WHITE & CASE

Consumer financial services: The road ahead

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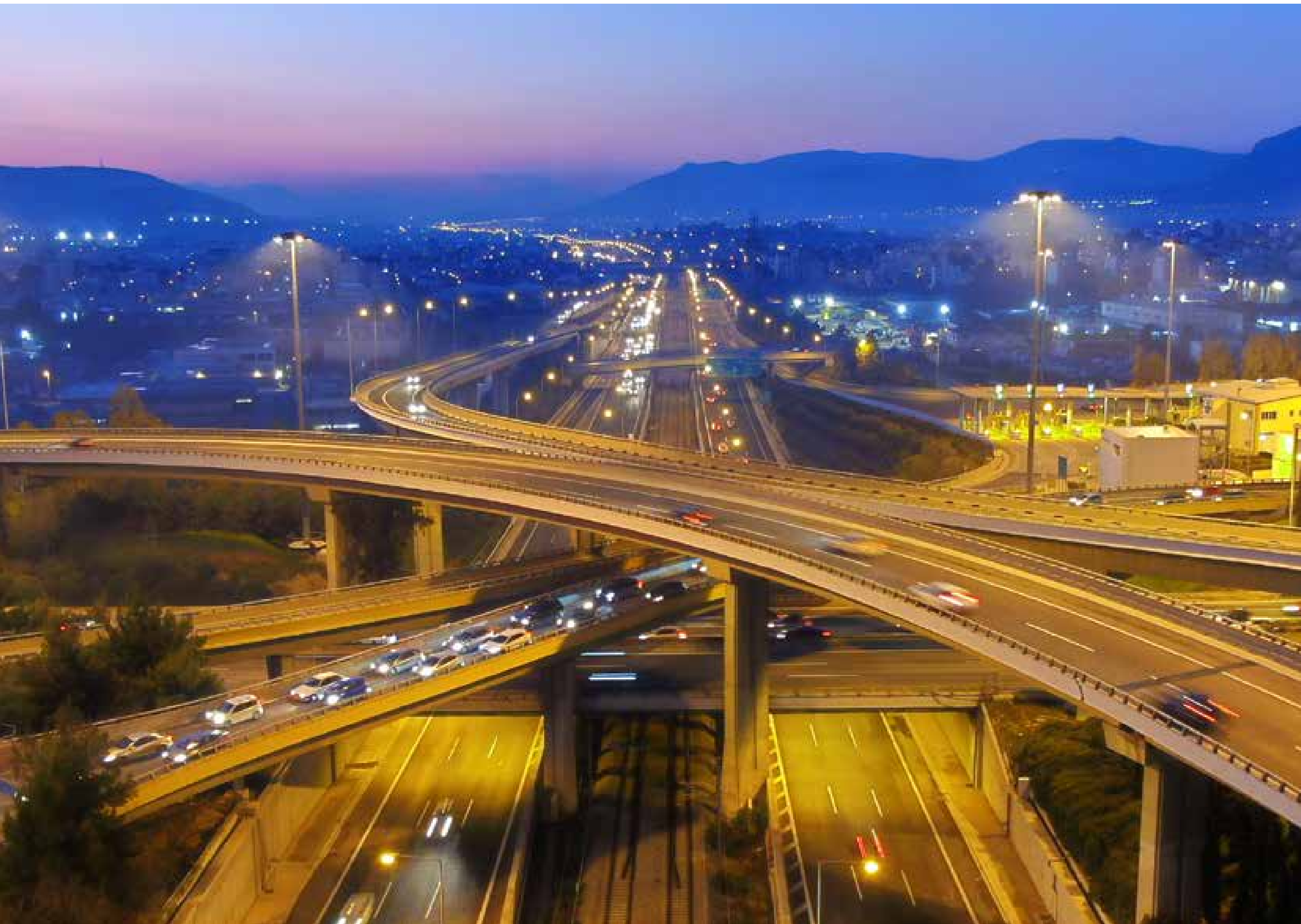


Consumer financial services: The road ahead

The seismic shifts in the consumer financial services (CFS) regulatory landscape that began in 2017 continued throughout 2018. Additional changes are on the horizon as the new leadership of the Consumer Financial Protection Bureau (CFPB or Bureau) sets out to define future priorities.

Ben Saul

John Wagner

Margaux Curie

As the Trump Administration, Congress and courts continue to rethink and reshape the structure and agenda of the CFPB, and as state regulators react to such changes, companies are dealing with the associated uncertainty regarding the CFS supervisory and enforcement landscape. To help institutions anticipate, adapt and respond to this rapidly evolving regulatory environment, we present a concise retrospective and guide to navigate the road ahead. Amidst the change witnessed over the past several years, and in an environment featuring strong deregulatory rhetoric, it remains paramount to take an intermediate and even long view toward compliance as the ramifications of decisions made today might not become apparent for years. As always, a commitment to best practices, a strong compliance culture and a firm grasp on enduring requirements will serve CFS market participants well.

2018: A time of change

Former Acting Director Mick Mulvaney oversaw a series of notable changes during his tenure at the Bureau, which ran from November 2017 until the confirmation of current Director Kathy Kraninger in December 2018. Former Acting Director Mulvaney initiated a sweeping review of the CFPB's core processes and procedures, placed a moratorium on its (since resumed) enforcement activities and realigned its enforcement, supervisory and rulemaking priorities. The Bureau reorganized, for example by limiting the functions of the Office of Fair Lending and Equal Opportunity and the Office of Students and Young Consumers to outreach and educational responsibilities. These actions were met with strong opposition from consumer advocacy groups, Congressional Democrats and, in some cases, state regulators.

Consumer financial services: The road ahead
(continued)

Although the CFPB adopted a less aggressive enforcement approach overall, the Bureau continued to employ similar legal theories and leverage its broad authority to prohibit unfair, deceptive or abusive acts or practices (UDAAP). The Bureau concurrently dialed down its fair lending enforcement activity to prioritize other areas reflecting higher consumer complaint volumes, such as disclosures and debt collection.

In light of the Bureau's retrenchment, several state attorneys general (AGs) and regulatory agencies have used, or signaled their intent to use, their enforcement powers, including their ability under the Dodd-Frank Act to enforce violations of federal CFS laws, with many drawing on or otherwise forming special consumer units. Beyond enforcement, state AGs, regulators and legislators are further considering changes to existing laws, regulations and guidance—and enhancing multi-state coordination where feasible—all in the name of filling any perceived voids left by the CFPB.

While several legislative proposals were introduced in 2018 by Republicans to cut back the CFPB's authority, none gained sufficient traction to pass the Republican-controlled House and Senate. Deep structural reforms are likely not on the horizon with Democrats now in control of the House. Rather, the House Financial Services Committee as chaired by Rep. Maxine Waters (D-CA) is expected to ramp up political pressure on Director Kraninger and scrutinize the Bureau's strategies and priorities.

The road ahead

Former Acting Director Mulvaney left behind a full agenda, some of which has already been addressed by Director Kraninger. The Bureau recently finalized proposed revisions to its payday lending rule, and is expected to engage in rulemaking to modernize debt collection communications and to clarify the "abusive" prong under its UDAAP authority. The Bureau is also expected to revisit how it treats disparate impact claims under the Equal Credit Opportunity Act (ECOA).

Unlike former Acting Director Mulvaney, Director Kraninger will have the benefit of a full five-year term to develop her vision for the Bureau, albeit against the backdrop of increased congressional oversight and ongoing constitutional challenges to the CFPB's leadership structure. Notably, comments received from the CFPB's "Call for Evidence" will allow Director Kraninger to leverage industry insights to implement more substantial and organizational changes at the Bureau going forward.

CFPB structural changes

During his tenure, former CFPB Acting Director Mick Mulvaney brought significant changes to the Bureau's structure and operations. As the new CFPB Director, Kathy Kraninger will have the benefit of a full five-year term to develop her vision for the Bureau's strategy and priorities.

2018 in review

In just over a year at the helm of the CFPB, former Acting Director Mulvaney left his mark on the consumer financial watchdog. Chosen by President Trump in late November 2017, his temporary appointment was immediately the subject of litigation lodged by former Deputy Director Leandra English.[3] After his appointment was upheld,[4] former Acting Director Mulvaney made quick work in reshaping the approach and structure of the Bureau.[5] In a series of swift moves, he initiated a sweeping review of the CFPB's core processes and procedures, placed a moratorium on its enforcement activities (since resumed), and realigned its enforcement, supervisory and rulemaking priorities. Mulvaney also temporarily rebranded the CFPB as the "BCFP," adopted a Bureau seal, and brought in a dozen political appointees to run daily operations and reorganized the Bureau, limiting the Fair Lending and Student Loan Ombudsman's Offices to outreach and educational responsibilities. Consumer advocacy groups and Congressional Democrats generally opposed Mulvaney's efforts to reform the Bureau, as did certain high-profile staffers.[6]

"I call on Director Kraninger to put consumers first by rolling back the anti-consumer actions taken by [former Acting Director Mulvaney] and allowing the [CFPB] to resume its work of protecting hardworking Americans from unfair, deceptive or abusive practices."

Rep. Maxine Waters (D-CA), Chairwoman of the House Financial Services Committee[1]

Enforcement

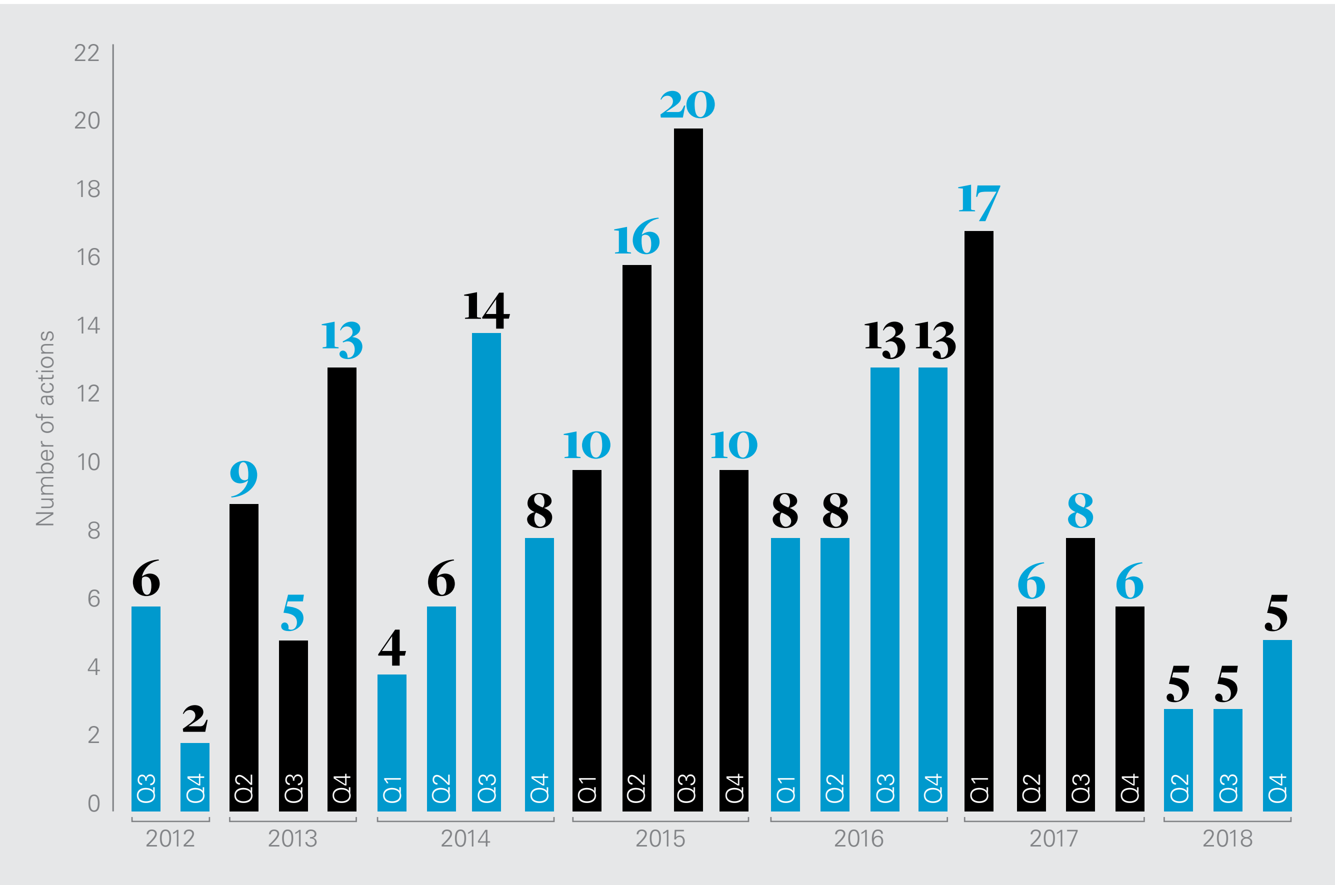
2018 started with former Acting Director Mulvaney announcing that the Bureau had pushed its "last envelope" and signaling an end to "regulation by enforcement."[7] A look-back at his tenure, however, suggests otherwise. Although the CFPB adopted a less aggressive enforcement approach overall and largely trimmed penalties, the Bureau continued to employ similar legal theories and leveraged its UDAAP authority. Notably, the Bureau brought new allegations of "abusive" conduct shortly after announcing that it was considering engaging in rulemaking to clarify the abusiveness standard in the face of unsettled case law.[8]

The CFPB kicked off 2019 by settling five actions against a bank, a nonbank retailer and several US- and foreign-based lenders, partly or exclusively relying on its UDAAP authority.[9] At the same time, the Bureau significantly reduced its fair lending enforcement activity, and continued to deploy its enforcement resources in other areas of focus, such as disclosures and debt collection.[10] The arrival of newly confirmed Director Kraninger brings to the Bureau another period of transition as she determines her enforcement, supervisory and rulemaking priorities.

Rulemaking

Determined to ease regulatory burdens on industry and to issue more formal rulemakings, former Acting Director Mulvaney was quick to address industry concerns and left the Bureau with a packed agenda for Director Kraninger. Among the most notable developments, the Bureau intends to engage in rulemaking to modernize communication and disclosure requirements placed on third-party debt collectors subject to the Fair Debt Collection Practices Act (for which no implementing regulation exists), and clarify the meaning of "abusive" in connection with the CFPB's UDAAP authority under

CFPB enforcement actions (2012 – 2018)



Source: Bloomberg Law (2019)

> **"I am here to be the director of this bureau and I will be fully accountable for the decisions that I make going forward and they will be mine."**
>
> ***CFPB Director Kathy Kraninger[2]***

Section 1031 of the Dodd-Frank Act.[11] In addition to shelving or delaying certain rulemaking initiatives introduced by former Director Cordray, the Bureau also expressed an interest in revisiting how it treats disparate impact claims under the ECOA.[12] In line with former Acting Director Mulvaney's intent[13] to revamp the Bureau's payday lending rule (Payday Rule),[14] Director Kraninger recently proposed to rescind the Payday Rule's onerous underwriting requirements and push its compliance date to November 2020.[15] In other areas, Director Kraninger may, however, forge her own rulemaking priorities going forward, and will likely draw upon her "listening tour" with relevant CFPB staff and stakeholders to do so.[16] Director Kraninger also indicated that she will prioritize data privacy and cybersecurity, two areas that are expected to be hot topics in the coming year.[17]

Legislation

While several legislative proposals were introduced in 2018 by congressional Republicans to rein in the CFPB's authority, none gained any significant traction under the Republican-controlled House and Senate in the last Congress. Such proposals are even less likely to gain momentum with Democrats now in control of the House. New pro-industry bills, such as the Home Mortgage Disclosure Adjustment Act,[18] and efforts to repeal the Bureau's Payday Rule under the Congressional Review Act,[19] failed to secure sufficient bipartisan support. The now Democratic-run House Financial Services Committee has wasted no time aggressively scrutinizing the CFPB, including former Acting Director Mulvaney's decisions.[20] Rep. Waters (D-CA), the new Chairwoman of the House Financial Services Committee, may also re-introduce legislation seeking to reverse almost all of the recent structural changes made to the Bureau, thus previewing the committee's upcoming agenda. Opportunities to pass meaningful legislation will, however, likely stall in the Republican-controlled Senate, and we thus expect that the committee will ramp up political pressure on the Bureau through its oversight and investigatory powers.

A note on new technologies

Faced with an ongoing influx of new actors that leverage increasingly more complex technologies in the CFS sector, federal regulators have so far struggled to provide a coordinated response to such innovation. Although regulatory hesitation for a full embrace of innovative solutions remains, the CFPB has taken notable steps to revamp its no-action letter policy and trial disclosure program to encourage consumer-friendly innovation in the marketplace.[21] Differing responses by federal regulators, including the federal bank regulators, will continue, however, to pose ongoing compliance challenges to fintech companies and financial institutions seeking to leverage these new technologies while managing their risk exposure to federal and state regulations.

CFPB structural changes (continued)

A new CFPB director: The road ahead

As only the second permanent director in the CFPB's short history, Director Kraninger will likely echo some of her predecessor's initiatives; she has already signaled her intent to forge her own legacy by scrapping former Acting Director Mulvaney's plan to rebrand the Bureau. Notably, comments received from the CFPB's "Call for Evidence" give her the opportunity to leverage industry insights to implement more substantial and organizational changes at the Bureau.[22] As she sets the Bureau's agenda, Director Kraninger will need to navigate increased oversight by the House Financial Services Committee and take positions on constitutional challenges faced by the Bureau until resolution, if any, by the US Supreme Court. While former Acting Director Mulvaney contended that his ratification of pending litigation cured any alleged constitutional defect given the President's ability to remove the interim CFPB Director at will, Director Kraninger will need to rely on other grounds should additional industry participants contest the constitutionality of future CFPB enforcement actions—provided that she chooses to defend the Bureau's constitutionality going forward.

Constitutional challenges to the CFPB

PHH Corp. v. Consumer Fin. Prot. Bureau	DC Circuit	In 2015, PHH Corporation argued that the Bureau's leadership structure, which makes the CFPB's director only removable for cause by the President, is unconstitutional. In January 2018, the Court of Appeals for the District of Columbia, sitting en banc, declared the CFPB's single-director structure constitutional.
RD Legal Funding LLC v. Consumer Fin. Prot. Bureau	Second Circuit	In June 2018, the US District Court for the Southern District of New York ruled that the CFPB's structure is unconstitutional. In September 2018, the CFPB filed an appeal with the US Court of Appeals for the Second Circuit from that order, which is currently pending.
All American Check Cashing v. Consumer Fin. Prot. Bureau	Fifth Circuit	In 2015, PHH Corporation argued that the Bureau's leadership structure, which makes the CFPB's director only removable for cause by the President, is unconstitutional.
State National Bank of Big Spring (SNB) v. Mnuchin	DC Circuit	In April 2018, the US Court of Appeals for the Fifth Circuit agreed to hear All American Check Cashing's interlocutory appeal from a district court's ruling upholding the CFPB's constitutionality. The appeal is currently pending. In July 2018, the Fifth Circuit held that the Federal Housing Finance Agency is unconstitutional because it is excessively insulated from Executive Branch oversight. *See Collins v. Mnuchin*. The Fifth Circuit will review the appellate panel's decision in an en banc hearing on March 12, 2019.
Consumer Fin. Prot. Bureau v. Seila Law, LLC	Ninth Circuit	In September 2017, Seila Law, LLC requested that the US Court of Appeals for the Ninth Circuit overturn a district court's refusal to set aside a CFPB's civil investigative demand, raising constitutional challenges. The appeal is currently pending.

Mortgage origination and servicing

In 2018, the CFPB issued multiple rules, and Congress passed legislation, to clarify, revise and update the regulatory framework applicable to the home mortgage origination and servicing market.

Home Mortgage Disclosure Act (HMDA)

Section 104(a) of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which became law in May 2018, amended HMDA with the intent of decreasing the compliance burdens of smaller depository institutions.[3] The EGRRCPA also requires the Government Accountability Office (GAO) to submit a report to Congress by May 2021 evaluating the impact of the EGRRCPA's changes on the amount of data available under HMDA.

In August 2018, the CFPB issued an interpretive and procedural rule to implement and clarify certain of the EGRRCPA's changes to HMDA.[4] Notably, the rule clarifies that insured depository institutions and insured credit unions covered by a partial exemption under the EGRRCPA have the option to report exempt data fields, provided they report all data fields within any exempt data point for which they report data.[5] In addition, the rule clarifies that only loans and lines of credit that are otherwise HMDA-reportable count toward the thresholds for the partial exemptions.[6] The Bureau also updated its Filing Instructions Guide[7] and Small Entity Compliance Guide[8] to reflect the EGRRCPA changes. In addition, in December 2018, the Bureau issued final policy guidance describing modifications it intends to apply to the HMDA data reported by financial institutions under HMDA and Regulation C before making such data available to the public at the loan level.[9]

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"It is illegal for home lenders and banks to discriminate against applicants—and it sets city blocks and whole neighborhoods back. [W]e need to hear from consumers who believe they've been victimized in the home lending and banking industries so we can hold those responsible accountable."

Pennsylvania Attorney General Josh Shapiro[1]

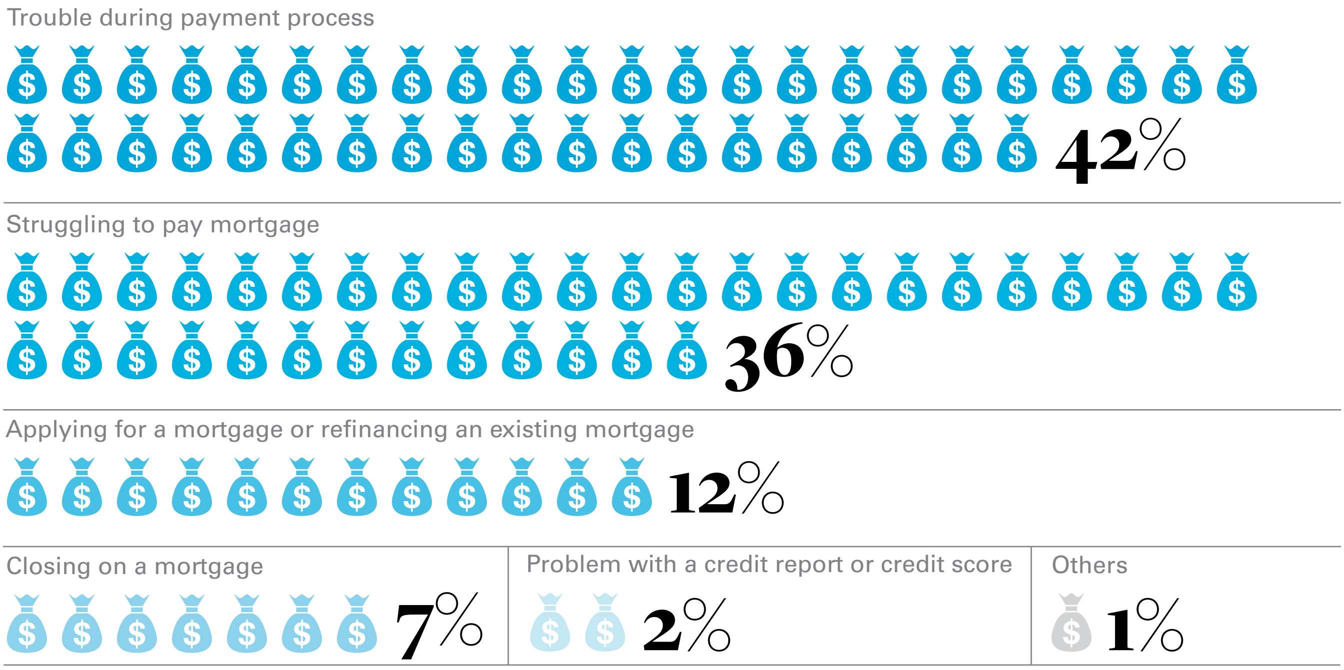
The Bureau is currently considering amendments to Regulation C to address institutional and transactional coverage tests and discretionary data points, along with other changes to reduce the regulatory burden for mortgage-related activities.[10] We expect the CFPB to issue a notice of proposed rulemaking, which would likely incorporate the August 2018 rule and further implement certain EGRRCPA provisions, by as early as spring 2019.[11]

Truth in Lending Act (TILA)

In March 2018, the CFPB also finalized an amendment to its 2016 mortgage servicing rule to clarify and, as of April 19, 2018, afford mortgage servicers more latitude in providing periodic statements to consumers entering or exiting bankruptcy.[12]

Section 101 of the EGRRCPA created a safe harbor under the qualified mortgage and ability to pay (ATR/QM) rule for certain mortgage loans originated by a depository

Types of mortgage complaints reported by consumers (2016 – 2018)



Source: CFPB, Complaint Snapshot: Mortgage (2019)

institution or credit union with less than US$10 billion in total consolidated assets.[13] The EGRRCPA also amended TILA to specify that mortgage appraisal services donated by a fee appraiser to an organization eligible to receive tax-deductible charitable contributions are deemed to be customary and reasonable and that a retailer of manufactured housing that meets certain requirements is generally not a "mortgage originator" subject to TILA requirements.[14]

In September 2018, the Office of the Comptroller of the Currency (OCC) issued an updated TILA booklet of its *Comptroller's Handbook*.[15] The booklet replaces a 2014 version and includes updated guidance and procedures to OCC examiners in connection with changes made to Regulation Z. In January 2019, the Bureau issued a five-year lookback report on the ATR/QM rule, as well as a five-year lookback report on its Real Estate Settlement Procedures Act (RESPA) servicing rule.[16]

"Know-Before-You-Owe" mortgage disclosure

In April 2018, the CFPB finalized an amendment to its TILA-RESPA integrated disclosure (TRID) rule to address the so-called "black hole" issue that prevented creditors from resetting tolerance (i.e., the percentage by which the amount ultimately paid by the customer is permitted to exceed the estimated amount), except in very limited circumstances.[17] The April 2018 rule permits a creditor to reset these tolerances through closing disclosures regardless of the number of days between consummation and the required delivery date of the closing disclosure, provided that the creditor delivers the revised closing disclosure within three business days after receiving information sufficient to establish that a triggering event has occurred.[18]

In January 2019, the CFPB issued frequently asked questions and accompanying responses (FAQs) concerning the TRID rule. Three of the FAQs address the issuing of corrected closing disclosures and the three business-day waiting period before consummation and the fourth states that lenders can rely on a safe harbor when using CFPB model disclosures, even if the model disclosures do not reflect recent rule changes.[19] We also expect the CFPB to provide guidance pursuant to Section 109(b) of EGRRCPA on the applicability of the TRID rule to mortgage assumption transactions and construction-to-permanent home loans and the conditions under which such loans can be properly originated.

Enforcement

The CFPB brought far fewer enforcement actions, including in the mortgage space, in 2018 than in 2017. After several months without initiating an enforcement action, the Bureau announced, in April 2018, a joint enforcement action with the OCC in which it reached a US$1 billion settlement with a major US financial institution for activities that included alleged mortgage servicing abuses, including improperly charging fees to borrowers for mortgage interest rate-lock extensions.[20] As discussed below, multiple states and the District of Columbia reached a settlement with the same institution for related conduct.

In December 2018, the CFPB filed a complaint alleging that a loan company that offered a product to veterans with a loan guaranteed by the Department of Veterans Affairs to refinance their mortgages at lower interest rates, engaged in deceptive conduct by misleading customers by overstating the benefits of such refinancing.[21] The settlement provides that the company will pay approximately US$270,000 in consumer redress and a civil penalty of US$260,000.[22]

Another notable enforcement action concerning alleged improper mortgage servicing practices remained pending throughout 2018. The Bureau filed a lawsuit against a leading nonbank mortgage servicer in 2017 for allegedly failing to provide routine servicing functions, including making widespread errors and runaround costs, failing to send accurate monthly statements, illegally foreclosing on struggling borrowers, ignoring customer complaints and selling off the servicing rights to loans without fully disclosing the mistakes it made in borrowers' records. Litigation is ongoing in the US District Court for the Southern District of Florida.[23]

The CFPB reported that from November 2016 through October 2018, mortgage products were the source of 11 percent of consumer complaints to the Bureau[24], down from 18 percent in 2016.[25] Despite this reduction, we anticipate that the CFPB will continue to scrutinize the mortgage area, and in particular mortgage servicing practices. The most common source of consumer complaints was the payment process, including late or inaccurate periodic statements, servicers not applying payments to loan accounts as intended, escrow analyses showing a shortage of funds and payoff information requests that were not addressed or were inaccurate.[26]

The Bureau highlighted mortgage servicing as a top supervisory issue, and in particular, the loss mitigation process and how servicers handle trial modifications where consumers are paying as agreed.[27] The Bureau noted that mortgage servicing examinations observed unfair acts or practices relating to conversion of trial modifications to permanent status and initiation of foreclosures after consumers accepted loss mitigation offers.[28] In addition,

Mortgage origination and servicing (continued)

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"We're not [revising HMDA requirements] to undermine the consumer confidence in the system. We're actually doing it to help the marketplace. That's what we are told to do in the statute."

Former CFPB Acting Director Mick Mulvaney[2]

2,957

mortgage-related complaints received each month by the CFPB since November 2016[42]

$200.7 billion

in mortgages originated since the CFPB creation[43]

examinations identified unfair acts or practices when institutions charged consumers amounts not authorized by modification agreements or mortgage notes.[29]

In 2017, the Department of Justice (DOJ) reached several settlements with banks and nonbank mortgage companies, as well as with a service provider to a nonbank mortgage company, under the False Claims Act (FCA) and the Fair Housing Act (FHA). As in recent years, the DOJ in 2018 frequently proceeded through joint actions with the Department of Housing and Urban Development. These enforcement efforts primarily focused on origination and servicing violations in connection with FHA-insured loans, as well as discriminatory lending practices. Such efforts notably included:

- In October 2018, the DOJ obtained a US$13.2 million settlement with a mortgage company for allegedly violating the FCA by falsely certifying that it had complied with FHA mortgage insurance requirements in connection with certain loans.[30]
- In May 2018, the DOJ reached a settlement with a Minnesota bank to resolve allegations that the bank had engaged in lending discrimination by "redlining" predominantly minority neighborhoods.[31]
- In February 2018, the DOJ reached a US$149.5 million settlement with a firm that served as the outside auditor of a mortgage loan originator that had engaged in a fraudulent scheme involving the purported sale of fictitious or double-pledged mortgage loans. The DOJ alleged that the auditor knowingly deviated from applicable auditing standards and therefore failed to detect the mortgage originators' fraudulent conduct and resulting materially false and misleading financial statements.[32]

Fintech outlook

Fintechs in the mortgage origination and servicing space have focused on developing software to assist mortgage lenders in complying with HMDA disclosure requirements and performing real-time audits of the entire mortgage origination process to reduce cost and risk exposure. Fintechs have also developed AI-based scoring algorithms used to evaluate alternative data sources and assess mortgage seekers' creditworthiness, as well as provide more accurate mortgage origination pricing and rates.

In addition, many fintech and traditional mortgage lenders have digitized all or a portion of the mortgage origination process. In 2017, 43 percent of mortgage customers applied for a mortgage digitally, up from 28 percent in 2016.[33] While many lenders now offer digital applications, fewer have digital capabilities through the full back end of the loan process.[34] The transition to a fully digitized process, in which electronic mortgage notes replace paper notes, is currently challenged by the refusal of Ginnie Mae and the federal home loan banks to accept electronic notes.[35]

Research by the Federal Reserve Bank of New York suggests that the market share of fintech mortgage lenders increased from 2 percent to 8 percent from 2010 to 2016. The research also indicates that fintech lenders process mortgage applications approximately ten days faster than traditional lenders, without increasing the credit risk of loans. As in other market segments, these tech-based solutions may raise novel and significant fair lending considerations.

State spotlight

Against the backdrop of decreased CFPB enforcement actions and statements by former Acting Director Mulvaney that states should take the lead in enforcing consumer protection laws, states continued to focus on mortgage origination and servicing in 2018.[36]

In December 2018, all 50 states and the District of Columbia reached a settlement with a major financial institution for, among other things, alleged mortgage servicing abuses that include improperly charging fees to borrowers for mortgage interest rate-lock extension.[37]

In another notable action, Maryland's Consumer Protection Division and Commissioner of Financial Regulation entered into a settlement agreement in May 2018 with a large nonbank servicer of residential mortgages that allegedly charged homeowners illegal inspection fees. As a result of the investigation and settlement, the servicer returned to consumers approximately US$1 million in fees and paid a fine of approximately US$500,000.[38] In April 2018, the New York Department of Financial Services (NYDFS) announced that it had reached a settlement in excess of US$17 million with a large nonbank mortgage servicer for alleged violations of New York banking law, including document retention and document management processes that demonstrated significant flaws, as well as failure to fund mortgage loans within the required timeframe.[39]

Several states established or revised requirements that nonbank companies engaging in mortgage lending and/or mortgage servicing must obtain a state license, joining others that took similar action in 2017.[40] In August 2018, the Conference of State Bank Supervisors (CSBS) announced that all US state and territories would now use a single, common exam to assess mortgage loan originators (MLOs), simplifying the licensing process for MLOs. A mortgage license applicant that passes the national test will not be required to take any additional state-specific tests to hold a license with a US state or territory.[41]

2019 outlook

- Further rulemaking is forthcoming in the HMDA/Regulation C area to address institutional and transactional coverage tests and discretionary data points and other changes to reduce the regulatory burden for mortgage-related activities.
- We expect the CFPB to provide guidance on the applicability of the TRID rule to mortgage assumption transactions, construction-to-permanent home loans and the conditions under which such loans can be properly originated and the extent to which lenders can rely on CFPB model disclosures without liability if recent changes to regulations are not reflected in the Bureau's forms.
- In light of the focus on mortgage origination and servicing and other consumer protection issues by state regulators in 2018, we expect the announcement of additional state-level enforcement actions throughout 2019.

Small-dollar loans

In February 2019, the CFPB released the highly anticipated revamp of its Payday Rule, reinforcing its more lenient attitude towards payday lenders. In light of the Bureau's softer touch, as well as similar developments at the banking agencies, we expect states to step into the void and take further action to curtail payday lending at the state level.

The CFPB's Payday Rule: An update

Finalized in 2017, the Payday Rule[4] sought to subject small-dollar lenders to strict criteria for underwriting short-term high-interest loans, including by imposing enhanced disclosures and registration requirements and an obligation to determine a borrower's ability to repay various types of loans.[5] Shortly after his interim appointment, former Acting Director Mulvaney announced that the Bureau would engage in notice and comment rulemaking to reconsider the Payday Rule, while also granting waivers to companies regarding early registration deadlines.[6] Consistent with this announcement, CFPB Director Kraninger recently proposed to overhaul the Bureau's Payday Rule, contending that substantive revisions are necessary to increase consumer access to credit.[7] Notably, this proposal would rescind the Rule's ability-to-repay requirement as well as delay the Rule's compliance date to November 19, 2020.[8] The proposal stops short of the entire rewrite pushed by Treasury and Congress,[9] retaining provisions governing payments and consecutive withdrawals.

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"The Bureau is committed to the financial well-being of America's service members [and] this commitment includes ensuring that lenders subject to our jurisdiction comply with the Military Lending Act."

CFPB Director Kathy Kraninger[1]

CFPB ceases supervision of Military Lending Act (MLA) creditors

In line with former Acting Director Mulvaney's intent that the CFPB go "no further" than its statutory mandate in regulating the financial industry,[10] he announced that the Bureau will not conduct routine examinations of creditors for violations of the MLA,[11] a statute designed to protect servicemembers from predatory loans, including payday, car title and other small-dollar loans.[12] The Dodd-Frank Act, former Acting Director Mulvaney argued, does not grant the CFPB statutory authority to examine creditors under the MLA.[13] The CFPB, however, retains enforcement authority against MLA creditors under TILA,[14] which the Bureau intends to exercise by relying on complaints lodged by servicemembers.[15] This decision garnered strong opposition from Democrats in both the House[16] and the Senate[17], as well as from a bipartisan coalition of state AGs,[18] urging the Bureau to reconsider its supervision policy change and commit to military lending examinations. New Director Kraninger has so far been receptive to these concerns, and requested Congress to provide the Bureau with "clear authority" to conduct supervisory examinations under the MLA.[19] While it remains unclear how the new CFPB leadership will ultimately proceed, we expect Rep. Waters

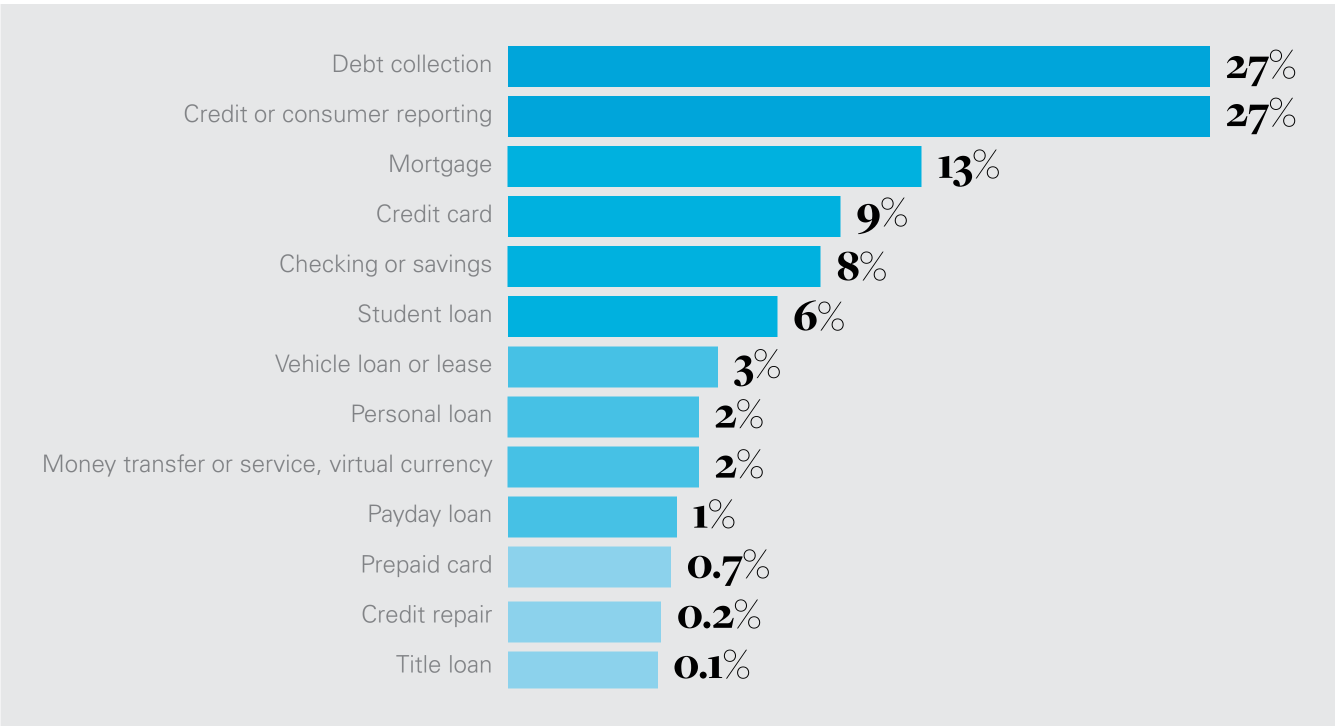
(D-CA), in her capacity as Chairwoman of the House Financial Services Committee, to press the Bureau further on its interpretation and its plans vis-à-vis servicemembers.

Federal banking regulators encourage banks to offer small-dollar loans

Alongside a wave of new leadership appointments at the federal banking regulators came an attitude shift towards Obama-era policies governing banks' and credit unions' ability to offer small-dollar loans.[20] The OCC set the tone in May 2018 when it released new guidelines inviting national banks to offer small short-term loans to subprime consumers.[21] Shortly thereafter, the National Credit Union Administration (NCUA) proposed a rule creating a new loan product to accompany its preexisting payday loan alternative.[22] The Federal Deposit Insurance Corporation (FDIC) also signaled a similar interest by issuing a request for information seeking input on how it can encourage its supervised institutions to offer small-dollar credit products.[23]

Stakeholders supporting this deregulatory push emphasize consumer benefits resulting from the offering of diversified small loan products subject to more direct oversight by the federal banking regulators. Critics, on the other hand, question these regulators' commitment to enforcing adequate safeguards to protect subprime borrowers.[24] Despite a clear desire by the federal

Types of consumer complaints by products



Source: *CFPB Semi-Annual Report* (2018)

Small-dollar loans (continued)

banking regulators to make small-dollar lending at banks commonplace, financial institutions remain hesitant to enter this market, notwithstanding certain early-movers.[25] This trend is likely to continue in the absence of further regulatory clarity as to what would constitute "responsible" and "prudent" underwriting for such loans.

Enforcement

In 2018, former Acting Director Mulvaney started his interim directorship by dropping certain actions initiated by the previous CFPB leadership against payday lenders. In addition to dismissing a suit against four tribal lenders for alleged deceptive collection practices,[26] former Acting Director Mulvaney also terminated at least one probe into another payday lender resulting from a 2014 civil investigative demand.[27] In spite of these early decisions, the Bureau continued to litigate actions previously brought under former Director Cordray and resolved a number of cases against in-person and online payday lenders that charged illegal interest rates and fees, and employed deceptive lending and debt collection practices.[28] The Bureau, however, resolved certain of these actions by imposing lower penalties than were previously sought under the former CFPB leadership,[29] in line with former Acting Director Mulvaney's intent not to "push the envelope" on enforcement activities.[30]

Director Kraninger is likely to take a similar approach to payday lending enforcement during her tenure.[31] We anticipate that the new CFPB leadership will continue litigating active cases against payday lenders, including one notable pending action, filed under former Acting Director Mulvaney, against a company that offered pension advance products.[32] The Bureau also recently settled a 2015 enforcement action against offshore payday lenders for deceptive marketing tactics and collecting on loans void under state laws.[33] We do not, however, expect the Bureau to prioritize payday lending enforcement in the year ahead due to the low number of payday loan-related complaints the CFPB received relative to other areas.[34] Payday lenders will nonetheless remain subject to strict scrutiny by the Federal Trade Commission (FTC), which continues to crack down on payday lending schemes[35] pursuant to its authority under Section 5 of the Federal Trade Commission Act (FTCA).[36]

Federal regulators encourage small-dollar lending

May 23, 2018
The OCC encourages banks to offer short-term small-dollar loans.

May 24, 2018
The NCUA proposes to create a new small-dollar loan product to accompany its preexisting payday loan alternative.

July 31, 2018
The US Treasury recommends that "federal and state banking regulators take steps to encourage prudent and sustainable short-term small-dollar installment lending by banks."

November 14, 2018
The FDIC seeks comments on the steps it can take to help banks "offer responsible, prudently underwritten credit products."

Fintech outlook

Fintech companies continue to gain stronger footing in the small-dollar lending industry, targeting prospective borrowers online with damaged or no credit history. Using AI-driven scoring products and non-traditional analytics, fintechs are able to offer lower rates than traditional payday lenders, as well as flexible solutions for subprime borrowers to improve their credit scores and, potentially, gain access to lower rates. New market entrants are also changing the traditional pay cycle by offering small earned-wage advances and financing to employees unwilling, or unable, to wait until the next payday.[37] While the use of AI and alternative data for assessing creditworthiness continues to raise fair lending risks, the Bureau's increased openness to tech-driven approaches and emphasis on increasing credit access for so-called "credit invisibles"[38] may facilitate increased regulatory certainty for fintechs operating in this space.

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"The Bureau will evaluate comments [received to the revised Payday Rule], weigh the evidence, and then make its decision. In the meantime, I look forward to working with fellow state and federal regulators to enforce the law against bad actors and encourage robust market competition to improve access, quality, and cost of credit for consumers."

CFPB Director Kathy Kraninger[2]

State spotlight

In 2018, states continued to take aim at payday lenders through ballot initiatives, legislation and AG actions to fill any perceived gaps in the CFPB's oversight of the industry. This trend does not show any sign of waning—we anticipate that some states will take further actions to restrict or eliminate payday lending at the state level in light of the Bureau and federal bank regulators' shifting stances on the small-dollar loan industry.

- **Ballot initiatives.** In November 2018, Colorado voters overwhelmingly approved Proposition 111, a ballot measure to cap the state's interest rate on deferred deposit and payday loans at 36 percent per annum.[39] Proposition 111 also makes it an unfair or deceptive act or practice, under Colorado law, for any person to offer or assist a consumer with obtaining a deferred deposit or payday loan with rates in excess 36 percent. In particular, Proposition 111 applies regardless of a lender's physical location and, therefore, affects both traditional lenders as well as bank partnerships and lead generators doing business with Colorado residents.

- **New legislation.** In July 2018, the Ohio legislature passed the "Fairness in Lending Act"[40] in an effort to curtail predatory payday lending. The new law addresses perceived loopholes in the state's existing payday law, and requires most short-term loans of US$1,000 or less to abide by the state's interest rate cap. The new law further introduces additional protections for Ohio borrowers, including limits on origination and maintenance fees.

- **Enforcement.** The Virginia AG revamped his consumer protection section in March 2017 to include a special Predatory Lending Unit dedicated to tackling suspected violations of state and federal consumer lending statutes.[41] Since then, the Virginia AG has announced several settlements against high-cost online lenders for charging rates in excess of Virginia's usury limit and misrepresenting their licensure status.[42] The Virginia AG has brought other enforcement actions for similar allegations.[43] Other state regulators have also been active in this area. In January 2019, the California Department of Business Oversight (DBO) entered into a US$900,000 settlement with a payday lender that steered consumers into getting higher loan amounts to avoid the state's interest cap.[44] This settlement is part of a broader effort by the DBO to crackdown on small-dollar lenders charging excessive interest rates in violation of state usury limits.[45]

2019 outlook

- While we expect the Bureau to continue litigating active cases against payday lenders, the new CFPB leadership will likely prioritize other market segments due to the overall low volume of small-dollar-related consumer complaints.
- The CFPB's proposal to rescind the mandatory underwriting provisions of the Payday Rule will likely be finalized, resulting in less onerous underwriting requirements for the payday lending industry. It bears watching as to whether a second proposal to reform the Payday Rule's payment provisions will be forthcoming.
- In 2018, state regulators targeted payday lenders for operating fraudulent lending schemes to evade interest limits and using deceptive loan marketing tactics. We expect this momentum to continue in light of the CFPB's policy changes on payday lending and the federal banking regulators' call for banks to offer small-dollar credit products.

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"[The FDIC is] trying to make an informed opinion on how to proceed with short-term lending. [W]e are able to work with the banks on how to ensure the consumer protection protocols are in place and compliant while making sure that the consumers' needs are met."

FDIC Chairwoman Jelena McWilliams[3]

5,4927

consumer complaints directed at payday lenders (between Nov. 2016 and Nov. 2018)[46]

Student loans

In 2018, the CFPB shifted away from student lending supervision and enforcement. We anticipate this trend to continue in the year to come, with states seeking to fill any voids left by the Bureau.

Supervision

While the CFPB remained an active participant in the student lending and servicing markets in 2017, the Bureau noticeably reduced supervisory and enforcement scrutiny in 2018, in part, due to its change in leadership and a focus on other market segments reflecting higher consumer complaint volumes.[3] As we foreshadowed in last year's issue, former CFPB Acting Director Mulvaney scaled back from an enforcement-oriented approach and increased the Bureau's educational role and outreach in the student lending space.[4] Notably, the CFPB did not file any student lending- or servicing-related enforcement actions and limited the functions of the Office of Students and Young Consumers to just consumer education by folding it into the Bureau's financial literacy unit.[5] The Bureau also indefinitely shelved a CFPB proposal from former Director Cordray to issue student loan servicing rules and reallocated resources to other rulemaking initiatives.[6] The Bureau's first (and only) Supervisory Highlights issue released under former Acting Director Mulvaney did not include any observations on student lending, compared with other areas of focus, such as debt collection and payday lending.[7] In addition, although required by the Dodd-Frank Act,[8] the Bureau failed to release the annual report for 2018 of its student loan ombudsman, which is designed to provide a snapshot and analysis of student borrower complaints for each year.[9] At a time when new CFPB Director Kraninger is setting her agenda for 2019, we anticipate that the Bureau will continue to cede oversight of the federal student lending and servicing markets to the US Department of Education (ED). In response, states will likely continue to scrutinize student loan servicers, but may face greater challenges in federal court on preemption grounds.

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"American families need an independent Consumer Bureau to look out for them when... student loan companies are allowed to drive millions of Americans to financial ruin with impunity."

Former CFPB Student Loan Ombudsman Seth Frotman[1]

8,340

student loan-specific complaints filed with the CFPB in 2018[41]

The Bureau's retreat from student lending has faced criticism, including by the former CFPB student loan ombudsman, who announced his resignation by releasing a public letter to former Acting Director Mulvaney and key members of the Trump Administration, criticizing the CFPB leadership's decision to suppress a report about student account fees and other attempts to undermine the Bureau's independence.[10] After the CFPB declined to issue its annual ombudsman report, two advocacy groups separately released their own versions by compiling student grievances submitted to the CFPB complaint database in 2018.[11] Both reports highlight servicing failures by federal student loan servicers, including errors in

Student loans (continued)

“To ensure that students are adequately protected, [Director Kraninger’s] first actions as CFPB Director should include reinstating the enforcement authority of the Office of Students and Young Consumers, filling the position of Student Loan Ombudsman, and rapidly providing Congress with information on student borrowers as required by statute.”

Senator Elizabeth Warren (D-MA) [2]

36%
complaints related to private student loans

64%
complaints related to federal student loans

processing payments across multiple loans, conflicting information received about repayment options, and difficulties in accessing advertised loan benefits.[12]

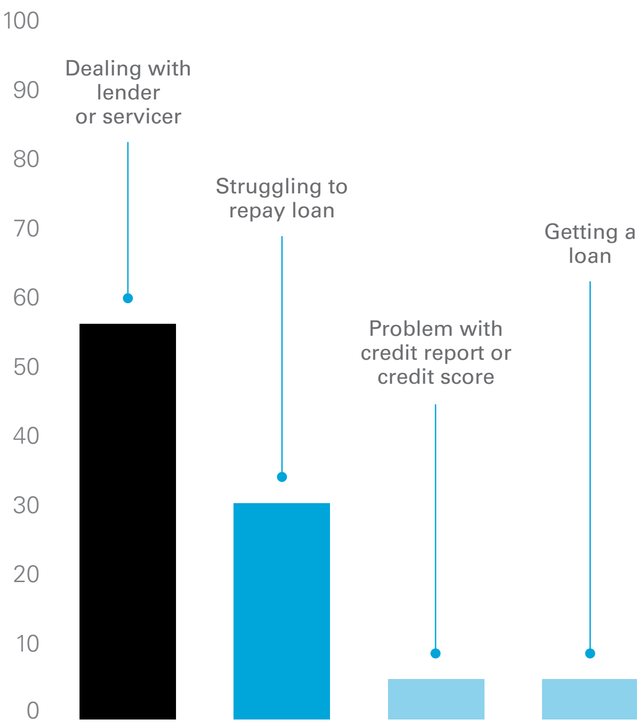
Leaders in the House and Senate have also expressed concerns about the Bureau’s apparent retreat from student lending supervision and enforcement. In a letter addressed to the new CFPB leadership, Sen. Warren (D-MA) urged Director Kraninger to ensure adequate protection of student borrowers by reinstating the Office of Students and Young Consumers to its prior supervisory functions.[13] Proposed legislation by Rep. Waters (D-CA), Chairwoman of the House Financial Services Committee, also seeks to largely restore the Bureau’s organizational structure by, among other steps, reinstating and clarifying the Office of Students and Young Consumers’ role and restricting the CFPB Director’s ability to reorganize it.[14] The proposed bill would also require the CFPB Director to respond to the allegations articulated by the ex-student loan ombudsman in his resignation letter.[15] While it remains unclear how much weight such requests will carry with Director Kraninger, we expect that House Financial Services Committee oversight of student lending will become more aggressive in the year ahead under Rep. Waters’ direction. Although changes to the CFPB’s structure may necessitate new legislation, which is unlikely, given that Democrats control the House and Republicans control the Senate, increased public and political pressure on the Bureau’s supervision of student lending may result in requests for House Financial Services Committee hearings related to the ex-student loan ombudsman’s allegations.

Enforcement

Although the Bureau did not bring any new action against a student lender or servicer in 2018, one notable enforcement action remains pending. In 2017, the Bureau filed a lawsuit against the largest US student loan servicer for failing to provide routine servicing functions, including by steering borrowers into expensive forbearance programs, preventing borrowers from accessing income-driven repayment plans (IDR), misallocating payments, and failing to ensure accurate credit reporting.[16] The litigation is currently embroiled in a discovery dispute related to the disclosure of borrowers' records,[17] and the Bureau did not pull back from litigation under former Acting Director Mulvaney. Accordingly, we expect the CFPB under Director Kraninger to continue litigating this matter. In 2017, the Bureau also targeted a conglomerate of private student loan trusts that, among other actions, allegedly misplaced loan documentation and initiated illegal lawsuits by filing false affidavits through third-party debt collectors.[18] Although a proposed consent order was filed shortly thereafter,[19] the case remains pending in US district court. It remains unclear how Director Kraninger will proceed on this issue.

By contrast, the FTC's enforcement efforts continued to target student loan debt relief scams in coordination with state AGs as part of Operation Game of Loans.[20] In 2018, the FTC resolved several actions[21] and filed a new lawsuit against debt relief companies for allegedly collecting illegal upfront fees and deceiving student borrowers about their eligibility for federal relief programs or their affiliation with the ED.[22] The FTC also separately entered into a settlement with a leading student loan refinancer for allegedly misrepresenting the average amounts borrowers would save by refinancing their loans with the company.[23]

Most common private student loan complaints reported by consumers (2018)



Source: *LendEDU CFPB Complaint Report* (2019)

Fintech outlook

Fintechs in the student lending space have principally focused on developing tech-driven solutions to assist student borrowers with consolidating and refinancing their debt. By leveraging non-traditional data analytics (e.g., education, employment and salary history), student loan-focused fintech companies often endeavor to tailor their services to each individual borrower. Increased reliance on non-traditional sources of data in loan underwriting or refinancing continues, however, to raise fair lending risks, especially for new market entrants who may not be as familiar with applicable consumer protection laws. Although the CFPB has yet to clearly communicate its view on the appropriate use of alternative data, the Bureau has demonstrated increased openness to tech-driven approaches and may provide future guidance as the recently created Office of Innovation sets its agenda. Finally, and as highlighted in last year's issue, new

Student loans (continued)

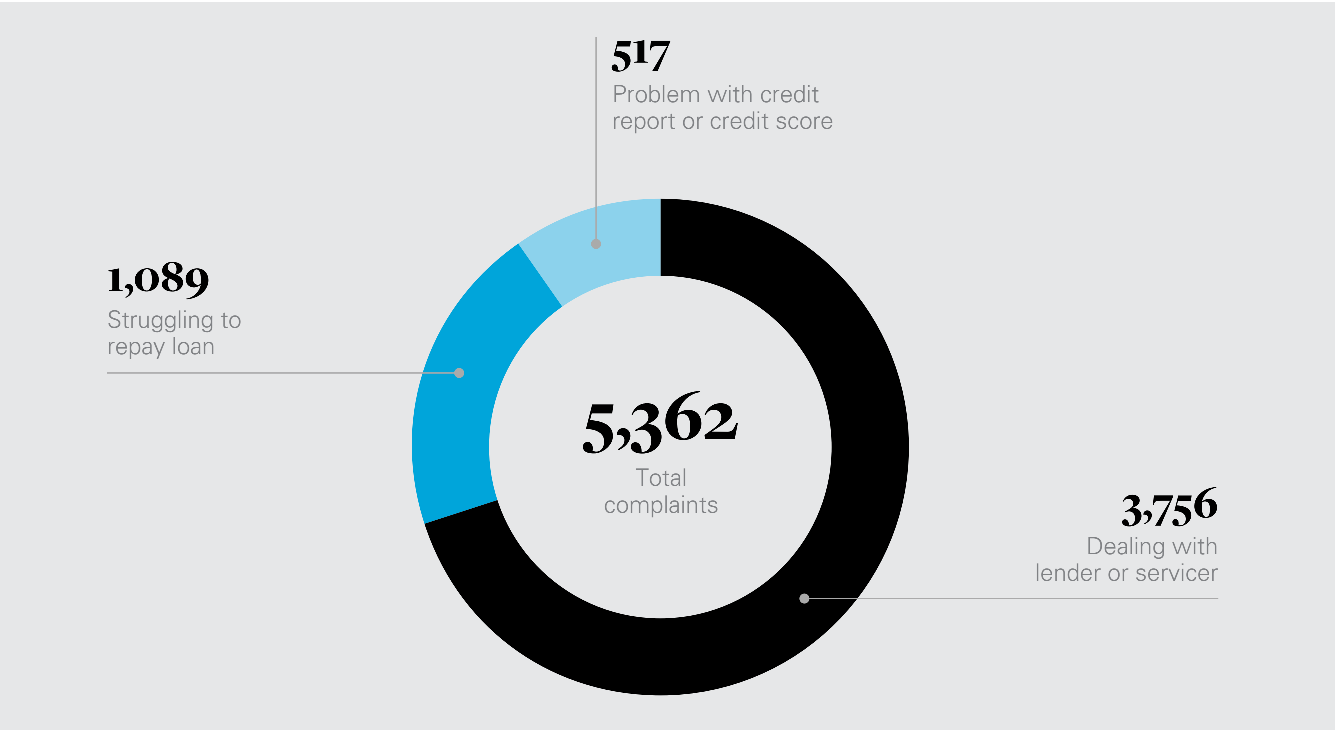
arrangements such as "Income-Share Agreements"[24] also raise novel legal and policy concerns but continue to gain traction with universities[25] and receive political support[26] as an alternative to traditional student loans.

State spotlight

- **States continue to enact new borrower protection laws.** Since 2015, several states have enacted legislation to protect student borrowers. While ED maintains that regulating loan servicers is the federal government's responsibility,[27] states continue to introduce so-called "bills of rights" in connection with student loans and increase state oversight of loan servicing practices.[28] This is a trend that shows no signs of abating—for instance, Maryland recently created a state student loan ombudsman modeled after its CFPB counterpart,[29] and other states have similar legislation pending.[30]

- **Preemption debate remains open.** In the wake of a wave of new state student loan servicing laws and enforcement activity, ED sought to stymie these efforts by arguing[31] that states are federally preempted from regulating federal student loan servicers under the Higher Education Act (HEA).[32] Proposed amendments to the HEA were also introduced in Congress that would preempt state law requirements regarding licensing, disclosures and communications with

Most common federal student loan complaints reported by consumers (2018)



Source: *LendEDU CFPB Complaint Report* (2019) borrowers that apply to the origination, servicing or collection of a federal student loan.[33] In response, a bipartisan coalition of state AGs released a letter asserting their fundamental right to protect student borrowers absent a clear and contrary indication by Congress.[34] This follows a statement published by the CSBS opposing ED's position in favor of a "cooperative state-federal regulatory framework" governing federal student loan servicers.[35]

- **Parallel and coordinated state enforcement.** In our prior issue, we noted that the AGs of Pennsylvania, Washington and Illinois brought parallel suits to one notable CFPB enforcement action against a large student loan servicer.[36] This trend persisted in 2018 with additional state AGs joining the fray,[37] and we suspect others may follow. More recently, AGs in 48 states[38] and the District of Columbia entered into a settlement agreement with a for-profit education company over allegedly predatory and deceptive practices.[39] Closing a years-long investigation led by a coalition of eight states, the multi-state settlement resolves allegations that the company misled students about enrollment costs and job prospects, among other practices.[40]

2019 outlook

- While we expect the Bureau to continue litigating notable pending actions against student loan servicers, the new CFPB leadership seems likely to seize on the low number of student loan-related complaints to shift further away from student lending enforcement and supervision.
- At the same time, House oversight of the Bureau's student lending activities is expected to become more aggressive under Chairwoman Waters, and will likely translate into some increased public and political pressure.
- Student lending supervision and enforcement is expected to remain a key concern of states as ED continues to assert oversight of federal student loan servicers. We anticipate states to continue to fill any perceived voids left by the CFPB by way of new legislation and enforcement actions.

Auto finance

In 2018, the CFPB continued to pay attention to the auto finance industry, with a particular focus on indirect (dealer-arranged) auto lenders and unfair or abusive loan servicing practices.

Supervision

The CFPB has continued to target the auto finance industry, with a focus on indirect (i.e., dealer-arranged) auto lenders and unfair, deceptive or abusive loan servicing practices. In 2018, the Bureau paid particular attention to auto loan servicing activities, primarily to assess whether servicers have engaged in unfair, deceptive, or abusive acts or practices. Notably, the CFPB has specifically identified deceptive and unfair acts or practices related to billing statements and wrongful repossessions through its supervisory function.[3]

Origination

The results of the CFPB's most recent examinations evidence a focus on auto loan servicing as opposed to loan origination. Still, the Bureau brought certain enforcement actions in 2018 for unfair or deceptive acts and practices and violations of TILA in auto loan origination. The Bureau has also focused on educating service members on auto finance matters, including with respect to loan origination by publishing articles with information regarding how to shop for financing and how to evaluate add-on financing products.[4]

Servicing

The Bureau's supervisory efforts in 2018 addressed automobile loan servicing deficiencies by focusing on illegal repossessions[5] and inaccurate billing statements. Specifically, the CFPB focused on unfair practices used by servicers to wrongfully repossess consumers' vehicles in instances where the servicer and consumer had reached an agreement to cancel the repossession. In addition, the Bureau found that servicers acted deceptively by sending billing statements after a total vehicle loss showing that the insurance proceeds had been applied to the loan payments such that the loan was paid ahead, but then treated consumers who failed to pay by the next month as late, and in some cases, also reported the resulting inaccurate negative information to credit bureaus.[6]

In May 2018, President Trump signed into law a joint resolution under the Congressional Review Act that disapproves the CFPB's Bulletin 2013-2,[7] which targeted dealer markups using disparate impact discrimination theories under the ECOA.[8] The resolution was passed in the wake of a December 2017 determination by the GAO that the bulletin should have been submitted for Congressional review as a rule.[9] Former Acting Director Mulvaney issued a statement[10] in May 2018 acknowledging that the bulletin is no longer in force and noting that the Bureau is reexamining ECOA enforcement in light of a recent US Supreme Court decision concerning the disparate impact doctrine "distinguishing between antidiscrimination statutes that refer to the consequences of actions and those that refer only to the intent of the actor."[11] A coalition of 14 state AGs subsequently urged the Bureau against reading disparate impact liability out of the ECOA.[12]

Enforcement

The CFPB previously brought enforcement actions against auto lenders for alleged UDAAP, ECOA and Fair Credit Reporting Act (FCRA) violations, frequently through joint actions with the DOJ. The CFPB brought far fewer enforcement actions in 2018 than in past years, including in the auto lending space, but did bring certain notable enforcement actions for alleged UDAAP and TILA violations. Alleged violations included not properly describing the benefits and limitations of add-on products and the impact of obtaining a loan extension,[13] as well as failing to disclose finance charges associated with auto title loans, APR and other information required by TILA in advertisements.[14] In a joint enforcement action with the OCC, the Bureau notably reached an unprecedented US$1 billion settlement with a major financial institution for activities, including auto loan servicing abuses that include forcing consumers to buy mandatory auto loan insurance coverage.[15] As is discussed below, the various states and the District of Columbia reached a settlement with the same institution for related conduct.

The FTC also sued a group of four auto dealers for activities that included falsifying consumers' income and down-payment information on vehicle financing applications, in some cases after the consumers had signed the applications, and deceiving consumers about the nature and terms of financing or leasing offers.[16] The DOJ has also filed a lawsuit against an auto finance company for allegedly repossessing protected service members' motor vehicles without obtaining the necessary court orders for such repossessions.[17]

Given the CFPB leadership's decreased focus on UDAAP as an enforcement tool, as well as the reassignment of the CFPB's fair lending office to educational activities,[18] we anticipate that the CFPB will continue to bring enforcement actions against the auto lending industry at a slower pace than under former Director Cordray.

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"Let's be clear. Discrimination in auto lending is alive and well."

Senator Elizabeth Warren (D-MA)[1]

US$54.6

billion in auto loans originated (since CFPB's creation)[30]

17,134

consumer complaints related to auto loans or leases (between Nov. 2016 and Nov. 2018)[31]

"As the federal government stands down on protecting consumers from financial frauds and abuses, [the New York Department of Financial Services] stands up to safeguard New Yorkers from unfair lending practices [and] continues to... review indirect automobile lending programs where appropriate."

Former NYDFS Superintendent Maria T. Vullo[2]

State enforcement and litigation

The states have not signaled such a shift in focus,[19] and will likely continue to rely on state prohibitions on unfair and deceptive acts or practices to protect consumers in this market segment. In 2018, states mainly targeted indirect auto lenders and auto dealers and successfully reached settlements with, or obtained successful verdicts against, industry participants, notably:

- **Massachusetts:** The AG has continued to be active in this market segment. The AG entered a consent judgment against an auto lending company that the state found to have facilitated the dealerships' sale of defective and inoperable vehicles by supplying the dealerships with financing, despite knowing of consumer complaints against the dealerships and of the associated high default and repossession rates.[20]
- **New Jersey:** The AG and the state Division of Consumer Affairs sued a luxury used auto dealership for alleged deceptive practices including conducting credit checks without the consumer's knowledge or authorization, submitting false financial information to a lending institution, failing to refund monies paid by consumers after they cancelled the sales transaction, and advertising used motor vehicles at a price lower than the price posted on the vehicle at the dealership location.[21]
- **Arkansas:** The AG brought a successful lawsuit against an auto dealer and its related companies for failures to deliver title to cars, satisfy prior liens on the vehicles and return money rightfully belonging to consumers, including loan proceeds from third-party lenders.[22]
- **Arizona:** The AG settled with an auto dealer for engaging in false advertising practices, including internet advertising that listed vehicles at prices that included all possible rebates and excluded mandatory dealer "add-ons" that had already been applied to the vehicles, and misrepresenting consumers' financial information on loan applications.[23]

Going forward, the rise in state involvement may also lead to increased class action litigation against the auto lending industry.

Fintech outlook

Fintechs in the auto finance space generally focus on pairing consumers with financing offers—both for vehicle purchases and leases—by either establishing partnerships with auto finance companies or banks,[24] or by allowing consumers to compare different financing options online. While such tech-focused methods—as seen in the residential mortgage space—do not appear to show any sign of subsiding, we note that there continues to be fair lending compliance and enforcement risk in this area, especially for new market entrants who may not be as familiar or experienced with applicable laws and regulations. Even if the CFPB continues to put less of an emphasis on federal fair lending enforcement, state fair lending laws will apply and state-level scrutiny of fair lending issues is likely to continue, if not increase.

State spotlight

In addition to state enforcement and litigation efforts, we also note the following developments:

- **Increased cooperation.** State AGs are considering the creation of a multi-state task force to target the auto finance industry and, more specifically, the subprime segment.[25] Cooperation efforts have resulted in joint investigations and settlements: notably in December 2018, the 50 states and the District of Columbia reached a settlement with a major financial institution for, among other things, charging auto loan customers for insurance they did not need and failing to ensure that customers received refunds of unearned premiums on certain optional auto finance products.[26]

- **Rulemaking.** The invalidation of the CFPB's 2013 Indirect Auto Lending Bulletin may incentivize state AGs to issue similar rules or guidance to replace the bulletin. For example, in August 2018, NYDFS issued guidance[27] to remind its supervised institutions and sales finance companies that engage in indirect automobile lending through third parties that they must comply with New York's Fair Lending Law,[28] in light of what the head of the Department characterized as "federal supervisory lapses and rollbacks in enforcement."[29]

2019 outlook

- We anticipate that the CFPB will continue to bring enforcement actions against the auto lending industry at a slower pace, although the Bureau will continue to be attentive to auto lending matters, especially auto loan servicing.

- State regulators will likely continue to address what some perceive as a lack of action by the CFPB in the auto lending space while at the same time enhancing cooperation with other states, resulting in possible increases in state-level enforcement actions in 2019.

- Fair lending enforcement will continue to take a backseat at the CFPB, as the industry waits for the Bureau's next steps with respect to ECOA enforcement and use of the disparate impact doctrine.

Marketplace lending

The CFPB has traditionally not prioritized marketplace lenders in its supervisory and enforcement efforts. As a result, state regulators have increasingly sought to fill any perceived voids left by the Bureau.

"[The CFPB] must ensure that the marketplace is innovating in ways that enhance both choice and the needs of the consumers."

CFPB Director Kathy Kraninger [1]

Supervision

Federal regulators

The CFPB does not have direct supervisory or regulatory oversight over marketplace lending generally, and the Bureau has not demonstrated a specific focus on marketplace lenders in recent years. However, industry participants remain subject to consumer financial protection laws enforced by the Bureau, and the CFPB's supervision and guidance on lending issues also generally applies to marketplace lending. For instance, the CFPB issued its first (and to this point only) no-action letter in September 2017 to a marketplace lending platform that uses automated models for underwriting unsecured, non-revolving credit.[4] We expect the Bureau to issue additional no-action letters going forward, especially in light of the CFPB's December 2018 proposed guidance intended to give companies greater certainty about the level of enforcement and supervisory relief they can receive from the Bureau.[5] At the same time, it is possible that the CFPB may clarify certain related positions (e.g., small-dollar loan payday issues) and, in doing so, provide more clarity to marketplace lenders in an effort to increase subprime consumers' access to credit.[6]

We also note that the Bureau issued a request for information regarding the use of alternative data (i.e., information not traditionally used by credit bureaus when calculating a credit score) to assess creditworthiness in February 2017,[7] which would affect marketplace lenders, especially new fintech entrants and online platforms. The CFPB acknowledged in 2018 that the initiative is ongoing but has not provided any updates. In December 2018,[8] the GAO issued a report encouraging the CFPB, FDIC, OCC and Federal Reserve Board (FRB) to provide clarification concerning lenders' use of alternative data.[9]

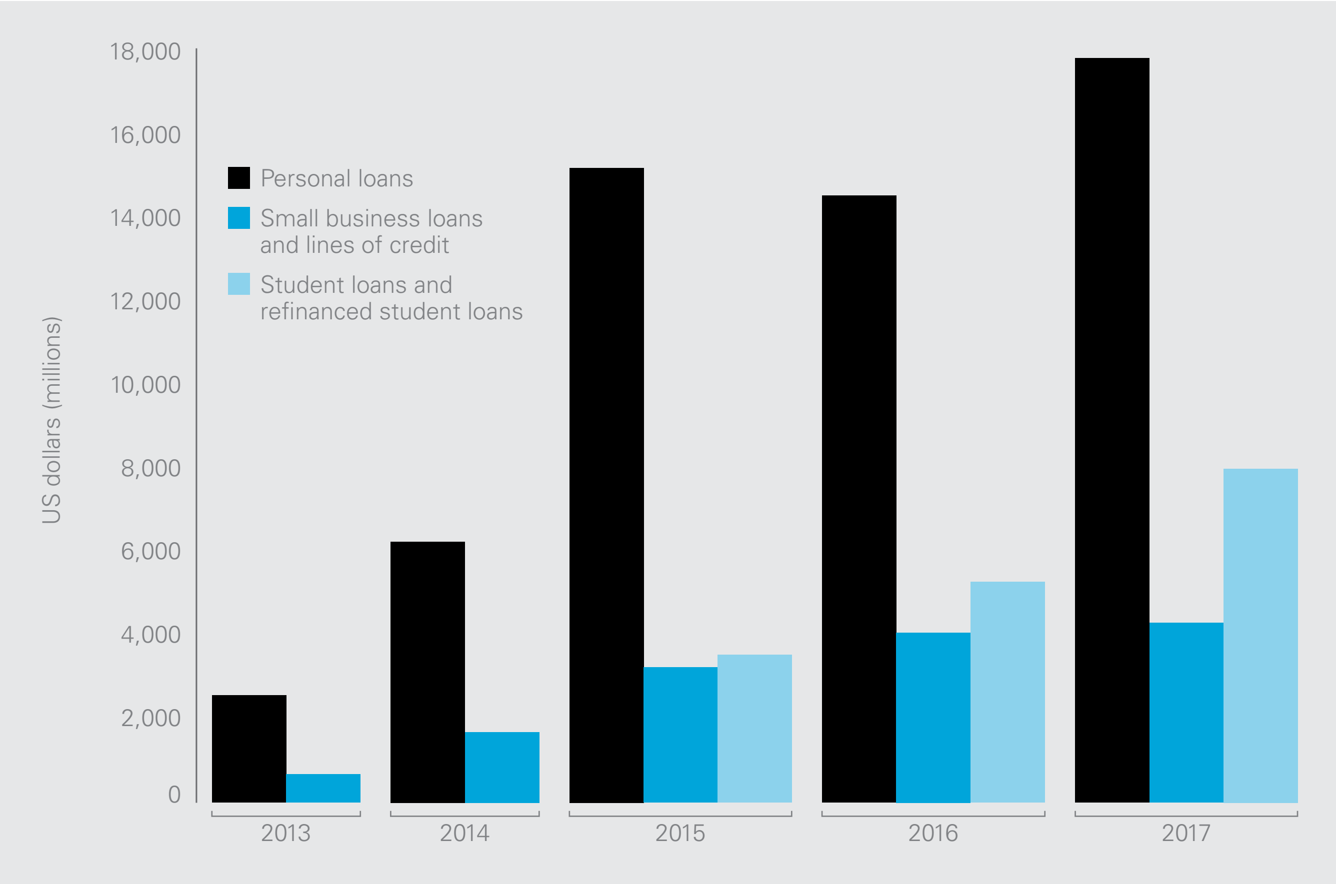
The FDIC and the OCC have highlighted certain risks involved in developing relationships between supervised financial institutions and third-party lenders. In March 2017, the FDIC updated its Compliance Examination Manual on Third Party Risk to address such concerns, including how to manage and minimize associated risks.[10] Throughout 2018, the FDIC did not indicate whether it intends to finalize its 2016 proposed guidance outlining the risks to FDIC-supervised banks that may be associated with third-party lending.[11] In June 2017, the OCC issued additional guidance for managing operational, compliance, reputation, strategic and credit risk presented by third-party business relationships of national banks and federal savings associations.[12]

Although federal agencies have not traditionally been at the forefront in overseeing marketplace lenders, they could become more proactive should the OCC begin to license fintechs as special-purpose national banks or the FDIC resume chartering industrial loan companies (ILCs), assuming marketplace lenders seek to obtain such charters.[13]

Congress

The 115th Congress, which concluded in January 2019, considered several notable bills that would have affected marketplace lenders, none of which ultimately became law. Specifically, the House passed three bills that would have substantially benefited marketplace lenders. The CHOICE Act and the Protecting Consumers' Access to Credit Act, passed by the House in June 2017 and February 2018, respectively, were intended to overturn the Second Circuit's decision in *Madden v. Midland Funding.*[14] If enacted, the bills would have made interest rates on loans valid so long as they were valid at the time the loan was originated — regardless of whether the loan were later sold, assigned or transferred to a third party that could not have originated such a loan under otherwise applicable state usury laws.[15] The MOBILE Act would have allowed online lenders to obtain a borrower's personal information from a scanned driver's

Evolution of US loan volume for leading marketplace lenders (in US$ millions)



Source: *GAO Report 19-111* (2018)

Marketplace lending (continued)

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> **"You can make a strong argument... that new technology actually offers new and innovative ways to protect consumers."**
>
> ***Former CFPB Acting Director Mick Mulvaney[2]***

license image.[16] Other proposed legislation would have established guidelines for when parties to a bank/nonbank partnership would be considered the "true lender" in consumer loan transactions.[17] We expect that some of these bills may serve as the starting point for legislative proposals in the current 116th Congress.

Treasury is a strong supporter of such legislation. In a 2018 report, Treasury encouraged Congress to codify the "valid when made" doctrine and clarify that the existence of a service or economic relationship between a bank and a fintech in a lending partnership does not affect the role of the bank as the "true lender" of the loans made through such partnership.[18] Many states take the opposite view. In June 2018, a coalition of 21 state AGs wrote to congressional leaders opposing this *Madden*-fix and true lender legislation,[19] and the Conference of State Bank Supervisors (CSBS) announced its opposition to true lender legislation in May 2018.[20]

Enforcement

Federal regulators

In early 2018, a federal court ruled in favor of the CFPB in a 2013 action brought against an online loan servicer that employed unfair, deceptive and abusive servicing practices by executing automatic debits from customers' accounts and violating state usury laws, but approved only a fraction of the relief sough.[21] The Bureau has appealed the reduced penalty, arguing that it would set a bad precedent for the market.[22] The Bureau did not bring any new marketplace lending enforcement actions in 2018, and we expect the CFPB will likely maintain the status quo for marketplace lenders, especially because such lenders represent a relatively low number of consumer complaints submitted to the Bureau.[23]

In March 2018, the FDIC announced a settlement with a New Jersey bank and its nonbank partner in a lending arrangement for unfair and deceptive practices under the FTCA and violations of TILA and the Electronic Fund Transfer Act (EFTA). The FDIC exercised jurisdiction over the nonbank partner on the basis of it being an institution-affiliated party of the supervised bank. Each party was subject to a fine, and US$20 million was reserved for customer restitution.[24]

The FTC also took action against marketplace lenders in 2018. In April 2018, the FTC charged a prominent marketplace lender with violating the FTCA and Gramm-Leach-Bliley Act (GLBA) by falsely promising consumers they would receive a loan with no hidden fees, when the company in fact deducted significant up-front fees.[25] In addition, in October 2018, the FTC reached a settlement with a marketplace lender and its affiliate over allegations that the lender had deceptively advertised inflated amounts that student loan borrowers would save from refinancing loans.[26]

State regulators

State financial regulators have sought to protect consumers from unlicensed online marketplace lenders. Consistent with actions brought by Massachusetts and New Hampshire authorities in early 2018 and 2017,[27] the Vermont Department of Financial Regulation fined an online marketplace lender in December 2018 for operating without a license.[28]

In March 2018, NYDFS sent an online survey to marketplace lenders operating in New York in an effort to gather information regarding their business practices, and subsequently published a report in July 2018.[29] NYDFS indicated that, in many cases, it considers the nonbank online lender, rather than the bank, to be the "true lender" in such partnership arrangements.[30] Accordingly, NYDFS might pursue cases against marketplace lenders going forward.

In another 2018 development, the administrator of the Colorado Uniform Consumer Credit Code expanded its suits against two marketplace lenders by adding as defendants certain securitization trusts that had acquired loans from the defendants.[31] In each case, Colorado is arguing that the marketplace lender, rather than its bank partner, was the "true lender."[32]

State AGs

Unlike state regulators, state AGs did not appear to focus on marketplace lenders in their 2018 enforcement efforts. In light of the Bureau's recent call for states to take the lead in enforcing consumer protection laws, we expect that state AGs may more actively bring enforcement actions against this market segment in the future.[33]

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"The decision to consider applications for special purpose national bank charters from innovative companies helps provide more choices to consumers and businesses, and creates greater opportunity for companies that want to provide banking services in America."

OCC Comptroller Joseph Otting[3]

Marketplace lending (continued)

Class action litigation

In May 2018, a clothing retailer filed a putative class action lawsuit against a marketplace lender asserting violations of Massachusetts usury, false advertising and unfair competition laws, as well as two federal Racketeer Influenced and Corrupt Organizations Act[34] claims.[35] The lender has moved to compel arbitration. In other cases, plaintiffs are suing marketplace lenders and their bank partners to void loan agreements that include arbitration and choice-of-law provisions.[36]

Moving forward, increased state enforcement actions may also contribute to increased class action litigation targeting marketplace lenders.

Fintech outlook

Fintechs in this space have principally focused on pairing borrowers with lenders online, and built AI-based scoring algorithms used to evaluate alternative data sources to assess creditworthiness and price loans. Fintech lenders typically operate through (1) a bank partnership, in which the bank originates a loan sourced and serviced by the fintech, or (2) a direct lender model, which requires the fintech to be licensed in each state in which it does business (or, perhaps in the future, seek a federal option such as the FDIC's ILC designation or the OCC's special purpose national bank charter).[37] As in other market segments, these innovative approaches and business models may yield significant benefits to subprime consumers, but also may raise novel, or at least significant, fair lending and financial inclusion considerations. Fintech lenders represented 36 percent of the unsecured consumer loan market in 2017 and are not expected to dwindle moving forward.[38]

2019 outlook

- We expect that state regulators, especially the NYDFS, will continue to keep a close eye on marketplace lenders and pursue "true lender" challenges to marketplace lending bank partnerships.
- Use of alternative data will likely remain a hot topic for federal regulators following the GAO's report encouraging regulatory clarification concerning lenders' use of alternative data.
- While the Trump administration and many in Congress support *Madden*-fix and true lender legislation, strong opposition from the states makes the legislative path uncertain.

Payment processing

The CFPB continued to be active in the consumer payments space in 2018, while the Federal Reserve and market participants considered the future of payment processing, including the development of faster payments systems.

Prepaid Card Rule

The CFPB finalized changes to its prepaid card rule in January 2018[3] and delayed the rule's compliance date to April 2019.[4] The amended rule preserves significant restrictions on credit features and detailed disclosure requirements, while some burdens on industry participants have been alleviated. Notably, the amended rule now includes: (1) an exception for error resolution and limited liability requirements for unregistered prepaid accounts; (2) more flexibility for credit cards that are linked to digital wallets; (3) an exclusion from the rule for loyalty, award or promotional gift cards; (4) flexibility regarding the pre-acquisition disclosures for certain prepaid accounts; and (5) flexibility in submitting prepaid account agreements to the CFPB.[5]

Remittance Rule

In October 2018, the Bureau released a five-year look-back report on its 2013 remittance rule (Remittance Rule).[6] The Remittance Rule requires remittance transfer providers to disclose to consumers costs, fees and other information; provide cancellation and refund rights; investigate disputes; and remedy certain errors.[7] The Bureau's report concludes that the Remittance Rule "did not lead to a large increase in prices," but may have created some upward pricing pressure.[8] The Bureau indicated that the report will inform

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"Today, our payment system is again at a crossroads. There is a growing gap between the transaction capabilities we need and expect in the digital economy — fast, convenient, and accessible to all — and the underlying settlement capabilities."

Federal Reserve Board Governor Lael Brainard[1]

any potential future rulemaking to amend the Remittance Rule[9], although we do not expect such a rulemaking in the near term.

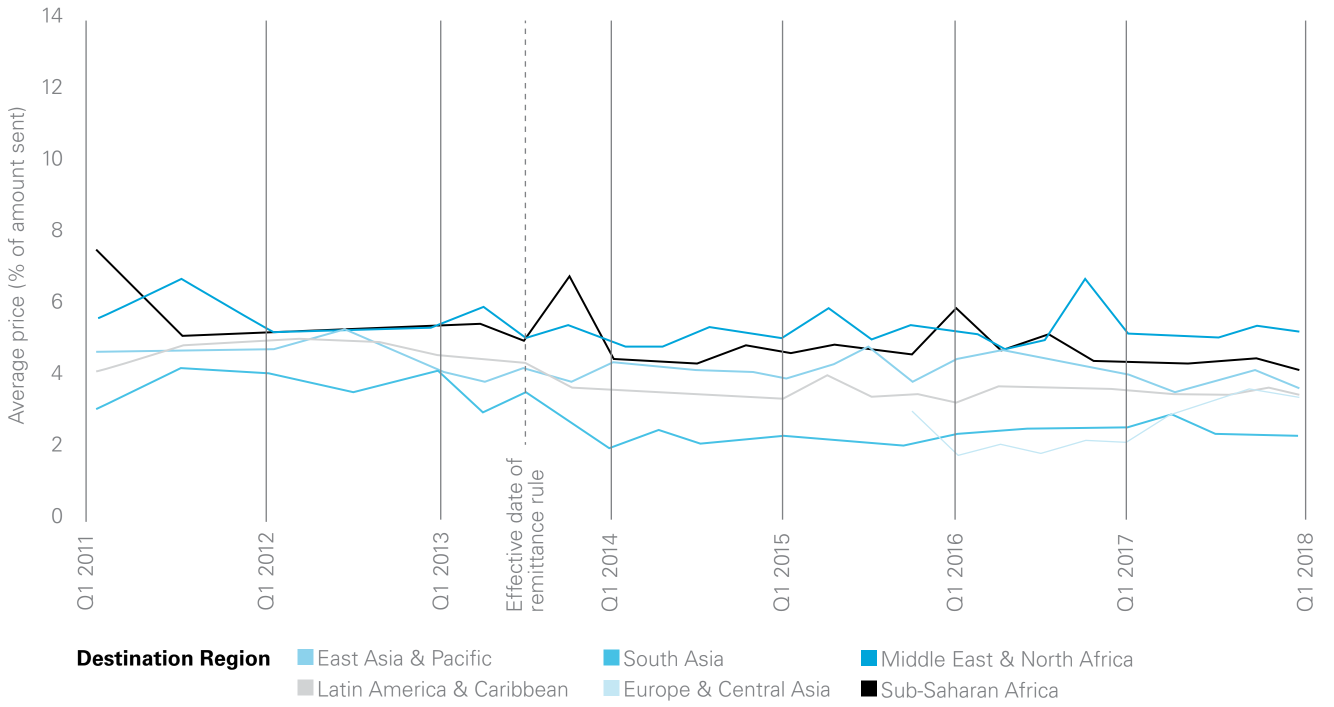
Funds availability and remote capture

In November 2018, the CFPB and the FRB jointly proposed amendments to Regulation CC, which generally regulates the US check clearing system, to implement a statutory requirement to adjust for inflation the amount of funds depository institutions must make available to their customers.[10] The joint proposal also reopened for public comment the agencies' 2011 proposal on certain fund-availability amendments to subpart B of Regulation CC (Subpart B), which they jointly administer.[11] The proposal would revise requirements specifying the schedules within which banks must make funds available for withdrawal and rules regarding exceptions to the schedules, disclosure of funds availability policies and payment of interest.[12] In September 2018, the FRB adopted changes to Regulation CC that reflect the evolution of the check collection process from largely paper-based to virtually all electronic and include new indemnities related to electronically created items and remote deposit capture.[13]

Examinations and Regulation Z

In the credit card space, CFPB examinations typically assess advertising and marketing, account origination, account servicing, payments and periodic statements, dispute resolution and the marketing, sale and servicing of credit card add-on products.[14] In recent examinations, the Bureau has generally found supervised entities in compliance with applicable consumer financial laws.[15] In 2018, however, the Bureau did find that certain supervised institutions failed to meet their obligations under the TILA and Regulation Z when conducting periodic re-examinations to assess whether it is appropriate to reduce an account's APR(s) and is likely to focus on this issue in future examinations.[16]

Average price of US$500 remittance transfer from the US by region (2011 – 2018)



Source: *CFPB Remittance Rule Assessment Report* (2018)

Fair access to credit and credit card market

The CFPB has devoted substantial attention to underserved communities' fair access to credit. In its spring 2018 semi-annual report[17] and December 2017 report on the consumer credit card market,[18] the Bureau highlighted significant problems faced by non-prime borrowers seeking to obtain a credit card. In January 2019, the Bureau issued a request for information[19] about aspects of the consumer credit card market to inform its biannual review of the market required by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act).[20]

Data security

The CFPB will likely continue to focus on payment processors' data security practices. In a statement made shortly after assuming leadership of the Bureau in December 2018, Director Kraninger said that she will focus on data security and privacy, particularly with respect to information collected by the Bureau.[21] Director Kraninger's words echoed previous statements on data security priorities by former Acting Director Mulvaney.[22]

The European Union's General Data Protection Regulation, which carries the potential for substantial fines (up to the greater of €20 million or 4 percent of worldwide revenue), came into force in May 2018 and generally applies to payment processors and other institutions that advertise and provide products or services to European Union customer.[23] In addition, California adopted the California Consumer Privacy Act of 2018 (CCPA),[24] which creates compliance responsibilities for most businesses that collect personal information about California residents.[25]

Enforcement

The CFPB found that a large financial institution violated TILA by failing to reevaluate and reduce the APRs for certain consumer credit card accounts and failing to have reasonable written policies and procedures in place to conduct the required APR re-evaluations.[26] Pursuant to a consent order with the institution, the Bureau required restitution of US$335 million for affected consumer accounts.[27]

In a January 2019 action, the Bureau entered into a consent order with a bank for violations of the EFTA and the Consumer Financial Protection Act by failing to properly stop preauthorized electronic fund transfers and failing to initiate and conduct adequate error resolution investigations.[28] The Bureau also found that the bank engaged in unfair acts or practices by reopening closed consumer deposit accounts in certain circumstances without providing timely notice.[29] The CFPB imposed a US$3.5 million fine and required consumer redress payments in excess of US$12 million.[30]

The FTC has also continued to actively police participants in the payments industry:

- The FTC reached a notable settlement with a prominent peer-to-peer payment service provider over allegations that the company misled consumers about their ability to transfer funds to external bank accounts and control the privacy of their transactions in violation of the FTCA and the GLBA.[31]
- The FTC also reached a settlement, which included a fine of approximately US$6 million, with an individual and his associated company over charges of laundering millions of dollars in credit card charges through fraudulent merchant accounts.[32] The FTC originally filed suit against 12 independent sales organization and sales agent defendants, and litigation continues with respect to eight of the defendants.[33]

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> **"The increased prevalence of overdraft fees, high cost small dollar credit, and check cashing has cost our constituencies tens of billions of dollars that a real time payments system would help ameliorate."**

Reps. Cedric Richmond (D-LA), Gregory Meeks (D-NY), Joyce Beatty (D-OH) and Dwight Evans (D-PA) on behalf of the Congressional Black Caucus[2]

Litigation

In June 2018, the Supreme Court issued its decision in *Ohio v. Am. Express Co.*, holding that provisions in American Express's merchant contracts that restrict merchants from encouraging the use of other cards did not violate the Sherman Act.[34] The Court found that the plaintiffs failed to show that the provisions had anticompetitive effects.

Faster payments

In November 2018, the FRB sought public comment on potential actions to facilitate real-time interbank settlement of faster payments through the development of (1) a 24x7x365 faster payments real time gross settlement (RTGS) system and/or (2) a liquidity management tool to enable transfers between Federal Reserve accounts 24x7x365 to facilitate faster paymentst.[35] The proposal follows a multi-year initiative by the Federal Reserve to engage with industry and other stakeholders to upgrade and enhance the nation's payment system, which resulted in the publication of final recommendations of the Faster Payments Task Force in 2017.[36] The FRB's proposal follows the 2017 launch of an RTGS system for faster payments by The Clearing House Payments Company, LLC.[37] Same-day settlement via the automated clearing house (ACH) system became available in 2017, and NACHA adopted new rules in 2018 to expand the availability of same-day ACH.[38]

Fintech outlook

- Fintech companies have developed AI-based regtech tools to improve fraud detection, identity theft, compliance with anti-money laundering (AML) obligations and Know-Your-Customer requirements, all of which are expected to be of particular usefulness in the payment processing area. The federal bank regulators have expressed an openness to engagement and dialogue with financial institutions on innovative approaches to AML compliance programs that increase the effectiveness of such programs and allow banks to maximize the use of their AML resources, provided that institutions continue to run existing processes in parallel while testing new approaches.[39]

- Faster payments developments and blockchain technology are introducing new "rails" by which payments are processed and offering new options to consumers, businesses and financial institutions. These developments, along with the pursuit of these technologies by fintech players, could reshape this market segment going forward. A challenge for new entrants in this market will be to assimilate into a highly regulated space, while competing with established players pursuing similar technologies.

2019 outlook

- We expect the CFPB to continue to focus on consumer access to credit, as well as on the data security practices of both payments processors and the Bureau itself. Consistent with 2018, we do not expect the payment processing space to be a busy enforcement area for the Bureau in 2019.

- We expect continued debate around access to Federal Reserve payments services as the Federal Reserve considers its next steps with respect to potential faster payments solutions. Large technology companies have advocated for expanded access rules to permit direct access by non-banks to Federal Reserve payments services,[40] while the banking industry has argued in favor of maintaining the existing framework.[41] Discussions regarding the future of the US payments system, along with the related debate over access, will continue throughout 2019.

CFPB structural changes

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