

# Consumer Financial Protection Bureau Five-Year Retrospective

2016

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# Introduction

## The CFPB's First Five Years

By Ori Lev and Stephanie C. Robinson

The Consumer Financial Protection Bureau (CFPB or the “Bureau”) marks its fifth birthday having made a substantial mark on the consumer financial services marketplace. From re-writing the rules governing mortgages, to creating the first-ever federal supervision program for non-bank consumer financial services providers, to pursuing a robust enforcement agenda, the Bureau has assertively used all of the tools that Congress gave it. In addition to its regulatory powers of rulemaking, supervision, and enforcement, the CFPB has also launched a consumer complaint portal that has handled nearly one million consumer complaints and launched a comprehensive consumer education and outreach program. The CFPB has made it clear that it is the new sheriff in town when it comes to consumer financial services.

None of this has been without controversy. The CFPB's first director was a recess appointment by the President and was not confirmed by the Senate until July 2013. Legal challenges to the CFPB's structure and some of its enforcement actions are pending. And political disagreements about its proposed rules governing arbitration agreements and payday lending and its funding mechanism are just a few of the issues that have stirred differences of opinion and debate. None of that is expected to die down any time soon.

This retrospective of the Bureau's first five years of operations provides an overview of the Bureau's actions in the realms of rulemaking, supervision, and enforcement. It would be difficult to chronicle all of the agency's activities over the past half decade. The articles on the following pages, however, provide a fairly comprehensive snapshot of the rules the CFPB has written or proposed, the supervision program it has implemented, and the enforcement actions it has taken across the landscape of consumer financial services. Some of these articles appeared previously on our blog ([www.cfsreview.com](http://www.cfsreview.com)). Others appeared as Mayer Brown Legal Updates, and many are new analyses or summaries of the CFPB's actions.

The lawyers in Mayer Brown's Financial Services Regulatory & Enforcement practice have assisted clients with legal issues relating to the Bureau's rulemaking, supervisory, and enforcement authorities for the past five years. We are well-versed in both the underlying federal consumer financial laws and the Bureau's policies and procedures, and we are here to help our clients navigate the ever-changing regulatory landscape. Our lawyers have substantial experience in regulatory counseling, handling CFPB enforcement investigations and examinations, class action defense, and internal investigations.

We hope this retrospective proves informative and also reflects the breadth of our knowledge and experience. If you have questions about any of the articles, or wish to obtain further information, please feel free to contact the authors or other members of the Financial Services Regulatory & Enforcement practice directly.



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Mayer Brown’s global Financial Services Regulatory & Enforcement practice provides intelligent, forward-thinking solutions for financial services firms operating in today’s complex regulatory environment. We offer the full range of regulatory, enforcement, litigation, transactional and policy capabilities in order to comprehensively address the myriad issues facing the sector around the world. Our lawyers work with leading global financial institutions to provide thoughtful, creative, and practical solutions to their complex issues.

In the United States, our Consumer Financial Services group is considered a leading practice of its kind. The group includes a dedicated team of lawyers and professionals who advise residential mortgage lenders, non-mortgage consumer credit lenders and card and payment system operators with regard to the full panoply of federal and state laws that impact their businesses operations. Members of the group serve as trusted advisors in every aspect of the consumer lending industry, including licensing and approvals, regulatory compliance, government enforcement, internal investigations, class action defense, and public policy and government affairs.

Rulemaking

# RULEMAKING

# Rulemaking: An Overview

The CFPB has had a busy rulemaking agenda since it gained its authorities five years ago. Its first rulemaking tasks were the Congressionally-mandated mortgage rules, which have transformed both mortgage origination and servicing. The agency has also issued five larger participant rules, which have expanded its supervisory authority to the larger participants in the debt collection, consumer reporting, international money transfers, student loan servicing, and auto finance markets. Other substantial rulemakings are nearing completion – the agency has issued proposed rules regarding arbitration provisions, payday lending, and prepaid cards, all of which have the potential to dramatically impact the marketplace for consumer financial products and services.

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Beyond these rulemakings, the CFPB has embarked on other rulemakings, but none has yet reached the proposed rule stage. Nearly three years ago, in November 2013, the CFPB issued an Advance Notice of Proposed Rulemaking regarding debt collection. The CFPB has recently announced that it will be holding a public hearing on debt collection on July 28, 2016, when it is widely expected to announce an outline of the proposals it is considering for including in a proposed rule, in preparation for convening a review panel required by the Small Business Regulatory Enforcement Fairness Act. The CFPB has also engaged in pre-rulemaking activities regarding overdrafts, but has provided no timeline for issuance of a proposed rule. Similarly, after announcing nearly five years ago that it would “expeditiously” implement provisions of the Dodd-Frank Act concerning data collection on small business lending, the CFPB has yet to issue a proposed rule, although recent activity suggests that the agency is finally, if slowly, moving in that direction.

Notwithstanding the many rules the CFPB has yet to write, the rules it has written or proposed have had a profound effect on the mortgage market and the scope of the agency’s authority, and promise to have a similar impact on the use of arbitration provisions, payday lending, and prepaid products. We provide an overview of this rulemaking activity in the sections below.

# Mortgage Origination After Dodd-Frank: The New Normal

“Tsunami.” “Sea change.” “Barrage.” “Landslide.” In looking back, these are just a few of the ways we described the effect the Mortgage Reform Act portions of the Dodd-Frank Act were expected to have on the way lenders make residential mortgage loans. Certainly the Act touches nearly every aspect of the loan origination process, from the way lenders underwrite the loans, to the products they can offer, the disclosures they provide, the way they move the loans through the pipeline, and even how they compensate their loan officers. While experts debate whether the regulatory hurdles that the CFPB has promulgated will have a long-term effect on housing finance, it’s hard to disagree that the past five years have resulted in a “new normal” in mortgage origination.

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One aspect of the “new normal” relates to the way lenders underwrite closed-end residential mortgage loans. Beginning in 2011, the Federal Reserve Board (Board) (predating the transfer of authority to the CFPB) proposed regulations to implement the Dodd-Frank Act’s ability-to-repay requirements. The Board asked the public to consider two alternatives for defining a Qualified Mortgage (QM) that would be deemed to meet the ability-to-repay requirements. The first alternative QM would have had to meet a set of underwriting criteria and would have received a legal presumption of compliance. The other proposed alternative would confusingly have required complying with all the first set of criteria, plus the lender would have had to consider and verify additional underwriting factors. In spite of the fact that the second alternative QM would have imposed more underwriting burdens than the first, it would have provided only a rebuttable presumption of compliance with the ability-to-repay requirement, and thus very little legal certainty to lenders or their investors. The CFPB, after taking over authority for the rulemaking, finalized a safe harbor QM, and provided that the rebuttable presumption of compliance would apply only to QMs that meet higher-priced thresholds. Although the final QM definition imposed strict requirements (e.g., a 3 percent points-and-fees limit, a 43 percent debt-to-income ratio), the CFPB also provided a seven-year window during which Fannie Mae or Freddie Mac loans (the bulk of the market) qualify for QM status. Questions remain as to the potential for a non-QM market, and as to how the market will function when the agency QM status “sunsets.”

Another aspect of the new normal continues to have a large impact on the way mortgage lenders do business. That change also started with the Federal Reserve Board. Even prior to the Dodd-Frank Act, the Board, somewhat controversially, used its authority to prohibit unfair and deceptive mortgage loans and issued a rule to prohibit yield spread premiums or other loan originator compensation that is based on loan terms. That rule was delayed briefly due to litigation, but became effective in April 2011. The Board also imposed an anti-steering prohibition on brokers, allowing them to rely upon a complicated safe harbor by offering consumers specified loan options. When the CFPB then had to grapple with the Dodd-Frank Act and its loan originator compensation provisions, it found that the Act prohibited a creditor from imposing points or fees on the consumer if anyone other than the consumer pays the loan originator compensation. After an outcry from public commenters, the CFPB created an

## Mortgage Origination After Dodd-Frank: The New Normal

exception and discarded that prohibition, and even issued some clarifications that were helpful (although several ambiguities still exist). While loan-term based compensation to loan originators has been prohibited for over five years, some lenders and brokers are still struggling to structure their compensation plans in ways that both comply with the restrictions and encourage the recruiting and retention of great loan originators.

Ability-to-repay/QM and loan originator compensation, as new and different as they are, pale in comparison to the “tsunami landslide” that the CFPB created when it integrated the disclosures under the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA). Although we saw multiple iterations of the Loan Estimate (LE) and Closing Disclosure (CD) forms over the months leading up to the (delayed) effective date in October 2015, even the most well-prepared of us soon realized that TRID (as the integration rule came to be known, or “Know Before You Owe”) is much more than a new set of forms. TRID ushered in new responsibilities for lenders, title agents, and other settlement service providers, causing everyone to agonize over changes to systems and processes, and to spend an inordinate amount of time worried about the size of spaces and dashes. That agony is amplified by the fact that the two statutes – TRID and RESPA – have different liability schemes, so that suddenly it seemed that minor, technical variations in the disclosures from those presented in the regulations could create significant liability and enforcement risks, including for secondary market investors. Recently, in May 2016, the CFPB sought to provide some clarity regarding liability by mapping out the particular TILA section on which it relied in implementing each portion of the LE and the CD, but it emphasized that the mapping guide is not binding. The CFPB has promised to issue some binding TRID clarifications this summer, but it is still unclear what the rule will tackle. In the end, many agree that the forms

themselves are fine and that TRID would work smoothly so long as there are never any surprises and the loan transaction sails smoothly from start to finish. It’s just that so few of them do.

As if TRID did not create enough havoc, everything we know about the Home Mortgage Disclosure Act (“HMDA”) is about to change. From the institutions that must report (certain low-volume depository institutions may get a break, but certain nondepositories will get swept in), to the data and types of loans that must be reported (over 40 new data elements on a broader set of loans, including home equity lines of credit), to the way in the which the data must be reported (via a new web-based portal) – our systems, processes, and vendors will once again be taxed. In some ways the implementation of the HMDA changes may be easier than TRID, since arguably there are more objective elements to the rule, and fewer subjective nuances. However, the CFPB has emphasized the importance of accurate HMDA data submissions, and its frustration with lenders and their vendors in allegedly not preparing in advance for upcoming regulatory changes. Accordingly, a strategic plan for implementing HMDA changes is advised.

In all, CFPB rulemaking arising out of the implementation of the Dodd-Frank Mortgage Reform Act has changed nearly every aspect of mortgage loan origination – from the way we interact with consumers to the way we interact with our business partners and even our employees. A lot of lenders have expressed frustration about the weight of the regulatory burdens, and continue to wonder whether any or all of those burdens are really helping consumers understand the transaction or save any money. However, most lenders are at least learning to ride the wave. ♦



# Mortgage Servicing

Mortgage servicing has been among the Bureau's top regulatory priorities. On January 17, 2013, the Bureau released two final rules to amend and enhance the mortgage servicing requirements of the Truth-in-Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA).

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These new rules, which became effective on January 10, 2014, address a variety of different topics, with a particular focus on ensuring that consumers experiencing financial distress have a full and fair opportunity to take advantage of any loss mitigation options that may be available. While implementing these new rules has been a significant operational challenge, the Bureau has worked closely with the industry to identify and respond to issues as they arise.

The Bureau's servicing rules cover the following nine broad topics:

**Periodic billing statements.** The rules contain a new periodic statement requirement for closed-end residential mortgage loans, pursuant to which a servicer must provide a statement for each billing cycle. Such statements must satisfy particular timing, format, and content requirements – for example, among other information, the statement must inform the borrower of the minimum periodic payment due, the due date, transaction activity during the billing cycle, the outstanding balance, and the consequences of delinquency. The rule exempts fixed-rate loans from the periodic statement requirement if the servicer provides the consumer with a coupon book that meets certain requirements and the consumer may obtain additional delinquency-related information upon request.

**Interest-rate adjustment notices for ARMs.** The rules require servicers to provide two new notices in connection with adjustable-rate mortgage loans (or ARMs). First, a creditor, assignee, or servicer must provide an estimate of the new rate and payment between 210 and 240 days prior to the first payment that is due after an initial rate adjustment. A notice also is required between 60 and 120 days before payment at a new level is due when a rate adjustment causes the payment to change.

**Prompt payment crediting and payoff statements.** Under the rules, servicers must promptly credit periodic payments of principal, interest, and escrow (if applicable) as of the day of receipt. The rules also address how a servicer must treat partial or non-conforming payments and require servicers to provide an accurate payoff statement to the consumer not later than seven business days after written request.

**Lender-placed insurance.** A servicer may not charge a borrower for lender-placed hazard insurance unless the servicer has a reasonable basis to believe that the borrower has failed to maintain the minimum hazard insurance required under the terms of the loan documents, and has provided at least two required notices (the first at least 45 days prior to charging for

## Mortgage Servicing

lender-placed coverage, followed by a reminder notice at least 30 days later) in order to give the borrower an opportunity to provide proof of adequate coverage. If the borrower does provide such proof, the servicer must cancel any lender-placed insurance and refund any premiums paid for overlapping periods of coverage. Charges for such insurance must be for services actually performed and bear a reasonable relationship to the cost of providing such services. Finally, a servicer may not obtain a lender-placed insurance policy for a delinquent borrower with an escrow account, provided that the servicer is able to maintain the existing hazard insurance policy by advancing funds through the account.

**Error resolutions and information requests.** The rules outline the procedures that a servicer must follow in order to respond to written notices of error and requests for information that a servicer receives at the address (if any) that the servicer has designated for such purposes. Subject to certain exceptions, a servicer must acknowledge receipt of such a written communication within five days and: (i) with respect to a notice of error, correct the error within 30 days, or conduct an investigation within such period and inform the borrower in writing of the servicer's determination that no error has occurred; and (ii) with respect to requests for information, provide the requested information within 30 days or provide a written explanation of why the information is not available.

**Early intervention.** A servicer must make a good-faith attempt to establish live contact with a delinquent borrower no later than the 36th day of the borrower's delinquency in order to provide the borrower with information about loss mitigation options that may be available to them. The servicer also must provide the borrower with a written notice about available loss mitigation options no later than the 45th day of the borrower's delinquency.

**Continuity of contact.** The rules require servicers to provide delinquent borrowers with access to a single point of contact available to assist them throughout the loss mitigation and foreclosure process. Such personnel must be assigned no later than the 45th day of delinquency and, among other things, be able to: (i) provide the borrower with

loss mitigation assistance (assuming that loss mitigation options are available), including by advising on loss mitigation application status and giving the borrower accurate information about loss mitigation and foreclosure timelines; and (ii) access all information that has been provided by the borrower in connection with a loss mitigation request and relay that information to those responsible for evaluating the application.

**Loss mitigation procedures.** The rules take a process-oriented approach to loss mitigation. In other words, rather than requiring servicers to offer particular loss mitigation options, the rules focus on ensuring that a borrower receives an opportunity to be considered for all such options as are available. For any loss mitigation application received 45 days or more before a foreclosure sale, the servicer must determine whether the application is complete and provide a written notice within five days in order to inform the borrower of that determination, specifying any information required to complete the application and the date by which such information must be received. The servicer must exercise reasonable diligence in obtaining the documents and information that are necessary to complete the application. Once complete, the servicer has 30 days to evaluate the borrower for all loss mitigation options that are available (including both home retention and non-retention options). If the borrower's request is denied, the servicer must provide a written notice stating the basis for the denial and informing the borrower of certain appeal rights. Finally, the rule prohibits the so-called "dual-tracking" of loss mitigation and foreclosure processes. Specifically, a servicer may not make the first notice or filing required to start the foreclosure process until a borrower is at least 120 days delinquent. If a borrower submits a complete loss mitigation application before a servicer has made the first such notice or filing (or within certain timeframes before a scheduled foreclosure sale), the servicer may not initiate the foreclosure process until: (i) the application has been denied and appeal opportunities have been exhausted; (ii) the borrower declines or fails to accept an offered loss mitigation option; or (iii) the borrower fails to comply with the terms of a loss mitigation agreement.

## Mortgage Servicing

**General servicing policies and procedures.** Finally, the rules require servicers to establish policies and procedures that are reasonably designed to achieve certain objectives (taking into account the size, scope, and nature of the servicer’s operations), including with respect to: (i) providing accurate and timely information to borrowers, investors, and courts; (ii) properly evaluating loss mitigation applications; (iii) providing vendor and counterparty oversight; (iv) facilitating servicing transfers; and (v) informing borrowers of how to submit notices of error and requests for information. The rule also requires servicers to comply with certain documentation requirements and be able to compile a complete servicing file containing certain information upon regulatory request.

The initial release of the servicing rules has been followed by an iterative process of clarifications, amendments, revisions, and updates. In addition to three formal amendments to the servicing rules to resolve various operational challenges servicers have encountered,<sup>1</sup> the Bureau also has issued interpretive guidance and announcements on issues it considers to carry particular importance, such as the interplay between the servicing rules and other federal laws,<sup>2</sup> vendor management,<sup>3</sup> servicing transfers,<sup>4</sup> and the treatment of successors-in-interest.<sup>5</sup>

The Bureau also recently has proposed a number of additional substantive and technical changes after “outreach and monitoring with consumer advocacy groups, industry representatives, housing counselors and other stakeholders.” The adjustments contemplated in the proposed rule include:

(i) applying the rules to successors-in-interest to the property; (ii) requiring servicers to follow the required loss mitigation evaluation processes more than once during the life of the loan; (iii) requiring the foreclosure process to be abandoned if a servicer fails to comply with the prohibition on dual-tracking; (iv) clarifying how the loss mitigation process must be handled during a transfer of servicing; (v) revising the loss mitigation application receipt and evaluation process; (vi) narrowing the exemption from early intervention requirements for borrowers in bankruptcy or who have made a cease-and-desist request under the Fair Debt Collection Practices Act; and (vii) requiring servicers to send periodic statements to borrowers in bankruptcy (and providing model forms to specify how the relevant information should be presented to borrowers in the bankruptcy context). ♦

### Endnotes

<sup>1</sup> See 78 Fed. Reg. 44685 (July 24, 2013), 78 Fed. Reg. 60382 (Oct. 1, 2013) and 78 Fed. Reg. 62993 (Oct. 23, 2013).

<sup>2</sup> CFPB Bulletin 2013-12.

<sup>3</sup> CFPB Bulletin 2012-3.

<sup>4</sup> CFBP Bulletin 2014-01.

<sup>5</sup> 79 Fed. Reg. 41631 (July 17, 2014).

# Larger Participants of a Market for Consumer Financial Products or Services

Section 1024 of the Dodd-Frank Act gives the CFPB supervisory authority over all nonbank covered persons offering or providing three enumerated types of consumer financial products or services: (1) origination, brokerage, or servicing of consumer loans secured by real estate, and related mortgage loan modification or foreclosure relief services; (2) private education loans; and (3) payday loans. The CFPB also has supervisory authority over “larger participant[s] of a market for other consumer financial products or services,” as the CFPB defines by rule. The CFPB issued a rule with various procedures, definitions, standards, and protocols that apply to all markets in which the CFPB defines larger participants’ and rules covering larger participants of a market for the following five products: (i) automobile financing; (ii) international money transfer; (iii) student loan servicing; (iv) consumer debt collection; and (v) consumer reporting. The general rule and each one of the market specific rulemaking are briefly discussed below.

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## General Rule Applicable to Larger Participants

In July 2012, the CFPB published a final rule applicable to all subsequent rulemakings with respect to larger participant of a market for consumer financial products or services. The final rule provides generally applicable definitions and the criteria for disputing whether a person qualifies as a larger participant in a market. If a person receives a written communication from the CFPB indicating its intention to undertake supervisory activity, the person may respond by asserting that the person does not meet the definition of larger participant. This written response is required within 45 days of the written communication from the CFPB unless an extension is granted and must include an affidavit setting forth the basis for the person’s assertion. In addition, the person may submit documentary evidence and written arguments that it is not a larger participant. The CFPB may require submission of certain records, documents, and other information for purposes of assessing whether a person is a larger participant of a covered market.<sup>2</sup> Any nonbank that qualifies as a larger participant under a specific rule will remain a larger participant until two years after the first day of the tax year in which the person last met the applicable test.<sup>3</sup>

## Automobile Financing

In June 2015, the CFPB published a final rule defining a market for automobile financing that covers specific activities and sets forth a test to determine whether a nonbank covered person is a larger participant of that market.<sup>4</sup> The final rule defines a market for consumer financial products or services labeled “automobile financing” and establishes a test to determine which participants of the automobile financing market qualify as larger participants. The final rule defines “automobile financing” as providing or engaging in the transactions identified under the term “annual originations” as defined below.

Under the final rule, a nonbank that engages in automobile financing is a larger participant of the automobile financing market if it has at least 10,000 aggregate annual originations. The final rule defines “annual originations” to mean the sum of the following transactions for the

## Larger Participants of a Market for Consumer Financial Products or Services

preceding calendar year: (i) credit granted for the purchase of an automobile; (ii) refinancings of such obligations that are secured by an automobile; (iii) automobile leases; and (iv) purchases or acquisitions of any of the foregoing obligations. To determine a nonbank covered person's aggregate annual originations, the annual originations of a nonbank covered person must be aggregated with the annual originations of any person (other than a dealer that is excluded from larger-participant status) that was an affiliated company of the nonbank at any time during the preceding calendar year.

The term "annual originations" does not include investments in asset-backed securities. Furthermore, purchases or acquisitions by special purpose entities that are established for the purpose of facilitating asset-backed securities transactions are excluded from annual originations. Finally, certain auto dealers, including those that the Dodd-Frank Act excludes from the CFPB's jurisdiction, do not qualify as larger participants under the final rule.<sup>5</sup>

When promulgating the final rule, the CFPB estimated that under the rule it would have authority to supervise about 34 of the largest nonbank auto finance companies and their affiliated companies that engage in auto financing.<sup>6</sup>

### International Money Transfer

In December 2014, the CFPB published a final rule defining the international money transfer market that covers certain electronic transfers of funds sent by nonbanks that are international money transfer providers.<sup>7</sup> The final rule defines "international money transfer" to mean "the electronic transfer of funds requested by a sender to a designated recipient that is sent by an international money transfer provider. . . ."<sup>8</sup> The term applies regardless of whether the sender holds an account with the international money transfer provider, and regardless of whether the transaction is also an electronic fund transfer as defined in the CFPB's Regulation E. The final rule's definitions are modeled in part on the definitions of "remittance transfer" and related terms in the Electronic Fund Transfer Act and Regulation E, but are not co-extensive with those definitions.

The final rule sets forth a test to determine whether a nonbank is a larger participant of the international money

transfer market. An entity is considered a larger participant if it has at least one million aggregate annual international money transfers. When promulgating the final rule, the CFPB estimated that under the rule it would have authority to supervise approximately 25 of the largest nonbank international money transmitters.<sup>9</sup>

### Student Loan Servicing

In December 2013, the CFPB published a final rule defining the student loan servicing market that would cover the servicing of both federal and private student loans.<sup>10</sup> Under the final rule "student loan servicing" means (A) receiving loan payments (or receiving notification of payments) and applying payments to the borrower's account pursuant to the terms of the post-secondary education loan or of the contract governing the servicing; (B) during periods when no payments are required, maintaining account records and communicating with borrowers on behalf of loan holders; or (C) interactions with borrowers, including activities to help prevent default, conducted to facilitate the foregoing activities.

The final rule establishes a test based on the number of accounts on which an entity performs student loan servicing. The final rule defines the criterion "account volume," which reflects the number of accounts for which an entity and its affiliated companies were considered to perform student loan servicing as of December 31 of the prior calendar year. An entity is a larger participant if its account volume exceeds one million.

When promulgating the final rule, the CFPB estimated that under the rule it would have authority to supervise approximately 7 of the largest nonbank student loan servicers, which were currently servicing 49 million student loans.<sup>11</sup>

### Consumer Debt Collection

In December 2013, the CFPB published a final rule defining the market for consumer debt collection.<sup>12</sup> The market includes collection by a debt collector of debts incurred by consumers primarily for personal, family, or household purposes related to consumer financial products or services. The final rule broadly defines "debt collector" to include any person who

## Larger Participants of a Market for Consumer Financial Products or Services

uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due to another and any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts.”<sup>13</sup> The final rule excludes certain affiliates and non-profit organizations and any person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity: (A) concerns a debt which was originated by such person; or (B) concerns a debt that was not in default at the time it was obtained by such person.

The final rule establishes a test, based on “annual receipts,” to assess whether a nonbank engaging in consumer debt collection is a larger participant in this market. The test for qualifying as a larger participant of the consumer debt collection market is more than \$10 million in annual receipts resulting from relevant consumer debt collection activities. The definition of annual receipts excludes those receipts that result from collecting debts that were originally owed to a medical provider.

When promulgating the final rule, the CFPB estimated that under the rule it would have authority to supervise approximately 175 of the largest nonbank debt collectors.<sup>14</sup>

### Consumer Reporting

In July 2012, the CFPB published a final rule defining the market for consumer reporting.<sup>15</sup> The consumer reporting market is broadly defined as means collecting, analyzing, maintaining, or providing consumer report information or other account information used or expected to be used in any decision by another person regarding the offering or provision of any consumer financial product or service. This would generally include consumer reporting agencies selling consumer reports, consumer report resellers, analyzers of consumer reports and other account information (analyzers), and specialty consumer reporting agencies. The final rule generally excludes the following activities from the definition of “consumer reporting”: (A) collecting, analyzing maintaining or providing transaction and experience

information; (B) furnishing affiliate information to a consumer reporting entity; (C) authorizations or approvals of a specific extension of credit, and (D) providing information to be used solely in a decision regarding employment, government licensing, or residential leasing or tenancy.<sup>16</sup>

The final rule establishes a test, based on “annual receipts,” to determine whether a nonbank is a larger participant of the consumer reporting market. The definition of “annual receipts” is adapted from the definition of the term used by the Small Business Administration for purposes of defining small business concerns. A nonbank is a larger participant of the consumer reporting market if it has more than \$7 million in annual receipts resulting from relevant consumer reporting activities.

When promulgating the final rule, the CFPB estimated that under the rule it would have authority to supervise approximately 30 consumer reporting entities, which collectively had generated 94 percent of industry receipts among consumer reporting agencies.<sup>17</sup>

### Procedural Rule To Establish Supervisory Authority Over Certain Nonbank Covered Persons Based on Risk Determination

The CFPB has the authority to supervise (1) nonbank covered persons of any size that offer or provide: (a) Origination, brokerage, or servicing of loans secured by real estate for use by consumers primarily for personal, family or household purposes, or loan modification or foreclosure relief services in connection with such loans, (b) private education loans, and (c) payday loans; and (2) “larger participant[s] of a market for other consumer financial products or services, as described above. The CFPB also has the authority to supervise any nonbank covered person that the CFPB “has reasonable cause to determine, by order, after notice . . . and a reasonable opportunity . . . to respond . . . is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.”<sup>18</sup>

In July 2013, the CFPB published a final rule establishing the procedures by which a nonbank covered person may become subject to this supervisory authority of the CFPB.<sup>19</sup> The final rule is intended to provide guidance regarding the procedures

## Larger Participants of a Market for Consumer Financial Products or Services

by which the CFPB exercises this authority. The final rule sets forth the procedures relating to the determination process, including: (1) Issuing a notice commencing a proceeding (“Notice”), (2) contents of a Notice of Reasonable Cause, (3) service of a Notice, (4) response to a Notice, (5) conduct of a supplemental oral response, (6) manner of filing and serving papers, (7) issuance of recommended determinations, (8) determinations by the Director, (9) voluntary consent to CFPB’s authority, (10) notice and response included in an adjudication proceeding otherwise brought by the CFPB, and (11) relief available sought in a civil action or administrative adjudication.

Under the final rule, receipt of a Notice does not constitute a notice of charges for any alleged violation of Federal consumer financial law or other law. Proceedings under the final rule are informal and do not constitute an adjudication proceeding with a hearing on the record under the Administrative Procedure Act. ♦

### Endnotes

<sup>1</sup> 12 C.F.R. §§ 1090.100 – 1090.103.

<sup>2</sup> 12 C.F.R. § 1090.103(d).

<sup>3</sup> 12 C.F.R. § 1090.102.

<sup>4</sup> 80 Fed. Reg. 37495 (June 30, 2015) (effective August 31, 2015)(codified at 12 C.F.R.§1090.108).

<sup>5</sup> 12 C.F.R. § 1090.108(c).

<sup>6</sup> 80 Fed. Reg. 37495, 37514.

<sup>7</sup> 79 Fed. Reg. 56631 (Dec. 1, 2014) (effective December 1, 2014) (codified at 12 C.F.R. § 1090.107).

<sup>8</sup> 12 C.F.R. § 1090.107(a).

<sup>9</sup> 79 Fed. Reg. 56631, 56643.

<sup>10</sup> 78 Fed. Reg. 73383 (Dec. 6, 2013) (effective March 1, 2014) (codified at 12 C.F.R. § 1090.106).

<sup>11</sup> 78 Fed. Reg. 73383, 73399.

<sup>12</sup> 77 Fed. Reg. 65775 (Oct. 31, 2012) (effective January 2, 2013) (codified at 12 C.F.R.§1090.105); 77 Fed. Reg. 72913 (Dec. 7, 2012)(correction).

<sup>13</sup> 12 C.F.R. § 1090.105(a).

<sup>14</sup> 77 Fed. Reg. 65775, 65797.

<sup>15</sup> 77 Fed. Reg. 42873 (July 20, 2012) (effective September 30, 2012) (codified at 12 C.F.R.§1090.104).

<sup>16</sup> 12 C.F.R. § 1090.106(a).

<sup>17</sup> 77 Fed. Reg. 42873, 42889.

<sup>18</sup> 12 U.S.C. § 5514(a)(1)(C).

<sup>19</sup> 78 Fed. Reg. 40352 (July 3, 2013) (effective August 2, 2013)(codified at 12 C.F.R. Part 1091).

# The CFPB's Payday Proposal: Broader Than One May Think

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Consumer lenders have a lot of reading to do these days. The CFPB recently proposed new ability-to-repay and other requirements applicable to a wide range of short-term and longer-term consumer loans. While the CFPB seeks to address unfair and abusive “debt traps” in payday, title and other high-cost loans, the 1334-page proposal is important not just to payday lenders but also to servicers of covered loans and consumer reporting agencies. And as the proposal represents the CFPB’s first significant attempt at rulemaking under its authority to address unfair, deceptive, and abusive acts and practices (UDAAPs), rather than to implement provisions of a specific federal consumer financial law, the broader consumer financial services industry should take note of what the proposal suggests regarding the agency’s thought process.

The proposed rule includes requirements for ability-to-repay determinations, payment processing, and reporting in connection with certain loans. The proposal generally covers loans of 45 days or less as well as certain longer-term loans that have an annual cost of credit of more than 36 percent and that include what the CFPB calls a “leverage payment mechanism” or a non-purchase-money security interest in a vehicle. This Legal Update describes the CFPB’s use of its UDAAP authority, the types of consumer loans to which the proposal would and would not apply, and the proposed ability-to-repay requirement. It also describes other proposed restrictions and requirements for covered loans.

Comments on the CFPB’s proposal are due September 14, 2016, and will supplement the public input the agency previously received on its [initial outline from last year](#). After the CFPB finalizes its rule, it intends to provide a 15-month implementation timeline. If interested parties or groups challenge the rulemaking, that effective date could be pushed back further. Of course, the CFPB can in the meantime pursue lenders engaging in unfair, deceptive or abusive practices, including those in areas beyond the payday lending arena.

## A Medley of Rulemaking Authorities

The proposal marks the CFPB’s first significant use of UDAAP rulemaking authority, providing lessons for payday and other lenders that are directly affected by the proposal as well as other companies subject to the CFPB’s authority.

## IDENTIFYING UDAAPs

The Dodd-Frank Act authorizes the CFPB to prescribe rules identifying acts or practices as unfair, deceptive, or abusive, as well as to enforce the Act’s UDAAP prohibition. In its proposal, the CFPB has identified two practices as both unfair and abusive: to make a



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covered loan without reasonably determining that the consumer will have the ability to repay the loan, and to attempt to withdraw payment from a consumer's account in connection with a covered loan after the lender's second consecutive attempt has failed due to a lack of sufficient funds, unless the lender obtains the consumer's new authorization. The CFPB has not chosen to identify any practices as "deceptive" in the proposed rule, although it has the authority to do so.

Unfairness has a well-established statutory definition that focuses on whether there is likely to be substantial injury to consumers, whether the substantial injury is reasonably avoidable by the consumers, and whether the substantial injury is outweighed by countervailing benefits to competition. A secondary consideration is "established public policies."

The CFPB's analysis of abusiveness is more novel because this concept did not exist before the agency was created. For purposes of this rulemaking, the CFPB indicates that the practices it identifies "take unreasonable advantage of ... a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service," and/or "take unreasonable advantage of ... the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service."

The CFPB states that it recognizes that any consumer financial transaction may involve some "information asymmetry" between the consumer and the financial institution as well as uneven bargaining power. While the agency acknowledges that a market economy demands that financial institutions pursue their self-interests, the agency takes the position that they must not leverage their superior information or bargaining power to take "unreasonable advantage," and it is up to the CFPB to determine, based on all the facts and circumstances, when that line has been crossed.

### PREVENTING UDAAPs

The CFPB does not stop, however, with merely requiring an ability-to-repay determination or prohibiting repeated attempts to withdraw funds from an insufficient account. Instead, the agency proposes a number of additional, specific

requirements and alternatives for lenders in underwriting and offering these loans, as well as certain specific requirements regarding payment processing, all of which are discussed in greater detail below. Among other rulemaking authorities, the CFPB indicates that many of these additional detailed requirements are necessary "for the purpose of preventing" the unfair and abusive practices that it has identified. The CFPB asserts, based on case law regarding Federal Trade Commission rulemaking on unfair practices, that it can impose preventative requirements as long as there is a "reasonable relation" between those requirements and the unfair or abusive practices that it has identified.<sup>1</sup>

### CONDITIONAL EXEMPTIONS

The Dodd-Frank Act also authorizes the CFPB to "conditionally exempt" classes of products or services from a rule after considering certain statutory factors. Using that authority, the CFPB has proposed several conditional exemptions, or safe harbors, for certain products, allowing those products to be offered without the full ability-to-repay analysis. A failure to comply with the conditions specified by the CFPB would not generally be an unfair or abusive practice in itself, but would subject the transaction to the regular requirements for a full ability-to-repay analysis.

### ANTI-EVASION

Additionally, the Dodd-Frank Act authorizes the CFPB to prescribe rules "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."<sup>2</sup> The CFPB has relied on this authority for several elements of the proposed rule, including an anti-evasion clause. In determining whether a person is evading the requirements of the rule, the CFPB would consider whether all relevant facts and circumstances reveal "the presence of a purpose that is not a legitimate business purpose."<sup>3</sup>

The CFPB also emphasizes that it will consider whether other practices akin to those addressed in its proposal are unfair, deceptive or abusive in connection with other types of loans. Thus, technical compliance with the rule, or structuring

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products so that they technically fall outside the scope of the rule, may not guarantee that a company escapes scrutiny or liability.

### ENFORCEMENT OF THE PROPOSED RULE

If finalized, the proposed rule would be enforceable by the CFPB, the Federal Trade Commission, the federal banking agencies, state attorneys general and/or certain state banking regulators, depending on the circumstances. The CFPB may be able to obtain civil money penalties of as much as \$1,087,450 per each day that each violation continued as well as disgorgement, consumer restitution, and/or other relief.<sup>4</sup>

### LESSONS FOR FUTURE CFPB RULEMAKING

Going forward, the CFPB may issue a number of additional rules that rely on its UDAAP rulemaking authority. In particular, the CFPB is working on a debt collection rulemaking to impose requirements on various entities that collect debts but are not subject to the Fair Debt Collection Practices Act (FDCPA). The CFPB is also developing a regulation regarding overdraft practices that might exercise its UDAAP authority.

If this proposal is any guide, one lesson for future UDAAP rulemakings is that the CFPB may not stop at simply identifying and prohibiting UDAAPs themselves. It may also deploy additional authorities to impose a variety of procedures, disclosures, model forms and/or registration requirements.

### The Proposal

The CFPB proposes to impose requirements on two types of consumer credit transactions.<sup>5</sup> The two types of loans contemplated by the rule would be differentiated by contractual duration, with “covered short-term loans” generally being loans with contractual durations of 45 days or less and “covered longer-term loans” being loans with contractual durations in excess of 45 days and subject to additional restrictions. More specifically:

- i. **Covered short-term loans** would include any single-advance, closed-end loan requiring the consumer to repay substantially the entire amount of the loan within 45 days of consummation and any

multiple-advance, closed-end or open-end loan requiring the consumer to repay substantially the entire amount of each advance under the loan within 45 days of the advance;<sup>6</sup> and

- ii. **Covered longer-term loans** would include consumer loans of longer duration than covered short-term loans if (a) the total cost of credit for the loan exceeds 36 percent per year and (b) the lender obtains either a “leveraged payment mechanism” (discussed further below) or a non-purchase-money security interest in the consumer’s vehicle no later than 72 hours after the consumer receives the entire amount of the loan.<sup>7</sup>

### “COST OF CREDIT” FOR COVERED LONGER-TERM LOANS

When determining whether a loan is a “covered longer-term loan,” the “cost of credit” would be similar to an annual percentage rate (APR) calculation under the federal Truth in Lending Act (TILA) and Regulation Z. But the calculation would take into account certain fees not otherwise considered finance charges for TILA purposes, including: (i) charges incurred in connection with credit insurance, debt cancellation or debt suspension plans no later than 72 hours after the consumer receives the entire amount of the loan, even if excludable from the finance charge under TILA; (ii) charges incurred in connection with credit-related ancillary products such as credit report monitoring or identity theft prevention products that are sold in connection with the loan (even by third parties not affiliated with the creditor) no later than 72 hours after the consumer receives the entire amount of the loan; (iii) application fees; and (iv) plan participation fees.<sup>8</sup>

For open-end credit, the calculation must use the TILA rules to determine an effective APR for a billing cycle, assuming full credit line utilization. The method for calculating the cost of credit for open-end accounts may serve as a trap for certain open-end lenders who may not believe they are offering higher-cost products because it treats fees as applying within a single billing cycle even if they cover the cost of line access or a credit-related product or service for a period extending beyond one billing cycle. CFPB commentary to the proposal presents an example of an open-end account: (i) with a \$500

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credit limit; (ii) repayable over monthly billing cycles through recurring Electronic Funds Transfers (EFTs), though not requiring full repayment of advances each month; (iii) bearing periodic interest at an annual rate of 8.25 percent (or 0.6875 percent per month); and (iv) for which the creditor charges a \$25 fee when the account is opened and annually thereafter. The comment clarifies that this account would have a cost of credit of 68.26 percent for the purposes of the proposal and would therefore be a “covered longer-term loan.” The calculation involves treating the sum of \$3.44 in periodic interest (the periodic rate applied to a fully utilized line for one monthly billing cycle) and the full \$25 fee as the applicable cost for a monthly billing cycle, multiplying by 12 billing cycles and dividing the resulting total of \$341.28 by the \$500 fully-utilized line.<sup>9</sup> Were the \$25 participation fee spread out over the period to which it applies rather than being treated as charged each monthly billing cycle, the annualized cost of credit would arguably be only 13.25 percent. A consumer having \$500 outstanding on the account for a period of one year (corresponding to the period over which the \$25 participation fee applies) would pay total charges of \$41.25 in periodic interest (assuming no compounding) and a single \$25 participation fee for a total cost of \$66.25. Interest application rules such as compounding would change the calculation slightly but would not result in a cost anywhere near the \$341.28 implied by the CFPB's calculation.

### “LEVERAGED PAYMENT MECHANISM” FOR COVERED LONGER-TERM LOANS

In developing its proposal, the CFPB assumed that the combination of higher-priced loans with the “preferred payment position derived from a leveraged payment mechanism or vehicle security” would reduce a lender's incentive to underwrite a consumer's ability to repay. The ability to recover funds from consumers' deposit accounts, sources of income, or vehicles could result in circumstances in which higher-priced loans are underwritten based on collateral sufficiency rather than on a consumer's ability to repay.<sup>10</sup> Accordingly, the CFPB proposes to cover longer-term loans when they provide the creditor a “leveraged payment mechanism” or non-purchase-money security interest in the consumer's vehicle.

“Leveraged payment mechanisms” would include a variety of means of accessing consumer deposit accounts or sources of income, including: (i) the right to initiate transfers from a consumer's account other than by initiating a one-time EFT immediately after the consumer authorizes the transfer; (ii) the right to obtain payment directly from the consumer's employer or other source of income; or (iii) requiring the consumer to repay through a payroll deduction or deduction from another source of income. Commentary to the proposal clarifies that a lender will be deemed to have obtained a leveraged payment mechanism or non-purchase-money security interest in the consumer's vehicle no later than 72 hours after the consumer receives the entire amount of the loan if: (i) the lender actually obtains the mechanism or interest within that timeframe; or (ii) the consumer becomes contractually obligated within that time to provide the mechanism or interest after the expiration of the 72-hour window.

### PRODUCTS EXEMPTED FROM THE PROPOSAL'S REQUIREMENTS

While the CFPB proposal applies to a wide range of consumer credit transactions, there are six product-level exemptions:

- i. Purchase money loans in which a security interest is taken in purchased goods (including purchase-money vehicle loans) and that are for the sole and express purpose of financing a consumer's initial purchase of a good;
- ii. Residential mortgage loans;
- iii. Credit card accounts subject to the Credit CARD Act of 2009 (i.e., any “credit card account under an open-end (not home-secured) consumer credit plan” as defined by Regulation Z);
- iv. Student loans;
- v. Non-recourse pawn transactions in which the consumer does not retain possession and use of the pledged collateral during the term of the loan; and
- vi. Overdraft services and lines of credit (including such products when offered in connection with prepaid cards).<sup>11</sup>

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As with many provisions of the proposal, the CFPB expressly solicits comments regarding whether it has drawn appropriate boundaries for exempted products. In addition, the CFPB warns that it “may consider on a case-by-case basis, through its supervisory or enforcement activities, whether practices akin to those addressed [in the proposal] are unfair, deceptive, or abusive in connection with loans not covered by this proposal.”<sup>12</sup>

### Ability-to-Repay Requirements

The proposal would create a multi-tiered underwriting requirement for covered short-term and longer-term loans. In general, the lender would be required to make a reasonable determination that the consumer will have the ability to repay such loans. The lender generally would have to verify certain consumer information and conclude that the consumer's income will be sufficient to make the payments under the loan while also covering the consumer's major financial obligations and basic living expenses. As explained below, presumptions of inability to repay would apply in certain circumstances and would be different for covered short-term and longer-term loans. Moreover, lenders would be able to avoid application of the general requirement by originating a safe-harbor product.

For traditional payday lending, the exceptions may swallow the rule. Comprehensive underwriting for small-dollar loans may be difficult, so lenders may stick with the proposed safe-harbor products described below. For these safe-harbor products, there will be strict limits on loan size and the number and duration of loans that may be taken out by a single borrower in a 12-month period as well as limits on repeat borrowing.

For longer-term loans, lenders in the prime, near-prime and top-end of the sub-prime categories may choose to avoid the rule altogether by limiting the cost of credit to 36 percent.

### GENERAL UNDERWRITING REQUIREMENTS

Under the proposal, covered loans would be subject to a general ability-to-repay requirement. For closed-end covered loans, the ability-to-repay determination would have

to be made prior to consummation. For open-end covered loans, the ability-to-repay determination would have to be made prior to the initial advance or increase in available credit and then again for an additional advance taken more than 180 days after the date of the prior ability-to-repay determination.

To verify the consumer's income for the ability-to-repay determination, the lender must obtain reliable records such as records from the income source itself or transaction records from a consumer's depository or prepaid account. The lender must obtain a credit report on the consumer in order to verify debt and child support obligations. The lender also must analyze its own records and those of its affiliates. In addition, the lender must obtain a consumer report from a registered “information system” (if such a system is available, as discussed below). The lender also may need to obtain a lease or other records in order to verify housing expenses or find a reliable method of estimating a consumer's housing expense based on the housing expenses of consumers with households in the same locality.

In addition, the lender would have to obtain a written statement from the consumer that explains the amount and timing of the consumer's income and major financial obligations. While the consumer's statement is not wholly reliable on its own, the CFPB explains that it is an important component for projecting future net income and payments because it is often helpful in resolving ambiguities that arise in the verification evidence.

For a covered short-term loan, the ability-to-repay determination would require a reasonable conclusion that:

- i. The consumer's residual income will be sufficient to make all payments under the loan and to meet basic living expenses for the shorter of the term of the loan or 45 days following consummation; and
- ii. The consumer will be able to make payments required for major financial obligations as they fall due, to make any remaining payments under the loan and to meet basic living expenses for 30 days after the due date of the highest payment required under the loan.

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The CFPB notes that most covered short-term loans are due in a single payment, so this standard would require the lender to determine that even after making that payment, the consumer will still be able to meet his/her living expenses. For a covered longer-term loan, the lender must conclude that the consumer can repay the loan and his/her basic living expenses over the term of the loan.<sup>13</sup>

The lender would have to determine that the consumer can make his or her payments “as they fall due.” Proposed commentary would provide an example in which: (i) a covered loan requires a payment on April 29 that will “consume all but \$1,000 of the consumer’s last paycheck preceding or coinciding with the date of the loan payment;” (ii) the consumer will not receive another paycheck until May 13; and (iii) the consumer will have a \$950 rent payment and a \$200 student loan payment due on May 1 and May 5, respectively.<sup>14</sup> Since the consumer will not have sufficient income after the covered loan payment to make the two major debt obligation payments “as they fall due,” the lender cannot make a reasonable determination that the borrower has the ability to repay the loan.

### PROVISIONS SPECIFIC TO COVERED SHORT-TERM LOANS

#### *Prohibitions and Rebuttable Presumptions Related to Inability to Repay*

Since the CFPB is seeking to eliminate what it perceives to be the debt traps that may be lurking unfairly in payday, title, or certain other loans, the proposal would establish certain absolute prohibitions concerning the consumer’s inability to repay as well as certain presumptions that can be rebutted with evidence. To effectuate the prohibitions and rebuttable presumptions, the proposal requires that lenders review the consumer’s borrowing history, relying on the records of the lender and its affiliates as well as a consumer report obtained from a “registered information system.”

Lenders would be prohibited from making a covered short-term loan: (i) if the loan would be the fourth in a sequence of covered short-term loans made under the general underwriting requirement without the consumer taking a 30-day cooling-off period between two such loans;

or (ii) following a short-term safe-harbor loan, unless the borrower takes a 30-day cooling-off period.

The rule also proposes limitations on covered short-term loans (i.e., rebuttable presumptions of inability to repay) that apply unless the lender can show that the consumer will have sufficient improvement in financial capacity to repay the new loan. For instance, the rule would generally require a 30-day cooling-off period after repaying a covered short-term loan and before obtaining a new covered short-term loan. However, that cooling-off period does not apply in the following circumstances:

- i. The consumer has repaid the prior loan and the new loan would be limited in amount (including all charges) to half the prior loan, and the term of the new loan is not longer than the period over which the consumer made a payment(s) on the prior loan;
- ii. Rolling a prior loan into a new loan generally represents a declining balance (i.e., considering the rolled-over remaining balance and the new loan, the consumer would not owe more than he or she paid on the prior loan), and the term of the new loan is not longer than the period over which the consumer made a payment(s) on the existing loan; or
- iii. The lender reasonably determines, based on reliable evidence, that the consumer’s financial capacity is sufficiently improved since obtaining the prior loan, despite the unaffordability of that loan.

The rule proposes important specifications for implementing these exceptions.

The rule also would generally require a 30-day cooling-off period after repaying a covered longer-term balloon payment loan. It would also generally prohibit making a covered short-term loan to a consumer who has any loan outstanding with the lender or its affiliate if: (i) there are specified indications of financial distress; (ii) the first payment will be due after the consumer would have to make a payment on the outstanding loan; or (iii) the proceeds of the new loan are not much more than the impending payments due on the outstanding loan. However, both this cooling-off period after a longer-term balloon loan and the restrictions on loans

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to a current customer could be avoided if the lender can demonstrate that the consumer's financial capacity has sufficiently improved.

While it is clear the CFPB has set its targets on certain lending circumstances that could create a cycle of improper debt, its web of specifications, restrictions, prohibitions, rebuttable presumptions, and conditional exceptions will be difficult for lenders to absorb and implement. The CFPB's proposal would create a strong incentive to avoid that web by making safe-harbor loans as described below.

### *Short-Term Safe-Harbor Loans*

A lender making a covered short-term loan may avoid the application of the general ability-to-repay requirement and the prohibitions and presumptions described above by originating a loan that fits within the CFPB's proposed safe harbor. The CFPB designed its short-term safe-harbor loan to allow borrowers to step down to lower debt levels and avoid a perpetual cycle of debt. In order to take advantage of this safe harbor, a lender's short-term loan would have to meet the rule's restrictions on loan amount and declining balances (as described below), the loan must be closed-end and fully amortizing, and the lender must not take an interest in the consumer's vehicle. The lender may only make up to three such loans in a sequence, after which the lender would need to provide a 30-day cooling-off period.

As indicated above, although the lender may make up to three safe-harbor loans in a row, the first loan cannot exceed \$500, and the second and third loans in the sequence must have principal balances not more than two-thirds and one-third of the amount of the initial loan, respectively. In any consecutive 12-month period, the consumer may not have more than six covered short-term loans outstanding or have covered short-term loans outstanding for an aggregate period of more than 90 days. The lender would have to verify the consumer's borrowing history to ensure that: (i) the consumer does not have an outstanding covered loan that the lender would be rolling over; (ii) the consumer does not have, and has not had in the past 30 days, an outstanding covered short-term loan (other than a safe-harbor loan as described above) or a covered longer-term balloon payment loan; and (iii) the loan would not be the fourth in a sequence of

short-term safe-harbor loans made without a 30-day cooling-off period.

The proposal requires, and includes model forms for, disclosures for each of the loans in the sequence. The rule would allow, but would not require, making the disclosures in a language other than English, although the lender would have to make English language disclosures available upon request.

### PROVISIONS SPECIFIC TO COVERED LONGER-TERM LOANS

#### *Prohibitions and Rebuttable Presumptions Related to Inability to Repay*

Covered longer-term loans are subject to somewhat different prohibitions and rebuttable presumptions.

First, a lender would be prohibited from making a covered longer-term loan while the consumer has a safe-harbor short-term loan from that lender or its affiliate that is outstanding and for 30 days thereafter.

Second, similar to the proposal for covered short-term loans, the rule would generally require a 30-day cooling-off period before making a covered longer-term loan to a consumer after he or she pays off a covered short-term loan or a longer-term balloon payment loan. However, the rule would establish that restriction as a rebuttable presumption of inability to repay. The cooling-off period would not be required if:

- i. Every payment on the new covered longer-term loan would be substantially smaller than the largest required payment on the prior loan; or
- ii. The lender reasonably determines, based on reliable evidence, that the consumer's financial capacity is sufficiently improved since obtaining the prior loan despite the unaffordability of that loan.

The rule would also generally prohibit making a covered longer-term loan to a consumer who has any loan outstanding with the lender or its affiliate if: (i) there are specified indications of financial distress; (ii) the first payment will be due after the consumer would have to make a payment on the

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outstanding loan; or (iii) the proceeds of the new loan are not much more than the impending payments due on the outstanding loan. However, that prohibition would not apply if: (i) the size of every payment on the new loan would be substantially smaller than the size of every payment on the outstanding loan; (ii) the new loan would result in a substantial reduction in the total cost of credit; or (iii) the lender can demonstrate that the consumer's financial capacity has sufficiently improved since obtaining the prior unaffordable loan.

Rebuttable presumptions of an inability to repay would apply to:

- i. Any covered longer-term loan taken out while a covered short-term loan or a covered longer-term balloon loan made under the general underwriting requirements is outstanding, or within 30 days thereafter, unless every payment of the new loan would be substantially smaller than the largest required payment on the old loan; and
- ii. Any covered longer-term loan taken out while the consumer has a covered or non-covered loan outstanding that was made or serviced with the lender or its affiliate and for which the consumer shows certain signs of financial distress or the relationship between the new and old loans suggests the borrower had been captured by a cycle of debt. This rebuttable presumption would not apply if each payment under the new loan would be substantially smaller than each payment under the old loan, or the new loan would result in a substantial reduction in the total cost of credit relative to the old loan.

### *Longer-Term Safe-Harbor Loans*

The proposal also establishes two safe-harbor products for covered longer-term loans.

The first safe-harbor product is modeled on the National Credit Union Administration (NCUA) Payday Alternative Loan.<sup>15</sup> To take advantage of the safe harbor and generally avoid the restrictions and requirements described above: (i) the loan must be a closed-end loan, between \$200 and \$1,000 in principal amount and not more than six months in duration; (ii) the loan must be repayable in two or more fully

amortizing, substantially equal payments due no less frequently than monthly; and (iii) the total cost of credit must not be more than the permissible cost for an NCUA Payday Alternative Loan (currently 28 percent periodic interest plus an application fee up to \$20).<sup>16</sup> The loan must not contain a prepayment penalty or provisions permitting any lender to sweep the consumer's deposit account to a negative balance, exercise a set-off right, place a hold on the account or close the account in response to an actual or expected delinquency or default on the loan.

A lender making this first type of longer-term safe-harbor loan would be required to review its records and the records of its affiliates to ensure that the consumer is not indebted to the lender or its affiliates on more than three loans originated under this safe harbor in any given 180-day period. In addition, the lender must maintain and comply with policies and procedures for documenting proof of recurring income.

The second longer-term safe-harbor product is a closed-end loan of up to 24 months. Similar to the first safe-harbor product, the loan would have to be repayable in two or more fully amortizing payments with substantially equal periodic payments due no less frequently than monthly. The total cost of credit for the loan would have to be no greater than 36 percent plus the value of a limited origination fee. The loan must not contain a prepayment penalty or permit a lender to sweep the consumer's deposit account to a negative balance, exercise a set-off right, place a hold on the account or close the account in response to an actual or expected delinquency or default on the loan. A lender making this second type of longer-term safe-harbor loan would be required to review its records and the records of its affiliates to ensure that the consumer is not indebted to the lender or its affiliates on more than two loans originated under the second safe harbor in any given 180-day period.

In addition, this second type of safe-harbor longer-term loan would essentially require the lender to maintain a portfolio default rate on those loans that is no higher than 5 percent per year. If the lender's default rate exceeds that amount, the lender would be required to refund all the origination fees charged to borrowers for those loans over that year. The default rate for this purpose relates to safe-harbor loans that have either been at least 120 days' delinquent or were

## The CFPB's Payday Proposal: Broader Than One May Think

charged off during that year, and the percentage is measured based on outstanding balances (not number of loans). The need to refund those origination fees based on an excessive default rate would not, however, affect the safe-harbor status of the loan or the lender's ability to make safe-harbor loans going forward.

In its 2015 outline for this proposal, the CFPB described an NCUA-type product as one of two safe harbors that would comply with the ability-to-repay requirement.<sup>17</sup> However, the outline's safe-harbor loan could have been no longer than six months, but it had no portfolio default aspect and would have generally permitted the payment on the loan to be as much as 5 percent of the consumer's income. Several banks indicated support for "5% of income" payday loan products. While the CFPB apparently decided not to propose such a safe-harbor product, it is unclear whether banks or other lenders would be willing to bear the risk of the proposed portfolio default refund provision. Lenders may find more flexibility in the fact that the proposed product may be longer in duration (24 months, as opposed to six months as described in the outline), particularly if they can avoid the complexity of verifying the consumer's income.

### Additional Obligations for Lenders and Servicers of Covered Loans

#### PAYMENT PROCESSING REQUIREMENTS

The proposal addresses CFPB concerns that the servicer of a covered loan might routinely attempt to draw payment from a consumer's account even when it knows, or has reason to know, that the consumer does not have sufficient funds in the account to make the required payment. Such a practice may result in the consumer being charged multiple non-sufficient funds (NSF) fees from the servicer and/or the institution holding the consumer's account.

Accordingly, the proposal would generally limit a servicer to two consecutive failed attempts at withdrawing payments from a consumer's account before the servicer would be required to obtain a new payment authorization from the consumer. A new payment authorization obtained after two failed attempts must either be a signed, written authorization or an oral authorization provided on a recorded telephone

call that is later memorialized by the servicer in writing no later than the date on which the first payment transfer attempt under the new authorization is initiated. The proposal requires several disclosures to be made in connection with payment attempts and provides model forms for each such disclosure.

#### INFORMATION FURNISHING REQUIREMENTS

Various provisions of the proposal relating to presumptions of inability-to-repay and safe-harbor loan products require the lender to assess the consumer's covered loan borrowing history. In order to facilitate these requirements, the proposal requires certain information to be furnished to "information systems" and/or traditional national consumer reporting agencies for all covered loans. All of the proposal's information furnishing requirements formally apply to the lender, though some of the requirements relating to information furnishing for outstanding and satisfied loans will likely be implemented by loan servicers on lenders' behalf.

For covered loans other than longer-term safe-harbor loans, the lender must furnish certain information to each "information system" that, as of the date the loan is consummated, has been registered or provisionally registered with the CFPB for 120 days or more or that has moved from provisional registration to full registration. Information must be submitted at or before consummation, while the loan is outstanding and when the loan ceases to be an outstanding loan (i.e., when the loan is fully repaid or when the loan reaches 180 days' delinquency). The information to be furnished includes information regarding the terms of the loan, how it was originated and its payment status. Information must be furnished in a format acceptable to each information system.

For longer-term safe-harbor loans, the lender may choose the manner in which it will furnish information. It may choose to furnish information to registered "information systems" as would be required for all other covered loans. Alternatively, it may furnish information to a national consumer reporting agency at the earlier of: (i) the time of the lender's next regularly scheduled furnishing to such consumer reporting agency; or (ii) within 30 days of consummation of the loan.



# The CFPB's Payday Proposal: Broader Than One May Think

## COMPLIANCE SYSTEM AND RECORDKEEPING REQUIREMENTS

The proposal also establishes various ancillary requirements intended to develop a broader compliance structure around the core ability-to-repay requirements and to permit the CFPB to enforce the requirements. First, it is not sufficient to simply comply with the substantive requirements of the proposed rule. Each lender making covered loans must develop and follow a compliance program, including written policies and procedures, that is reasonably designed to ensure compliance with the requirements of the proposal. Second, lenders must retain certain records for 36 months after the date on which any covered loan ceases to be an outstanding loan. Records required to be retained include: (i) each covered loan agreement; (ii) consumer reports obtained from registered information systems; (iii) verification evidence in connection with covered loans, including statements obtained from the consumer; (iv) payment transfer authorization documents; (v) information regarding underwriting calculations for loans originated under the general underwriting requirements; (vi) information regarding exceptions to the ability-to-repay requirement or overcoming a presumption of inability to repay; (vii) information regarding loan types and terms; and (viii) information regarding payment history and loan performance. Some of these records must be maintained as electronic records in a tabular format and must contain specific required elements.

### Registered Information Systems

To facilitate compliance with the rule's underwriting requirements, the CFPB proposes to establish a process for registering "information systems" to which lenders would be required to furnish information about most covered loans and from which lenders would be required to obtain consumer reports when originating covered loans. Under the rule, entities seeking to become registered information systems before the effective date of the proposal's information system provisions could apply for preliminary approval; those seeking to register after the effective date would first need to be provisionally registered for a period of time.

In order to become registered, an entity must demonstrate that it meets the following criteria: (i) has the ability to receive furnished information; (ii) has the ability to generate

consumer reports containing information substantially simultaneously as it is received; (iii) performs or will perform in a manner that facilitates compliance with the proposal; (iv) has an acceptable compliance program with respect to federal consumer financial laws; and (v) has an acceptable information security program. The entity must also consent to being supervised by the CFPB. In all cases, the entity's compliance management and information security programs must be assessed to the satisfaction of a qualified, objective and independent third party.

## Conclusion

The CFPB's first UDAAP rulemaking proposal, if finalized, is likely to significantly reduce traditional payday lending and cause installment and vehicle title lenders to think carefully about whether higher rates and leveraged payment mechanisms are worth the regulatory burden. On the other hand, the rulemaking may provide certain credit reporting agencies with a new market opportunity. Stakeholders should review the rule and its official commentary to ensure they understand the obligations that would apply to them. If limitations under the proposal would adversely affect their businesses, it may prove worthwhile to submit comments to the CFPB suggesting that substantive or technical changes be made in the final rule. ♦

## Endnotes

<sup>1</sup> Proposal at 130 (quoting *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 988 (D.C. Cir. 1985) (quoting *Jacob Siegel Co. v. FTC*, 327 U.S. 608, 612-13 (1946))).

<sup>2</sup> 12 U.S.C. § 5512(b)(1) (emphasis added).

<sup>3</sup> Proposal at 1330 (to be codified at 12 C.F.R. pt. 1041, supp. I, comment 19-1).

<sup>4</sup> See 12 U.S.C. § 5565; Civil Penalty Inflation Adjustments, 81 Fed. Reg. 38,569, 38,571 (June 14, 2016) (to be codified at 12 C.F.R. § 1083.1(a)).

<sup>5</sup> Proposal at 1128 (defining "consumer," to be codified at 12 C.F.R. § 1041.2(4)), 1132 (defining "covered loan," to be codified at 12 C.F.R. § 1041.3(b)).

<sup>6</sup> Proposal at 1129, 1132-33 (defining "covered short-term loan," to be codified at 12 C.F.R. §§ 1041.2(6), 1041.3(b)(1)).

<sup>7</sup> Proposal at 1129, 1133 (defining "covered longer-term loan," to be codified at 12 C.F.R. §§ 1041.2(8), 1041.3(b)(2)).

<sup>8</sup> Proposal at 1131-32 (indicating the "charges included in the total cost of credit," to be codified at 12 C.F.R. § 1041.2(18)(i)-(ii)). In its 2015 outline for this proposal, the CFPB suggested it was considering using an all-in cost of credit metric already in use under federal law in order to ease

## The CFPB's Payday Proposal: Broader Than One May Think

compliance burdens on lenders. The specific metric under consideration was the Military APR (MAPR) under the Military Lending Act. 2015 SBREFA Outline at 19. Under recent amendments effective October 2015 (with compliance required by October 2016), the MAPR calculation would be nearly identical to the CFPB's proposed cost of credit, differing only in that an application fee charged by credit unions or insured depository institutions in connection with certain short-term, small amount loans is not included in the MAPR calculation. See 32 C.F.R. § 232.4(c).

<sup>9</sup> Proposal at 1207 (to be codified at 12 C.F.R. pt. 1041, supp. I, comment 2(18)(iii)(B)-2).

<sup>10</sup> Proposal at 176.

<sup>11</sup> Proposal at 1134–35, 1208–09 (to be codified at 12 C.F.R. § 1041.3(e) and associated commentary).

<sup>12</sup> Proposal at 168.

<sup>13</sup> Proposal at 1151 (to be codified at 12 C.F.R. § 1041.9(b)(2)). A covered longer-term loan is a “covered longer-term balloon payment loan” if it is a single-payment loan or a loan in which any one payment is more than twice as large as any other payment under the loan. Proposal at 1129 (to be codified at 12 C.F.R. § 1041.2(7)).

<sup>14</sup> Proposal at 1218–19 (to be codified at 12 C.F.R. pt. 1041, supp. I, comment 5(b)(2)(ii)-1(i)).

<sup>15</sup> Compare Proposal at 1156–58 (to be codified at 12 C.F.R. § 1041.11) with 12 C.F.R. § 701.21(c)(7)(iii).

<sup>16</sup> Proposal at 1156–57 (to be codified at 12 C.F.R. § 1041.11(b)).

<sup>17</sup> 2015 SBREFA Outline at 26–27.

# The CFPB's Proposed Anti-Arbitration Rule

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The rule recently proposed by the CFPB to regulate arbitration agreements is not a surprise: the Bureau has said for months that it was developing such a rule.

The CFPB's 377-page proposal, published on May 24, 2016, effectively bans the use of arbitration by companies in the consumer financial services arena. As proposed, it would subject providers of covered consumer financial products or services and potentially holders of such assets to abusive class action litigation. The proposal ignores the longstanding federal policy favoring arbitration and amounts to an invitation to the plaintiffs' bar to declare "open season" on companies caught within the CFPB's net.

The CFPB now will receive comments until August 22, 2016. If a rule is adopted in the proposed form, parties are certain to seek judicial review.

## The CFPB's Proposal

**Exclusion from arbitration of all class actions filed in court.** The principal restriction on arbitration agreements is as far-reaching as it is easy to explain: a flat prohibition on invoking an arbitration provision to require arbitration with respect to claims asserted in a class action filed in court (§ 1040.4(a)(1)). Indeed, the proposal requires that the arbitration agreement state: "We agree that neither we nor anyone else will use this agreement to stop you from being part of a class action case in court. You may file a class action in court or you may be a member of a class action even if you do not file it" (§ 1040.4(a)(2)(i)). The sole exception to the Bureau's prohibition is if a court has already held that class treatment is improper (and immediate appellate rights exhausted), which is like saying it's okay to close the barn door only after the horse has long been gone.

**Reporting requirements.** The proposal also would require companies to submit information to the CFPB regarding each arbitration conducted under agreements covered by the rule—such as the claim and any counterclaim, the arbitrator's award, a copy of the arbitration agreement, and any communications relating to a company's failure to pay arbitration fees or with the designated arbitral forum's fairness principles.

**Scope.** The Bureau states that its intent is "to cover a variety of consumer financial products and services that the Bureau believes are in or tied to the core consumer financial markets of lending money, storing money, and moving or exchanging money." The following consumer products and services would be subject to the arbitration regulation (§ 1040.3(a)(1)-(10)):

- Extending "consumer credit" as defined in Regulation B, or acting as a "creditor" under the Regulation by participating regularly in consumer credit decisions or referring applicants to creditors or selecting creditors to whom requests for credit may be made (although some merchants and sellers of nonfinancial products and services are excluded);

## The CFPB's Proposed Anti-Arbitration Rule

- Extending or brokering auto leases (although auto dealers are excluded);
- Debt management or settlement services relating to an extension of consumer credit that would be covered by the rule;
- Providing consumers with credit reports, credit scores, or other information from a consumer report (except if the report is provided in connection with an adverse credit action with respect to a product or service not subject to the arbitration rule);
- Providing accounts subject to the Truth in Savings Act;
- Providing accounts or remittance transfers subject to the Electronic Fund Transfer Act;
- Transmitting or exchanging funds for consumers, unless with respect to products and services not covered by the proposed rule;
- Accepting financial data from a consumer, or providing a product or service to accept such data, for the purpose of initiating a payment or credit or charge card transaction for the consumer—unless the person accepting the data is selling the nonfinancial product or service that is the subject of the transaction;
- Check cashing, check collection, or check guaranty services; and
- Collection of a debt arising from the above financial products or services by the entity providing the product or service giving rise to the debt, its affiliate, or one acting on behalf of the entity or affiliate; an entity purchasing the debt or its affiliate or one acting on its behalf; or a debt collector as defined in the Fair Debt Collection Practices Act.

Notably, the CFPB is proposing to cover creditors as defined by Regulation B instead of Regulation Z. The definition of a creditor under Regulation B is broader than the definition under Regulation Z.

Expressly excluded from the proposed regulation are (§§ 1040.3(b)(1)-(5)):

- Merchants, retailers, and other sellers of nonfinancial goods and services that provide an extension of credit directly to a consumer for the purpose of allowing the consumer to purchase the nonfinancial good or service from the merchant, retailer, or other seller—unless the credit extended significantly exceeds the market value of the nonfinancial good or service (or the sale of the nonfinancial good or service is a subterfuge to avoid regulation) or the merchant or seller regularly extends credit and the credit is subject to a finance charge, in which circumstances the arbitration regulation would apply;
- Persons who provide the specified product or service to no more than 25 consumers in the current and prior year;
- Activities falling within the statutory exclusions from the CFPB's authority set forth in Sections 1027 and 1029 of the Dodd-Frank Act, that provide protection (often subject to significant limitations) for—among others—real estate brokerage, accounting, legal, and insurance services and (as noted above) for auto dealers;
- Broker-dealers subject to regulation by the Securities and Exchange Commission;
- The federal government and its affiliates; and
- State, local, and tribal entities to the extent they provide a consumer financial product “directly to a consumer who resides in the government’s territorial jurisdiction.”

Importantly, an affiliate of a company providing a financial product or service is subject to the proposed regulation when the affiliate is acting as a service provider to that company. That means that activities of the affiliate not otherwise subject to the arbitration regulation—either because the affiliate’s activity does not qualify as providing a financial product or service or because it falls within one of the exclusions—would nonetheless be subject to the arbitration regulation in such circumstances (§ 1040.2(c)(2)).

Finally, when a business’s relationship with a consumer includes some products or services covered by the regulation and some that are not, the arbitration regulation applies only to those covered by the regulation. The “Official Interpretations” appended to the proposed rule state that a business that is subject to the proposed rule “must comply with this part only for the products or services that it offers or provides that are covered” by the rule. (Official Interpretations, Section 1040.2(c).1). The proposal permits

## The CFPB's Proposed Anti-Arbitration Rule

the arbitration agreement to state, in relevant part, “[w]e are providing you with more than one product or service, only some of which are covered by the Arbitration Agreements Rule issued by the Consumer Financial Protection Bureau,” and that the ban on applying the arbitration agreement to class actions in court “applies only to class action claims concerning the products or services covered by that Rule” (§ 1040.4(a)(2)(ii)).

The Bureau’s proposal provides an illustrative list of the businesses likely to be subject to the rule:

banks, credit unions, credit card issuers, certain automobile lenders, auto title lenders, small-dollar or payday lenders, private student lenders, payment advance companies, other installment and open-end lenders, loan originators and other entities that arrange for consumer loans, providers of certain automobile leases, loan servicers, debt settlement firms, foreclosure rescue firms, certain credit service/repair organizations, providers of consumer credit reports and credit scores, credit monitoring service providers, debt collectors, debt buyers, check cashing providers, remittance transfer providers, domestic money transfer or currency exchange service providers, and certain payment processors.

**Effective date.** The Dodd-Frank Act provides (in Section 1028(d)) that any arbitration regulation issued by the CFPB may apply only to arbitration agreements entered into 180 days after the effective date of the regulation (the “Compliance Date”). Recognizing this limitation, and the general rule that regulations do not take effect until 30 days after their promulgation, the proposed rule states that it would apply to contracts entered into 211 days after the date the final rule is published in the federal register (§ 1040.5(a)).

The delayed effective date means that all arbitration agreements in effect 210 days after the rule’s effective date can continue to be enforced—and any class waiver in those agreements can continue to be enforced—for the agreement’s duration. Significantly, moreover, the Official Interpretations state that a business does not enter into an arbitration agreement, and therefore the regulation is not triggered, if it “[m]odifies, amends, or implements the terms

of a product or service that is subject to a pre-dispute arbitration agreement that was entered into before” 211 days after the rule’s effective date. This appears to mean that businesses can change the terms of service governing an existing consumer relationship without invalidating the pre-existing arbitration clause (including any class waiver) (see Official Interpretations, Section 1040.4.a.ii).

But if a business with an existing relationship with a consumer provides that consumer with a new product or service after the Compliance Date, any arbitration agreement with respect to that new product or service will be subject to the limitations in the Bureau’s regulation (see Official Interpretations, Section 1040.4.a.i.A). And if, 211 days or more after the effective date (the Compliance Date), an entity subject to the rule acquires or purchases a product that is covered by the rule and subject to an arbitration agreement, that arbitration agreement becomes subject to the Bureau’s restrictions (see Official Interpretations, Section 1040.4.a.i.B).

### The Rulemaking Process and Judicial Review

The Bureau’s issuance of a proposed rule is just the beginning of the rulemaking process. The Bureau has established a ninety-day period for any interested party to file comments (the period begins on the date the proposed rule is published in the Federal Register, which has not yet occurred).

The CFPB then is obligated to study the comments, decide whether to modify any provisions of the proposed rule—or terminate the rulemaking without issuing a rule—and, if a rule is issued, explain its provisions and respond to the public comments. That process typically requires at least several months following the close of the comment period.

The Dodd-Frank Act specifies (in Section 1028(b)) that the Bureau may promulgate a regulation governing arbitration only if it finds that the regulation “is in the public interest and for the protection of consumers”; in addition, the findings underlying the rule “shall be consistent with” the arbitration study required by the statute. The Act also requires the Bureau to consider (a) “the potential benefits and costs to consumers and [regulated businesses], including the potential reduction of access by consumers to consumer financial

## The CFPB's Proposed Anti-Arbitration Rule

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products or services resulting from” the proposed rule; and (b) the impact of proposed rules on smaller financial institutions and on consumers in rural areas (Section 1022(b)(2)(A)).

To the extent the Bureau's final rule fails to satisfy these statutory requirements, or is otherwise arbitrary and capricious or contrary to law, anyone adversely affected by the rule may seek judicial review—invoking the applicable provisions of the Administrative Procedure Act—and obtain an order invalidating the rule.

Finally, the [questions](#) about the constitutionality of the CFPB's structure raised by the DC Circuit prior to oral argument in the *PHH Corp. v. CFPB* case, and the [focus on that question at the oral argument](#), cast a shadow on the proposed arbitration rule. A holding in PHH that the Bureau's structure

confers too much unconstrained authority on a single individual—the Bureau's Director—and therefore violates the Constitution could provide grounds for invalidating the arbitration rule. And if the issue is not addressed by the PHH Court, it is likely to be raised in any judicial challenge to a final arbitration rule.

### Contingency Planning

Although the arguments supporting judicial review are powerful, many businesses are nonetheless engaging in contingency planning to address the possibility that the rule will be finalized and implemented. ♦

Supervision & Guidance

# SUPERVISION & GUIDANCE

# The New Federal Frontier: An Overview of the CFPB's Supervisory Activities

Supervision has been one of the CFPB's most novel tools, particularly for nonbanks that had never been subject to federal examination before.

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## Universe of Supervised Entities

The CFPB has supervisory authority over a variety of institutions: banks, thrifts, and credit unions with assets of more than \$10 billion and their affiliates; larger participants in the nonbank debt collection, consumer reporting, student loan servicing, international money transfer, and automobile financing markets; and nonbank mortgage originators and servicers, payday lenders, and private student lenders, regardless of size.<sup>1</sup>

Although the CFPB maintains a list of supervised depository institutions and their affiliates, perhaps uniquely among federal supervisors, the CFPB does not have a definitive list of all the institutions that it is authorized to supervise. For example, the CFPB has explained to the Government Accountability Office that “there is no single source of data that identifies all nonbank servicers,” and there are servicers that it has yet to identify.<sup>2</sup> The CFPB may be considering whether to issue rules requiring certain nonbank entities to register with the CFPB in order to facilitate supervision.<sup>3</sup> In the case of payday lenders, there is no statutory definition of a “payday loan” and the CFPB has not as yet established a definition by rule, so there currently appear to be no definitive criteria for identifying payday lenders that are subject to CFPB supervision.

Additionally, the Dodd-Frank Act authorizes the CFPB to decide that a covered person of a type not described above should be subject to supervision if it engages in “conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.”<sup>4</sup> The CFPB has required various companies to consent to CFPB supervision under this provision as a condition of an enforcement settlement, including certain consumer lenders, smaller debt collectors, smaller consumer reporting agencies, and others. The CFPB also has an administrative procedure for imposing supervision on a company outside the enforcement context, potentially over the company’s objections, although there is no public information available about the extent to which this procedure has been used.<sup>5</sup>

## Examination Process

The scheduling of CFPB examinations depends upon an assessment of the risks to consumers, as well as coordination with other federal and state supervisors.<sup>6</sup> The CFPB published the current version of its Supervision and Examination Manual in October 2012.<sup>7</sup> It has since published over a dozen updates to specific sections, including the examination procedures on debt collection, payday lending, remittance transfers, education loans, automobile finance, credit card account management, mortgage origination, mortgage servicing, and the Truth in Lending Act (TILA) Integrated Disclosure form. Updates also cover specific statutes like the



## The New Federal Frontier: An Overview of the CFPB's Supervisory Activities

Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, and the Home Mortgage Disclosure Act resubmission schedule and guidelines. The manual is now over a thousand pages long and covers myriad subjects. Many companies use the manual as a resource for their own compliance programs, although the manual itself cautions that it “should not be relied on as a legal reference.”<sup>8</sup>

When examiners identify perceived problems, there is a range of actions that they may take, including noting the issue as a matter requiring attention in the exam report, requiring the company to sign a memorandum of understanding, and referring the matter to the Office of Enforcement for possible public enforcement action. A supervisory appeals process exists to allow supervised entities to appeal final CFPB compliance ratings that are less than satisfactory (i.e., a 3, 4, or 5 rating) or any underlying adverse finding or adverse findings conveyed to an entity in a supervisory letter. Such appeals go to the Associate Director for Supervision, Enforcement and Fair Lending, who then appoints a committee of individuals who were not involved in the underlying supervisory matter. The Associate Director has final say in the matter, but the CFPB Ombudsman Office serves as an “independent, impartial, and confidential resource” to act as a liaison between supervised entities and the CFPB. The Ombudsman can provide information about the appeals process and assist in resolving any process-related issues.

With the exception of public enforcement actions, there is typically little or nothing on the public record regarding these resolutions. The CFPB publishes a quarterly newsletter on its website titled *Supervisory Highlights* that describes trends in its supervisory activities, without identifying the relevant companies by name.<sup>9</sup> The CFPB has recently started to republish the *Supervisory Highlights* in the United States Government's *Federal Register*, which may highlight how the agency regards the *Supervisory Highlights* as an important source of guidance for industry.

The latest, summer 2016, version of *Supervisory Highlights* documents the agency's recent observations in the areas of auto loans, mortgage loans, small-dollar loans, fair lending, and debt collection. In the first quarter of this year alone, the CFPB directed supervised entities to provide relief amounting to approximately \$24.5 million to more than 257,000

consumers. An additional \$8 million was required through a public enforcement action stemming from a supervisory examination.

These figures are not atypical. The previous quarter's issue noted supervisory resolutions that resulted in restitution of approximately \$14.3 million to more than 228,000 consumers and boasted that the CFPB's supervisory activities had either led to or supported three recent public enforcement actions, resulting in \$52.75 million in consumer remediation and other payments and an additional \$8.5 million in civil money penalties. Every change in season brings with it another slew of supervisory actions that have required significant payments like these. To date, the CFPB has issued 13 *Supervisory Highlights* reports. The back issues can be found on the CFPB's website at <http://www.consumerfinance.gov/data-research/research-reports>.

### Official Guidance

The CFPB has been publishing guidance to industry participants since April 2011, before most of its powers even vested. To date, they have published 51 pieces of official guidance in the form of bulletins, notices, interagency statements, and in various other forms. These important documents can be found on the CFPB's website and can be filtered by topic (e.g., a search for all guidance involving “mortgages” yields 17 results, while the topic “rulemaking” yields two results). A list of published guidance is in the chart below.

### Compliance Management Systems and Consumer Complaints

Many of the CFPB's supervisory priorities are industry-specific, but a few themes apply to all industries. One theme since the beginning of the program has been compliance management; the CFPB has specific expectations for the structure of a supervised entity's compliance management system that are in addition to the substantive requirements imposed by law.<sup>10</sup> Relatedly, the CFPB values consumer complaints as both a source of information for targeting its exams and as a means for companies themselves to identify problems.

The CFPB's exam manual describes an effective compliance management system as one that has four interdependent control components that are strong and well-coordinated. Such components include: (1) proper Board and management

## The New Federal Frontier: An Overview of the CFPB's Supervisory Activities

oversight; (2) a documented compliance program that includes written policies and procedures, compliance training, and monitoring and corrective action; (3) responsible handling of consumer complaints; and (4) audit coverage of compliance matters. Supervised institutions should ensure that they have effective compliance management systems.

With regard to consumer complaints, the CFPB has established robust and sophisticated mechanisms for the intake and analysis of consumer complaints. In addition to the ability to accept and monitor complaints submitted by consumers in relation to a variety of industries, the Bureau has made a significant portion of complaint data available to the public. Anyone can go to the CFPB's website to browse the public Consumer Complaint Database and look up data about the number and types of complaints that have been lodged about a particular covered person. Reflecting the agency's apparent fondness for data analysis, the CFPB also now publishes a Monthly Complaint Report, which is designed to provide a high-level snapshot of trends in consumer complaints. Given

this heavy focus on complaints, any covered person would do well to monitor carefully all complaints consumers are making about their activities. ♦

### Endnotes

<sup>1</sup> See 12 U.S.C. §§ 5514, 5515; 12 C.F.R. pt. 1090.

<sup>2</sup> U.S. Gov't Accountability Office, GAO-16-278, Nonbank Servicers 43(2016).

<sup>3</sup> *Id.* (citing Semiannual Regulatory Agenda, 80 Fed. Reg. 78056, 78057 (Dec. 15, 2015)).

<sup>4</sup> 12 U.S.C. § 5514(a)(1)(C).

<sup>5</sup> See 12 C.F.R. pt. 1091.

<sup>6</sup> CFPB Supervision & Examination Manual v.2 at Overview 5 (Oct. 2012).

<sup>7</sup> CFPB Supervision & Examination Manual v.2 (Oct. 2012).

<sup>8</sup> *Id.* at 1.

<sup>9</sup> See, e.g., <http://www.consumerfinance.gov/data-research/research-reports/supervisory-highlights-winter-2016/>.

<sup>10</sup> See CFPB Supervision & Examination Manual v.2, Compliance Management Review (Oct. 2012).

### List of Official Guidance

1	General counsel letter regarding section 1071 of the Dodd-Frank Act	General Counsel Leonard J. Kennedy's letter to financial institutions regarding section 1071 of the Dodd-Frank Act
2	Bulletin re: amendments to the Alternative Mortgage Transaction Parity Act (AMTPA)	CFPB Bulletin 2011-1
3	Bulletin re: the Interstate Land Sales Full Disclosure Act	CFPB Bulletin 2011-2
4	Bulletin re: ex parte presentations in rulemaking proceedings	CFPB Bulletin 2011-3
5	Bulletin re: Notice and Opportunity to Respond and Advise	CFPB Bulletin 2011-04 (Enforcement)
6	Interagency statement for determining asset size of institutions	Interagency statement for determining asset size of institutions for federal consumer financial law supervisory and enforcement purposes
7	Bulletin re: whistleblower and law enforcement information, protections	CFPB Bulletin 2011-05 (Enforcement and Fair Lending)
8	Bulletin re: the Bureau's supervision and authority and treatment of confidential supervisory information	CFPB Bulletin 2012-01
9	Bulletin re: the payment of compensation to loan originators	CFPB Bulletin 2012-02
10	Bulletin re: service providers	CFPB Bulletin 2012-03
11	Bulletin re: lending discrimination	CFPB Bulletin 2012-04 (Fair Lending)

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12	Bulletin re: SAFE Act and transitional licensing of mortgage loan originators	CFPB Bulletin 2012-05
13	Memorandum of Understanding on supervisory coordination	Memorandum of Understanding on supervisory coordination among the CFPB, Federal Reserve Board, FDIC, NCUA, and OCC
14	Interagency guidance on mortgage servicing practices	Interagency guidance on mortgage servicing practices concerning military homeowners with Permanent Change of Station orders
15	Final policy statement on the publication of credit card complaint data	As published in the Federal Register
16	Bulletin re: marketing of credit card add-on products	CFPB Bulletin 2012-06
17	Statement on supervisory practices	Statement on supervisory practices regarding financial institutions and borrowers affected by Hurricane Sandy
18	Bulletin re: implementation of the remittance rule	CFPB Bulletin 2012-08
19	Bulletin re: FCRA's streamlined process requirement for consumers to obtain free annual reports	CFPB Bulletin 2012-09
20	Statement of Intent for sharing information with State regulators	Statement of Intent for sharing information with State banking and financial services regulators
21	Bulletin re: indirect auto lending and compliance with the Equal Credit Opportunity Act	CFPB Bulletin 2013-01
22	Disclosure of consumer complaint data	Final policy statement as published in the Federal Register
23	Bulletin re: the SAFE Act – uniform state test for state-licensed mortgage loan originators	CFPB Bulletin 2013-05
24	Bulletin re: responsible business conduct: self-policing, self-reporting, remediation, and cooperation	CFPB Bulletin 2013-06
25	Bulletin re: prohibition of unfair, deceptive, or abusive acts or practices in the collection of consumer debts	CFPB Bulletin 2013-07
26	Bulletin re: representations regarding effect of debt payments on credit reports and scores	CFPB Bulletin 2013-08
27	Bulletin re: the FCRA's requirement to investigate disputes and review “all relevant” information	CFPB Bulletin 2013-09
28	Bulletin re: payroll card accounts (Regulation E)	CFPB Bulletin 2013-10
29	Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults	Issued with the Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Federal Trade Commission, National Credit Union Administration, Office of the Comptroller of the Currency, and Securities and Exchange Commission

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30	Bulletin re: HMDA and Regulation C – Compliance management; CFPB HMDA resubmission schedule and guidelines; and HMDA enforcement	CFPB Bulletin 2013-11
31	Bulletin re: implementation guidance for certain mortgage servicing rules	CFPB Bulletin 2013-12
32	Homeownership counseling list requirements	CFPB Bulletin 2013-13
33	FFIEC guidance on social media	Federal Financial Institutions Examination Council (FFIEC) final supervisory guidance entitled “Social Media: Consumer Compliance Risk Management Guidance”
34	Bulletin re: FCRA requirement that furnishers conduct investigations of disputed information	CFPB Bulletin 2014-01
35	Bulletin clarifying mortgage lending rules to assist surviving family members	Application of Regulation Z’s Ability-to-Repay rule to certain situations involving successors-in-interest
36	Guidance regarding brokers shifting to “mini-correspondent” model	Policy guidance on supervisory and enforcement considerations relevant to mortgage brokers transitioning to mini-correspondent lenders
37	Compliance bulletin and policy guidance re: mortgage servicing transfers	Compliance bulletin and policy guidance regarding mortgage servicing transfers. (CFPB Bulletin 2014-01 and superseded CFPB Bulletin 2013-01)
38	FFIEC credit practices guidance	Interagency guidance regarding unfair or deceptive credit practices
39	Bulletin re: marketing of credit card promotional APR offers	CFPB Bulletin 2014-02
40	Bulletin re: social security disability income verification	CFPB Bulletin 2014-03
41	Bulletin re: treatment of confidential supervisory information	CFPB Bulletin 2015-01
42	Bulletin re: Section 8 housing choice voucher homeownership program	CFPB Bulletin 2015-02
43	Bulletin re: private mortgage insurance cancellation and termination	CFPB Bulletin 2015-03
44	Bulletin re: Interstate Land Sales Full Disclosure Act amendment	Compliance bulletin posted in the Federal Register
45	Bulletin re: RESPA compliance and marketing services agreements	CFPB Bulletin 2015-05
46	Supervisory matters appeal process	Process for appeals of supervisory matters. (Includes CFPB Bulletin 2012-07 and Revised Process documents)
47	Bulletin re: requirements for consumer authorizations for preauthorized EFTs	CFPB Bulletin 2015-06
48	Bulletin re: in-person collection of consumer debt	CFPB Compliance Bulletin 2015-07

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49	Bulletin re: furnisher FCRA obligation to have reasonable written policies and procedures	CFPB Bulletin 2016-01
50	Submission of credit card agreements under the Truth In Lending Act (Regulation Z)	Notice about the submission of credit card agreements to the Bureau
51	Interagency Guidance Regarding Deposit Reconciliation Practices	Supervisory expectations regarding customer account deposit reconciliation practices

# Enforcement

# ENFORCEMENT

# Enforcement: An Overview

The Dodd-Frank Act gave the CFPB substantial enforcement authority, combining the enforcement powers of the Federal Trade Commission (FTC) with substantial civil penalty authority. The Act allows the CFPB to issue Civil Investigative Demands (CIDs) whenever it has reason to believe that any individual or entity has in its possession information that may be relevant to a violation of Federal consumer financial law.<sup>1</sup> Modeled on the FTC's pre-complaint investigatory authority, the Act allows the CFPB to seek the production of documents, information, answers to interrogatories and sworn testimony. This power allows the CFPB to conduct robust investigations prior to initiating enforcement actions. And the CFPB has used this power with gusto, issuing hundreds of CIDs to companies and individuals across the landscape of consumer financial services providers and beyond.

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Once the CFPB determines to pursue an enforcement action, it has the choice of proceeding before an administrative law judge (ALJ) or in federal court.<sup>2</sup> The administrative process is governed by the CFPB's Rules of Practice for Adjudication Proceedings,<sup>3</sup> which themselves are modeled on the rules adopted by the Securities and Exchange Commission (SEC), the FTC, and the prudential regulators. Like the SEC's rules until their recent amendment, the CFPB's rules impose strict timelines for completion of the proceedings and allow for limited discovery and no depositions. Cases heard by an ALJ are then reviewed by the CFPB Director, whose decision is appealable to the Courts of Appeal. While the CFPB has regularly used the administrative forum as a mechanism to issue Consent Orders in settled matters, it has initiated only three contested administrative proceedings, one of which settled, one of which is ongoing, and one of which is on appeal to the DC Circuit. Cases filed in federal court are subject to the Federal Rules of Civil Procedure and the ordinary course of civil litigation.

Importantly, the Act provides the CFPB the ability to seek the very same remedies whether proceeding administratively or in federal court. Those remedies are expansive, including rescission or reformation of contracts, refunds of moneys or the return of real property, restitution, disgorgement or compensation for unjust enrichment, payment of damages or other monetary relief, limits on the activities and functions of a person, and substantial civil money penalties.<sup>4</sup> Civil money penalties can total \$1,087,450 per day for knowing violations of law, \$27,186 per day for reckless violations, and \$5,437 per day for other violations. Most CFPB enforcement matters involve two or three kinds of relief from among injunctive relief, monetary payments to consumers (as restitution or damages), and civil money penalties.

The CFPB has used its enforcement authorities aggressively. In its five years of existence, the agency has brought nearly 140 enforcement actions. Those actions have netted, by the CFPB's estimate, over \$11 billion in consumer payments or debt forgiveness, and over \$420 million in civil money penalties. The cases have ranged from the very large – several cases involve civil penalty amounts of over \$10 million – to the very small – some cases have involved no or nominal penalties. They have covered the entire landscape of the consumer financial services

## Enforcement: An Overview

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marketplace, including cases involving mortgage origination, mortgage servicing, auto lending, student lending, payday lending, banking practices, debt collection, credit reporting, debt relief, and fair lending.

About one quarter of the cases have been brought against banks, with the remaining cases brought against non-bank entities or individuals. Speaking of individuals, the CFPB's enforcement authority extends to them as well, and roughly 30 percent of enforcement actions brought in the agency's first five years have included claims against individuals. In all cases, these claims against individuals have involved either claims that the individuals violated the Real Estate Settlement Procedures Act or that they were liable for violations of law allegedly committed by non-bank companies that they owned, managed, or with which they were otherwise affiliated. The majority of the CFPB's cases settle. About one quarter have involved contested litigation, in all cases against non-banks or individuals.

Below, we offer an overview of the CFPB's authority over individuals, its authority to bring claims against those who knowingly or recklessly provide "substantial assistance" to a violation of the prohibition on unfair, deceptive and abusive conduct, and its authority to enforce the prohibition on abusive acts or practices. We also provide a summary of the CFPB's enforcement actions in the fair lending, credit card, debt collection, mortgage origination and servicing, student lending, payday, credit furnishing, banking, payments, and retail markets. ♦

### Endnotes

<sup>1</sup> 12 U.S.C. § 5562(c)(1).

<sup>2</sup> 12 U.S.C. §§ 5563-64.

<sup>3</sup> 12 C.F.R. Part 1081.

<sup>4</sup> 12 U.S.C. § 5565.



# Dodd-Frank Legal Issues

# Dodd-Frank Legal Issues: The CFPB's Pursuit of Individuals

Just one year after the Bureau's first public enforcement action, CFPB Director Richard Cordray set the tone for the CFPB's position on individual liability: "I've always felt strongly that you can't only go after companies. Companies run through individuals, and individuals need to know that they're at risk when they do bad things under the umbrella of a company."<sup>1</sup> Cordray reiterated that position in 2014: "There are legitimate occasions where it is appropriate to sue not only the company that was a party to the consumer's transactions, but also individuals who were decision-makers or actors relevant to that transaction ... Under the law, this includes not only a provider of consumer financial products or services, but also, in certain cases, anyone with 'managerial responsibility' or who 'materially participates in conduct of [its] affairs.'"<sup>2</sup>

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The existence of the CFPB has not only created new liability risks for institutions, but also for the individuals who participate in the affairs of those institutions. Since its inception, the agency has brought over 30 public enforcement actions against individuals. The actions have resulted in joint and several liability that includes penalties, consumer redress, injunctive relief, and bans on participation in certain consumer financial product or service markets. In this section we explore the legal bases for the CFPB's authority over individuals and discuss examples of how the CFPB has interpreted this authority.

## Legal Bases for Individual Liability

In addition to the CFPB's ability to pursue enforcement actions against "any person" that violates a federal consumer law,<sup>3</sup> the CFPB has relied upon two main avenues to bring actions against individuals: (1) arguing that the individual aided and abetted a covered person committing a UDAAP violation or (2) arguing that the individual was a covered person directly liable for the violation.

## AIDING AND ABETTING A UDAAP

The Dodd-Frank Act makes it unlawful for "any person to knowingly or recklessly provide substantial assistance to a covered person or service provider in violation of the provisions of section 1031 [prohibiting unfair, deceptive, or abusive acts or practices (UDAAPs)], or any rule or order issued thereunder."<sup>4</sup> It further provides that, "the provider of such substantial assistance shall be deemed to be in violation of that section to the same extent as the person to whom such assistance is provided."<sup>5</sup>

In order to bring an action under this provision, the CFPB must show that the individual "knowingly or recklessly" provided "substantial assistance" to a covered person who violated the UDAAP prohibition. The CFPB's use of the substantial assistance theory against individuals has been increasing. In 2015, the CFPB asserted its first substantial assistance claims against individuals for their alleged role in setting up various entities that the CFPB alleged were involved in a phantom debt collection scheme. Subsequently, in a series of matters, the CFPB has asserted that individual owners and managers of a lead generation business knowingly and



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## Dodd-Frank Legal Issues: The CFPB's Pursuit of Individuals

recklessly provided substantial assistance to the company's alleged UDAAPs in buying and selling payday loan leads. Most recently, the CFPB asserted that two co-owners of a payment processor provided substantial assistance to that company's debiting of consumer bank accounts on behalf of clients allegedly engaged in unlawful practices, where the payment processor allegedly should have been aware of various red flags such as high return rates on its customers' transactions.

### INDIVIDUAL COVERED PERSONS

The CFPB has more regularly brought actions against individuals by arguing that the individual is him or herself a covered person. The term "covered person" means any person that engages in offering or providing a consumer financial product or service and includes any affiliate of the person if such affiliate acts as a service provider to the person.<sup>6</sup> The term "affiliate" means any person that controls, is controlled by, or is under common control with another person.<sup>7</sup> The term "person" includes individuals.<sup>8</sup>

"Related persons" are deemed covered persons under the Dodd-Frank Act and include:

- Any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person;
- Any shareholder, consultant, joint venture partner, or other person, as determined by the Bureau (by rule or on a case-by-case basis) who materially participates in the conduct of the affairs of such covered person; and
- Any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any violation of any provision of law or regulation, or breach of a fiduciary duty.<sup>9</sup>

However, the definition of "related person" excludes any person related to a bank holding company, credit union, or depository institution.<sup>10</sup> The definition of "related person" nearly mirrors the definition of "institution-affiliated party" used by prudential regulators to pursue individuals in the depository context. Most CFPB enforcement actions against related persons have involved officers and individuals who were alleged to have materially participated in the affairs of the covered institution.

### Examples from Enforcement Actions

Of the CFPB's over 135 public enforcement actions, over 30 have included claims against individuals. These actions involved alleged violations in the areas of: debt relief (including student loan, credit card, and mortgage/foreclosure relief), debt collection, payment processing, appraiser or title company referrals, consumer loans (including payday loans), and loan originator compensation. Each of the CFPB's actions includes differing allegations regarding the individual's participation in the institution's affairs, ranging from being a signatory on the company's bank accounts to communicating directly with consumers, and the majority are against relatively small companies and their owners.

Over one third of the CFPB's actions involving personal liability have come in the debt relief context. These actions include claims against individuals with alleged managerial responsibility of the institutions and who allegedly materially participated in the conduct of the institutions' affairs.

In one action against a provider of student loan debt settlement services and the institution's founder, president, and sole owner, the CFPB alleged that the individual defendant had, "substantial managerial responsibility for and daily control over the operations" of the company, "including sales, onboarding, training, communications, compliance, as well as [defendant's] policies and procedures" and was therefore a related person and covered person.

In another debt relief action, the CFPB took the position that the institution's owner was a related person and therefore a covered person because he "approved, ratified, endorsed, directed, controlled, and otherwise materially participated in the conduct of [the company's] affairs." In that matter, the individual defendant allegedly managed the company's day-to-day operations, including engaging "directly in debt-relief sales and customer-support functions on [the company's] behalf." The CFPB alleged that the individual knew or should have known about the company's alleged violations of the Telemarketing Sales Rule and unfair, deceptive, and abusive acts and practices, and "had authority to control these actions."

In other debt relief actions, the CFPB has taken the position that certain individuals were related persons due to their

## Dodd-Frank Legal Issues: The CFPB's Pursuit of Individuals

direct communications with consumers, being authorized signatories on company bank accounts, and being listed as an owner of business names.

In the payment processing context, the CFPB has taken action against related persons who were alleged to have personally profited from the covered institution's activities and allegedly knew or should have known about violations of consumer financial protection laws. In one action, the CFPB assessed equitable monetary relief of \$6,099,000 and a \$1,000,000 civil money penalty against the corporate and individual defendants, jointly and severally.

In an action against a company offering a biweekly mortgage payment option, the CFPB alleged that the company's owner "formulated, directed, controlled, or participated in the acts and practices" of the company, including by regularly appearing in the company's advertisements.

In an action against a nationwide retailer, finance company, and the institutions' respective presidents/CEOs for alleged UDAAPs in connection with retail installment contracts, the CFPB alleged that the individuals were covered persons due to their status as officers of the companies. The CFPB asserted that, even though the individuals delegated all collections and compliance responsibilities to other parties, "As owners and executive officers of the companies, they had the authority to control [the alleged] practices and the collections staff charged with implementing them." The individuals also "had the authority to ensure that their contracts complied with federal and state laws governing the consumer-finance industry." The individuals were jointly and severally liable for the resulting \$2.5 million in consumer relief and \$100,000 civil money penalty.

Finally, in CFPB settlements alleging violations of the Real Estate Settlement Procedure Act's (RESPA) anti-kickback provisions, the CFPB has asserted that individual defendants violated RESPA when they paid or accepted allegedly illegal kickbacks.

### Conclusion

Although the majority of the CFPB's public enforcement actions and complaints have not included claims against individuals, the impact of the actions against individual defendants is severe. The CFPB has recently begun to rely upon the Dodd Frank Act's aiding and abetting provision. As Cordray promised in 2014, the Bureau has pursued individuals who were alleged to have had direct involvement in the conduct of the institutions' affairs, including developing, approving, and/or implementing the alleged bad acts. In most of those cases, the individual defendants were sole owners of the institutions. In other cases, it appears that the CFPB took action against individuals solely due to their position as officers of the covered institutions pursuant to the definition of related person. In nearly all of the cases, the CFPB imposed joint and several liability, thereby enabling the institutions to suffer the financial consequences of the actions. It is unclear whether the CFPB will continue these trends in the years to come, but it is clear that the CFPB is willing to use its personal liability enforcement authority. ♦

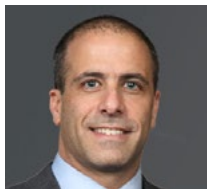
### Endnotes

- <sup>1</sup> Emily Stephenson, US consumer watchdog says committed to stiff penalties, Reuters (October 23, 2013), available at <http://www.reuters.com/article/us-washington-summit-cordray-idUSBRE99M1K520131023?iRPC=932>.
- <sup>2</sup> Prepared Remarks of CFPB Director Richard Corday, Federal Reserve Bank of Chicago at 4, Consumer Finance Protection Bureau (May 9, 2014), available at <http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-director-richard-corday-at-the-federal-reserve-bank-of-chicago-2/>.
- <sup>3</sup> 12 U.S.C. § 5564(a).
- <sup>4</sup> 12 U.S.C. § 5536.
- <sup>5</sup> *Id.*
- <sup>6</sup> 12 U.S.C. § 5481(6).
- <sup>7</sup> 12 U.S.C. § 5481(1).
- <sup>8</sup> 12 U.S.C. § 5481(19).
- <sup>9</sup> 12 U.S.C. § 5481(25).
- <sup>10</sup> *Id.*
- <sup>11</sup> 12 U.S.C. § 1813(u).

# Dodd-Frank Legal Issues: Substantial Assistance

The CFPB’s new favorite enforcement tool – “substantial assistance” – is becoming a common way the agency is going after parties that might otherwise escape its reach. In the past year, the CFPB has started to bring such claims with increasing frequency. Below, we examine what “substantial assistance” is and how the CFPB has been relying on it.

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In its first four years, the CFPB brought claims alleging unfair, deceptive, or abusive acts or practices (UDAAPs) under various of its authorities – over covered persons, service providers, affiliates, and related persons. But the CFPB waited almost four years – until March 2015 – before using its authority to bring claims against individuals and entities that provide “substantial assistance” to UDDAP violations. Based on its enforcement actions to date, the CFPB apparently intends to use substantial assistance claims both as a fallback if other claims fail and to extend its jurisdictional reach where other theories are unavailable. But key questions remain, including:

- What must the CFPB establish under the provision’s scienter requirement?
- What constitutes substantial assistance under the provision?
- What violations may form the predicate of a substantial assistance claim?
- How does substantial assistance liability interact with other limitations on CFPB authorities?

The resolution of these questions will go a long way toward defining the scope of substantial assistance liability and, in turn, how frequently this authority is used by the CFPB going forward. Companies that assist in the marketing or delivery of consumer financial products or services, but do not themselves qualify as covered persons or service providers, will be particularly well-served to monitor developments in this area and to consider the possible application of this provision to their operations.

## The Statutory Prohibition on Providing “Substantial Assistance” to a UDAAP Violation

Section 1036(a)(3) of the Dodd-Frank Act makes it unlawful for:

*any person to knowingly or recklessly provide substantial assistance to a covered person or service provider in violation of the provisions of section 1031 [‘s prohibition on unfair, deceptive, or abusive acts or practices], or any rule or order issued thereunder, and notwithstanding any provision of this title, the provider of such substantial assistance shall be deemed to be in violation of that section to the same extent as the person to whom such assistance is provided.’*

Generally analogous to “aiding and abetting” prohibitions enforced by other federal agencies, this provision has significant textual limits on its scope, including a scienter requirement

## Dodd-Frank Legal Issues: Substantial Assistance

(“knowingly or recklessly”); a requirement that any assistance be “substantial”; and a requirement that the recipient of the assistance itself be liable for a UDAAP. But the provision also has facets that suggest a potentially broad application: it applies to “any person”; it applies “notwithstanding any provision of this title”; and it allows imposition of liability equivalent to that imposed on the recipient of the assistance.

### The CFPB’s Use of its “Substantial Assistance” Authority To-Date

The CFPB did not use its substantial assistance authority in an enforcement action until early 2015, but subsequently has asserted substantial assistance claims with increasing frequency. The CFPB now has used that authority as a basis of liability in ten of the 67 enforcement actions it has filed since first bringing a substantial assistance claim in March 2015.

In the first case to allege substantial assistance, the CFPB brought a variety of claims against individuals and entities allegedly involved in a phantom debt collection scheme. In addition to bringing Fair Debt Collection Practices Act and UDAAP claims against the individuals and entities alleged to have been directly involved in the scheme, the CFPB brought substantial assistance claims against three groups of defendants: the individual defendants, for their alleged “substantial assistance” to the various LLCs they had established as part of the scheme by operating those entities; payment processors, for their alleged substantial assistance to the debt collectors by processing payments they collected from consumers; and a telephone broadcast service provider, for its alleged substantial assistance to the debt collectors by broadcasting collection calls. As discussed below, the claims against the individual defendants are part of a pattern that has emerged whereby the CFPB seeks to impose individual liability pursuant to the “substantial assistance” provision. On the other hand, the claims against the payment processors and phone broadcast service reflect the agency’s apparent view that individuals and entities have an obligation to be aware of “red flags” in connection with services they provide to others. Although litigation in this case is ongoing, it has produced the only judicial opinion to date addressing the “substantial assistance” provision, discussed further below.

Following this case, the CFPB’s substantial assistance cases can be grouped in two general categories: (1) claims against counterparties of entities alleged to have committed UDAAP violations, where the counterparty’s conduct in selling goods or providing services to the alleged UDAAP violator is alleged to constitute substantial assistance; and (2) claims against individual owners and managers of closely held companies, whose managerial involvement is alleged to constitute substantial assistance to those companies’ alleged UDAAP violations.

### SUBSTANTIAL ASSISTANCE CLAIMS AGAINST COUNTERPARTIES

The CFPB has brought a number of substantial assistance claims against companies on the theory that their provision of certain goods or services to others constituted substantial assistance to the counterparties’ alleged UDAAP violations. The phantom debt collection case discussed above involved just such claims with respect to the payment processors and telephone broadcast service provider. Their provision of services to the other defendants in that case was alleged to constitute substantial assistance to the allegedly unfair debt collection scheme.

In the CFPB’s next substantial assistance case, the agency asserted substantial assistance claims in a consent order against various individuals and entities engaged in an alleged mortgage referral scheme that violated the Real Estate Settlement Procedures Act (RESPA). The agency brought RESPA claims against all the defendants – the individuals and entities who paid and received the kickbacks. It brought substantial assistance claims against various LLCs that had been established by some of the individual defendants and that allegedly received the actual kickback payments. Although not elaborated in the Complaint, the CFPB’s theory appears to be that those entities substantially assisted their individual owners by serving as conduits for the payments they received. As discussed below, this imposition of substantial assistance liability in a non-UDAAP case seems to be beyond the agency’s authority.

The CFPB next brought a substantial assistance claim against a party that provided credit monitoring services to customers

## Dodd-Frank Legal Issues: Substantial Assistance

of various banks. Many of the banks themselves had been subject to CFPB consent orders for billing their customers for credit monitoring services that the consumers did not receive. In an action against the banks' service provider, the CFPB alleged that it had provided substantial assistance to those UDAAP violations by instructing the banks to bill for services that were not received.

In two separate cases, the CFPB alleged that the sale of delinquent debts with either incomplete or incorrect information about the debts constituted substantial assistance to UDAAPs committed in collecting on this debt, allegedly as a result of the incomplete or incorrect information.

Finally in this regard, the CFPB also brought a separate substantial assistance case against a sole proprietor who sold consumer lead information to two of the defendants in the phantom debt case discussed above. The CFPB alleged that selling this information without conducting any due diligence concerning the purchaser or the uses for which it was buying the leads established the recklessness necessary for a substantial assistance claim. The CFPB did not assert any UDAAP claims against the lead generator, presumably because he was not a "covered person" or "service provider" to whom the UDAAP prohibition applies directly.

### SUBSTANTIAL ASSISTANCE CLAIMS AGAINST INDIVIDUAL OWNERS & MANAGERS

The second type of CFPB substantial assistance claim involves allegations that individual owners or managers of closely held companies have provided substantial assistance to, and thus are liable for, those companies' alleged UDAAP violations. As described below, these claims often appear to be intended to get around limitations on the CFPB's ability to assert individual liability pursuant to the statute's "related person" provision.

The phantom debt collection case discussed above itself involved substantial assistance claims against the individual defendants based on their conduct in setting up and operating various LLCs that allegedly were used in the debt collection scheme, although the CFPB also brought UDAAP claims against the individuals directly. The CFPB has also brought a series of cases alleging that individuals who were the owners or managers of a lead broker company

substantially assisted that company's alleged UDAAP violations. The underlying UDAAP claims against the company focused on its purchase of consumer leads from lead generators who allegedly promised to find consumers the best rates or lowest fees and the resale of those leads to tribal and online payday lenders who allegedly charged higher rates and fees. The substantial assistance allegations focused solely on the individual defendants' role in founding and managing the defendant lead broker company.

Finally, most recently, the CFPB alleged that two co-owners of a payment processor provided substantial assistance to that company's debiting of consumer bank accounts on behalf of clients allegedly engaged in unlawful practices, where the payment processor allegedly should have been aware of various red flags such as high return rates on its customers' transactions. Interestingly, unlike in the phantom debt case, the CFPB did not bring substantial assistance claims against the payment processor itself, but only against the individual owners.

### Key Issues Raised By the CFPB's Substantial Assistance Claims To-Date

#### A. THE SCIENTER REQUIREMENT

The CFPB's assertion of substantial assistance claims to date has raised questions about how the CFPB must establish the knowledge or recklessness required for substantial assistance liability. The phantom debt collection case discussed above has seen the first judicial opinion on this point.

In response to a motion to dismiss by three defendants, the CFPB urged the district court to conclude that the Dodd-Frank Act did not incorporate the "severe recklessness" standard that had been applied by the Eleventh Circuit in related statutory contexts. The court rejected this argument in a September 1, 2015 order. It concluded instead that the recklessness standard under Section 1036(a)(3) is equivalent to the standard of "severe recklessness" previously adopted in aiding and abetting claims under the securities laws. Liability is limited under this standard to "those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers and sellers which

## Dodd-Frank Legal Issues: Substantial Assistance

is either known to the defendant or is so obvious that the defendant must have been aware of it.”<sup>22</sup>

The district court applied that standard and concluded that the CFPB had alleged “facts which, taken as true, plausibly allege that [the defendant payment processor] was ‘highly unreasonable’ in ignoring obvious signs of debt-collection fraud amounting to ‘an extreme departure from the standards of ordinary care,’ thus presenting an obvious danger of debt-collection fraud for consumers of which [the defendant] must have been aware.”<sup>23</sup> The Court went on to find that allegations against two other payment processors also satisfied the “severe recklessness” standard.

While the CFPB ultimately prevailed under the test employed by the district court, the court’s ruling confirms that Section 1036(c)(3)’s scienter requirement provides a significant limitation on the CFPB’s substantial assistance authority. Litigation of the precise contours of this limitation seems likely, in part because the CFPB continues to base substantial assistance claims on alleged failure to heed “red flags.” There may even be more litigation over the scope of that requirement in the phantom debt collection case itself. One defendant, the telephone broadcast service alleged to have provided substantial assistance by broadcasting the debt collectors’ collection calls even after having received a civil investigative demand (CID) from the CFPB, did not move to dismiss, but filed an answer denying that it had the requisite scienter or otherwise had violated the substantial assistance prohibition. In fact, in an affirmative defense, it specifically rejected the theory, implicit in the CFPB’s complaint, that receipt of a CID about a covered person’s behavior can be enough to establish knowledge of a UDAAP. Whether the CFPB will prevail on this and other applications of its “red flag” theory remains to be seen.

### B. SUBSTANTIAL ASSISTANCE

The CFPB’s enforcement actions also raise questions about what constitutes “substantial assistance” under Section 1036(a)(3), including whether the provision of routine commercial services can meet that definition.

The phantom debt collection opinion also addressed this point. That district court chose to adopt a test that looked to

the acts and motives of the defendant, rather than one that looked at how significantly the assistance contributed to the wrongful conduct. Specifically, the district court adopted the standard employed by the Second Circuit in securities fraud cases. It thus explained that “to plead substantial assistance against a defendant, the SEC must allege ‘that he in some sort associated himself with the venture, that the defendant participated in it as in something that he wished to bring about, and that he sought by his action to make it succeed.’”<sup>24</sup> The district court rejected the defendants’ argument that the CFPB must establish that the assistance proximately caused the wrongful conduct, concluding that a causal relationship was “relevant but not required.”<sup>25</sup>

In bringing substantial assistance claims against payment processors and a telephone broadcast service, as well as against various lead generators, the CFPB has suggested that even the delivery of routine commercial services may be sufficient in its view to support “substantial assistance” liability. The district court addressed this issue in the phantom debt collection case. It cited to Eleventh Circuit case law in other contexts and reasoned that “common business practices could . . . substantially assist unlawful conduct if there are ‘atypical’ factors involved in the common practice.”<sup>26</sup> The order then treated the failure to heed “obvious red flags” and “obvious warning signs” as a basis for substantial assistance claims against the various defendants, essentially collapsing the inquiry into scienter and substantial assistance by focusing on “red flags” in both instances.<sup>27</sup> The court summarized: “innocuous business practices in one context could amount to substantial assistance to unfair, deceptive, and abusive practices in another, as long as the aider and abettor knows of or is reckless to the risk of the primary violation.”<sup>28</sup> In other words, the court seemed to read the requirement that assistance be “substantial” so that it has little, if any, force independent of the scienter requirement. It remains to be seen whether other courts adopt this reading or conclude that it inappropriately renders the requirement of “substantial assistance” surplusage.

### C. PREDICATE VIOLATIONS FOR SUBSTANTIAL ASSISTANCE CLAIMS

Congress made clear that substantial assistance claims must



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be based on UDAAP violations. The CFPB, however, has sought to stretch its substantial assistance authority to reach other violations of federal consumer financial law.

In the RESPA enforcement action discussed above, the CFPB claimed that a title company and various loan officers had engaged in an illegal kickback scheme related to real-estate settlement services. The CFPB alleged that the various defendants violated RESPA and that they thereby violated Section 1036 of the Dodd-Frank Act, which renders any violation of Federal consumer financial law a violation of that section of the Dodd-Frank Act. On this basis, the CFPB alleged that the entities established by the individual defendants to accept the alleged kickback payments knowingly or recklessly provided substantial assistance to those individual defendants and the alleged payor of the kickbacks.

While the CFPB successfully settled the case, its substantial assistance claims exceed the agency's authority. By its terms, the substantial assistance provision applies only to conduct prohibited under Section 1031 of the Dodd-Frank Act or to a rule implementing that section.<sup>9</sup> Section 1031 permits the CFPB to take regulatory or enforcement actions against UDAAPs. By contrast, Section 1036 makes violations of RESPA or other Federal consumer financial laws a violation of the Dodd-Frank Act. By limiting substantial assistance claims to violations of Section 1031, Congress made a clear choice to apply substantial assistance liability only to UDAAPs – not to violations of RESPA or the other Federal consumer financial laws that the CFPB enforces. By treating a RESPA violation as a basis for a substantial assistance claim, the CFPB exceeded its substantial assistance authority. While this case can be seen as an aberration, the agency's willingness to settle claims beyond its authority is troubling and surprising. Respondents in CFPB investigations should resist any efforts by the agency to assert substantial assistance claims outside the UDAAP context.

### D. SUBSTANTIAL ASSISTANCE AND LIMITS ON OTHER CFPB AUTHORITIES

The CFPB repeatedly has used substantial assistance claims as one of multiple bases for asserting jurisdiction in an

enforcement action. For example, in the case against a company that provided credit monitoring services to bank clients, the CFPB alleged that the company was liable not only under the substantial assistance provision, but also as a covered person and as a service provider.

The CFPB also has used its substantial assistance authority to extend its authority to reach entities otherwise outside its jurisdiction. In the cases against the owners and operators of a lead broker, the CFPB has alleged that the individual defendants provided substantial assistance to the company's alleged unfair and abusive practices. The CFPB has treated company founders and managers of non-bank entities as "related persons" in the past, and sought to impose individual liability on such individuals based on their ownership or management role. (Indeed, the CFPB alleges a "related person" theory, in addition to a substantial assistance theory, against the individual defendants in its most recent payment processor action.) In order to assert that an individual is a "related person" of a company under the Dodd-Frank Act, however, that company itself must be a "covered person" (i.e., one who offers or provides a consumer financial product or service).<sup>10</sup> Because the lead generator at issue in these cases did not provide any consumer financial products or services – and thus was not itself a "covered person" – a related-person theory of individual liability was unavailable against the individual defendants. The CFPB's use of a substantial assistance theory (and nothing else) against these individuals thus appears to be an attempt to circumvent the limitations set forth in the statute with respect to the imposition of individual liability on those alleged to materially participate in an entity's affairs. As all three cases are currently in litigation, the courts may have an opportunity to opine on the validity of this approach.

The CFPB has also sought to use its substantial assistance powers to navigate other limitations on its authority in the phantom debt collection case. The CFPB alleged there that a telecommunications company provided substantial assistance by broadcasting allegedly abusive messages to consumers on behalf of the debt collector defendants. Such a service is arguably exempt from the CFPB's jurisdiction under the support services exception or the electronic conduit

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exception.<sup>11</sup> The CFPB likely will take the view that any inquiry into the application of those exceptions is unnecessary, however, because substantial assistance liability may attach “notwithstanding any provision of [Title X of the Dodd-Frank Act].” Judicial acceptance of such a theory could have significant implications for a wide range of companies and individuals otherwise exempted from the CFPB’s jurisdiction by the Dodd-Frank Act.

The CFPB has also sought to use its substantial assistance authority to regulate industries not otherwise within its purview. Last year, the agency sought to wade further into regulating the for-profit college industry by going after the institutions that accredit for-profit schools. Clearly, such accreditation is not a financial product or service within the CFPB’s purview. To get over this hurdle, the CFPB sought to assert that by accrediting for-profit schools, the accrediting body was providing substantial assistance to potential UDAAPs committed by those schools in connection with private student loans. The issue arose in connection with a CID the CFPB issued to such an accrediting body, which refused to comply on the grounds that the CFPB had no authority to conduct such an investigation. In discussing this issue, CFPB Director Richard Cordray commented that “[i]f an accrediting agency is *facilitating* for-profit colleges’ misleading consumers, treating them unfairly and deceptively, then that’s something that we should look at” (emphasis added).<sup>12</sup> Similarly, the CFPB argued in federal court that its CID was appropriate, among other reasons, because the CFPB is empowered to take action against those who “knowingly or recklessly provide substantial assistance to a covered person” who engages in UDAAPs. The district court dismissed the CFPB’s case seeking to enforce the CID, finding that the CFPB’s argument was “a bridge too far!”<sup>13</sup> The CFPB has appealed this order, meaning that the Court of Appeals will have an opportunity to opine on the scope of the substantial assistance provision, at least insofar as the CFPB’s investigatory authority is involved.

### E. DISFAVORED INDUSTRIES

The survey of cases above suggests that the CFPB is particularly likely to use its substantial assistance authority in cases involving debt collection and payday lending, two industries that the agency appears to view with particular suspicion. Of

the ten cases involving substantial assistance claims to date, four have involved substantial assistance claims related to debt collection and four have involved substantial assistance claims ultimately related to payday lenders. While this is a small data set from which to draw broad conclusions, it suggests that the CFPB is especially likely to pursue any avenue it thinks available to it to address conduct it is concerned with in these industries.

### Conclusion

After initially leaving this tool unused, the CFPB has begun to make regular use of its substantial assistance authority. While this authority is subject to clear textual limits, the CFPB’s actions to date strongly suggest that it expects this authority to play a significant role in its regulation of the consumer financial services market in the years ahead. Companies and individuals not otherwise subject to the CFPB’s UDAAP authority should pay particular attention to the development of the law in this area, as the CFPB seems intent on using this provision to expand its reach. ♦

### Endnotes

<sup>1</sup> 12 U.S.C. § 5536(a)(3) (emphasis added).

<sup>2</sup> See Order at 22, Dkt. 149, 15-cv-0859 (N.D. Ga. Sept. 1, 2015) (citing *Woods v. Barnett Bank of Ft. Lauderdale*, 765 F.2d 1004, 1010 (11th Cir. 1985)).

<sup>3</sup> See *id.* at 26-27.

<sup>4</sup> See *id.* at 38.

<sup>5</sup> *Id.*

<sup>6</sup> See *id.* at 40-41.

<sup>7</sup> *Id.* at 41, 43.

<sup>8</sup> *Id.* at 41.

<sup>9</sup> 12 U.S.C. § 5536(a)(3).

<sup>10</sup> See 12 U.S.C. § 5481(25).

<sup>11</sup> See *generally* 12 U.S.C. § 5481(15)(C)(ii) (electronic conduit exception); 12 U.S.C. § 5481(11) (defining “electronic conduit services”); 12 U.S.C. § 5481(26)(B)(i) (support services exception). The defendant has asserted the “support services” exception as an affirmative defense to service provider liability.

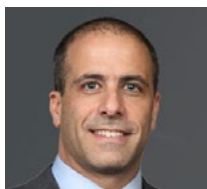
<sup>12</sup> <https://www.insidehighered.com/quicktakes/2015/10/29/cfpb-chief-defends-investigation-involving-college-accreditation>

<sup>13</sup> Slip Op. at 6, *CFPB v. ACICS*, No. 15-1838 (D.D.C. April 21, 2016), *appeal filed*, No. 16-5174 (D.C. Cir.).

# Dodd-Frank Legal Issues: An Analysis of the CFPB's Abusiveness Claims

Since 1938, the Federal Trade Commission Act has rendered it unlawful to engage in Unfair or Deceptive Acts or Practices as a matter of federal law. The scope and meaning of that “UDAP” prohibition has been fleshed out in agency pronouncements and case law over the years, and has an accepted, if still somewhat amorphous, meaning. Then in 2010 along came the Dodd-Frank Act, which created the CFPB and gave it authority to implement and enforce a prohibition on Unfair, Deceptive, or **Abusive** Acts or Practices. The age-old UDAP thus became UDAAP, and the \$64,000 question (or, given the scope of CFPB penalties and remedies, the \$64 million question) became what to make of the extra “A.” What does abusive mean? And more specifically, what conduct would be deemed abusive that wouldn’t already be deemed unfair or deceptive under the familiar UDAP prohibition?

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Five years after the CFPB gained its authorities, the answer to those questions is not yet clear, although certain patterns have begun to emerge. In its existence, the CFPB has brought over 125 enforcement actions. In over 80 of those, it has alleged or found UDAAP violations.<sup>1</sup> In only 19 cases has the CFPB alleged abusive conduct, but over half of those cases were filed in 2015 and 2016, suggesting an increased willingness to rely on this authority.<sup>2</sup>

## Background

Under the Dodd-Frank Act, it is unlawful for any “covered person” or “service provider” “to engage in any unfair, deceptive, or abusive act or practice.”<sup>3</sup> As noted above, the terms “unfair” and “deceptive” have long-standing definitions. An “unfair” act or practice is one that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers,” where “such substantial injury is not outweighed by countervailing benefits to consumers or to competition.”<sup>4</sup> A “deceptive” act or practice is a representation, omission, act, or practice that is likely to materially mislead a consumer whose interpretation is reasonable under the circumstances.<sup>5</sup>

The Dodd-Frank Act’s definition of an “abusive” act or practice consists of four prongs, any one of which is sufficient to constitute abusiveness:

- Prong (1) - “materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service.”
- Prong (2)(A) - “takes unreasonable advantage of ... a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service.”
- Prong (2)(B) - “takes unreasonable advantage of ... the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service.”
- Prong (2)(C) - “takes unreasonable advantage of ... the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.”<sup>6</sup>

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Thus, while there is single test for unfairness and a single test for deception, there are four separate tests for abusiveness.

The prohibition on abusiveness is generally enforceable by the CFPB or, with respect to banks and credit unions having total assets of \$10 billion or less, by federal prudential regulators.<sup>7</sup> Additionally, states generally have authority to bring abusiveness claims against covered persons and service providers that are not national banks or federal savings associations.<sup>8</sup>

### The Prongs of Abusiveness in Action

#### GENERAL PATTERNS

Looking at the statistics, there are some interesting patterns in the CFPB's abusiveness actions to date. The most striking is that the agency relies on two of the abusiveness prongs—prongs (2)(A) and (2)(B)—substantially more frequently than it relies on the others. The 19 CFPB abusiveness cases brought to date contain a total of 27 abusiveness claims, as some cases involve multiple claims or reliance on more than one prong of abusiveness. Of those 27 claims, 21—or over 75 percent—were based on prongs (2)(A) or (2)(B). By contrast, only three claims were based on prong (1) and only three claims were based on prong (2)(C).

All 19 abusiveness cases involve non-depository institutions. Whether that reflects a difference in the kind of conduct the agency is observing, a disparity in bargaining power, or a difference in how the agency treats depository versus non-depository institutions is hard to tell, although as discussed below, in some instances similar conduct has been treated differently by the agency when engaged in by non-depositories.

Finally, in virtually all the abusiveness cases, the CFPB has pled that the very same conduct also constituted unfair and/or deceptive practices. That is, the cases generally do not answer the question of what conduct is abusive that wouldn't otherwise be prohibited by the old UDAP prohibition. As discussed further below, in those few cases where the CFPB has alleged conduct to be abusive without at the same time alleging it to be unfair or deceptive, the conduct at issue could just as easily have been pled as unfair and/or deceptive.

With that background, we turn to an analysis of how the CFPB has applied the different prongs of abusiveness.

#### Prong (1) - Material Interference: Rarely Used

As noted above, the CFPB has relied on prong (1) of the abusiveness definition only three times. Prong (1) prohibits “materially interfer[ing]” with a consumer’s ability “to understand a term or condition” of the consumer financial product or service at issue. It is thus similar to prong (2)(A), which also looks to a consumer’s understanding. But unlike prong (2)(A), in which the operative prohibition is on “taking unreasonable advantage” of a consumer’s lack of understanding, prong (1) prohibits “materially interfering” with a consumer’s ability to understand. Perhaps believing that establishing such material interference requires greater affirmative action on the part of respondents, the CFPB has shied away from prong (1).

The first case to assert a prong (1) violation was an action against an online payday lender. The complaint in that case alleged that the defendants’ efforts to collect on loans that were allegedly void as a matter of state law, because they were either usurious or made by unlicensed lenders, constituted abusive conduct. In a single abusiveness claim, the CFPB relied on both prong (1) and prong (2)(A). The CFPB had brought similar abusiveness claims in two other cases, but in those cases the agency had relied solely on prong (2)(A). It is not clear whether some factual difference in the defendants’ conduct or loan documents led to this pleading change, whether it was inadvertent, or whether it reflects a more aggressive use of the abusiveness authority by the CFPB. In any event, not only did the CFPB allege prong (2)(A), but it also alleged that the same conduct was also unfair and deceptive.

The second prong (1) case likewise relied on prong (1) in conjunction with other prongs of abusiveness and other elements of UDAAAP. In a case against two so-called “pension advance” companies and their managers, the CFPB alleged that by denying their product was a loan and obscuring the true nature of the credit transaction, and by failing to disclose or denying the existence of an interest rate or fees associated with the pension advance, the defendants violated prongs (1), (2)(A), and (2)(B). At the same time, the CFPB also alleged that essentially the same conduct was unfair and deceptive.

## Dodd-Frank Legal Issues: An Analysis of the CFPB's Abusiveness Claims

These two cases — which both contain a single claim of abusive conduct relying on multiple prongs of the definition of abusive conduct — are emblematic of a “kitchen sink” or “belt and suspenders” approach to pleading abusiveness. As a result, they shed little light on what the CFPB considers to be “material interference” under prong (1). As discussed below, in both cases the CFPB alleged that defendants made misrepresentations that prevented consumers from understanding a term or condition of the financial product or service at issue. Presumably, it was these misrepresentations that constituted—at least in part—the “material interference” with consumers’ “ability to understand” that is necessary to plead a prong (1) claim. Why these misrepresentations rose above simple deceptive conduct, however, is not clear, nor is it clear why the agency chose to plead prong (1) in addition to prong (2)(A).

The last prong (1) case involved a check-cashing company that allegedly took affirmative steps to prevent consumers from knowing how much the company charged for check cashing. The complaint in the case alleges that the company had a policy to never tell the consumer the fee (even when the consumer asked), to block the fee amount listed on the receipt, to minimize the amount of time the consumer has to see the receipt, to interfere with the consumer’s ability to see the sign listing the fee, and to make false or misleading statements to consumers about the availability of information about the fee. This conduct, the CFPB alleged, constituted “material interference” with consumers’ ability to understand a term or condition of the check-cashing service being offered — how much it cost.

### Prongs (2)(A) and (2)(B) - Taking Unreasonable Advantage: The Workhorses

The vast majority of the CFPB’s abusiveness claims have been brought under prongs (2)(A) or (2)(B) (or both). Prong (2)(A) prohibits an act or practice that “takes unreasonable advantage of ... a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service,” while prong (2)(B) prohibits an act or practice that “takes unreasonable advantage of ... the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service.”

### PRONG (2)(A): DECEPTION PLUS?

Ten of the 27 abusiveness claims asserted by the CFPB to date have been based on prong (2)(A).<sup>9</sup> In all of these cases, the “lack of understanding” that the defendants allegedly took unreasonable advantage of was caused by alleged misrepresentations or omissions of the defendants or those acting in concert with them. Thus, most of the (2)(A) abusiveness claims pled by the CFPB include an allegation of misrepresentation as part of framing the abusiveness claim: the complaints and consent orders talk about how “contrary to representations” consumers were steered to high-cost loans; how defendants “obscured the true nature” of their pension advance product by “fail[ing] to disclose” certain information; how defendants “guarantee[d]” savings in a mortgage payment plan that they knew wouldn’t materialize for a substantial number of consumers; how defendants “did not adequately disclose” fees related to the use of allotments; and how defendant’s conduct in operating a debt relief program was not “as it represents to consumers.” All of these allegations formed the basis for the consumers’ “lack of understanding” for purposes of prong (2)(A) in these cases. Such allegations, of course, sound in deception, and not surprisingly the CFPB also alleged that the conduct at issue was deceptive in many of these cases. (The CFPB alleged unfairness in the other cases.)

The three other prong (2)(A) cases involved allegations that collecting on loans that state law allegedly renders void or voidable constitutes abusive conduct. In these cases, the CFPB simply alleged that “consumers likely were unaware” of, “lacked an understanding” of, or “generally do not know or understand” the impact of state law on the validity of their debt, without relying on underlying deception as part of the abusiveness claim. On their face, these cases appear to be based on consumers’ “lack of understanding” not caused by the defendant’s conduct. But all three cases also included a deception claim based on the theory that by seeking to collect on these loans, the defendants misrepresented that consumers had a legal obligation to pay them. Whether the prong (2)(A) abusiveness claims would stand alone absent that deception theory is unclear.

What is clear is that the prong (2)(A) has been used to date as a sort of “deception plus” claim, relying on alleged deceptive conduct as the basis for the consumers’ “lack of

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understanding,” and alleging that consummating the transaction that was the subject of the alleged deception somehow constitutes “taking unreasonable advantage” of the lack of understanding the defendants created. And in all instances, the CFPB has pled a parallel deception or unfairness claim, or both. Such an approach to prong (2)(A) does little to distinguish it from general deception, and the CFPB's actions to date do not provide a clear sense of when deceptive conduct will also be alleged to be abusive under prong (2)(A).

### PRONG (2)(B): UNFAIRNESS PLUS?

Prong (2)(B) is the most commonly pled prong of abusiveness, accounting for 11 of the 27 abusiveness claims to date. The prong (2)(B) cases are more difficult to categorize.

Half of the cases seem very much like the prong (2)(A) cases, in that the CFPB alleges that the “inability of the consumer to protect her interests” was based on a lack of information caused by defendants. Not surprisingly, in many (though not all) of these cases, the CFPB pled violations of prong (2)(A) in addition to (2)(B). Thus, for example, the CFPB alleged that a car dealership that misrepresented the annual percentage rate on its loans (which constituted a separate deception claim) and did not include sticker prices on its cars engaged in abusive conduct because “these actions left consumers unable to protect their interests.” In another case, the CFPB alleged that defendants engaged in abusive conduct under prong (2)(B) (in addition to prong (2)(A)) by “failing to disclose” and “misrepresenting” key aspects of their pension advance product. And in yet another case, the CFPB pled that a defendant's failure to disclose the existence and charging of fees caused the consumers' “inability to protect their interest” and violated prong (2)(B) in addition to prong (2)(A). Lastly, the CFPB alleged that “[b]y failing to disclose” the defendant's affiliation with a lender to whom consumers were referred for tax refund anticipation loans, and by withholding crucial information regarding the receipt of consumers' tax refunds, defendant violated prong (2)(B) (two separate counts). In all these instances, it is not clear why the CFPB chose to plead prong (2)(B) as opposed to prong (2)(A), or why it chose to plead both prongs. In each case, the consumers' alleged inability to protect their interests was caused by alleged deceptive statements or omissions,

rendering these prong (2)(B) cases very similar to the prong (2)(A) cases discussed above.

The remaining prong (2)(B) cases are different, focusing more on the nature of the conduct at issue, without regard to whether consumers had sufficient information to avoid it. This is most evident in two cases in which the CFPB alleged that conduct expressly authorized by contracts of adhesion that consumers had signed was abusive under prong (2)(B). In one case, the CFPB alleged that a retail store that sold goods on credit to military servicemembers violated prong (2)(B) by filing all collections litigation in Virginia, notwithstanding the forum-selection clause in the consumer credit contract that arguably informed consumers that litigation would be filed in Virginia. In pleading its abusiveness claim, the CFPB asserted that: “*Even if consumers read and understood the venue-selection clause, there was no opportunity to bargain for its removal because the clause was non-negotiable.*” Similarly, in a case against an auto-finance company, the CFPB alleged that threatened and actual contact with a military consumer's commanding officer in connection with the lender's debt-collection activities was abusive under prong (2)(B), notwithstanding the contractual language authorizing such conduct, because “[e]ven if [consumers] had been aware of the provision, they had no opportunity to bargain for its removal.” (Emphasis added.) In both of these cases, some consumers presumably did understand the contract clauses at issues, so arguably a claim that the defendant took unreasonable advantage of those consumers' “lack of understanding” under prong (2)(A) would not have been a viable theory. Relying on prong (2)(B), however, the CFPB asserted that there was nevertheless an “inability of the consumer to protect the interests of the consumer” due to the fact that the clauses were allegedly non-negotiable.

Not surprisingly, the CFPB also alleged in these two cases that the same conduct was unfair. In these cases, at least, prong (2)(B) abusiveness appears to be very similar to unfairness. While prong (2)(B) focuses on a consumer's “inability” to protect her interests and unfairness requires substantial injury “not reasonably avoidable” by consumers, they both turn on a perceived market failure in which consumers are deemed excused from the usual rules of *caveat emptor* due to the nature of the transaction at issue. While the overlap of

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prong (2)(B) and unfairness makes sense given the similarity in the required elements for each claim, these cases do not provide insight into what conduct is abusive that is not also unfair, or when the CFPB will decide to allege abusiveness in addition to unfairness.

The other prong (2)(B) cases also involve conduct that could have been alleged to be unfair, although the CFPB did not always plead unfairness. In two of the cases, the CFPB alleged that aggressively pushing consumers to take out loans they allegedly could not afford was abusive. One case involved a payday lender who allegedly created a sense of “artificial urgency” in the collection process to get consumers to roll over their loans; the other involved a for-profit school that allegedly pushed students into high-cost loans that defendant knew were likely to default. In both cases, the conduct could easily have been alleged to be unfair as opposed to abusive, for the very same facts that might lead one to conclude that consumers were unable to protect their interests under prong (2)(B) could similarly have been used to allege that consumers could not reasonably avoid the injury alleged under the unfairness doctrine.

Another prong (2)(B) case involved deferred-interest promotions in connection with online purchases. The CFPB asserted that the company's conduct in allegedly providing little information explaining its practices of allocating payments proportionally across most, if not all, balances, coupled with consumers' alleged inability to effectively change that allocation, was abusive. Again, the same conduct arguably could have been alleged to be unfair and, as discussed below, similar payment-allocation conduct has been described by the CFPB as unfair in other contexts.

The last prong (2)(B) case involved the same check-cashing company against whom the CFPB asserted a prong (1) claim for its alleged actions to prevent consumers from knowing the check-cashing fee. The prong (2)(B) claim in that case focused on different conduct — the company's alleged practice of pressuring or coercing consumers to cash their checks at the company, including by retaining custody of the check to prevent consumers from leaving, processing the check without the consumer's consent, applying the company's stamp to the back of the check during processing to impair the consumer's ability to cash the check elsewhere,

and making misrepresentations about the consumer's ability to cancel or reverse the transaction or cash the check elsewhere. Taken together, the CFPB alleged that these practices took unreasonable advantage of the inability of the company's consumers to protect their interests in selecting or using the company's check-cashing services. Not surprisingly, the CFPB also alleged that the company's check-cashing practices were unfair.

### COMPARING PRONGS (2)(A) AND (2)(B)

In the above analysis, prong (2)(A) is akin to deception, and prong (2)(B) is akin to unfairness. And just as deceptive conduct can be the cause of a consumer's inability to reasonably avoid certain harm (thus rendering the conduct unfair), so too deceptive conduct can cause not only the consumer's “lack of understanding” under prong (2)(A), but also her “inability to protect her interests” under prong (2)(B). In that respect, every prong (2)(A) case could be recast as a prong (2)(B) case (in the same way that deception is sometimes considered a subset of unfairness).<sup>10</sup>

There are, however, two ways in which prong (2)(B) may be a slightly easier standard to satisfy than prong (2)(A). First, prong (2)(B) does not require a misrepresentation by the defendant, or another factual basis, to conclude that a consumer lacks understanding. Second, prong (2)(A) relates to “material risks, costs, or conditions” of the product or service, while prong (2)(B) relates to “selecting or using” the product or service. The latter may be a less demanding standard, because there is no express materiality threshold, nor is there an express requirement that the abusive practice directly relate to the characteristics of the product or service. For example, in a complaint against tax preparers who allegedly marketed tax refund anticipation loans offered by an affiliated lender, the CFPB alleged that the tax preparers failed to disclose their financial interests in the lender to consumers and so allegedly violated prong (2)(B). Arguably, this undisclosed financial relationship was not a “risk, cost, or condition” of the loans themselves, and so even though the claim turned on defendants' material omission of that information, a theory under (2)(A) may not have been viable. But evidently the CFPB considered the relationship to be relevant to “selecting or using” the loans under (2)(B).

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We expect to continue to see the CFPB rely primarily on these two prongs when it alleges abusiveness, given its apparent reluctance to allege “material interference” under prong (1) and the unique nature of prong (2)(C), discussed below.

### PRONG (2)(C): FOCUS ON RELIANCE AND LACK OF BENEFIT

Prong (2)(C) makes it unlawful to take “unreasonable advantage” of a consumer’s “reasonable reliance” on a provider of consumer financial services to act in the consumer’s interest. With the exception of the agency’s first abusiveness case, which was brought against a debt relief firm and which appeared to rely on prong (2)(C) in addition to prong (2)(A), the CFPB’s reliance on prong (2)(C) has focused on college students and circumstances in which defendants allegedly took affirmative steps to induce the students’ reliance on the defendants’ acting in their interests. Thus, in its complaint against a for-profit college, the CFPB alleged that the school’s staff solicited students’ reliance and trust, rendering the students’ reliance on the school to act in their interests reasonable. The complaint further alleged that the school’s practice of aggressively pushing students into expensive, high-risk loans that the school knew were likely to default took unreasonable advantage of the reliance the school had induced. Similarly, in its case against a debt relief provider focused on student loans, the CFPB alleged that the defendant’s telemarketers held themselves out as loan counselors and advisors and created the illusion of expertise and individualized advice to induce consumers to reasonably rely on the company to act in the consumer’s interest. The complaint then alleges that the company took advantage of this reasonable reliance by enrolling and taking fees from consumers who did not qualify for the relief the company promised.

These cases provide the clearest articulation of a pattern in the CFPB’s limited abusiveness jurisprudence. They suggest that the agency believes prong (2)(C) is appropriate in instances where companies take affirmative action to induce consumer reliance, particularly in instances where the target population or other circumstances suggest such reliance is reasonable.

The CFPB’s first prong (2)(C) case — against a debt relief provider — does not fit this pattern. But that case was the first in which the agency alleged abusiveness, and, as noted above, the single abusiveness claim in that case appears to be based on prong (2)(A) in addition to prong (2)(C). There is nothing in that complaint alleging that the defendant took specific actions to induce consumers’ reliance or explaining why such reliance would be reasonable. As such, it appears to be an aberrational use of prong (2)(C).

There is, however, one similarity between all three prong (2)(C) cases: in all three, the CFPB alleged that the abusive conduct entailed providing consumers a financial product or service from which they were unlikely to benefit — debt relief services the consumers allegedly couldn’t afford or didn’t qualify for or expensive student loans that the defendant allegedly knew were likely to default. Although those facts don’t align with the statutory criterion of reasonable reliance on an institution to act in the consumer’s best interest under prong (2)(C), they do suggest that this is the kind of conduct that the CFPB is concerned about and likely to tag as abusive.

### Examples of Abusiveness Without Unfairness or Deception

As discussed above, in most cases the CFPB has alleged that the same conduct that it considers abusive is also unfair and/or deceptive. But in some cases, the CFPB pled “stand-alone” abusive claims — i.e., it alleged that certain conduct was abusive without also alleging that it violated the old UDAP standard.<sup>11</sup> These cases might provide some insight into what conduct might be abusive that was not already proscribed as unfair or deceptive.

The first two stand-alone abusiveness claims involved factual scenarios in which the defendant was alleged to have knowledge that the product being sold to the consumer was not suitable to the consumer. The first such claim involved a debt relief provider and an allegation that enrolling consumers in a debt relief program that defendant knew consumers were unlikely to complete (based on financial information gathered from consumers) was abusive under prongs (2)(A) and (2)(C). The second such claim involved a payday lender alleged to have created and leveraged an “artificial sense of



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urgency” to induce delinquent payday loan borrowers with a “demonstrated inability to repay their existing loan” to take out new loans. The CFPB alleged that was abusive under prong (2)(B). As in the debt relief case, this claim was predicated on the defendant’s knowledge that the product being sold to the consumer is not in the consumer’s interest — in this case, because of the consumer’s inability to repay their existing loan. As with the prong (2)(C) cases discussed above, these “suitability”-type claims appear to be a common theme of the CFPB’s abusiveness cases. The agency may believe that, in certain circumstances, companies have an obligation to not sell products and services that will not benefit the consumers to whom they are sold.

Two other stand-alone abusiveness claims focus on a different concept, “steering.” First, in its complaint against a tax preparer, the CFPB alleged that the defendants’ alleged practice of steering consumers into high-cost tax refund anticipation loans provided by one of the defendants, when cheaper alternatives were available, constituted “abusive steering” in violation of prong (2)(B). And in a recent complaint against an online lead generator, the CFPB alleged that the company’s practice of purchasing leads from lead generators who made representations to consumers that they (the original lead generators) would find consumers the best rate or the lowest fees, and then selling those leads to tribal or offshore payday lenders who “typically charge higher interest rates than lenders adhering to state laws” was abusive under prong (2)(A). The CFPB referred to this conduct as “steering” consumers to lenders “offering less-favorable terms than may otherwise be available to them.” Although the tax preparer case was pled as a prong (2)(B) case and the lead generator case pled as a prong (2)(A) case, the underlying conduct the CFPB found problematic was similar — directing consumers to loan products containing less-favorable terms than might be available and of which defendants were presumably aware. Such alleged “steering”—which has echoes of the suitability claims discussed above—also seems to be a focus of the CFPB’s.

The two abusiveness claims involving prong (2)(C) already discussed above, in which the CFPB alleged that the defendants induced consumers’ reasonable reliance on the defendants to act in the consumers best interest, are also

“stand-alone” abusiveness claims to the extent that they rely on the alleged acts of inducement. That is, while the CFPB alleged other UDAP claims in those cases, neither deception nor unfairness involve questions of reasonable reliance and the facts relevant to such reliance are therefore not necessary aspects of those claims.

An additional “stand-alone” abusiveness case involved a company’s alleged payment allocation practices with respect to consumers who had multiple deferred-interest balances on their account. The CFPB asserted that the company’s alleged practice of allocating payments proportionally across most, or all, account balances without regard to the expiration date of the deferred-interest promotion for each balance, coupled with the company’s alleged failure to provide adequate information about how it allocated payments and the difficulty consumers allegedly encountered when seeking to direct the allocation of payments, was abusive under prong (2)(B). It is not clear why the CFPB chose to plead these facts as abusive, as opposed to unfair, which, as discussed below, is how they have addressed similar payment allocation issues in the student loan context.

Indeed, with the exception of the prong (2)(C) claims involving inducement of reliance, all of the “stand-alone” abusiveness claims may well have been pled as unfairness and/or deception claims. All of the claims could arguably be alleged to constitute conduct likely to cause substantial harm to consumers not reasonably avoidable by the consumers and not outweighed by countervailing benefits to consumers or competition (the test for unfairness). And several of the claims were also based on alleged material misrepresentations or omissions of the defendant. These cases, therefore, do not necessarily shed light on the unique nature of abusive conduct. But they do suggest that suitability and steering are issues that the CFPB views as potentially abusive.

### Pleading Abusiveness

#### STATING A CLAIM: A HIGHER BURDEN?

It is common for an abusiveness claim to recite the same allegations as an unfairness or deception claim that is also being asserted in the same case, but with alterations to fit the prongs of abusiveness. Sometimes, likening abusiveness too

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closely to unfairness or deception seems to lead drafters of CFPB complaints and consent orders into trouble. For example, when the CFPB makes an unfairness or deception claim, it is adequate to assert that the act or practice is likely to cause substantial injury or is likely to materially mislead. But none of the prongs of abusiveness contain this kind of probabilistic assessment. As a federal district court noted in connection with prong (2)(B), “the Bureau’s burden here is to show that [consumers] were, in fact, unable to protect their own interests.” In that case, the court held that the Bureau had met its burden. But on some other occasions, the Bureau has framed its complaints and consent orders in probabilistic terms. For example: “Consumers are unlikely to understand that during the first several years of enrollment in the [product], they will pay more in fees to [the defendant] than they will save.” (Emphasis added.) Or: “Servicemembers may have been unaware that Respondents were deducting [certain] fees from [their accounts].” (Emphasis added.) Arguably, these are just assertions that abusiveness is probable or possible and so do not properly state a claim.

### CONSISTENCY (OR THE LACK THEREOF)

The CFPB’s pleading of abusiveness has been less than consistent in several respects. First, there appears to be no set format for how the agency pleads UDAAP claims in general or abusiveness claims in particular. While Emerson famously said that “a foolish consistency is the hobgoblin of little minds,” consistency in pleading would serve several important purposes here. It would allow the public to better compare and thus understand what the agency thinks constitutes abusive conduct, and it would help ensure the CFPB was applying its new powers with analytical rigor. And, indeed, an examination of the CFPB’s abusiveness jurisprudence to date suggests some uncertainty as to what the different prongs of abusiveness mean, how they differ from each other, or when an abusiveness claim is appropriate.

In some cases, this inconsistency is reflected in how similar claims are pled. Thus, for example, the steering claim in the case against a lead generator was based on prong (2)(A), whereas the steering claim in the case against a tax preparer was based on prong (2)(B). In both cases, defendants allegedly misrepresented or omitted material information from consumers about the loans they were being offered,

suggesting that a prong (2)(A) claim may have been appropriate. At the same time, in both cases the consumers were allegedly incapable of protecting their interests in light of these misrepresentations or omissions, rendering a prong (2)(B) claim seemingly appropriate. It thus seems equally plausible that the pleading in these cases would have been reversed, or that both cases would have relied on the same prong or both prongs. Absent additional information from the CFPB, it is difficult to ascertain whether this apparent inconsistency is intended to reflect the agency’s understanding of these different prongs, and if so, what that understanding is.

For example, the claim that attempting to collect on loans that are allegedly void or voidable under state law (due to usury or licensing issues) is abusive was pled under prong (2)(A) in the first two of these cases the CFPB brought, but was pled under both prongs (2)(A) and (2)(B) in the third case.

It may be that factual differences underpinned the CFPB’s choice of prongs in all these cases, but that is not readily apparent from the pleadings themselves and the lack of consistency in pleading format further makes a comparison difficult; that in turn makes it difficult for industry to gain an understanding of what the CFPB thinks these prongs mean.

In addition to these substantive pleading differences, the CFPB also lacks a consistent approach to the structure of its pleadings. Thus, in some cases it will allege separate abusiveness claims for separate prongs of the statute, providing greater insight into what conduct it believes violates each prong. In other cases, it will plead a single claim and assert that the conduct at issue violates multiple prongs of the abusiveness definition, making it difficult to discern the agency’s views. More precise pleading would translate into greater transparency.

More troublingly, apparently similar conduct has been deemed abusive in one case, but not another, on multiple occasions:

- In a complaint against an auto finance company, the CFPB alleged that threatening to contact and contacting servicemembers’ commanding officers about their debt constituted abusive conduct under prong (2)(B), notwithstanding the contractual provision authorizing such contact. But in a complaint against a retailer who

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was similarly alleged to have contacted servicemembers' commanding officers about the consumers' debt—pursuant to a contractual authorization that the CFPB characterized as “buried” in the credit contracts, not explained to consumers, and that “many consumers did not know” was included in the contract—the CFPB only alleged the conduct to be unfair, and not abusive.

- In a complaint against a retailer who filed all of its collections actions in Virginia pursuant to a venue-selection clause in its consumer credit contracts, the CFPB alleged that conduct to be abusive. But in a consent order against another retailer who also sold goods to servicemembers, the CFPB did not bring such a claim, notwithstanding press reports of similar practices.
- Perhaps reflecting a hesitation to use its abusiveness authority with respect to depository institutions, the CFPB has not alleged that the sale of credit card add-on products by banks to consumers allegedly ineligible to reap their benefits is abusive, although it made abusiveness claims based on the ineligibility of consumers in cases against debt-relief companies and a for-profit school.
- The CFPB's complaint against one company that provided mortgage payment services alleged that the company's promise of savings to consumers who enrolled in its bi-monthly mortgage payment program was abusive because the defendants knew that most consumers would leave the program prior to saving money. But the CFPB's consent order against another company providing similar services, which contained similar factual allegations about the company's marketing of savings that only a small number of consumers realize, did not contain an abusiveness claim.
- Finally, the CFPB alleged that a company's payment allocation practices, which allegedly presented challenges to consumers effectively allocating payments to specific deferred-interest balances on most, or all, of their accounts, constituted abusive conduct. But similar conduct allegedly engaged in by student loan servicers has been described by the CFPB in its Supervisory Highlights newsletter as the “unfair”—but not abusive—“practice of depriving consumers of an effective choice as to how to allocate these partial payments.” This last example is

particularly troubling, as it suggests that how a practice is characterized may depend on whether the institution at issue is subject to a CFPB investigation (conducted by its Office of Enforcement) or examination (conducted by its Office of Supervision Examinations).

The above comparisons are necessarily simplistic, based on the limited factually similar facts available in the public record. But they do suggest a possible lack of consistency in the agency's approach to this important issue. Such a lack of consistency is perhaps understandable given the newness of the abusiveness authority and the challenge in identifying what conduct is abusive. But as the agency matures and develops a body of abusiveness cases, greater consistency and providing more information about why certain conduct is deemed abusive would help the CFPB achieve its presumed goal of educating industry as to the meaning of this new prohibition.

### Takeaways about Abusiveness

So what does it all mean and what can we learn from how the CFPB has handled its abusiveness authority to date? For the most part, the abusive conduct alleged by the CFPB has also been alleged to be unfair and/or deceptive, or could have been. With the possible exception of the prong (2)(C) cases, therefore, there is still no clear answer to the question of what might constitute abusive conduct that wasn't already proscribed by the traditional UDAP prohibition. That said, some insights can be gleaned from these cases.

First, given the lack of clear distinction between abusiveness and unfairness or deception, it appears that bringing an abusiveness claim is a way for the agency to make a statement of moral disapproval. Many of the abusiveness cases involve consumers whom the CFPB views as especially vulnerable—students, seniors, members of the military, payday loan borrowers, and those seeking debt relief assistance. None involved instances where the CFPB recognized “responsible business conduct,” which is a CFPB policy to reward companies that engage in self-policing, self-reporting, remediation, and cooperation.<sup>12</sup> And none involved depository institutions, which the agency may see as less likely to deliberately seek to harm consumers. It thus appears that non-depository

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institutions that sell financial products and services to seemingly vulnerable consumers are more likely to be tagged with the “abusive” label. That, of course, provides little by way of clarity as to what conduct might be considered to cross the “abusive” line.

Second, many of the abusiveness claims turn on allegedly deceptive statements (or omissions) that companies made (or failed to make) to consumers. It is those statements that are deemed to constitute the “taking unreasonable advantage” required for the prong (2) abusiveness claims (or, in rarer circumstances, the “material interference” required for a prong (1) claim). But it is not clear if the CFPB has any more of a developed sense today of when such allegedly deceptive conduct crosses the line into abusiveness than it did five years ago, when it first gained this authority, since no discernable pattern has emerged of when an abusiveness count is added to these cases.

Third, it is clear that prongs (2)(A) and (2)(B) are those most frequently relied upon, although the distinction as to which of those prongs should apply to what specific conduct is not at all clear. As discussed above, in many instances it appears that the CFPB could have just as easily selected the other prong. The alleged “lack of understanding” underpinning prong (2)(A) claims can also be alleged to constitute an “inability to protect a consumer’s interests” under prong (2)(B). And many of the prong (2)(B) cases in fact rely upon alleged misrepresentations or omissions that could have formed the basis for a prong (2)(A) claim. That said, prong (2)(A) seems to most closely parallel deception claims, while prong (2)(B) seems to most closely parallel unfairness claims.

The one area in which some clarity may be developing is in the CFPB’s use of prong (2)(C) in cases where companies allegedly took affirmative action to induce vulnerable consumers to believe that the company will act in the consumer’s best interests in order to sell them products or services from which they were unlikely to benefit. While conclusions are difficult to draw from the small number of cases, if the pattern continues, it may provide the clearest indication of what conduct falls within the “abusive” arena.

Insofar as specific conduct is concerned, several themes are apparent. First, the CFPB has repeatedly asserted that

attempting to collect on loans that are allegedly void or voidable as a function of state law is abusive conduct. As two of those cases are currently being litigated, they may provide a heretofore rare opportunity for the federal courts to opine on the appropriate reach of the abusiveness authority. Second, steering consumers into high-cost loans may constitute abusiveness, particularly if the company should know that cheaper alternatives exist. Third, in some cases selling consumers financial products or services that they cannot afford or for which they do not qualify may constitute abusive conduct. In this respect, the CFPB appears to be using its abusiveness authority to seek to impose a “suitability”-type requirement on providers of consumer financial products or services. Finally, certain debt collection conduct may constitute abusive conduct, although it is difficult to ascertain what factors drive the CFPB to conclude that certain conduct is abusive but other conduct is not.

For companies seeking to comply with this emerging area of law, a few lessons emerge. First, a compliance program targeted at preventing traditional UDAPs is likely to address potential UDAAPs as well. Because the conduct alleged to be abusive to date could similarly have been alleged to be unfair and/or deceptive (and in most cases was so alleged), focusing on avoiding those better-defined legal prohibitions will go a long way toward preventing an abusiveness claim. Second, companies should take special care if they make statements that could reasonably be understood to induce consumers to rely on the company to act in the consumer’s interest. This is especially true with respect to the three specific populations that the CFPB is charged with protecting—students, seniors, and servicemembers. Companies should consider reviewing their marketing materials for such statements and take appropriate steps to either edit the marketing materials or ensure that the company is acting in accordance with them. Third, institutions marketing consumer financial products or services to arguably vulnerable populations should consider reviewing their marketing materials and products and services with an eye to whether the CFPB might allege that the companies steered consumers into more expensive or riskier products or otherwise sold consumers products or services for which the consumers were ineligible or from which they were unlikely to benefit. These seem to be the primary areas

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of abusiveness concern for the CFPB to date, and companies should consider proactively addressing any risks they face in these areas.

Given the importance of this emerging area of the law, the CFPB should take steps to be consistent and transparent in its use of this new authority. Particularly because few institutions have so far been willing to litigate with the agency, the agency's choice of claims in its complaints and consent orders plays an important role in shaping the contours of abusiveness. With the traditional UDAP arsenal at its disposal, the CFPB can afford to take a more deliberate approach to its implementation of the abusiveness prohibition. Consistency in approach—in terms of what conduct is deemed abusive, what prong of abusiveness applies, and how claims are pled—will serve to both ensure that the agency is exercising its authority in a consistent manner, and allow industry to better understand the CFPB's expectations. Ultimately, the final word will come from the federal courts. But in the intervening years, the CFPB has a special responsibility to carefully develop this new area of law. ♦

### Endnotes

<sup>1</sup> The CFPB *alleges* a UDAAP violation when it files a complaint in federal district court, and such an allegation is not a finding of a violation. It *finds* a UDAAP violation when it issues an administrative consent order based on such findings. For ease of reference, we refer to both complaints and consent orders as containing "allegations." In entering a settlement with the CFPB, companies generally do not admit the allegations (or findings) contained in the complaint or consent order.

<sup>2</sup> At least four state attorneys general have used their authority under the Dodd-Frank Act to bring separate actions alleging abusive acts or practices. See 12 U.S.C. § 5552. Those cases are not discussed herein, as they do not shed much light on how the CFPB intends to use this authority.

<sup>3</sup> 12 U.S.C. § 5536(a)(1)(B).

<sup>4</sup> 12 U.S.C. § 5531(c); see also 15 U.S.C. § 45(n).

<sup>5</sup> See, e.g., CFPB, Supervision & Examination Manual at UDAAP 5 (Oct. 2012), available at [http://files.consumerfinance.gov/f/201210\\_cfpb\\_supervision-and-examination-manual-v2.pdf](http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf); FTC Policy Statement on Deception (Oct. 14, 1983), appended to *Cliffdale Assocs., Inc.*, 103 F.T.C. 110, 174 (1984).

<sup>6</sup> 12 U.S.C. § 5531(d).

<sup>7</sup> See 12 U.S.C. §§ 5516(d)(1), 5531(a).

<sup>8</sup> 12 U.S.C. § 5552(a).

<sup>9</sup> This count includes cases in which the defendants were alleged to have provided substantial assistance to the abusive conduct of others.

<sup>10</sup> See, e.g., J. Howard Beales, *The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection* (May 30, 2003) ("Commission precedent incorporated in the statutory codification makes clear that deception is properly viewed as a subset of unfairness.... Material misleading claims prohibited by the Commission's deception authority almost invariably cause consumer injury because consumer choices are frustrated and their preferences are not satisfied. That injury is substantial as long as enough consumers are affected. Moreover, consumers cannot reasonably avoid the injury precisely because the seller misled them about the consequences of the choice."), available at <https://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection>.

<sup>11</sup> Determining whether an abusiveness claim is merely duplicative of unfairness or deception claims based on the same conduct or a "stand-alone" claim that is based on a different aspect of that conduct necessarily involves the exercise of some judgment. The summary below is based on our consideration of the nature of the facts alleged and the claims pled by the CFPB, but we recognize that others might reach different conclusions with respect to some of the cases we have included or excluded from the "stand-alone" category.

<sup>12</sup> See CFPB Bulletin 2013-06 (June 25, 2013), available at [http://files.consumerfinance.gov/f/201306\\_cfpb\\_bulletin\\_responsible-conduct.pdf](http://files.consumerfinance.gov/f/201306_cfpb_bulletin_responsible-conduct.pdf).

# Cases

# Cases: Fair Lending

Fair lending has been among the CFPB's top priorities since its inception in July 2011. The Bureau has authority to implement and enforce the Equal Credit Opportunity Act (ECOA) and the Home Mortgage Disclosure Act (HMDA), and has an Office of Fair Lending and Equal Opportunity that is dedicated to ensuring "fair, equitable, and nondiscriminatory access to credit."

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The following is a summary of the highlights of the CFPB's key fair lending activities during its first five years.

## Rulemaking

The Dodd-Frank Act transferred rulemaking authority for ECOA and HMDA to the CFPB. The Bureau has amended HMDA's implementing regulation, Regulation C, and is in the early stages of developing a proposed rule to implement the Dodd-Frank Act's provision requiring information gathering on certain business loans.

## HMDA

The Dodd-Frank Act amended HMDA to require covered lenders to report new data points and to authorize the Bureau to require reporting of additional information. In October 2015, the Bureau issued final amendments to HMDA's implementing regulation, Regulation C, most of which will become effective in January 2018. Most significantly, the amendments will require reporting of numerous new data fields, including applicant age, credit score, automated underwriting system information, property value, pricing information, loan term, and other features. The data reported under the amended rule will have a major impact on fair lending supervision and enforcement, because it will allow the CFPB and other regulators to more accurately screen for potential fair lending violations and to identify more types of potential discrimination.

## DODD-FRANK ACT SECTION 1071: INFORMATION CONCERNING CREDIT APPLICATIONS BY WOMEN- OR MINORITY-OWNED BUSINESS AND SMALL BUSINESSES

Section 1071 of the Dodd-Frank Act amended ECOA to add a HMDA-like provision requiring financial institutions to collect and report information on applications made by women- and minority-owned businesses and small businesses. The Act directed the CFPB to issue regulations implementing this requirement. The Bureau now is in the process of gathering information to aid in formulating a proposal.

## Compliance Bulletins

Over the past five years, the CFPB issued four compliance bulletins covering fair lending issues and one addressing HMDA data accuracy.

## Cases: Fair Lending

### CFPB BULLETIN 2012-04: LENDING DISCRIMINATION

In April 2012, the CFPB issued Compliance Bulletin 2012-04 indicating that the Bureau will use the disparate impact doctrine (among other methods) to evaluate and enforce compliance with ECOA.

### CFPB BULLETIN 2013-01: INDIRECT AUTO LENDING AND COMPLIANCE WITH ECOA

In March 2013, the CFPB issued Compliance Bulletin 2013-01 describing the Bureau's views about the application of ECOA to dealer mark-ups, and providing recommendations about how indirect auto lenders can manage the related fair lending risks.

### CFPB BULLETIN 2013-11: HMDA AND REGULATION C – COMPLIANCE MANAGEMENT; CFPB HMDA RESUBMISSION SCHEDULE AND GUIDELINES AND HMDA ENFORCEMENT

In October 2013, the CFPB issued Compliance Bulletin 2013-11 reminding institutions of their obligations to accurately collect and report HMDA data; providing recommendations on how to establish an effective HMDA compliance management system; announcing the Bureau's revised HMDA resubmission schedule and guidelines; and describing the factors the Bureau may evaluate in deciding whether to pursue a HMDA enforcement action.

### CFPB BULLETIN 2014-03: SOCIAL SECURITY DISABILITY INCOME VERIFICATION

In November 2014, the CFPB issued Compliance Bulletin 2014-03 to remind institutions that ECOA requires them to consider public assistance income when underwriting loans, and describing the standards they may and may not use to verify Social Security Disability Income and Supplemental Security Income.

### COMPLIANCE BULLETIN 2015-02: SECTION 8 HOUSING CHOICE VOUCHER HOMEOWNERSHIP PROGRAM

In May 2015, the CFPB Published Compliance Bulletin 2015-02 to remind institutions that ECOA requires them to consider income from the Section 8 Housing Choice Voucher Homeownership Program when evaluating mortgage loan applications.

## Enforcement

The CFPB has settled ten ECOA enforcement matters and two HMDA enforcement matters since its inception. In all but one of its ECOA settlements, the Department of Justice joined the settlement, typically after conducting its own investigation.

Four of the Bureau's ECOA settlements involved disparities in dealer mark-ups in indirect auto lending transactions. These settlements required the indirect auto lenders to issue refunds to minority consumers who were alleged to have overpaid, civil money penalties, and, for those institutions that remained in operation after the settlement, revisions to their dealer mark-up policies.

Two of the ECOA settlements resolved allegations of redlining in mortgage lending transactions. These settlements required the lenders to provide mortgage lending subsidies, pay civil money penalties, and undertake a variety of remedial measures, including minority-area advertising, branch expansions, and employee training.

Another two ECOA settlements involved alleged discrimination in mortgage pricing. One case involved wholesale pricing disparities, and the other involved disparities in both wholesale and retail pricing. These settlements required damages to aggrieved borrowers and remedial measures.

The other two ECOA settlements involved credit cards. One case involved a claim that a credit card issuer discriminated on the basis of ethnicity by excluding Spanish speaking borrowers from debt relief initiatives, and the other involved claims that a credit card issuer's age split scorecard did not comply with ECOA's requirements.

Finally, the Bureau settled two enforcement matters involving alleged HMDA reporting violations. These settlements required the lenders to correct and refile their HMDA data, and imposed civil money penalties and enhanced HMDA compliance measures. ♦



# Cases: Credit Cards

The CFPB has directed considerable attention to credit cards from the minute it launched its operations on July 21, 2011. The Bureau's Consumer Response office's system for receiving and addressing consumer complaints focused first on credit cards, and its first public enforcement action targeted credit card issuers' marketing of add-on products. The following summary highlights the Bureau's key credit card-related activity during its first five years.

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## Regulation and Guidance

### KNOW BEFORE YOU OWE – SIMPLIFIED CREDIT CARD AGREEMENT PROTOTYPE

In December 2011, the CFPB kicked off a credit card-focused initiative under the rubric of its Know Before You Owe campaign. This initiative was designed to simplify credit card agreements so that consumers could more easily understand credit card prices, risks, and other features. As part of this effort, the Bureau published a simplified credit card agreement prototype that presented key information in a clear and concise format. The Bureau also established an online database of existing credit card agreements that consumers can use to compare the agreements with the simplified prototype.

### CREDIT CARD COMPLAINT DATA

In June 2012, the CFPB finalized a policy statement describing how it discloses information about credit card complaints submitted by consumers. The disclosures are designed “to provide consumers with timely and understandable information about credit cards and to improve the functioning of the credit card market.” The policy statement explains that the Bureau will disclose the complaint information in a public database and in the Bureau's own periodic reports. In October 2015, the CFPB reported that between its first day of operations in July 2011 and October 1, 2015, it had received approximately 79,500 credit card-related complaints. Consumers' complaints included confusion over late fees, difficulty resolving inaccurate billing statements, and accounts closed without advance warning.

### COMPLIANCE BULLETIN ADDRESSING ADD-ON PRODUCTS

In July 2012, the CFPB issued Bulletin 2012-06 to address practices associated with marketing of add-on products. The Bulletin expressed concern with various practices associated with add-on products, including failing to adequately disclose important product terms and conditions, enrolling consumers in programs without their consent, and billing consumers for services not actually provided. The Bulletin instructs companies to, among other things, ensure that marketing materials “reflect the actual terms and conditions of the product,” not use employee incentive programs that “create incentives for employees to provide inaccurate information about products,” conform telemarketing scripts and manuals to a variety of requirements, and employ compliance management programs that meet certain, enumerated expectations.

## Cases: Credit Cards

### CARD ACT RULE AMENDMENTS BENEFITTING STAY-AT-HOME SPOUSES AND PARTNERS

In April 2013, the CFPB finalized amendments to its CARD Act rule to make it easier for stay-at-home spouses and partners to obtain credit cards. The final rule expressly permits credit card issuers to consider, when evaluating an application for a new card or account increase, income that a stay-at-home spouse or partner shares with his/her spouse or partner. The amended rule revised a prior provision that generally permitted card issuers to consider only the applicant's income and assets.

### COMPLIANCE BULLETIN ADDRESSING PROMOTIONAL APRS

In September 2014, the CFPB issued Bulletin 2014-02 to inform credit card issuers of the UDAAP risk in connection with solicitations that offered a promotional APR. The Bulletin advised credit card issuers to clearly, prominently, and accurately describe the effect of promotional APR offers on the grace period for new purchases. The Bulletin noted that solicitations risked being deceptive if they did not “convey that a consumer who accepts such an offer and continues to use the credit card to make purchases will lose the grace period on new purchases if the consumer does not pay the entire statement balance, including the amount subject to the promotional APR, by the payment due date.”

### Enforcement

During its first five years, the CFPB has instituted approximately 20 proceedings concerning credit cards or credit card-related products. Although a vast majority of these proceedings were administrative, the Bureau filed a handful of them in federal district courts across the country. Overall, although certain conduct and products were of particular concern, the Bureau's enforcement proceedings covered an array of issues. The following summarizes the key aspects of the CFPB's first five years of credit card-related enforcement.

### TYPE OF CLAIMS

The CFPB's favored vehicle—by a landslide—for bringing an action related to credit cards is CFPB Sections 1031 and 1036, the provisions prohibiting unfair, deceptive, or abusive acts or practices (UDAAPs). Virtually all of the credit card

proceedings over the past five years involved such a claim, and most of them involved more than one. But the Bureau is focused on more than UDAAP claims. Several of the proceedings also alleged violations of the Fair Credit Reporting Act (FCRA), the Truth in Lending Act (TILA), and the Equal Credit Opportunity Act (ECOA) (or those statutes' implementing regulations). One proceeding alleged a violation of Regulation E, the implementing regulation of the Electronic Fund Transfer Act (EFTA).

Just as the CFPB had a favored vehicle for bringing proceedings related to credit cards, it also had a favored area of concern. About half the credit card-related proceedings stemmed from unfair and deceptive practices relating to the marketing, sale, billing, and/or administration of add-on products. Typically, the add-on products concerned credit monitoring, identity theft, and debt cancellation programs.

A common claim among these cases was that an entity made material misrepresentations or omissions during inbound or outbound telemarketing sales calls. For example, in one proceeding, the CFPB alleged that a company misrepresented in telemarketing calls the cost of a particular add-on product because the company led cardholders to believe that there would be no fee if the monthly balance was paid off. In another proceeding, the CFPB alleged the company omitted material information because some cardholders disclosed information indicating they would be ineligible for certain benefits of an add-on product, but the company did not inform the cardholders of that ineligibility. In several proceedings, the Bureau alleged that a company offered a credit monitoring service that required a consumer to authorize access to his or her credit report in order for the company to provide the service. Even if that authorization was not provided, either immediately or ultimately, and thus the company could not provide the credit monitoring service, the company still charged the consumer's account for the service. Finally, many cases involved claims that a company had used deceptive tactics in collecting time-barred debts.

Other claims were more straightforward. For example, one case alleged that a company offered a cash bonus offer in its solicitations but failed to provide the cash bonus. Another case alleged that a company violated Regulation E because it did not obtain an affirmative “opt-in” before charging an

## Cases: Credit Cards

overdraft fee. And in one case, the agency alleged that a company violated TILA and Regulation Z because during the first year after account opening it required cardholders to pay fees exceeding 25% of the credit limit in effect when the account was opened.

Although most of the proceedings were aimed at primary actors, the CFPB also brought proceedings against companies allegedly providing “substantial assistance” to another company engaging in a UDAAP violation. For example, the CFPB brought one case against an entity that provided a credit card add-on product by partnering with depository institutions. The CFPB alleged that the entity instructed the depository institution to bill the consumer for a product even though the consumer was not receiving the full product benefit. As a result, the CFPB alleged, the entity provided “substantial assistance” to the depository institution’s UDAAP violation. In another case, a debt buyer did not have correct information about the annual percentage rate for the charged-off accounts it had purchased and on which it was attempting to collect. The CFPB brought a proceeding against the entity that had sold the accounts to the debt collector, alleging that the entity had provided “substantial assistance” to the UDAAP violation because it had not provided the debt buyer with correct APR information and thus contributed to the collection of incorrect amounts.

### MONETARY IMPACT

The targets of CFPB proceedings typically pay both civil monetary penalties and restitution. For credit card proceedings over the past five years, the civil penalties have ranged from \$70,000 to \$35,000,000, with an average penalty of approximately \$8,800,000. In a few of the proceedings, the company had self-reported the violations, and the penalties in those cases were below the average. No mention was made, however, whether the self-reporting affected that determination.

The other monetary component of the proceedings is restitution, which typically consisted of reimbursing the consumer for various fees and finance charges. In most of the proceedings, the CFPB required the company to establish a separate account from which it would make restitution, even if a company had already made restitution payments to

consumers. These are substantial accounts, with amounts ranging from \$55,000 to \$700,000,000. In many of the proceedings, if, after all restitution payments were made, there was an amount remaining in the account, that amount went to the CFPB, with the option of it ultimately being paid to the US Treasury as disgorgement.

### QUALITATIVE IMPACT

All of the CFPB’s credit card settlements required substantial action on the company’s part, and most of the requirements are very detailed and tailored to the underlying allegations. Thus, it is impossible to summarize the qualitative actions that companies have been required to undertake. Nonetheless, all or almost all of the proceedings resulted in certain remedial actions that can be generalized.

In addition to the restitution payments themselves, the proceedings required the companies to undertake significant processes to effectuate the payments. For example, either the companies themselves or an outside auditor (approved by the CFPB) had to develop a plan to identify each consumer that was entitled to restitution, identify the amount to which each consumer was entitled, and locate the consumer. Restitution payments often had to be accompanied by a company-drafted, agency-approved letter explaining what the payment was for and that it was the result of a CFPB enforcement proceeding. The settlements also have detailed provisions as to how restitution payments should be made depending on the status of the account, e.g., an account credit, a check, etc.

Of course, all proceedings required the companies to cease the alleged illegal conduct, and most of them went much further. In one proceeding, the CFPB prohibited a company from offering any more credit products. If the subject of the proceeding was unfair and deceptive telemarketing representations with respect to a specific product, the company would usually have to undertake a system-wide review to ensure all products were compliant. In some proceedings, the company had stopped marketing the product before the proceeding commenced. The CFPB still required that company to seek agency approval before marketing a similar product in the future.

## Cases: Credit Cards

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Also not surprisingly, all companies were directed to update their Compliance Management Systems. Usually this involved the revision or creation of certain policies and procedures. In several of the proceedings, the CFPB directed a company to create or update a UDAAP policy and a vendor management policy. Training—both of internal employees and employees of affiliated entities—was often required.

Oversight of the changes and of overall compliance with the consent orders often fell to the Board's audit committee or a new committee mandated by the settlement, although the

Board had ultimate responsibility. Moreover, settlement agreements often required the company to retain multiple third-party consultants and auditors, approved by the agency, to help the company develop and implement certain requirements and to fulfill ongoing reporting requirements to the Board and CFPB regarding compliance. All of the proceedings resulted in recordkeeping requirements and a duty to notify various parties, such as shareholders, of the proceeding. ♦

# Cases: Debt Collection

Since its inception, the CFPB has brought more than 20 actions alleging violations of the Fair Debt Collection Practices Act or unfair, deceptive, or abusive acts or practices in connection with debt collection. Companies subject to such actions have included banks, payday lenders, student lenders, auto finance companies, retailers, mortgage loan servicers, debt buyers and sellers, and law firms. Although these enforcement actions have involved a wide variety of allegations, certain types of allegations have made repeat appearances in the Bureau's actions to date. These areas of focus are discussed in greater detail below.

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## Debt Collection Communications

Many of the Bureau's debt collection actions have focused on allegations of improper communications in connection with debt collection. Allegations have included making an excessive number of calls to consumers' home, work, and cell phone numbers; calling consumers at inconvenient times, such as early in the morning or late at night; using obscene, profane, or abusive language in collection calls; disclosing the existence of consumers' debts to third parties, such as consumers' family members and employers; continuing to call consumers at work after being told that such calls were prohibited; continuing to call consumers directly after being told that they were represented by counsel; falsely threatening litigation or wage garnishment; falsely threatening to report non-payment to credit bureaus or the consumer's employer; and falsely threatening arrest, criminal prosecution, or imprisonment.

In July of 2014, for example, the CFPB took action against one of the largest payday lenders in the country for engaging in unfair, deceptive, and abusive practices in connection with its collection of payday loans. The Bureau alleged that the company engaged in unfair acts or practices by making an excessive number of calls to consumers; disclosing the existence of consumers' debts to non-liable third parties; continuing to call consumers at work after being told that such calls were prohibited; continuing to call consumers directly after being told that they were represented by counsel; and continuing to call consumers with no relation to the debt after being told that the payday lender had the wrong person. The Bureau alleged that the company engaged in deceptive acts or practices by misrepresenting the acts that would be taken by third-party debt collectors if the debt were transferred; misrepresenting its ability to prevent a debt from being transferred to a third-party collector; falsely threatening litigation; falsely threatening to report non-payment to credit bureaus; falsely threatening to refer non-payment for criminal prosecution; and falsely threatening to add collection fees. Finally, the Bureau alleged that the company engaged in abusive acts or practices by creating an artificial sense of urgency and leveraging this sense of urgency to induce borrowers unable to repay their existing loan to take out a new loan, for which the borrower would pay new fees to the lender. The company in question entered into a consent order with the Bureau, agreeing to pay \$5 million in consumer refunds, cease the unfair, deceptive, and abusive acts and practices noted above, and pay a \$5 million fine.

## Cases: Debt Collection

As another example, in July of 2015 the CFPB took action against a bank and its affiliates for, among other things, illegal debt collection tactics related to student loan servicing. The Bureau alleged that the bank engaged in unfair acts or practices by making more than 150,000 collection calls to borrowers' cell phone numbers before 8 a.m. or after 9 p.m. in the time zone of the borrower's address. Borrowers whose cell phone number and mailing address were associated with different time zones often received collection calls before 7 a.m. and after 10 p.m. in the time zone of the borrower's address. The Bureau also alleged that the bank violated the Fair Debt Collection Practices Act in connection with 252 loans that were in charged-off status when the bank purchased them. The bank allegedly failed to provide these borrowers with specific information about the amount and source of the debt and the consumers' right to contest the debt's validity during the bank's initial communication with the borrower or in a written debt-validation notice sent within five days of that initial communication. To resolve these and other allegations, the bank and its affiliates entered into a consent order with the Bureau, agreeing to pay a \$2.5 million civil penalty. The bank also agreed, in relevant part, to stop making calls to borrowers before 8 a.m. or after 9 p.m., absent specific authorization from the borrower, based on the time zones associated with the borrower's known address and telephone number. For borrowers with multiple addresses or telephone numbers, the bank agreed to ensure that any calls made to the borrower fall within the period between 8 a.m. and 9 p.m. in each location where the consumer might live based on the addresses and telephone numbers known to the bank.

### Purchase and Sale of Debt

Several other cases have focused on the sale, purchase, and subsequent collection of consumer debt. The CFPB has taken action against debt sellers for selling accounts that were settled, discharged in bankruptcy, not owed by the consumer, or otherwise uncollectable; providing inaccurate account information to debt buyers; and failing to remit consumers' post-sale payments to debt buyers in a timely fashion. For example, in February of 2016 the Bureau took action against a bank for engaging in unfair acts or practices in connection with the sale of charged-off credit card debt. When the bank sold portfolios of charged-off credit card accounts, it

normally provided the debt buyer with an electronic spreadsheet including information about each account, such as the name, address, and social security number of the consumer, the amount of the debt, and the APR applicable to the debt. According to the Bureau, for approximately 128,000 accounts, the bank overstated the APR in the spreadsheet provided to debt buyers. The Bureau alleged that the bank did not confirm that the APR listed in the spreadsheet was consistent with the APR information in the account-level documentation, nor did the bank provide debt buyers with account-level documentation that the debt buyers could use to verify the APR information contained in the spreadsheet, unless the debt buyers requested this documentation. Moreover, the bank's debt sale contracts usually placed a limit on the number of documents that a debt buyer could request following the debt sale before paying a fee of \$10 per document to the bank. The Bureau also alleged that the bank delayed sending consumers' post-sale payments to debt buyers or completely failed to identify and remit such payments to debt buyers. The bank entered into a consent order with the Bureau, agreeing to pay nearly \$5 million in consumer redress, as well as a \$3 million civil money penalty. The bank also agreed to modify its practices, such as by providing certain account-level documentation to debt buyers for each account sold and by timely identifying and forwarding payments from consumers on sold accounts.

On the other side of the transaction, debt buyers have found themselves subject to enforcement action for collecting unverified debts, in certain instances even after the debt had been disputed by the consumer. According to the Bureau, debt buyers often failed to obtain or review account-level documentation. In September of 2015, for example, the Bureau took action against two of the country's largest debt buyers and collectors. One of the primary allegations was that the debt buyers attempted to collect debts that they knew or should have known were inaccurate or unenforceable. The Bureau alleged that the debt buyers normally relied on summary data files provided by debt sellers as the only basis for their collection efforts, rarely requesting account-level documentation from debt sellers to verify the accuracy of the data file. Rather than conducting their own investigations, the debt buyers generally relied upon consumers to notify them of inaccurate information when the debt buyers

## Cases: Debt Collection

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attempted to collect the debt. To resolve these and other allegations, the debt buyers entered into consent orders. Pursuant to the consent orders, the debt buyers agreed to review account-level documentation to verify debts before collecting on them under certain circumstances, such as when a consumer has disputed the debt or when the agreement for the purchase of the debt did not include meaningful and effective seller representations and warranties regarding the accuracy or validity of the debt. Among other things, the debt buyers also agreed to refund millions of dollars to consumers, to cease collecting on millions of dollars of debt, and to pay civil money penalties of \$8 million and \$10 million, respectively.

### Preparation of Documents in Debt Collection Litigation

Finally, the CFPB has also focused its attention on the preparation of court documents in debt collection lawsuits. Companies have been cited for filing inaccurate affidavits and pleadings as a result of “robo-signing,” a practice in which

documents are signed without being properly reviewed by the signer. Similarly, law firms have been subject to enforcement action for relying heavily on automation and non-attorney support staff, with each lawsuit receiving minimal review by an attorney, as well as for altering declarations to change the date of execution or the balance owed and then filing those declarations in collections litigation.

### Looking Forward

With the Bureau expected to reveal a proposal to regulate debt collection practices in the near future, debt collection is likely to remain one of the Bureau’s top priorities for the foreseeable future. ♦

# Cases: RESPA

While the CFPB gained authority to implement and enforce the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. §§ 2601 *et seq.*) (RESPA) in July 2011, its RESPA enforcement efforts began in earnest in April 2013, when it entered into a \$15.4 million settlement with four mortgage insurance companies. RESPA enforcement has been and continues to be a priority for the CFPB, which has brought approximately 20 RESPA enforcement actions in its short history. Over the past three years, the CFPB has brought mortgage-related RESPA enforcement actions against over 25 respondents and collected nearly \$75 million, with another \$109 million on the line pending the outcome of current litigation. In looking at the mortgage space, one can discern a pattern in the types of activities that tend to draw the CFPB's attention. This section identifies those activities and related enforcement actions and highlights some of the lessons to be learned.

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Sections 8(a) and 8(b) of RESPA impose broad bans on referral fees and the splitting of unearned fees, and the CFPB has been aggressive in its pursuit of RESPA compliance. In fact, it has become well known for regulating through enforcement and demonstrated that it is not beholden to past regulatory advice from the US Department of Housing and Urban Development (HUD). The CFPB's 2014 action against PHH Corporation (PHH), which is currently pending in federal district court, is the most significant RESPA enforcement action to date. As it will decide the future of the most widely used exception to RESPA's anti-kickback provisions, as well as a number of procedural issues, it has the potential to re-write RESPA history. That being said, while the CFPB's other RESPA enforcement actions may be more pedestrian, they address a variety of issues of critical importance to the mortgage industry, including practices of which settlement service providers already should have been wary.

**PHH Corporation:** In January 2014, the CFPB initiated an administrative proceeding against PHH and its affiliates, alleging an illegal captive mortgage reinsurance scheme dating back 20 years. The CFPB alleged that PHH did business exclusively with mortgage insurance companies that agreed to purchase reinsurance from a wholly owned PHH subsidiary at inflated rates and the insurance premiums PHH received were illegal referral fees. The CFPB sought \$430 million. An administrative law judge (ALJ) determined, however, that the CFPB's claims accrued when the subject loans closed in 2008, HUD's power had been limited to civil actions in federal court where a three-year statute of limitations applied, and the transfer of RESPA enforcement authority to the CFPB could not restore time-barred claims. Thus, the ALJ determined that \$6 million – not \$430 million – was an appropriate penalty.

The CFPB did not accept the ALJ's Recommended Decision and issued a final order requiring PHH to disgorge \$109 million, which included all of the reinsurance premiums it had received on or after July 21, 2008, regardless of whether the underlying loans had closed before, on, or after that date. Director Richard Cordray stated that, although the CFPB is subject to a three-year statute of limitations when it files a complaint in court, it is not subject to any statute of limitations in administrative enforcement. Cordray also expressed a novel view of



## Cases: RESPA

Section 8(c)(2) of RESPA, the reasonable compensation exception on which most claims of RESPA compliance appear to be based. He declared that Section 8(c)(2) does not provide a substantive exemption from the anti-kickback provisions and that merely entering into a contract is a thing of value. PHH has appealed the CFPB's order and the case is now pending before the US Court of Appeals for the DC Circuit. A decision is expected later this summer.

While the PHH case involves captive reinsurance, the legality of most activities that seem to raise RESPA concerns for regulators – e.g., marketing agreements, office rentals, promotional activities, co-advertising arrangements, lead generation purchases, Internet advertising, etc. – hinge on the Section 8(c)(2) exception. If the CFPB's interpretation of Section 8(c)(2) is upheld, providers will find it much more difficult to justify any business arrangement between entities when referrals are present. The PHH case also will decide a number of procedural issues with far-reaching impacts, including: whether enforcement actions are subject to a statute of limitations; when RESPA claims accrue; what constitutes disgorgement; and the constitutionality of the CFPB itself. For these reasons, the PHH case arguably is the most significant enforcement action since RESPA's enactment 42 years ago and the outcome will be of momentous importance to the entire settlement services industry.

**Captive Reinsurance:** In April 2013, the CFPB brought an enforcement action against four national mortgage insurance companies, alleging that they paid millions of dollars in illegal kickbacks to mortgage lenders across the country for over a decade. The insurance companies purportedly ceded portions of their insurance premiums to referring lenders' captive reinsurers. The CFPB stated its concern that, while mortgage insurance helps borrowers get loans, it also increases monthly payments, especially when its cost is inflated by illegal kickbacks, which in turn may increase the risk that borrowers will default, thereby damaging both communities and the housing market. The CFPB's statements highlight the need to be suspicious of any business arrangements that steer consumers to particular entities and/or increase costs to consumers. Under the resulting Consent

Orders, the CFPB banned the mortgage insurers from captive reinsurance arrangements for 10 years, subjected them to ongoing compliance monitoring, reporting and recordkeeping requirements, and required them to pay a total of \$15.4 million in penalties.

**Affiliated Business Arrangements:** Like HUD in the past, the CFPB also has expressed concern with affiliated business arrangements (AfBAs) aimed at circumventing the anti-kickback provisions. In May 2013, it alleged that the owner of a homebuilding company created sham mortgage brokerage firms with two banks; the homebuilder referred mortgage business to the brokerage firms and the banks performed all of the work for them. The CFPB relied on HUD's 10-part test to determine the legitimacy of an AfBA and concluded that the brokerage firms' profit distributions and payments under a services agreement were kickbacks in return for the homebuilder's referrals. Under the resulting Consent Order, the respondents disgorged all profits received under the arrangement, which totaled \$118,194.20, and were prohibited from entering into any AfBAs for five years.

Later, in August 2014, the CFPB alleged that a national mortgage company, along with its affiliated appraisal company and the individual owner of both entities, had entered into a bait-and-switch scheme whereby consumers had to schedule and pay for appraisals and marked-up credit reports before receiving Good Faith Estimates and customers were referred to the appraisal company without disclosure of the affiliation. The respondents ultimately paid \$6 million in civil penalties (including \$1.5 million from the individual owner), and \$14.8 million in refunds to customers. They also were subject to detailed reporting, compliance, quality control, monitoring, and recordkeeping requirements.

**Office Rentals:** In December 2013, the CFPB ordered a mortgage lender and its former owner/current president to pay \$81,076 for purported kickbacks to a bank in the form of inflated office rents in return for mortgage loan referrals. The CFPB asserted that, rather than paying a flat monthly fee, the lender paid rents tied to the volume of successful mortgage transactions that the lender originated at the bank's office.

## Cases: RESPA

The CFPB highlighted an exclusivity clause requiring each entity to promote only the other entity, and lower rents in the geographic area. The \$81,076 penalty included \$27,076 in proceeds from unlawfully referred business and \$54,000 in civil penalties.

**Fee-Splitting:** In February 2014, the CFPB ordered a lender that provides loss-mitigation financing to distressed borrowers to pay an \$83,000 civil penalty for splitting loan origination and loss-mitigation fees with a hedge fund from which it obtained financing for its loans. The lender self-reported the violation and provided information relating to the conduct of other actors. The CFPB factored the lender's self-reporting and cooperation into the settlement, which may account for its subsection to just a penalty, as opposed to restitution as well.

**Marketing:** Marketing services agreements (MSAs) have become a topic of increasing concern. In September 2014, the CFPB fined a title company \$200,000, required it to terminate all existing MSAs, and prohibited it from entering into any new MSAs. In February 2015, it imposed a \$2 million penalty on a lender for its arrangement with a veterans' organization. In the first case, the CFPB noted that the parties did not document any methodology for determining fair market value payments, parties considered the volume and value of referrals in determining the fee, and the title company did not monitor the service provider to ensure it performed the contracted services. In the second case, the CFPB noted that the lender was designated as the exclusive lender for the veterans' organization, advertisements promoted the entities' relationship and encouraged use of the lender, and the parties did not disclose the financial arrangement to consumers. Nothing in these cases suggests that MSAs are per se illegal, and in fact, the CFPB has said they are not illegal. The CFPB's statement that merely entering into a contract is a thing of value to an entity that makes referrals, however, raises a question as to whether and when an MSA ever would be condoned. As the foregoing cases created confusion, in October 2015, the CFPB issued a Compliance Bulletin to address market behavior and the legal and compliance risks that MSAs pose ([http://files.consumerfinance.gov/f/201510\\_cfpb\\_compliance-bulletin-2015-05-respa-compliance-and-marketing-services-agreements.pdf](http://files.consumerfinance.gov/f/201510_cfpb_compliance-bulletin-2015-05-respa-compliance-and-marketing-services-agreements.pdf)). The Compliance

Bulletin, however, does not state when and under what circumstances MSAs will comply with RESPA or what specific facts would have validated the arrangements in the foregoing cases.

**Kickback Schemes:** Finally, in January and April 2015, the CFPB brought an enforcement action against two national mortgage companies, a title company, and eight individuals in connection with illegal kickbacks from the title company to the mortgage companies in return for referrals of title business. Specifically, title company employees furnished cash, marketing materials, and consumer information to loan officers in return for referrals. Hundreds of loan officers and thousands of loans were involved. The CFPB imposed nearly \$36 million in penalties and redress payments on the mortgage lenders. It collected \$767,500 in payments from the eight individuals and banned each individual from participating in the mortgage industry for two or five years. The CFPB noted, however, that a lender that had self-reported and terminated all loan officers involved was not prosecuted.

Lastly, and most recently, in May 2016, the CFPB took action against a former bank employee for alleged mortgage fee-shifting. The CFPB charged him with referring customers to an escrow company that manipulated customer prices to enable him to offer no-cost loans to some buyers, resulting in higher costs to other buyers, which ultimately increased the number of loans he could close and the number of commissions he earned. Under the Consent Order, the individual must pay an \$85,000 civil penalty and is banned from the mortgage industry for one year.

### Lessons To Be Learned

While the CFPB's RESPA enforcement activity may have started off slow, it quickly picked up steam. The most common allegation in mortgage-related RESPA cases is that a service provider has paid or received referral fees, and the relief sought typically includes: a cease and desist order or injunction prohibiting continuing and future violations; monitoring, reporting, and recordkeeping requirements; restitution to consumers; civil money penalties; and perhaps shareholder notice of the enforcement action. Although the CFPB's approach to any given situation is unpredictable, and although the parameters of Section 8 remain undefined and

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open to interpretation pending resolution of the PHH case, there are lessons to be gleaned from the CFPB's enforcement actions to date. For example:

- Do not rely only on prior HUD interpretations in considering RESPA compliance. Consider the facts laid out in each CFPB Consent Order and avoid any particular conduct the CFPB denounced.
- Take care not to steer consumers to particular providers.
- Be suspicious of any arrangements that increase costs to consumers.
- Ensure any joint venture is an independent, legitimate, *bona fide*, stand-alone entity with separate office space and employees who perform all core services for the entity.
- Document the methodology for determining fair market value.
- Monitor the performance of services required for receipt of payment.
- Avoid exclusivity clauses.
- Ensure AfBA disclosures meet RESPA's form, content, and timing requirements.

- Disclose financial arrangements for marketing and advertising.
- Consider that self-reporting matters.
- Remember that individuals are not immune from enforcement.

The RESPA enforcement landscape is ever-changing. There are tools available, however, to help settlement service providers navigate within the mortgage space. In addition to the statute itself and the implementing regulation, CFPB Compliance Bulletins address particular topics and CFPB Supervisory Highlights share recent examination findings. The CFPB also publishes regulatory overviews, plain language guides, and answers to frequently asked questions. All of these materials, as well as enforcement actions, can be found on the CFPB's website. In an effort to limit compliance exposure and minimize enforcement risk, settlement service providers should take care to monitor the CFPB's enforcement activities closely, with special attention to the outcome of the PHH litigation. ♦

# Cases: Loan Originator Compensation

So far, there have been four public CFPB consent orders related to alleged violations of the loan originator compensation restrictions in 12 C.F.R. § 1026.36(d).

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The first occurred in November 2013. Drawing from the details in the consent order and press release, the CFPB charged that company officers were awarding quarterly bonuses to loan originators in amounts calculated based on the interest rates of the loans originated. To those familiar with the prohibitions in the regulations, that may seem like the CFPB found some low-hanging fruit. Nonetheless, the CFPB's consent order was instructive as a reminder that the agency and its forensic accountants will look beyond the loan originator's compensation plans, which, in this case, allegedly were relatively straight forward and did not reflect the basis for or amount of the quarterly bonuses. The CFPB required the company to pay \$13 million, including \$4 million as a penalty and \$9 million in consumer redress. Apparently, receiving that check from the CFPB alerted several consumers to the fact that they may have a private right of action against the company, which is currently defending a class action lawsuit alleging, among other causes of action, violation of the loan originator compensation regulations.

Then, the next year, in November 2014, the CFPB entered into a consent order with a mortgage lender that the agency similarly accused of improperly paying periodic bonuses to loan originators. In this case, the company allegedly was funding those bonuses with amounts based on a percentage split of higher interest rates and fees charged to consumers. While the CFPB forced the company to pay \$730,000 to affected consumers, it found that the company could not afford a civil penalty without being driven into bankruptcy.

In June 2015, the CFPB imposed its largest loan originator compensation penalty to date. Although the mortgage company had changed its compensation practices, the agency looked back prior to those changes to the first loan originator compensation rules of the Federal Reserve Board (which became effective in April 2011, before the CFPB gained its transfer of authority). The CFPB charged that the company deposited profits on mortgage loans into expense accounts and used those deposits to fund bonuses or raises, borrower pricing concessions, RESPA tolerance cures or appraisal costs. The agency required the company to pay \$18 million in borrower relief, plus a \$1 million penalty. In addition, the agency required the company's CEO individually to pay a \$1 million penalty, claiming that the officer benefitted from, controlled, directed and was personally knowledgeable of the alleged violations.

Also in June 2015, the CFPB found that loan originators (including producing branch managers) employed by a mortgage company had ownership interests in separate marketing services entities. The mortgage company allegedly made monthly payments to those entities based on the terms of loans originated (interest rates). The loan originator-owners then drew

## Cases: Loan Originator Compensation

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a portion of those fees as compensation. The CFPB required the company (which is now defunct) and its individual owners to pay a \$228,000 penalty. This case makes clear that the CFPB will look at all types of compensation that branch managers and other loan originators receive to determine whether they are based on loan terms.

The CFPB has emphasized that its supervision and enforcement activities will continue to focus on loan originator compensation. In its Supervisory Highlights issued in March 2016, the agency reported that it was finding instances in

which companies had failed to maintain written loan originator compensation policies and procedures, which we have found often leads examiners to dig further to uncover additional violations. CFPB Deputy Assistant Director Calvin Hagins also warned in December 2015 that the agency's upcoming examinations would target loan originator compensation plans, indicating that the agency believes it is an area ripe for violations or consumer harm. ♦

# Cases: Mortgage Advertising

The CFPB has brought a handful of enforcement actions concerning how mortgage products are advertised over the past five years. To date, these actions have focused on two key areas: misrepresentation of mortgage rate information and misrepresentation of government affiliation.

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## Alleged Misrepresentation of Mortgage Rates

In a 2015 action, the CFPB alleged a mortgage lender's direct mail advertisements were deceptive and also violated the Truth in Lending Act (TILA) and the Mortgage Acts and Practices Advertising Rule (MAP Rule) by failing to clearly and conspicuously disclose the fact the advertised products were adjustable rate mortgages. The CFPB further alleged that the lender failed to include required information on the mailer disclosing the applicable variable interest rate over the life of the loan, the term during which the advertised payment amount would apply, and the fact that the estimated payment amount did not include any taxes or insurance that would apply—all in violation of TILA. The CFPB also alleged that the lender misrepresented its affiliation with the government, discussed below. The lender settled with the CFPB for \$250,000 in civil money penalties.

Another CFPB enforcement action indicates that advertisements must disclose all relevant terms and conditions in a transaction, not just those expressly required by TILA. In a 2014 matter, the CFPB alleged a mortgage lender's online advertisements were deceptive for failing to disclose information on the discount points and high credit score used to calculate the advertised rate, despite the fact that APR was prominently disclosed in advertisements. The CFPB also alleged other legal violations relating to the lender's mortgage origination process. The lender settled with the CFPB for \$14.8 million in consumer redress and \$6 million in civil money penalties.

## Alleged Misrepresentation of Government Affiliation

In 2015, the CFPB took action against four mortgage lenders advertising FHA-insured or VA-guaranteed loan products. The Bureau alleged the lenders' advertisements violated the MAP Rule and were deceptive. The CFPB's allegations focused on direct mail marketing efforts targeted toward older and veteran borrowers. Three of the cases involved reverse mortgage lenders, a recent supervisory and enforcement priority of the Bureau.

The CFPB claimed the lenders' advertisements were deceptive and misleading, because they implied US government approval of the products. In particular, the CFPB alleged the lenders' marketing materials were deceptive because of the use of official looking seals or logos on letters, envelopes designed and formatted to appear like official government notices, statements in mailers indicating a relationship with or an endorsement from the government, and the lenders' failure to prominently disclose their lack of government affiliation.

## Cases: Mortgage Advertising

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In three of the matters, the CFPB agreed to a consent order with the lender and fined the lender a civil money penalty in amounts ranging from \$85,000 to \$250,000. In one case, the CFPB filed a complaint with the US District Court for the District of Maryland before reaching a settlement for \$13,000 in civil money penalties.

In another mortgage advertising case in 2015, the CFPB alleged that a lender's marketing to members of a veterans' organization touting the lender as the veterans' organization's "exclusive lender" as a result of the lender's high standards for service and excellent value was deceptive,

because the lender failed to disclose its financial relationship with the veterans' organization. The CFPB also alleged that the veterans' organization's endorsement of the lender was an illegal paid referral under RESPA. The CFPB entered a consent order against the lender requiring it to pay a \$2 million civil money penalty. ♦

# Cases: Mortgage Servicing

The past five years have seen several high-profile and high-dollar enforcement actions by the CFPB against mortgage loan servicers. Just six settlements with mortgage loan servicers have resulted in over \$2.75 billion in relief to underwater borrowers, direct consumer remediation and civil money penalties.

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## Focus on Servicing Transfers

The CFPB has brought three enforcement actions against mortgage loan servicers alleging unfair, deceptive or abusive acts or practices (UDAAP) related to the servicing transfer process. Specifically, the CFPB alleged the servicers failed to honor in-process loan modifications offered by prior servicers, delayed decisions on loss mitigation applications following transfer, failed to correct inaccurate information received from prior servicers and initiated foreclosure proceedings using inaccurate information from prior servicers. Two of the settlements also alleged violations of the Mortgage Servicing Rules, which went into effect on January 10, 2014.

The three actions resulted in remediation to borrowers ranging from \$1.5 million to \$48 million and civil money penalties ranging from \$100,000 to \$15 million.

As part of the settlements, the CFPB also required the servicers to implement additional preventative measures surrounding the servicing transfer process. Two of the settlements required the servicers to implement data integrity programs to test, identify and correct errors in transferred loans. All three settlements required the servicers to undertake certain home preservation efforts for borrowers potentially affected by servicing transfer issues. Specifically, the mortgage loan servicers agreed to convert in-process loan modifications into permanent modifications, engage in outreach to offer certain borrowers loss mitigation options and cease the foreclosure processes for certain transferred borrowers.

## A Team Effort

The CFPB has often partnered with other federal government agencies or state attorneys general in its cases against mortgage loan servicers. This may explain in part the large overall settlement costs for mortgage loan servicing claims.

In addition to the three actions described above, the CFPB joined 49 states and the District of Columbia in its \$2.125 billion settlement with one mortgage loan servicer and joined the Department of Justice, HUD, and attorneys general in 49 states and the District of Columbia in its \$550 million settlement with another mortgage loan servicer. The CFPB alleged the servicers engaged in illegal foreclosure practices, including robo-signing of foreclosure



## Cases: Mortgage Servicing

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documents. As part of the settlement agreements, the CFPB required these two servicers to agree to the servicing standards under the 2012 National Mortgage Settlement.

The CFPB also joined the Federal Trade Commission in its \$63 million settlement against a third mortgage loan servicer. In addition to servicing transfer claims, the consent agreement in this case alleged deceptive practices around the charging of pay-by-phone fees.

### Payment Processing

The CFPB has brought enforcement actions against two mortgage payment processing companies offering biweekly mortgage payment programs. Under the programs, borrowers would have payments automatically deducted from bank accounts every two weeks by the payment processing

company. The payment processor would then transmit payment to the mortgage loan servicer once a month. The CFPB alleged the companies' advertisements, which promised borrowers interest savings through more frequent mortgage payments, were deceptive.

One of the payment processing companies partnered with a mortgage loan servicer when offering the program, and the CFPB brought an action against the servicer as well. That case was settled with a \$100,000 fine against the mortgage loan servicer. The payment processing company settled with the CFPB for \$33.4 million in consumer remediation and a \$5 million civil money penalty. In a case that is still pending, the CFPB filed a complaint against the other payment processing company in the US District Court for the Northern District of California. ♦

# Cases: Student Lending

In its efforts to regulate the higher education industry, the CFPB has brought actions against a broad range of different companies — from student loan servicers and debt relief companies to financial aid service providers and the colleges themselves. An overview of the Bureau's student lending enforcement actions is below.

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## Predatory Lending

The CFPB brought two enforcement actions in 2014 against for-profit schools alleging predatory lending practices. Both complaints alleged the colleges pressured students into taking out high-cost private student loans that were likely to fail. The CFPB alleged the schools misled students about future job prospects and placement rates following graduation. In one of the matters, the CFPB also alleged the college engaged in illegal debt collection practices by blocking access to academic resources and withholding diplomas unless the student borrowers made monthly loan payments.

In October 2015, the CFPB won a default judgment of \$530 million against one of the for-profit colleges. Although the college had already been dissolved in a Chapter 11 bankruptcy proceeding at the time of the default judgment, the CFPB secured \$480 million in debt forgiveness for the student borrowers from an entity that had purchased the loans from the school. The other action is currently pending in the US District Court for the Southern District of Indiana, where the CFPB defeated a motion to dismiss.

## Student Loan Servicing

In 2015, the CFPB brought an enforcement action against a student loan servicer for violating the Consumer Financial Protection Act's prohibition of unfair, deceptive and abusive acts and practices (UDAAP) in connection with its servicing of transferred loans. Specifically, the CFPB alleged the student loan servicer overstated the minimum amount due in billing statements, misrepresented the interest paid by student borrowers, and engaged in illegal debt collection practices by contacting student borrowers early in the morning or late at night and by failing to provide required debt validation notices. Under the consent order, the student loan servicer agreed to pay \$16 million in consumer remediation to over 100,000 student loan borrowers and a \$2.5 million civil money penalty.

## Student Loan Debt Relief

The CFPB has brought three actions against student loan debt relief companies in 2014 and 2016. The CFPB alleged the companies illegally charged student loan borrowers up-front fees for their debt relief services, which helped students receive federal loan repayment benefits; misrepresented the services offered and the benefits consumers could receive; and, in two of the cases, also alleged the debt relief companies misrepresented an affiliation with the

## Cases: Student Lending

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Department of Education. As a result of the actions, the companies and their owners were permanently barred from providing debt relief services and were required to pay fines and consumer remediation ranging from \$25,000 to \$8.2 million.

### Financial Aid Services

In 2015, the CFPB also brought two actions against companies offering services related to obtaining financial aid. In an action against one company, the CFPB alleged the company deceptively marketed its services by falsely promising to match consumers with individualized financial aid opportunities and by implying affiliation with the Department of Education and academic institutions. The CFPB also alleged the company pressured consumers to enroll and pay for services by creating a false sense of urgency and using fake deadlines. The action against the company and its owner/operator is currently pending before the US District Court of the Southern District of California.

The other action, against a company that offered assistance in completing the Free Application for Federal Student Aid (FAFSA), alleged unlawful billing practices. The CFPB

alleged the company charged consumers through an annual subscription service without the consumers' consent or authorization and without adequate disclosure of the recurring charges. The matter was settled via consent order, which required the company to refund \$5.2 million to consumers.

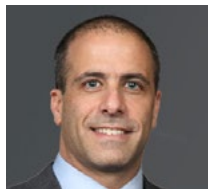
### Accrediting for Profit Schools

The CFPB is also embroiled in litigation regarding the scope of its authority in the student lending space. The CFPB issued a civil investigative demand (CID) to an entity that accredits for-profit schools, seeking to investigate whether that entity could be liable for unfair, deceptive or abusive acts of practices in connection with its accreditation activities. After the entity refused to comply with the CID, the CFPB filed suit to enforce it. The district court dismissed the CFPB's action, finding that the intended investigation exceeded the CFPB's authority, which is limited to consumer financial products or services. The CFPB recently appealed this matter to the DC Circuit. ♦

# Cases: Payday Lending

The CFPB has brought a dozen enforcement action against payday lenders or industry participants working with such lenders in the past five years. The actions have focused on the origination of payday loans, debt collection by payday lenders, and the provision of various services to payday lenders by third parties. Most of the actions have also involved claims against individuals and many are still pending in litigation.

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## Origination of Payday Loans

Only a few of the CFPB's payday cases have primarily involved allegations of wrongdoing in the origination of payday loans.

In a lawsuit against a group of companies, the CFPB alleged that the companies and their owners unfairly purchased consumer information from lead generators and then, without consumer authorization, deposited moneys in consumers' accounts and began withdrawing payments from those accounts indefinitely. The CFPB also alleged that the defendants created bogus loan documents and, in cases where the defendants did interact with consumers, failed to provide consumers with required disclosures regarding the costs of the loan, in violation of the Truth in Lending Act (TILA) and the prohibition on deceptive conduct. In what has become a common claim in such cases, the complaint also alleged that the company violated the Electronic Funds Transfer Act (EFTA) by requiring repayment of its loans via pre-authorized electronic funds transfer. The CFPB obtained a temporary restraining order freezing the defendants' assets, and the case is pending in the Western District of Missouri.

In a rare use of its administrative forum for contested litigation, the CFPB filed a notice of charges against a payday lender and its owner, alleging that the lender's loan agreements contained disclosures based on repaying the loan in a single payment, even though the default terms of the contract called for multiple rollovers of the loan and additional finance charges. The CFPB alleged that this practice was deceptive and also violated the TILA. The CFPB also alleged that the company violated the EFTA law by requiring consumers to agree to repay their loans via pre-authorized Automated Clearing House (ACH) payments, and that the company's use of remotely created checks was unfair. The administrative law judge hearing the case has awarded partial summary judgment to the CFPB, and a hearing on unresolved matters, including the owners' individual liability, is scheduled to begin in July.

Most recently, the CFPB brought an action against a check-cashing and payday lending company and its owner. While most of the allegations in the complaint relate to the company's check-cashing practices, the CFPB also alleged that the company deceptively described the terms and conditions of its thirty-day loan product. The case is in its early stages and is pending in the Southern District of Mississippi.

## Cases: Payday Lending

### Collection of Payday Loans

Most of the CFPB's actions involving payday loans have involved the collection of such loans.

In its first payday enforcement action, the CFPB alleged that a payday lender engaged in unfair robo-signing in connection with collecting on its loans. The CFPB alleged that the company had stamped signatures on legal pleadings and affidavits without prior review. The consent order in the case also alleged that the company had violated the Military Lending Act by making loans to over 300 servicemembers with interest rates over 36%. Finally, the consent order alleged that the company had impeded a CFPB examination by instructing employees to limit the information provided to the Bureau, deleting calls and shredding documents and withholding an internal audit report from examiners. The consent order required the company to provide \$8 million in customer remediation and dismiss pending collections lawsuits and cancel judgments in connection with the robo-signing allegations and to pay a \$5 million civil money penalty.

In an action against a company affiliated with an online lender and its owner, the CFPB alleged that attempting to collect on certain loans made in violation of state law constituted unfair, deceptive, or abusive acts or practices (UDAAPs). Specifically, the CFPB alleged that in those states where state law provides that loans made by unlicensed lenders or in violation of the state's usury cap are void, the attempt to collect on such loans violates the federal UDAAP prohibition. The case is pending in the Central District of California, where the parties recently filed cross-motions for summary judgment.

In a case against an online payday lender, the CFPB brought similar claims regarding the attempt to collect on loans that violate certain state licensing and usury laws. In that case, the CFPB also alleged that the lender engaged in deceptive conduct by falsely threatening lawsuits, arrest, prison, or wage garnishments in attempting to collect its debts. The CFPB also alleged that the lender's inclusion of a wage assignment clause in its loan agreements was an unfair practice and violated the FTC Credit Practices Rule. The case is currently pending in the Southern District of New York.

In another case involving payday debt collection practices, the CFPB alleged that a payday lender had unfairly pressured borrowers to renew their loans, thus allegedly creating a "cycle of debt." The CFPB also alleged that the lender deceptively threatened criminal prosecution, lawsuits, the imposition of extra charges, and adverse credit reporting if consumers did not pay their debts, even though it had no intention of pursuing any of those avenues. Finally, the CFPB alleged that the lender made an excessive number of collection calls to certain consumers. The case resulted in a consent order requiring the lender to pay \$5 million in consumer restitution and a \$5 million civil money penalty.

Finally, the CFPB brought an enforcement action against a payday lender alleging that its in-person debt collection activities risked disclosing the existence of the debt to third parties, that the lender had in fact improperly disclosed the debt to third parties, and had deceptively threatened legal action without the intent to follow through. The CFPB also alleged that the lender unfairly attempted multiple simultaneous withdrawals from consumer accounts when payments were due, misrepresented that consumers could not revoke their authorization for electronic payments, and violated the EFTA by requiring pre-authorized electronic payments as a condition of credit. In addition to the debt collection allegations, the CFPB also alleged that the lender deceptively told consumers that no credit check was necessary. The consent order in this case required the lender to pay \$7.5 million in consumer restitution, stop collecting on tens of millions of dollars of debts, and pay a \$3 million civil money penalty.

### Industry Participants

In addition to the above actions against payday lenders and their affiliates, the CFPB has also brought enforcement actions against other parties involved in the payday ecosystem. In the past year, the CFPB has filed a case against a payment processor, alleging that the payment processor engaged in unfair conduct by processing payments for clients without adequately investigating, monitoring, or responding to red flags that indicated some clients were breaking the law or deceiving customers. Among the categories of clients identified by the CFPB were payday lenders. The case is pending in the District of North Dakota.

## Cases: Payday Lending

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The CFPB has also brought a series of cases against a lead generator and its owners and managers, alleging that the lead generator purchased leads from other lead generators who often claimed to match consumers with lenders that “follow the rules” or offer “reasonable” terms and then sold those leads to lenders without first vetting the purchasers or requiring them to provide information about whether they complied with state laws. The cases are all pending in the Central District of California. ♦

# Cases: FCRA

The Fair Credit Reporting Act (FCRA) regulates Credit Reporting Agencies (CRAs), users of consumer reports and parties that furnish consumer information to the CRAs (furnishers) to promote the accuracy, fairness and privacy of consumer information in credit reports. The CFPB has brought and settled seven enforcement actions against CRAs, users and furnishers for alleged FCRA violations.

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## Consumer Reporting Agency

The CFPB brought an enforcement action against a CRA in 2015 in which it alleged that a background check company failed to implement reasonable procedures to ensure maximum possible accuracy of reported information, failed to maintain strict procedures to ensure that public information likely to adversely impact a consumer's ability to obtain employment is current and failed to exclude non-reportable information from its reports. In particular, the company permitted its employees to use their discretion to determine whether records matched consumers with common names and nicknames, which allegedly resulted in reports of mismatched criminal record information. The CFPB ordered the company to pay \$10.5 million for consumer redress and a \$1.25 million civil money penalty.

## Users of Consumer Reports

The CFPB has also brought an enforcement action against a company that acted both as a user of consumer information and a CRA. The company's business involved evaluating consumer reports for lenders by purchasing and assembling reports that it purchased from other CRAs. The CFPB found that the company obtained consumer reports from other CRAs to generate marketing materials for its prospective lender clients, which was not a permissible purpose under the FCRA. Additionally, in its capacity as a CRA, the company refused to investigate disputes in which it deemed that a consumer did not provide supporting documentation, failed to provide information concerning consumer disputes to furnishers and failed to investigate consumer claims of identity theft. The CFPB ordered the company to pay an \$8 million civil money penalty.

## Furnishers

The CFPB has brought five enforcement actions against furnishers, all from mid-2014 to 2015. In 2014, the CFPB filed an action against a buy-here, pay-here used car dealer for systematically providing inaccurate consumer information to CRAs, failing to correct or delete the inaccurate information, and failing to implement reasonable policies and procedures regarding the accuracy and integrity of the information it furnished. The dealer allegedly furnished inaccurate consumer balances and repossession information to CRAs and allegedly did not properly investigate consumers' disputes of such information. The company was subject to an \$8 million civil money penalty.

In an action against a debt collector, the CFPB alleged that the company failed to institute policies and procedures for investigating consumer disputes about furnished information in a timely manner. Specifically, the CFPB found that the debt collector lacked policies and

## Cases: FCRA

procedures tailored to handling and tracking consumer disputes and set no deadline for responding to such disputes. In addition to a \$500,000 civil money penalty, the CFPB also ordered the debt collector to provide over \$5 million in consumer redress.

The CFPB filed a similar case against another debt collector in late 2015 for its alleged reporting of inaccurate disputed information to CRAs, ordering \$743,000 in consumer redress as well as a \$1.85 million civil money penalty.

In two of its enforcement actions against furnishers for FCRA violations, the CFPB has also included Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) allegations related to the FCRA claims. In an action against an auto finance company, the CFPB alleged that the company committed a deceptive practice by informing consumers that it would only furnish accurate information to CRAs and that it would correct any inaccurate information, when, in fact the company furnished inaccurate information for many customer accounts and failed to promptly correct information it knew to be inaccurate. The company was subject to a \$2.75 million civil money penalty.

Similarly, in an action against a buy-here, pay-here used car dealer in which the CFPB found that the dealer furnished information it knew was inaccurate, the CFPB also claimed that the dealer engaged in deceptive acts and practices by representing that it would help consumers build good credit by reporting positive information to CRAs. Instead, the dealer failed to furnish positive payment history information and in some instances deleted previously furnished positive credit information in an attempt to undo its furnishing errors. The CFPB ordered the dealer to pay close to a \$6.5 million civil money penalty.

### Future CFPB Activity

FCRA compliance should continue to remain a concern for all consumer finance companies. The CFPB has explicitly identified consumer reporting as one of its policy priorities over the next two years. It plans to continue examining and investigating parties subject to the FCRA, gather information to assess options for improving consumer reporting data, and potentially consider rulemaking around furnisher and consumer reporting accuracy, dispute resolution and related issues. ♦



# Cases: Banking Practices

Since its inception, the CFPB has brought several enforcement actions against banks for certain banking practices, including advertising of accounts and related products, assessment of overdraft fees and deposit verification procedures.

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Since its inception, the CFPB has brought several enforcement actions against banks for certain banking practices, including advertising of accounts and related products, assessment of overdraft fees and deposit verification procedures.

In October 2014, the CFPB entered into a consent order with a New York State member bank for allegedly deceptively advertising its “Free Checking” account (Free Checking) product in violation of the prohibition on unfair, deceptive or abusive acts or practices (UDAAP). The CFPB asserted that customers who opened Free Checking accounts and failed to meet minimum activity requirements were automatically converted to a different account product that charged customers a monthly maintenance fee. The CFPB further asserted that neither the minimum activity requirements nor the automatic conversion were disclosed in advertising for the Free Checking product. The CFPB alleged that the bank engaged in a deceptive act or practice by implying in advertising and marketing that customers with the Free Checking product would not pay a monthly maintenance fee and failing to disclose the requirements to receive that benefit. The CFPB also alleged that the bank’s advertising violated prohibitions under Regulation DD against “misleading or inaccurate” advertising and advertising that “misrepresent[s] a depository institution’s deposit contract.” Finally, the CFPB alleged that the bank violated the Regulation DD prohibition against advertising an account as “‘free’ or ‘no cost ... if any maintenance or activity fee may be imposed on the account,’” since the Free Checking accounts were subject to minimum activity requirements that, if not met, could result in the assessment of maintenance fees.<sup>2</sup> The bank was assessed a civil money penalty of \$200,000 and was required to pay redress to affected consumers, including refunding the subject maintenance fees.

In April 2015, the CFPB entered into a consent order with a regional bank headquartered in Birmingham, Alabama for allegedly unlawfully assessing overdraft fees in violation of the Opt-In Rule<sup>3</sup> and the prohibition on UDAAP. The CFPB asserted that the bank, as part of its efforts to comply with the Federal Reserve Board’s Opt-In Rule, initially determined that opt-in was not necessary for certain of its customers who had checking accounts linked to savings accounts for overdraft coverage. Further, the CFPB asserted that, if the balance of both accounts became overdrawn due to a customer transaction, the bank charged customers an overdraft fee despite the fact that it had not obtained affirmative opt-in for such coverage.<sup>4</sup> The CFPB alleged that, by wrongly stating in account materials that customers would not be charged overdraft fees unless they opted in and actually assessing some \$47 million of such

## Cases: Banking Practices

fees without an opt-in, the bank engaged in a deceptive act or practice. The CFPB also asserted that the bank represented in advertising relating to a short-term deposit advance product that customers would not be charged overdraft fees in connection with their repayments for advances, despite actually assessing such fees. The CFPB alleged that these actions by the bank also constituted deceptive acts or practices. The bank was assessed a civil money penalty of \$7.5 million and was required to pay redress to affected consumers, including refunding the subject overdraft fees.

In August 2015, the CFPB, FDIC and OCC (the “Agencies”) took action against two banks and their parent holding company for allegedly unfair and deceptive credit discrepancy reconciliation practices. The Agencies asserted that the banks failed to investigate and correct credit discrepancies that fell below certain thresholds, in violation of the prohibition on UDAAP. The banks allegedly credited the amount listed on the consumers’ deposit slips, rather than the actual amounts of money deposited into the consumers’ accounts. The

Agencies further alleged that the banks’ practice of implying that all consumer deposits were verified and corrected was a deceptive act or practice. The banks were assessed civil money penalties of \$3 million by the FDIC and \$10 million by the OCC, and the banks and their parent holding company (acting as a service provider) were assessed a civil money penalty of \$7.5 million by the CFPB. The parties were also required to pay redress to affected consumers, including any associated fees due to the discrepancy (e.g., overdraft, insufficient funds and monthly maintenance fees) and interest. ♦

### Endnotes

<sup>1</sup> 12 C.F.R. § 1030.8(a)(1).

<sup>2</sup> 12 C.F.R. § 1030.8(a)(2).

<sup>3</sup> 12 C.F.R. § 1005.17(b) (prohibiting “a financial institution holding a consumer’s account [from] assess[ing] a fee or charge on a consumer’s account for paying an ATM or one-time debit card transaction pursuant to the institution’s overdraft service [without] [o]btain[ing] the consumer’s affirmative consent, or opt-in, to the institution’s payment of ATM or one-time debit card transactions ...”).

<sup>4</sup> 1031(a) and 1036(a)(1)(B) of the CFPA, 12 U.S.C. §§ 5531(a), 5536(a)(1)(B).

# Cases: Payments

The CFPB's enforcement team turned its attention to payment companies only within the past two years. In that time, the agency has filed four actions (three judicial, one administrative). Unlike some other enforcement areas, such as credit card-related proceedings, which frequently take aim at particular practices, the payment enforcement proceedings have involved a variety of claims.

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Although the factual scenarios vary dramatically, each of the four proceedings have been based on alleged unfair, deceptive or abusive acts or practices (UDAAP). The CFPB's first action against a payment company involved claims against various payment processors that allegedly processed payments for a phantom debt collection scheme. The CFPB alleged that the companies ignored numerous red flags about their clients and that their conduct was both unfair and constituted substantial assistance to the debt collectors' UDAAP violations. The district court denied the motion to dismiss filed by several of the payment company defendants. The case is pending in the Northern District of Georgia.

In its second proceeding against a payment company, the CFPB alleged that the company engaged in UDAAP violations in offering, marketing, providing and servicing its online consumer credit product. The company offered an online line of credit for consumers when making online purchases. The CFPB alleged that the company enrolled consumers in the product without their knowledge or consent, caused consumers to pay for purchases with the product even though they expressly indicated they didn't want to, failed to process consumer payments promptly, failed to honor and apply promotional offers, and engaged in abusive practices related to billing and deferred interest. In a stipulated judgment, the company agreed to institute a variety of procedures to remedy the alleged violations, such as providing additional disclosures and prominent consent requirements. For example, the company agreed to "disclose through a method, such as a pop-up box," that the product was a line of credit and "may be subject to interest." During enrollment, the company would require affirmative consent through "a means that is specifically labeled to convey such consent, such as selecting a labeled button." It also agreed to other remedial provisions to address, such as allegations of delayed posting of payments and failure to adequately address billing disputes. The judgment required the company to establish a \$15 million restitution account and develop a plan (approved by the agency) to identify consumers who were entitled to restitution, with any balance left in the account after restitution payments going to the CFPB. The CFPB also assessed a \$10 million civil penalty. Finally, the judgment required Board oversight of the company's compliance, the development of a "comprehensive compliance plan" designed to avoid future violations, and other administrative requirements, such as reporting, monitoring and record-keeping.

The CFPB's third proceeding against a payment company focused not on payment issues per se but on data security. The agency alleged that the company engaged in deceptive acts and practices relating to false representations of its data security practices. The company

## Cases: Payments

operated a payment network and mobile applications on which consumers could create an account and direct the company to effect a transfer of funds to the account of another consumer or merchant. To offer this service, the company stored consumers' sensitive personal information. The CFPB alleged that the company made numerous misrepresentations about its data security practices, indicating that its network and the transactions were "safe" and "secure," that the company's data security practices exceeded "industry standards," that consumer information was "securely encrypted" and that it was "PCI compliant." The CFPB alleged these claims were not accurate, because the company did not "adopt and implement data-security policies and procedures reasonable and appropriate for the organization," "use appropriate measures to identify reasonably foreseeable security risks," ensure appropriate employees had proper training, "use encryption technologies" and practice secure software development.

The consent order restrained the company from misrepresenting its data security practices and required the company to adopt and implement heightened practices. For example, it required the company to develop a comprehensive data security plan, which included data security policies and procedures, designate a qualified individual to coordinate and be accountable for data security, conduct data security risk assessments, and provide ongoing employee training. The CFPB required an annual data security audit, which is to be provided to the Board and agency. Although no monetary

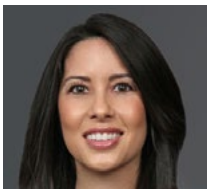
restitution was required, the company had to pay a \$100,000 civil money penalty. Like the proceeding discussed above, the consent order required Board oversight of the company's compliance and other administrative requirements, such as reporting, monitoring and record-keeping.

The fourth proceeding against a payment company was filed in June 2016 and has not yet been resolved. The complaint was filed against a third-party payment processor and both its Chief Executive Officer and its President. According to the allegations, the company "processed payments for many clients even in the face of numerous indicators that those clients were engaged in fraudulent or illegal transactions." Moreover, the complaint states that the company's "due diligence procedures when signing up clients have also been perfunctory, and it has ignored indicia of problems that were revealed through even its minimal due diligence." By processing payments under these conditions, the CFPB alleges that the company engaged in unfair acts and practices. The agency also claims that the named officers provided "substantial assistance" to these unfair acts and practices, because they continued "to maintain relationships with, and process transactions for, clients when they knew about warnings ... that the clients were engaged in fraud or illegal activity, knew about the risk of harm to consumers, or knew facts that made the risk of harm obvious." The complaint seeks monetary and injunctive relief. The case is pending in the District of North Dakota. ♦

# Cases: Servicemembers

Although the CFPB does not have the authority to enforce the Servicemembers Civil Relief Act (SCRA), over the past five years, the Bureau nonetheless has shown an interest in consumer credit issues that affect servicemembers, veterans and their families. During its first year, the Bureau established the Office of Servicemember Affairs (OSA), partnering with the Department of Defense to ensure that the military community is able to make well-informed financial decisions, that complaints and concerns from the military community are addressed, and that federal and state agencies coordinate their activities to improve consumer protection measures for the military community.<sup>1</sup>

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The OSA has published annual reports since 2013 that analyze the data and trends surrounding complaints submitted to the CFPB by servicemembers, veterans, and their families. In recent reports, the OSA has noted that complaints about debt collection are the most numerous. Debt collection complaints comprised 46% of all complaints received from the military community in 2016, up from 39% of complaints received in 2015. Additionally, the Bureau reported that servicemembers were nearly twice as likely to submit complaints about debt collection than the general population.

Two factors unique to servicemembers may account for the disproportionate number of complaints about debt collection. First, military personnel have unique concerns about advancing in rank and maintaining their security clearance.<sup>2</sup> Some debt collectors allegedly seek to coerce repayment from servicemembers by threatening to notify commanding officers or threatening servicemembers with the loss of security clearance. Second, the military offers a discretionary allotment system through which servicemembers may automatically direct a portion of their paycheck to designated financial institutions or other creditors.<sup>3</sup> Creditors can view the allotment system as a guaranteed means of repayment, and some have reportedly abused the system. Several recent CFPB enforcement actions reflect the Bureau's attention to debt collection activities affecting servicemembers, particularly in the context of retail goods and the use of unfair or deceptive debt collection practices.

Although the prohibited practices listed in FDCPA<sup>4</sup> only apply to third-party debt collectors (and not to persons attempting to collect their own debts), the CFPB has indicated that it believes many – if not all – of the FDCPA prohibitions also are prohibited as unfair, deceptive, or abusive acts or practices (UDAAP).<sup>5</sup> This expansive interpretation of UDAAP allows the CFPB to bring enforcement actions against creditors that seek to enforce servicemembers' repayment obligations by using threats against their military careers. For example, in an October 28, 2015 consent order, the CFPB alleged that a retail seller violated UDAAP by threatening to contact delinquent borrowers' commanding officers, actually contacting commanding officers, disclosing details about borrowers' debts and delinquencies, and making misleading statements regarding the potential impacts of debt delinquency on borrowers' military careers. The target company primarily lends to current and retired

## Cases: Servicemembers

servicemembers and services retail installment sales contracts originated by used motor vehicle dealers. Servicemembers who obtained financing through the company were allegedly required to sign a contract addendum with a provision that authorized the company to contact the borrowers' commanding officers in events of default. Many servicemembers were unaware of the provision and had no ability to negotiate their contracts. When borrowers defaulted, the company's collectors allegedly threatened to contact servicemembers' commanding officers regarding the delinquency and advised servicemembers that they were in violation of the Uniform Code of Military Justice. On many occasions, the company's collectors allegedly contacted debtors' commanding officers and disclosed details of their debts. The CFPB ordered the company to pay \$2.28 million in restitution, as well as a \$1 million civil money penalty.

The CFPB included a similar UDAAP claim in another 2015 action against a retail seller. The target company sold consumer goods and electronics and provided financing for those purchases, most frequently to servicemembers. The fine print of the purchase contracts allowed the company to contact the servicemembers' commanding officers about their outstanding debts. The company allegedly disclosed information about debts to commanding officers in writing and by phone and requested that the commanding officers intervene. Consumer credit problems for military members often resulted in disciplinary proceedings, loss of supervisory authority and promotion potential, and revocation of security clearances.

The CFPB also has used its UDAAP authority to bring enforcement actions for abuses of the military allotment system in collecting debt. The Bureau's action discussed above also included a separate UDAAP claim that alleged that the company frequently "double collected" from servicemembers by withdrawing from both servicemembers' bank accounts and through allotments. The company allowed customers who enrolled in payments through allotments to provide a backup payment method in case allotment payments could not be processed. The company preemptively initiated electronic transfers from the "backup" bank accounts of customers whose allotment payments it

anticipated would fail but did not notify customers about such withdrawals. In some situations, the company also processed the allotments, and thus the company in effect double-billed consumers.

In its enforcement action against another retail seller announced in April 2015, the CFPB brought a UDAAP claim against another form of abuse in connection with the allotment system. The Bureau alleged that the company violated UDAAP by enrolling servicemembers in a payment processing plan without disclosing various recurring fees. The target company arranged for servicemembers to set up an allotment that transferred part of their regular pay into a bank account under the company's control, and the servicemembers paid a monthly servicing fee to have the company pay the servicemembers' creditors out of that account. When excess funds accumulated in the company's account, the company charged residual balance fees without notifying consumers. Furthermore, the company did not provide electronic or paper account statements to consumers, and the company charged an additional fee to consumers to access their account history. The Bureau alleged that the company's failure to disclose residual balance fees was a material omission of information that took advantage of servicemembers' lack of understanding of the cost of the allotment processing service. The Bureau found this practice to be abusive. The consent order required \$3.1 million in restitution to injured servicemembers.

The Bureau's interpretation of its UDAAP enforcement authority with respect to consumer credit issues affecting servicemembers is far-reaching. In addition to bringing UDAAP claims for alleged improper threats to military borrowers and abuses of the allotment system, the CFPB also brought a UDAAP action in 2014 against a retail seller for allegedly misleading servicemembers into paying fees for services that the company did not provide. Specifically, the CFPB alleged that the retail seller deceptively marketed its legal obligations under the SCRA as a service to military borrowers and misled servicemembers into believing that the company provided an independent representative for them in connection with SCRA matters. The company sold consumer goods primarily near military bases and required

## Cases: Servicemembers

its military customers to pay a \$5 fee to its partner company, which would purportedly verify the servicemembers' military status to determine eligibility for protection under the SCRA. The retail seller also allegedly told customers that the partner company would act as agent to receive service of process when the partner company actually provided no such service. The CFPB required the company to pay \$350,000 in restitution and a \$50,000 civil money penalty to resolve the UDAAP allegations.

In 2014, the CFPB also made UDAAP allegations of "unfairly facilitating deception" against the purchaser of retail installment contracts. In an action announced on July 29, 2014, the CFPB alleged UDAAP violations by a company that purchased financing agreements from merchants that sold consumer goods to servicemembers on credit. The merchants allegedly misrepresented the terms in the financing disclosures by artificially inflating the prices of goods sold to hide the actual finance charges. The Bureau alleged that the purchaser of the financing agreements engaged in unfair practices, because it fully understood the merchants' disclosure practices and nonetheless enabled the merchants to extend credit, resulting in consumers paying higher finance charges than disclosed.

Given the Bureau's interest in preventing unfair, deceptive or abusive debt collection practices against servicemembers and the Bureau's broad interpretation of its UDAAP authority, CFPB scrutiny of consumer credit issues affecting servicemembers is likely to increase over the next few years. The OSA's annual reports indicate that complaints from the military community have steadily increased in volume.<sup>6</sup> Furthermore, the CFPB has been actively involved in expanding the scope of the Military Lending Act (MLA). The MLA currently applies a 36 percent interest rate cap to certain

closed-end, short-term credit.<sup>7</sup> In late December 2014, the CFPB issued a report highlighting how the MLA failed to provide adequate protection for servicemembers.<sup>8</sup> The Bureau reported that lenders frequently circumvented the 36 percent interest rate limit by adjusting the terms of their loans. In July 2015, the Department of Defense issued a final rule that extends the MLA's 36 percent interest rate cap to consumer credit subject to a finance charge or payable by a written agreement in more than four installments. (Residential mortgages and credit extended to finance the purchase of, and secured by, personal property are exempt.) As the new MLA provisions become effective on October 3, 2016 and the CFPB has announced its commitment to enforcing the MLA, we will likely see additional attention to consumer credit issues affecting servicemembers in the near future. ♦

### Endnotes

<sup>1</sup> <http://www.consumerfinance.gov/about-us/newsroom/treasury-department-announces-holly-petraeus-to-establish-office-of-servicemember-affairs-for-consumer-financial-protection-bureau/>.

<sup>2</sup> <http://www.consumerfinance.gov/about-us/blog/are-unpaid-debts-a-military-career-killer/>.

<sup>3</sup> <http://www.consumerfinance.gov/about-us/newsroom/cfpb-cautions-military-lenders-against-illegal-military-allotment-practices/>.

<sup>4</sup> 15 U.S.C. §51962 et seq.

<sup>5</sup> See "Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts," CFPB Bulletin 2013-07 (July 10, 2013) available at [http://files.consumerfinance.gov/f/201307\\_cfpb\\_bulletin\\_unfair-deceptive-abusive-practices.pdf](http://files.consumerfinance.gov/f/201307_cfpb_bulletin_unfair-deceptive-abusive-practices.pdf).

<sup>6</sup> [http://files.consumerfinance.gov/f/201603\\_cfpb\\_snapshot-of-complaints-received-from-servicemembers-veterans-and-their-families.pdf](http://files.consumerfinance.gov/f/201603_cfpb_snapshot-of-complaints-received-from-servicemembers-veterans-and-their-families.pdf).

<sup>7</sup> 10 U.S.C. § 987.

<sup>8</sup> [http://files.consumerfinance.gov/f/201412\\_cfpb\\_the-extension-of-high-cost-credit-to-servicemembers-and-their-families.pdf](http://files.consumerfinance.gov/f/201412_cfpb_the-extension-of-high-cost-credit-to-servicemembers-and-their-families.pdf).

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