as to certain lenders, even if it doesn't go into effect on time for banks.

But I think the second reason the court refused to grant a nationwide injunction is that one element of injunctive relief is a showing of irreparable harm. And so, to make that showing, the ABA and the other plaintiffs put forward affidavits showing that they would incur X dollars of compliance costs if they had to continue preparing to comply with the rule, submitted that evidence in the record, and the court simply didn't have evidence in the record as to irreparable harm suffered by any outside parties like credit unions. So, I think that's another reason the court limited the relief to the plaintiffs and their members.

Chris Willis:

Okay. Well, I guess that's understandable. Although side note, I guess the next time the trade associations bring a case like this, they should style it as a class action and have a class certified of all small business lenders in the country. That's just a joke actually, because that would slow down the injunction process a lot. But nevertheless, it would be a fun use of a class action where we'd be on the giving end rather than the receiving end of it for once. But Lori, let me turn to you. So, we know for whom the rule is stayed. That is members of the American and Texas Bankers Associations, but that leaves a lot of small business lenders out in the cold. Can you share with the audience some of the categories of small business lenders that are going to have to comply with the 1071 rule, but who are not benefiting from the injunction that was issued in the Southern District of Texas?

Lori Sommerfield:

Sure, Chris. And before I get into that specific list of categories of small business lenders, I wanted to circle back to a point you made earlier about how very broad the applicability of the Section 1071 rule is to various small business lenders. If you look back at the definitions in the rule, the final rule applies to covered financial institutions, and there's two parts to that definition. First, you have to have a financial institution that engages in financial activity, and that term can include many types of legal entities - depository institutions, nonprofit organizations, partnerships, companies, corporations, associations, trusts, estates, and even co-ops. In fact, it even includes governmental subdivisions and agencies. So that's a very broad definition.

Second, you have to have a covered financial institution, and that means that the institution has to have had at least 100 covered originations in each of the two immediately preceding years. So that low threshold brings in many small business lenders. So back to your question, only the small business lenders that are members of the ABA or the Texas Bankers Association or that one particular bank in Texas are benefiting from the injunction that was issued by the Texas Federal District Court and all other small business lenders are not. Some examples are members of other federal banking trade associations like the Independent Community Bankers of America and state bankers associations in all 50 states. That is if their members aren't a member of either the ABA or the Texas Bankers Association.

Then you've got credit union trade associations like the National Association of Federal Credit Unions, which is known as NAFCU or the Credit Union National Association known as CUNA. Then you've got non-bank trade associations, and there are many of those out there that apply to specialty lenders or various financial products. For example, there are trade associations for merchant cash advances, farm credit, and the list goes on and on. So, it's a very broad spectrum of small business lenders that are not benefiting from the injunction at this time.

Chris Willis:

So, we know that probably the majority of the market got left out of this injunction, at least as it currently sits, as the court initially ordered it. So, what is the rest of the market doing about it? What are they doing in response to this somewhat strange development where only a piece of the market has a stay on compliance with the rule?

Lori Sommerfield:

Well, generally, the rest of the market and their trade associations have acted in one of two ways. Either they've acted by trying to intervene in the ABA and Texas Bankers lawsuit, or they have petitioned or considering petitioning the CFPB to extend the stay to their membership. So, I'll take those in two pieces. First of all, with regard to litigation developments, on August 4th, the Independent Community Bankers of America, that's the national trade group, the Independent Bankers Association of Texas, and Texas First Bank filed an unopposed emergency motion for leave to intervene in the ABA and Texas Bankers lawsuit. That was the first sort of volley that happened. Then there were two credit union trade associations, CUNA and Cornerstone Credit Union League, which is a big regional credit union association, as well as a particular credit union, also filed a similar motion.

So those two interventions are now proceeding. And interestingly, the CFPB did not oppose their motions for intervention. Those trade associations argued that they will suffer irreparable harm if the CFPB isn't enjoined from enforcing the Section 1071 final rule against them because it currently doesn't apply to their members. So, they're primarily making an argument that by allowing the stay for certain small business lenders, not others, it creates an uneven playing field. And that basically will result in some lenders having to comply earlier than others and then will place those lenders at an unfair competitive advantage because they're going to have to incur all these additional compliance costs sooner than the other small business lenders that do have the benefit of the injunctive stay.

Chris Willis:

Well, it seems like not only that, but the borrower experience will be different because you go to one lender who's covered by the injunction, your loan application proceeds as normal, you go to one who has to comply with the rule, and you have all this extra questions that you have to answer. And so you'd be saying, "Well, why didn't this other lender make me do that?"

Lori Sommerfield:

That's exactly right. That's exactly right, Chris.

Chris Willis:

And the thing is that the final rule requires that the demographic information form contain a statement that federal law requires the collection of that information, if I'm recalling it correctly.

And so they'll get this statement of "federal law requires it," and yet there'll be parties in the market who aren't doing it.

Lori Sommerfield:

That's exactly right. And then that sets up the uneven playing field. So, the borrower experience will be very different depending on which lender to whom they apply.

Chris Willis:

So what is the CFPB's response to these various developments been?

Lori Sommerfield:

First of all, as I mentioned, the CFPB did not oppose the motions to intervene from the IBAA and that set of plaintiffs as well as CUNA and the credit union plaintiffs. But also the CFPB has been absolutely inundated with requests to extend the stay of the final rule to all covered small business lenders since the injunctive order was entered. There's been a whole set of letters that have been made public, so I'm just going to mention a few of them for the benefit of the audience. First of all, on August 2nd, the actual plaintiffs in this Texas litigation filed their own letter with the CFPB requesting that it extend the stay outlined in the injunction order to all FDIC insured banks. I think we all found that somewhat curious, that it was limited in that way, but nonetheless, that was the request of the ABA and the TBA.

Then CUNA and NAFCU, the two national credit union trade associations also jointly sent a letter to the CFPB just a few days later on August 7th, requesting a similar extension of the stay for their credit union members. And then the next day, on August 8th, bankers associations from all 50 states sent a joint letter to the Bureau arguing that relief should be provided to banks nationwide to be prudent and to ameliorate confusion. So, I'd also like to mention it's also likely that many non-bank trade associations have also petitioned the CFPB to extend the stay to their membership, but those letters haven't been made public yet.

So, the CFPB at this point, I guess, we're waiting to hear if the Bureau is going to succumb to all of this political pressure through this steady drumbeat of advocacy pieces from these various trade associations, and then act to extend the stay of the Section 1071 final rule to all impacted small business lenders. But if the Bureau doesn't do so, it's going to create an uneven playing field. And that would be unfair, in my view, to other small business lenders who aren't covered by the stay and are going to be forced to comply with it earlier. I think it would also be very difficult for the CFPB to administratively manage implementation of the final rule unless they set a level playing field.

Chris Willis:

Yeah, it makes sense. So, we'll all be sitting on the edges of our seat to see what either the court or the CFPB does in response to all of this activity. But Joe, the other thing about this litigation is that even though the court's injunction is based solely on what I'll call the CFSA issue, that is the issue of the Bureau's funding mechanism and whether it's constitutional under the appropriations clause or not, that's not the only issue that's raised in the complaint in the lawsuit. So, can you tell the listeners a little bit more about what's waiting behind door number two if the Supreme Court decides that the CFPB's funding structure is okay?

Joe Reilly:

Yeah, sure. Thanks, Chris. And this is important, and I alluded to it. In moving for this injunction, the plaintiffs really grabbed the low hanging fruit. There's binding precedent in the Fifth Circuit that CFPB is unconstitutionally funded so that was the only basis for the injunction. They also have arguments based on violations of the Administrative Procedures Act. Basically, the typical challenges you see from an industry to a wide-ranging rule, arguments such as, look, the statute only requires lenders to report seven things, but the CFPB rule requires 82 data fields to be filled out. Now, the CFPB will respond that the statute also says the CFPB can add data fields and really what the CFPB has done in issuing this rule isn't really different from what the Federal Reserve and later the CFPB have done in issuing rules under HMDA, which require reporting on many more fields than the statute mentions. But the point is, even if the Supreme Court does find the CFPB is unconstitutionally funded and this injunction goes away, the plaintiffs have another argument they're going to mount to challenge the rule, and we'll have to keep track of that.

Chris Willis:

Sure. Although without commenting on the strength of the APA challenges to this rule at all, I would just note that the parties that challenged the payday lending rule in the CFSA case raised a bunch of Administrative Procedure Act issues as well and the same Fifth Circuit that found the Bureau and its funding mechanism unconstitutional also rejected every single one of those APA arguments and the Supreme Court did not grant cert on any of those issues. There's not the clear lane to sale that there is on that issue as the Fifth Circuit had given the plaintiffs on the CFSA issue, I don't think.

Joe Reilly:

Yeah, I think you're right.

Chris Willis:

Let's just end the podcast and talk about practical reality here. There's probably a lot of hope in the industry that the implementation date, as you said, the earliest one being in October of 2024 for the largest small business lenders, is going to get delayed by sometime industry wide. We don't know if that's going to happen or not, but it might. And so even if that does happen, and let's say that date is stayed by 6, 8, 10 months, something like that, because of pendency of the CFSA case, what does that mean for covered small business lenders, particularly those big ones, who are in that first tranche of compliance dates? Should they just call the whole thing off and just sit on their hands until the CFSA case is decided and then start back where they are now? What should they do, Lori?

Lori Sommerfield:

Well, I believe that all small business lenders should continue to proceed with implementation of the Section 1071 final rule. In a way, this presents a gift of time, but those small business lenders that are covered by the injunction should not take this as basically a "put everything on hold" concept. I mean, there is so much that needs to be done in order to implement this rule operationally and from a compliance perspective. So, I would proceed full speed ahead and just, as I said, consider this as the luxury of a little additional time. But this rule is going to proceed and it will be implemented.

Chris Willis:

And one of the things that I would note in agreeing with you, which I 100% agree with you on that, is that one of the most repeated calls from industry groups after the 1071 rule was finalized was that, the implementation period isn't long enough and we need more time to build the systems, do the training, do the monitoring, all of the other stuff that the rule requires. And so, the CFPB didn't give that, it gave the periods of time... It gave at least to the larger lenders, not being very long, about 18 months, in the final rule. And so, in a sense, it sort of gives the industry what it asked for in that, hey, we need more time to work, not, we need more time till kickback and have a couple of margaritas.

So I'm right with you in terms of the fact that if industry's right, that it really does take more than 18 months to build the systems and monitoring and training and all of that to comply with the rule, well, are you ready to take yes for an answer and actually use that time in the same way that you've said to the CFPB that you need to use that time? I think that's the important lesson from the standpoint of the marketplace.

Lori and Joe, thank you very much for being on the podcast today, sharing these important updates with our listeners. We, of course, are going to continue to monitor this issue very closely. You'll see us write about it on the blogs and you'll hear about it on the podcast as well. And of course, thanks to our audience for listening into today's episode as well.

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