Business Litigation Update

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Court Rules CFPB’s Prepaid Rule Does Not Mandate Model Clauses

On February 3, the U.S. Court of Appeals for the D.C. Circuit revived a provision in the Consumer Financial Protection Bureau’s (CFPB) rule governing disclosure requirements for prepaid accounts (Prepaid Rule). In a case filed by PayPal, Inc., the court held that the Prepaid Rule does not require providers to use specific language in disclosures and, therefore, does not mandate a “model clause” in violation of the Electronic Fund Transfer Act (EFTA). The court remanded the case to the district court to address PayPal’s administrative and constitutional challenges to the Prepaid Rule.

Background

In December 2019, PayPal, one of the largest providers of digital wallets, filed suit challenging the Prepaid Rule. The Prepaid Rule, which regulates digital wallets and other prepaid accounts, requires financial institutions to make certain account-opening disclosures using model language or other “substantially similar” wording. PayPal’s suit challenged the rule’s “short-form” disclosure provision, which requires providers to disclose a prepaid account’s “most important fees” to customers.

The district court held that the short-form disclosure requirement exceeded the CFPB’s statutory authority by effectively imposing a mandatory disclosure clause. According to the court, the EFTA’s text and legislative history authorize the CFPB to issue only optional, not mandatory, disclosure clauses. In granting PayPal’s motion for summary judgment, the court found that the short-form disclosure requirement mandates model clauses because the rule specifies the form, structure and contents of the disclosures. The district court struck down the Prepaid Rule “to the extent that the short-form disclosure requirement provides [for] mandatory disclosure.” The CFPB appealed.

D.C. Circuit Decision

On appeal, the D.C. Circuit intentionally addressed only the narrow issue of whether the Prepaid Rule imposes mandatory model clauses. The court held that it does not, concluding that because the Prepaid Rule does not require the use of specific language, the CFPB has not mandated a model clause in contravention of the EFTA.

The court determined that the term “model clause,” in the context of the EFTA, means specific, copiable language, not content or formatting requirements. Applying that definition, the court held that the Prepaid Rule does not mandate model clauses.

The Prepaid Rule requires financial providers to disclose certain fees by using a suggested phrase or a “substantially similar term.” For example, providers must disclose a “cash reload fee” using “cash reload” or a substantially similar term, and they must disclose a “periodic fee” using “monthly fee,” “annual fee” or a substantially similar term. In each instance, the Prepaid Rule suggests the use of a particular word or phrase along with the option to use a term that is substantially similar. In other words, the court reasoned that the CFPB has not mandated that financial providers use specific, copiable language to describe the fees; they can choose to use the CFPB’s model clauses or other language that is substantially similar.

The court recognized that in practice, the range of permissible wording to satisfy the Prepaid Rule's short-form disclosure requirement may be limited. "There are, after all, only so many ways to describe the fee charged for account inactivity or the frequency with which a fee is charged," but the court concluded that the limited range of available phrasing does not convert the rule's model clauses into mandatory ones. Because the Prepaid Rule does not mandate the use of specific language, the court held that the CFPB has not mandated a model clause in contravention of the EFTA.

The court remanded the case to the district court, cautioning that while the Prepaid Rule's "content and formatting requirements do not fall within the meaning of 'model clause,'" it does not follow that the CFPB can "impose whatever content and formatting requirements it chooses."

Conclusion

PayPal's lawsuit is the latest in a series of challenges to the CFPB's authority. Although such challenges have been successful in some instances, the CFPB has continued to push its regulatory and supervisory agenda. As a result, those subject to the CFPB's oversight should continue reviewing their policies and procedures to ensure compliance with its regulations and guidance.

FOR MORE INFORMATION

For more information, please contact:

Jessica E. Salisbury-Copper
937.443.6854
Jessica.Salisbury-Copper@ThompsonHine.com

Todd M. Seaman
614.469.3257
Todd.Seaman@ThompsonHine.com