**Newsletter** | Financial Institutions / Regulatory & Compliance

# CFPB

## The Quarterly Review

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If the first quarter is any indication, 2016 is going to be a busy year for the CFPB and market participants alike.

## The CFPB Speaks

### Regulation by enforcement

On March 9, during his prepared remarks to the Consumer Bankers Association, CFPB Director Richard Cordray emphasized that institutions should pay careful attention to the agency's administrative and judicial enforcement orders, noting "[t]hese orders provide detailed guidance for compliance officers across the marketplace about how they should regard similar practices at their own institutions." He emphasized that "it would be compliance malpractice" for entities "not to take careful bearing from the contents of these orders about how to comply with the law." While acknowledging criticism about "regulation by enforcement," Cordray rationalized that "any responsible official or agency charged with enforcing the law is bound to recognize that they should develop a thoughtful strategy for how to deploy their limited resources most efficiently to protect the public."

Notwithstanding the Director's comments, consent orders remain negotiated documents that bind only the relevant parties. The facts, definitions of prohibited conduct and remedial measures set forth in such orders are often case-specific and generally arise out of circumstances fully known only to the involved parties. While informative, regulation by enforcement does not substitute for an effective regulatory process and may produce unpredictable outcomes, particularly in areas where policy has not been well developed. Accordingly, although market participants should review consent order content when navigating compliance issues, this should be informed by a holistic assessment of the relevant legal landscape.

### Insight into the rulemaking calendar

On March 16, the CFPB testified before Congress for the 59th time since July 2010. Similar to the previous hearings before the House Committee on Financial Services, criticism and accolades were doled out largely along partisan lines. Against that backdrop, the more insightful takeaways pertain to the agency's rulemaking calendar. Notably, the CFPB plans to (i) finalize the prepaid rule by the third week of June and (ii) finalize amendments to the mortgage servicing rules sometime in 2016. When asked about "regulation by enforcement," Cordray also alluded to the uncertainty surrounding the debt collection rulemaking: "The notion that because we may issue a rule on debt collection several years down the road, or—or maybe next year, whenever it will be, that in the meantime we can't stop people from engaging in an unfair and deceptive conduct, I just don't think is—is the right approach for us."

## Project Catalyst's no-action letter policy

On February 18, the CFPB announced a new policy that lets companies with consumer-friendly, innovative financial products and services apply for a no-action letter (NAL). The new process requires companies to first submit a request via email explaining the product or service, the benefits and risks to consumers, the proposed timetable and the reasons for the request. If the CFPB issues a requested NAL, it will state in the letter that it has no present intention to recommend enforcement or supervisory action for the particular aspects of the product or service in question. Given the newness of the NAL program, industry players and advisors are still evaluating the advantages and risks of this new option.

The new policy arises from the Project Catalyst initiative, which seeks to engage the CFPB with the broad community of innovators working on consumer financial products and services. While the CFPB's policy signals the agency's intent to engage in the fintech space, it is unclear whether the policy will be enough to draw innovators into the fold.

Although the CFPB's NAL policy may provide some certainty to the beneficiaries of a letter, there are several factors that may discourage applicants, including delays and costs attendant with completing the NAL process, uncertainty of getting the letter, the risk that proprietary information will be publicly disclosed, and the risk that the CFPB will not issue a NAL or that, if issued, the NAL will be caveated heavily and subject to revocation or amendment. Ultimately, whether the new policy helps the CFPB and industry balance the need for oversight with the desire to foster innovation in consumer financial services remains to be seen.

## Bureau's initiatives

On February 25, at the CFPB's Consumer Advisory Board Meeting, Cordray and CFPB Chief of Staff Chris D'Angelo reiterated four industrywide problems the agency continues to focus on: (i) deception; (ii) debt traps, i.e., where practices trigger a cycle of debt; (iii) dead ends, i.e., where people cannot "vote with their feet"; and (iv) discrimination. To address these issues, Cordray listed nine priorities: mortgage servicing; student loans; consumer reporting; small business lending; increasing consumers' financial savviness; increasing the agency's understanding of household balance sheets; open-use credit, such as credit cards, overdraft products, payday loans, auto title loans and installment loans; debt collection; and arbitration. While many of these are the subject of current and future rulemakings, the leadership was quick to emphasize that the agency will also deploy its full range of authorities, including supervision and enforcement, to address its concerns.

## Congressional testimony on small-dollar lending

On February 11, 2016, David Silberman, the CFPB's Acting Deputy Director and Associate Director of Research, Markets, and Regulations, testified before the House Subcommittee on Financial Institutions and Consumer Credit in a hearing examining the short-term, small-dollar credit marketplace and the CFPB's current regulatory proposals relating to payday and other short-term, small-dollar loans. The hearing emphasized the role that short-term, small-dollar lenders have in providing credit to underbanked American consumers and the effect that CFPB regulation could have on the market and its participants. Testimony provided by Silberman and several other panelists highlighted the potential for predatory or unfair lending practices within the market and the role that regulation could have in mitigating harm to consumers.

## 2015 Servicemembers report

On March 22, the CFPB released a report, *"Servicemembers 2015: A Year in Review,"* which provides an overview of complaints involving consumer financial products and services provided to servicemembers. The report noted that debt collection complaints topped the list, while other common complaints included mortgages or credit reporting, issues regarding receiving refunds from lenders for Veterans Administration (VA)-guaranteed mortgage funding fees and identity theft after deployment.

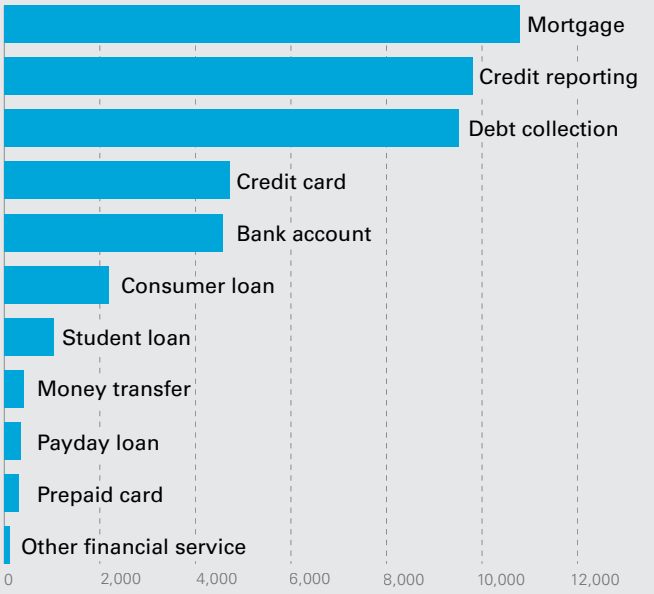
According to the report, in 90 percent of reported cases, companies closed complaints forwarded by the CFPB. While the CFPB has been an active intermediary for servicemembers, not all companies resolve complaints through the CFPB's system. In some cases, the CFPB has taken enforcement action to protect servicemembers, including imposing a US$1 million penalty and a US$2 million refund order against an Ohio auto lender, US$3 million in redress against a processor of military allotments, a US$250,000 penalty against a provider of variable-rate mortgage products and a US$2 million penalty against a nonbank mortgage lender focusing on originating refinance mortgage loans guaranteed by the VA. The report underscores the CFPB's willingness to use its authority to enforce the consumer financial services rights of servicemembers against a range of companies.

## Consumer Complaints

### Soliciting more consumer complaints

In late February, without any fanfare, the CFPB began accepting student loan complaints relating to federal student loans, which had previously been handled exclusively by the Department of Education's (ED) Federal Student Aid Ombudsman Group. Interestingly, ED is also developing, pursuant to a Presidential mandate, its own centralized complaint system for student loan servicing. Similarly, on March 7, the CFPB announced that it was accepting complaints from consumers encountering problems with loans from online marketplace lenders. With these expansions in the Consumer Complaint Database, it is clear that the CFPB's supervisory activities will continue to be driven, in part, by consumer complaints.

**Q1 2016 complaints by sector**




## Data Privacy & Protection

### UDAAP violations absent evidence of consumer harm

On March 2, the CFPB ordered an online payment platform company to pay a US$100,000 penalty for unfair, deceptive or abusive acts and practices (UDAAP) violations involving its data security practices. Although the CFPB found evidence of deceptive acts and practices relating to false representations on the company's part, the agency noted it did not find any evidence of actual injury to consumers.

The CFPB order focused on the company's representations to consumers and the potential harm to consumers as a result of such representations. For example, the company claimed to have data security practices that "exceed" or "surpass" industry standards and that "information is securely encrypted and stored." However, the CFPB identified various deficiencies, including delays in developing a written data security policy, failure regularly to assess data security risks, as well as failure to train employees after a penetration test revealed vulnerabilities from not encrypting certain sensitive consumer information. The order noted deficiencies in the company's software development platform, which was developed by an individual with no data security training. Through the platform, developers could independently release products to the public with security practices that went untested.

The order provided little useful guidance to the burgeoning fintech industry shape regarding data security practices. The order required the adoption of "reasonable and appropriate" data security measures, but gave no indication of what the CFPB viewed as reasonable or appropriate. The remaining guidance specified that companies have: a written data security plan; a specific person designated to oversee data security; risk assessments twice a year; regular employee training that speaks specifically to data security, handling sensitive consumer data and, if applicable, software development; customer identification at the registration phase and before enacting any funds transfer; procedures for selection and retention of service providers; and an annual data security audit.

## Auto

As expected, the CFPB continued to scrutinize indirect auto lenders during the first quarter of 2016.

### Changing "dealer markup" policies one entity at a time

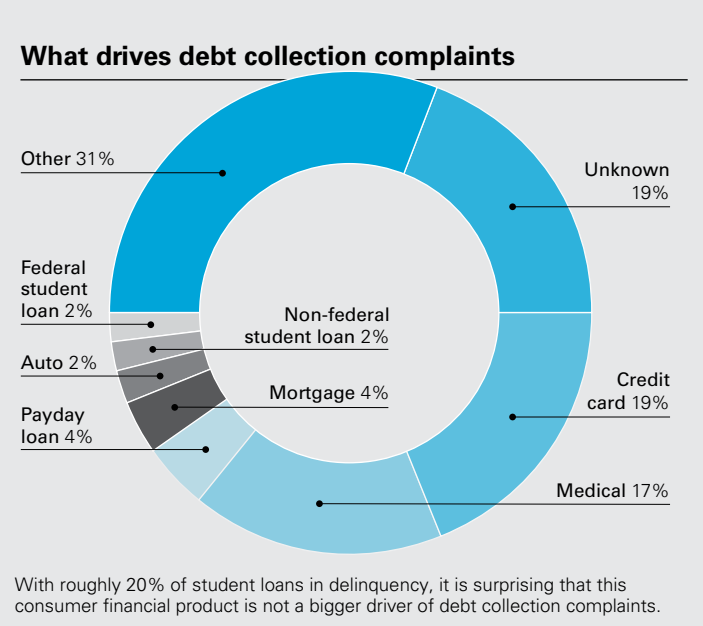
On February 2, the CFPB, along with the Department of Justice (DOJ), reached a settlement with one of the largest nonbank auto finance institutions. The settlement largely mirrors the July 2015 settlement that the CFPB and DOJ reached with another large nonbank auto finance institution. Under both settlements, the nonbanks were required to modify their dealer markup policy to implement one of three options, applicable to all of their dealers: (i) a limitation on dealers' discretion to mark up interest rates to 1.25 percent above the buy rate for an auto loan of five years or less and 1 percent for any loan with longer terms; (ii) a standard dealer participation rate; or (iii) no dealer discretion in setting contract rates. In the February 2016 and July 2015 settlements, both nonbank entities sought to resolve charges that they engaged in unlawful discrimination under the Equal Credit Opportunity Act (ECOA). Given the agency's actions to date, it is reasonable to expect that the CFPB will continue to review dealer markup and other pricing practices.

## Debt Collection

The CFPB's debt collection rulemaking is again delayed. The initial target for completion of pre-rule activities was set for December 2014, which was extended to April 2015, further extended to December 2015, and extended again to February 2016. To date, the CFPB has not convened a Small Business Regulatory Enforcement Fairness Act (SBREFA) panel, a required step, to solicit advice and recommendations on the proposed rulemaking, nor published an outline of proposals under consideration for input from the panel. It is anticipated that, when the agency releases its spring regulatory agenda in May, it will announce another delay in completing pre-rule activities. In the meantime, the industry can expect increased supervisory and enforcement activity in this space.

### Enforcement actions

Several of CFPB's 2016 enforcement actions involve alleged violations of the Fair Debt Collection Practices Act (FDCPA) and UDAAPs for certain debt collection and debt sales practices. For example, a large national bank was recently ordered to pay US$8 million for consumer redress and penalties in connection with UDAAP violations arising from its failure to provide account-level documentation, and to verify information such as annual percentage rate (APR) of interest when selling consumer debt to third-party buyers. As a result of the bank's alleged unfair practices, the CFPB alleged that third-party debt buyers applied incorrect APRs and misstated amounts owed in their collection efforts. With two of its credit card affiliates, the same bank was also a party to another action that concerned the use of affidavits provided by the bank to debt collection law firms attempting to collect the debt on the bank's behalf. The affidavits were altered by the debt collection law firms and included false or inaccurate information when filed with the court, giving rise to the law firm's alleged UDAAP and FDCPA violations.



With roughly 20% of student loans in delinquency, it is surprising that this consumer financial product is not a bigger driver of debt collection complaints.

### Joining forces with the Solicitor General

The CFPB joined the DOJ in filing an amicus curiae brief on behalf of the United States on March 22, in *Sheriff v. Gillie*, a case that considers whether lawyers hired as "special counsel" by the Attorney General of Ohio to collect debts owed to the state are "officers" of the state, which would exempt them from application of the FDCPA. In its amicus curiae brief, the CFPB asserted that the special counsel are not "officers" of the state and thus are subject to the FDCPA. The CFPB also argued that by using the letterhead of the State Attorney General's office in communications with consumers, the special counsel may have violated the FDCPA if doing so would "confuse the least sophisticated consumer." The

CFPB's position is contrary to the arguments that the Attorneys General of Ohio, Michigan and 11 other states—all of whom otherwise share a consumer protection mandate with the CFPB—submitted to the Court.

The Supreme Court held oral arguments on March 29 with the Assistant to the Solicitor General arguing on behalf of the CFPB. The Justices' questions indicated a willingness to clarify whether using the letterhead of the original creditor in communications to debtors made by "outside" debt collectors is always "misleading" in violation of the FDCPA.

### Annual FDCPA report

On March 22, the CFPB released its fifth annual report to Congress describing the federal government's 2015 efforts to administer the FDCPA. In the report, the CFPB noted that its enforcement actions resulted in more than US$79 million in fines and returned US$360 million to consumers for unlawful debt collection practices. During the same period, the Federal Trade Commission filed 12 new debt collection cases and banned 30 companies and individuals from the industry.

The CFPB highlighted three 2015 enforcement actions in its report, each involving inadequate verification and inaccurate documentation in the sale, purchase or judicial collection of debt. The first action (available here) was against one of the nation's largest banks selling credit card debts without properly verifying and/or misstating the amount owed or the individual owing the debt. The other two actions (available here and here) were brought against the nation's two largest debt buyers for demanding payments and filing lawsuits on debts without reviewing the appropriate documentation. Taken together, these three actions illustrate the CFPB's willingness to regulate both ends of the debt collection market—debt sellers and debt buyers—through enforcement.

## Deposits

### CFPB "suggestion" to retail banks

On February 3, Cordray sent a "suggestion" letter to the 25 largest retail banks. According to the agency, millions of consumers are "unbanked" due to the binary screening process implemented by the banks, i.e., those with manageable credit risks are provided access to the deposit account system while those with "negative account histories" may be blocked from accessing the banking system. Cordray encouraged banks to provide a third option of offering all applicants a "lower-risk account" for certain checking accounts and prepaid card products, similar to the FDIC Model Safe Accounts program, which are designed to prevent overdrafts and overdraft fees. In particular, Cordray suggested that such products would be helpful to millennials.

On the same day, the CFPB held a field hearing regarding checking account access and issued a bulletin reminding banks and credit unions about their furnisher obligations to consumer reporting agencies under Regulation V. As noted above, the agency has listed consumer reporting as a priority initiative that is currently listed as a "long-term action" rulemaking.

## Mortgages

### Update on PHH

The Court of Appeals for the District of Columbia Circuit is currently considering the constitutionality of the CFPB's single-director structure following oral arguments in *PHH Corp. v. Consumer Financial Protection Bureau*, which took place April 12. The case is an appeal from a controversial CFPB order issued by Cordray that increased a US$6.4 million disgorgement penalty recommended by the presiding administrative law judge to US$109 million. At oral argument, the judges repeatedly questioned the constitutionality of the CFPB's structure and expressed concern about the amount of power concentrated in the agency's director, who is removable only "for cause." Irrespective of the outcome, the panel decision likely will not be the final decision, as both parties are poised to request an en banc rehearing by the DC Circuit.

### Designating areas as "rural" under the HELP Act

On March 3, pursuant to the Helping Expand Lending Practices in Rural Communities Act ("HELP Act"), the CFPB published a final rule creating an application process to request that an area not currently deemed "rural" receive that designation under federal consumer financial law. The rural designation may allow certain small creditors doing business in such areas to be eligible for special provisions, including certain escrow exemptions and permission to originate balloon-payment qualified mortgages. In its announcement, the CFPB noted that, although the process will be open until December 4, 2017, any application submitted after April 9, 2017 will be considered only if the decision process could be completed

before the December 2017 close. This effectively gives applicants one year to submit applications in order to ensure CFPB consideration.

On March 25, the CFPB published an interim final rule further implementing the HELP Act. The CFPB interpreted the term "rural area" to mean that counties or census blocks are the only units eligible for designation as "rural" under the application process noted above. Currently, rural areas are designated using the Office of Management and Budget definition plus census blocks that the US Census Bureau defines as being outside urban areas.

Prior to the HELP Act, a small creditor was eligible for the special provisions only if it made more than half its covered mortgages on properties in designated rural areas. The interim final rule provides that a small creditor will be eligible if it originates at least one such mortgage. Therefore, the CFPB believes that the application process announced on March 3 will be of limited value because it will be relevant only to a small lender that does not make even a single loan in an area already designated as rural.

## Upcoming in 2016

- **Continued regulation by enforcement.** Likely areas of focus include Real Estate Settlement Procedures Act (RESPA) (in particular, Marketing Service Agreements), the TILA-RESPA Integrated Disclosure (TRID) rule, debt collection and debt sales practices, credit reporting practices, student loan servicing practices, auto add-on products, and fair lending (indirect auto markup and pricing as well as redlining and discouragement matters).
- **Prepaid final rule.** If the rulemaking proceeds under the agency's proposed time frame, a final prepaid rule will be issued in June 2016.
- **Debt Collection SBREFA panel.** Notwithstanding the delays in the debt collection rulemaking process (see above), given the agency's concerns about the US$13.7 billion debt collection industry, we expect the CFPB to initiate this important part of the process by 4Q 2016.
- **Increased scrutiny of marketplace lenders.** With the CFPB soliciting consumers for complaints about their online lending experiences, look for the CFPB to use the information to develop policy and influence its regulatory agenda as well as initiate investigations in this area.
- **Data privacy protections.** With the CFPB's recent enforcement action against an online payment platform company, banks and nonbank financial firms should be reviewing their data security practices and consumer disclosures to determine the accuracy and need to update information provided to consumers. We expect that this will be an area in which the CFPB will continue to review and influence through enforcement actions and/or other industry guidance, and it would not be surprising to see the other federal banking agencies and the Federal Trade Commission follow suit.

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