

It's the Final Countdown: The Small Dollar Rule's Looming Compliance Date

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In July 2020, the Consumer Financial Protection Bureau ("Bureau") at long last finalized the Rule governing Payday, Vehicle Title, and Certain High-Cost Installment Loans ("Small Dollar Rule" or "Rule"). The Rule, originally proposed in 2016, has undergone a wild ride - from being "finalized" in 2017 to having substantial sections rescinded in 2020, including the mandatory underwriting provisions. As a result, all that remains are the "payment provisions."

The payment provisions impose requirements regarding payment attempts - specifically, prohibiting subsequent payment attempts following a second consecutive failed payment transfer without a new authorization. The Rule also requires finance companies making covered loans to send three different types of payment notices to borrowers.

While compliance with the Small Dollar Rule is currently stayed pending the outcome of litigation between a trade association and the Bureau, finance companies may need to comply with the Small Dollar Rule soon.[1]

So, what does this mean for you? Below are five key issues that you should consider when creating a Small Dollar Rule compliance plan.

• Covered Loans

The Small Dollar Rule covers three categories of loans: (1) short-term consumer loans with a term of 45 days or less; (2) longer-term consumer balloon payment loans; and (3) longer-term consumer loans that exceed 45 days with a rate above 36% APR in which the lender obtains a leveraged payment mechanism. A lender or service provider obtains a leveraged payment mechanism if it has the right to transfer money from a consumer's account.

• Some Retail Installment Sales are Covered

Among other exclusions, the Small Dollar Rule includes an express exemption for "certain purchase money loans," defined as "[c]redit extended for the sole and express purpose of financing a consumer's initial purchase of a good when the credit is secured by the property being purchased, whether or not the security

interest is perfected or recorded." The Small Dollar Rule and its Official Interpretations do not focus on the legal distinctions between retail installment sales and loans, but rather appear to address all such transactions as "loans."

As a result, the Small Dollar Rule will apply to retail installment transactions that meet the definition of a covered loan and are not used solely and expressly to finance the consumer's initial purchase of a good (i.e., by including an ancillary product). Under the Rule, a loan is made solely and expressly to finance the consumer's initial purchase of a good even if the amount financed includes Federal, State, or local taxes or amounts required to be paid under applicable state and federal licensing and registration requirements. Additions of any other services or amounts, such as insurance or guaranteed asset protection waivers, will cause the transaction to fall under the Rule.

• **Payment Attempts - Key Terminology**

The remaining provisions of the Small Dollar Rule impose requirements on payment attempts on covered loans. Companies should be familiar with several terms in the Rule to understand the specific requirements and prohibitions regarding payment attempts, such as "first failed payment transfer," "second consecutive failed payment transfer," and "unusual withdrawal." Understanding these terms is going to be key in developing an effective compliance plan. In addition, though the definitions may appear straightforward in certain cases, there are still several nuances to be considered in applying such terms. Legal counsel can help you navigate these nuances.

• **Obtaining Electronic Consent**

The Rule requires finance companies to obtain consent before they can provide the required notices electronically. Your company probably already obtains an E-Sign consent during the origination phase. However, the electronic consent required under the Small Dollar Rule differs from that required under the E-Sign Act. Finance companies should ensure that any consent used satisfies the requirements of both the E-Sign Act and the Small Dollar Rule.

• **Payment Authorizations**

The Rule does not expressly impose requirements on the terms of any payment authorizations that finance companies may use during their transactions. But, companies should consider whether their payment authorizations need to be revised to more adequately address concepts covered by the Rule. For example, the Small Dollar Rule limits the number of payment attempts a company may make, which may differ from the number currently permitted under applicable law as well as the National Automated Clearing House Association rules. Ensuring that your payment authorization complies with the Small Dollar Rule could help your company reduce some of the potential risks related to claims of unfair or deceptive acts or practices.

• Required Notices

The Small Dollar Rule requires finance companies to provide borrowers with three types of notices: (1) a first payment withdrawal notice; (2) an unusual withdrawal notice; and (3) a consumer rights notice. The Rule provides model templates, which should be substantially complied with because the Rule provides a safe harbor for those who use such forms.

Finance companies also should familiarize themselves with the triggers for each of the three notices in order to provide the correct notice to the consumer under each set of circumstances. For example, an unusual withdrawal notice must be sent if the upcoming payment transfer will vary in amount from the previous payment transfer, the upcoming transfer will be initiated on a date other than the date of a regularly scheduled payment, the payment transfer will be initiated through a different payment channel than the preceding payment, or the payment transfer is for the purpose of re-initiating a returned payment transfer. Understanding the specific triggers for the various notices can be tricky but knowledgeable legal counsel can help you understand what notice is required and when.

Making sure your company understands these topics will help your company begin the process of establishing an effective plan for complying with the Small Dollar Rule. And while the specific date that you'll be required to comply is still in the hands of a Federal Court in Texas, the countdown is on and the time left for setting up a plan of action is ticking away. Make it a point to address these five key topics before the clock hits zero.

[1] The court recently lifted the stay on the litigation itself. The parties to the case can now proceed with filings and other matters. However, the requirement to comply with the Rule itself continues to be stayed.

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