

CFPB Affirms Regulation Z Does Not Apply To Non-Recourse Earned Wage Access

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Recently, the Consumer Financial Protection Bureau (CFPB) issued an [order](#) accepting into the CFPB's compliance assistance sandbox an earned wage access (EWA) program where participating employees are not obligated to repay the provider. The order affirms that the EWA program does not involve "credit" and therefore is not subject to the Truth in Lending Act and its implementing regulation, Regulation Z (together, Regulation Z).

What Are Earned Wage Access Programs?

EWA programs generally permit employees to access their earned but unpaid wages, salary, or other compensation before their scheduled payroll date. These "early access" or "on-demand" programs offer employees an alternative to employer-imposed pay cycles and a means to satisfy short-term liquidity needs arising between paychecks. Such programs enable employees to manage emergencies and to avoid third-party late fees, bounced checks, overdraft fees, and predatory debt traps. There are many providers in the marketplace that offer a variety of program structures, features, and distribution models. Some programs have credit-like features, while others do not. Because there are many different types of EWA programs, it is difficult to paint them in broad strokes.

What Does the CFPB's Order Do?

The CFPB's order grants a limited safe harbor to an EWA program that [describes](#) itself as a factoring arrangement. For a period of two years, the CFPB will not pursue an enforcement action for violations of Regulation Z with respect to select EWA products offered by the provider. As part of this relief, the order affirms that certain of the EWA products currently offered by the provider are not "credit" and therefore are not subject to Regulation Z. The order's safe harbor covers only some of the provider's EWA products—its other products, including some with credit-like features, such as repayment through debiting of consumer accounts, are expressly excluded from the scope of the order.

Why Is the Earned Wage Access Program Described in the Order Not "Credit"?

Regulation Z applies only to transactions that are credit transactions. Regulation Z defines "credit" as "the right to defer payment of debt or to incur debt and defer its payment." The defining characteristic of debt is the debtor's obligation to pay a sum of money. The order affirms that employees participating in the EWA program do not become obligated to repay the provider for the on-demand payments made to them by the provider. As a result, the program that is the subject of the order involves no debt, and without debt the CFPB will not treat the program as "credit" subject to Regulation Z for the duration of the order. This conclusion may seem unremarkable, and it is consistent with the types of structures described below.

How Can Earned Wage Access Programs Be Structured Under Regulation Z Without an Employee Obligation to Repay?

There are many ways. One way to structure an earned wage access program under Regulation Z is as a factoring arrangement. Factoring arrangements are transactions that are commonly used in commercial contexts, often to support a business' working capital or other liquidity needs by monetizing accounts receivable. In these arrangements, a provider factors (i.e., purchases) a business' accounts receivable on

which the business has a right to receive payment from a third-party account-debtor, such as a customer to whom the business has provided goods or services on credit terms (e.g., net 30, 60, 90 days). The provider buys the business' accounts receivable before their due date by paying a purchase price to the business. As a result, the provider acquires the business' rights to the payments expected to be made by the business' customer, and the provider also assumes the risk that the business' customer will not pay timely or at all. If the business' customer defaults on its payments, the business retains the purchase price proceeds, and the provider bears the risk of capital loss. In other words, the business does not have to repay the provider, and the provider lacks recourse against the business. Because factoring arrangements do not involve a repayment obligation by the business, they are recognized as purchase and sale transactions, not as credit transactions.

Similarly, some EWA programs have been structured according to these familiar factoring fundamentals. For example, the EWA provider purchases the employee's right to receive payment due from her employer, to whom she has provided services but for which her employer will not make payment until the scheduled payroll date. In such an EWA transaction, the provider buys the employee's rights to payments before the scheduled payroll date by paying a purchase price to the employee. As a result, the provider acquires the employee's rights to the payments expected to be made by the employer, and the provider also assumes the risk that the employer will not make payroll timely or at all. If the employer defaults on its payments (e.g., misses payroll or runs only a partial payroll), the employee retains the purchase price proceeds, and the provider bears the risk of capital loss. In other words, the employee does not have to repay the provider, and the provider lacks recourse against the employee. Just like commercial factoring arrangements, these EWA factoring arrangements do not involve a repayment obligation by the employee, and so they should also be recognized as purchase and sale transactions, not as credit transactions under Regulation Z.

Does the CFPB Consider Any Other Criteria When Determining Whether an Earned Wage Access Program Is “Credit”?

The CFPB has also considered other criteria in determining whether an EWA program is subject to Regulation Z. For example, in a recent [advisory opinion](#) granting an exemption from Regulation Z to a separate model EWA program (referred to in the advisory opinion as a “Covered EWA Program,” or “CEP”), the CFPB lists seven criteria that an EWA program must satisfy to qualify as a CEP exempt under the terms of the advisory opinion from Regulation Z:

1. Provider of the program contracts with employers to offer the program to their employees;
2. Provider does not advance more than the accrued cash value of wages earned at any given point in time, according to information obtained from the employer (i.e., not from the employee or based upon estimates);
3. Employee incurs no charges and makes no payments (including fees), voluntary or otherwise;
4. Provider recovers the amount of each advance only by payroll deduction from the employee's next paycheck (one additional payroll deduction is permitted in the event of an administrative or technical error);
5. Provider has no other legal or contractual recourse against the employee if a failed or partial payroll deduction occurs, except to deny future use of the program;
6. Provider delivers disclosures to the employee clearly explaining that there are (a) no charges or fees in connection with the program, (b) no legal remedies against the employee to recover the amount of any transaction, and (c) no debt collection activities, selling of debt, or reporting the employee to a consumer reporting agency; and
7. Provider does not assess the credit risk of the employee.

The CFPB's analysis in the advisory opinion “significantly resembles” (in the CFPB's words) its analysis in the order. Indeed, the order's EWA program is similar to the advisory opinion's CEP, except that the order's EWA

program imposes fees upon some of the employees using it. The imposition of a fee can cause a transaction that is also credit to become subject to Regulation Z, if the fee is a “finance charge.” However, the CFPB’s order did not have to reach the question of whether the fees are finance charges because it determined instead that the EWA program is not credit. Therefore, regardless of the fees, the determination that the EWA program is not credit is sufficient for the CFPB to affirm that the EWA program is not subject to Regulation Z.

Does My Earned Wage Access Program Need Its Own Regulatory Relief from the CFPB?

Fortunately, it may not be necessary for an EWA program to meet all seven criteria because the CFPB’s analysis of the applicability of Regulation Z to EWA programs, in both the order and the advisory opinion, focuses primarily on the definition of “credit,” and more specifically whether an employee participating in an EWA program is obligated to repay the provider.

Likewise, a provider of an EWA program that does not qualify as a CEP may very well have no legal need to seek its own sandbox order or no-action letter for relief from Regulation Z, if the provider has a strong basis to conclude that its program is not “credit.” Noncredit products, like many factoring arrangements, are not subject to Regulation Z. However, obtaining a regulatory no-action letter or order may provide certain marketing benefits to a provider. For example, the marketplace often perceives the narrow scope of a regulator’s indication of no-action as providing a broader indication that the regulatory risk of using the product, or investing in the product or its provider, is lower than the risk presented by others. As a result, third parties might give a product or its provider a higher valuation, or treat the regulatory action as a broader endorsement of a provider, product, or business model, despite the fact that the regulator disavows any such endorsement, like the CFPB’s disavowal in its recent order.

We Can Help

The CFPB’s order and advisory opinion together signal that the CFPB may become a hub for guidance on how certain Fintech and other innovative financial products may function within the bounds of Federal consumer financial laws. We take pride in helping investors and providers of EWA programs and similar consumer programs structure their products and evaluate their risk under Regulation Z and other financial regulations. We also help our Fintech clients with lending, alternative finance (e.g., factoring, merchant cash advances, and income share agreements), payments, bank partnerships and charters, and transactions. To learn more, please contact [Alexander J. Callen](#) or [Josh Burlingham](#).

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