

U.S. Consumer Financial Services Regulation: What to Expect in 2016

Digital Payments Intensive

April 13, 2016

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top 10

No. 1

“RULEMAKING
BY
ENFORCEMENT”



“We only have a few rules around here,
but we really enforce them.”

Rulemaking by enforcement

- New Consumer Financial Protection Bureau (2011)
- Aggressive use of its power to prevent and sanction unfair, deceptive, or abusive acts or practices (UDAAPs)
 - A new term: abusive
 - Comparable to suitability standard
 - Lack of clarity around its meaning – unclear what is abusive that isn't also unfair or deceptive
 - Case-by-case application
 - Fact-specific analysis
 - Many cases filed – 24 in 2014; 42 in 2015



Rulemaking by enforcement

- Aggressive use of its power to prevent and sanction unfair, deceptive, or abusive acts or practices (UDAAPs) (cont'd)
 - Targeted impact
 - Strategic use of enforcement actions to modify practices in specific industries and products
 - For example, debt cancellation contracts, debt collection practices, mortgage servicing practices, marketing to members of the military
 - Financial remedies – restitution, civil money penalties
 - Injunctive remedies – directives that company must comply with in the future, accompanied by monitoring and strict penalties for breach



top 10

No. 2

**CREDIT CARD
REGULATIONS**



Credit card regulations

- CARD Act of 2009 requires biennial reports on the card market
- Areas of concern in credit card market
 - Deferred interest products
 - Interest-free financing *if* debt repaid in full within certain period
 - If debt is not repaid in full at end of period, interest for the entire period becomes due
 - Viewed as “back-end” costs that consumers don’t understand
 - CFPB wants costs to be conveyed up-front, when purchase decisions are made
 - Behavioral economics – consumers overestimate their ability to succeed and underestimate their likelihood of failure
 - Disparities in successful use of these programs
 - Those with subprime credit scores are less likely to repay in full within the promo period, and likely to be charged the deferred interest



Credit card regulations

■ Areas of concern in credit card market (cont'd)

— Rewards

- Primary basis for consumers' card selection
- Challenges in disclosing complex terms – earn categories, burn limitations, forfeiture, etc.
- Views rewards as a type of “limited-purpose asset account”

— Disclosures

- Certain terms remain complex – grace periods, trailing interest, minimum payments, variable rates
- Electronic disclosures – many consumers that receive electronic statements do not view them and, as a result, do not see disclosures required to appear on statements



top 10

No. 3

**PENDING RULE
ON PAYDAY AND
INSTALLMENT
LOANS**



Pending rule on payday and installment loans

- Rule would impose restrictions on:
 - Short-term loans – 45 days or less (“payday loans”)
 - Longer-term loans – more than 45 days with an “all-in APR” of 36% or more (installment loans) *and* repaid by direct access to deposit account or paycheck
- Substantive limitations
 - Short-term loans – two alternatives being considered:
 - Front-end underwriting to determine ability to pay – verification of income and obligations; or
 - Back-end consumer protections – max \$500 loan, no more than one finance charge, verification of income, reporting to credit bureaus, cap on roll-overs with conversion to four-payment plan

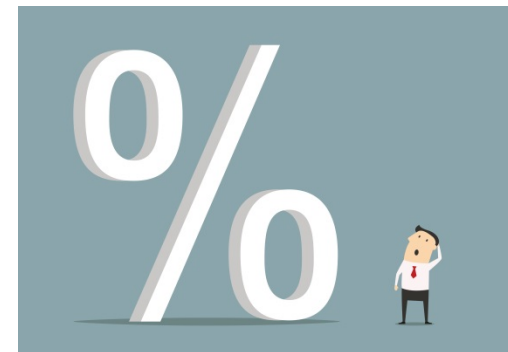


Pending rule on payday and installment loans

■ Substantive limitations (cont'd)

– Longer-term loans:

- Front-end underwriting to determine ability to pay – verification of income and obligations; or
- Back-end consumer protections – some combination of:
 - Cap on the loan amount;
 - Cap on the interest rate at 28%;
 - Cap on periodic payments at 5% of gross income; and/or
 - Limit on number of installment loans entered at
 - one time (across creditors).



- New disclosures regarding costs, payment channel, balances, and other items

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No. 4

**SMALL BUSINESS
AND MARKETPLACE
LENDING**



Small business and marketplace lending

- US Treasury Department requested information on “online marketplace lending”
 - Balance sheet lenders, peer-to-peer lending platforms, bank-affiliated online lenders, and bank-partnered arrangements
 - Innovative product structures and underwriting models
 - Facilitate loans to non-prime *consumer* borrowers
 - *Small business* loans of lower value and shorter terms
 - Significant growth in this market



Small business and marketplace lending

- CFPB focus on small business lending
 - Why is a consumer-focused agency interested in small business lending?
 - Fair lending mandate – prohibit discrimination in all forms of credit, including consumer and business credit
 - Rule will be issued to collect data on small business loans
- Momentum for additional policies and regulations governing small business loans is growing



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No. 5

**PENDING RULE
TO BAN
PRE-DISPUTE
ARBITRATION**



Pending rule to ban pre-dispute arbitration

- CFPB considering a rule to ban pre-dispute arbitration clauses in contracts for consumer financial services
- Such clauses also prohibit consumers from bringing class action lawsuits (“class action waiver”)
 - Significant backlash against arbitration clauses with class action waivers
 - Omnipresent in consumer agreements— credit cards, deposit accounts, employment, nursing home mobile phones, leases, etc.
 - Impede fundamental right of access to courts(?)



Pending rule to ban pre-dispute arbitration

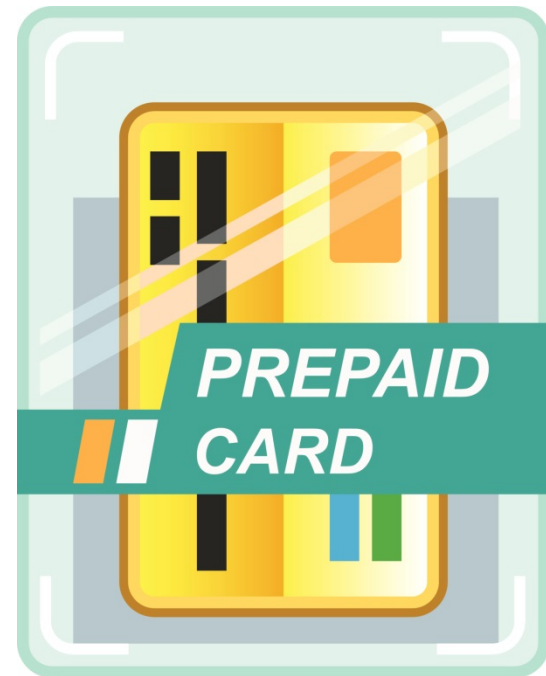
- Individual arbitrations would be permitted – but without a class action waiver
 - CFPB would collect data on these arbitrations
- Doesn't resolve problems with U.S. class action system
 - Class lawsuits motivate companies to settle to avoid protracted litigation and uncertain litigated outcomes – but benefits to consumers may be small



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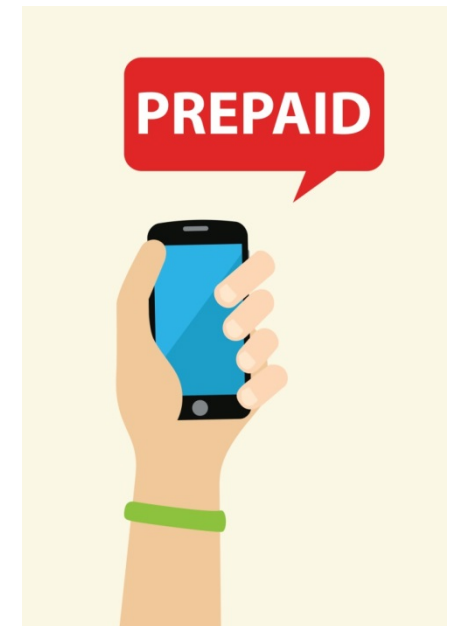
No. 6

**PENDING RULE
ON PREPAID
ACCOUNTS**



Pending rule on prepaid accounts

- CFPB rulemaking to fold “prepaid accounts” under Regulation E and Regulation Z
 - Final rules expected Q2-Q3 2016
- Will regulate “prepaid accounts” the same as checking, savings and other consumer asset accounts under Regulation E
 - Excludes gift card, gift certificates and reward cards, and general-use prepaid cards marketed and labeled as gift cards/certificates
- Overdraft will trigger Regulation Z requirements
 - Application/solicitation disclosures, first year fee caps, ability to pay, fee limits, notice of fee increases, prohibited fees, grace period



Pending rule on prepaid accounts

- Unintended consequences?
 - Standardized, “one-size-fits-all” regulation to diverse product offerings may stifle innovation in the fastest growing U.S. payments sector
- Shifting significant resources to legal compliance will take away from product R&D, raise costs to consumer
 - Reg E opening disclosures, periodic statements, error resolution
 - Individual and class action liability
- Compliance burden under Regulation Z for overdraft will effectively kill this feature to detriment of consumers
 - Insufficient fund transactions at time of settlement will have to be declined, resulting in consumer inconvenience and confusion

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No. 7

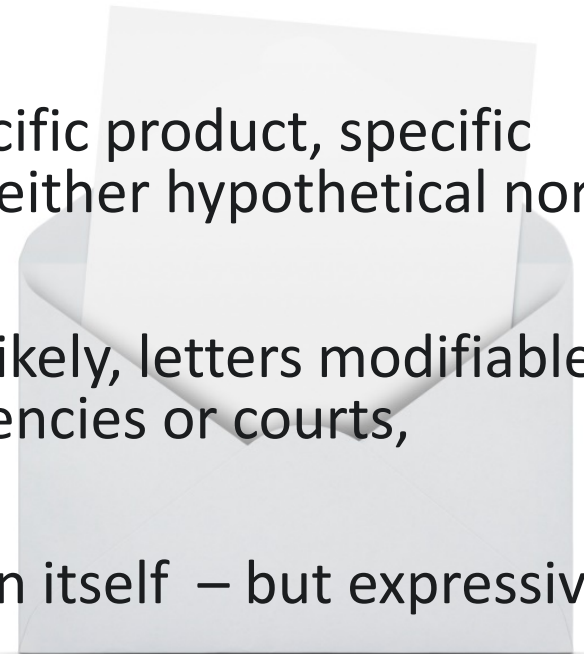
**AGENCY FOCUS
ON INNOVATION**



Agency Focus on Innovation

CFPB No-Action Letter Policy (Feb. 2016)

- Process to obtain written assurance from Bureau that it has “no present intention to recommend an enforcement or supervisory action against the requester”
- **Extremely limited circumstances** – specific product, specific rule of uncertain application, product neither hypothetical nor widely available
- **Very narrow relief** – UDAAP finding unlikely, letters modifiable and revocable, not binding on other agencies or courts, intended to be rare
- **Dubious utility** in fostering innovation in itself – but expressive of a broader policy



Agency Focus on Innovation

Office of Comptroller of the Currency on “responsible innovation” (March 2016)

- White paper from federal bank regulator on reorganizing to foster “responsible innovation”
- Identifies need for:
 - Clarity in “rules of the road” for banks launching innovative products
 - Better guidance on partnerships with non-banks (FinTech)
- Five of the eight principles concern OCC itself – organizing better to support innovation
- Importantly highlights the role of non-banks in collaborations with banks
 - Contrast white paper by The Clearing House on “Alternative Payment Providers” in Aug. 2015

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No. 8

**BANK SECRECY
ACT – KNOW
YOUR CUSTOMER**



Enhanced Due Diligence on Beneficial Owners



- **Past:** Required by regulation on certain accounts established for foreign financial institutions or private banking clients
- **Present:** Extended by FinCEN guidance to accounts identified as posing a heightened money laundering risk

- **Future:** Notice of Proposed Rulemaking issued Aug. 2014 further extends beneficial owner due diligence requirements to all legal entity customers



Proposed Customer Due Diligence Requirements

- Financial institutions opening a new account for a legal entity customer must follow the chain of ownership/control until they identify a natural person (the beneficial owner)
 - The FI must verify each beneficial owner's identity, but does not need to verify his or her ownership or control of the customer or any intermediate legal entity
- Rule will apply to banks and registered broker-dealers, futures commission merchants and introducing brokers in commodities
- Rule will not apply to money services businesses and other financial institutions not currently subject to full KYC requirements

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No. 9
DEBT
COLLECTION



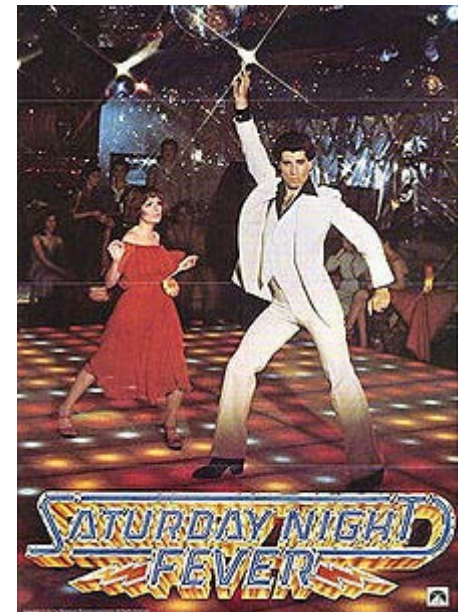
Regulatory scrutiny of debt collection

- Significant regulatory scrutiny in the debt collection area in recent years
 - Debt collection is the single largest source of complaints to the federal government of any industry
 - Several CFPB issuances focused on the debt collection industry, including UDAAP risks



Pending rule concerning debt collection

- In November 2013, the CFPB issued an advance notice of rulemaking regarding the debt collection industry
- CFPB has authority to issue substantive rules for debt collection under the Fair Debt Collection Practices Act (FDCPA)
 - Bureau sought comment, data and information from the public regarding a broad range of issues
 - Verification of disputed debts
 - Privacy and security concerns when owners of debt sell the debt to third parties
 - Extension of FDCPA to first-party debt collectors (currently, the FDCPA only governs the activities of third-party debt collectors)



Debt collection and UDAAP risks

- In July 2013, the CFPB released a bulletin which outlined UDAAP risks in the debt collection industry. Practices under review:
 - Collecting or assessing interest, fees and charges in connection with debts
 - Revealing the consumer's debt, without the consumer's consent, to the consumer's employer and/or co-workers
 - Threatening actions that are not intended or actions the debt collector does not have authorization to pursue (e.g., false threats of lawsuits, arrest, prosecution, or imprisonment)



top 10

No. 10

**PRIVACY AND
DATA-SECURITY
ENFORCEMENT**



Privacy and data-security enforcement

- Many regulators have increased their focus on cybersecurity
 - CFPB emerges in 2016 as another “enforcer” in the rush of US state and federal regulators entering the “cybersecurity” fray
 - Dwolla settlement - CFPB’s first action for misleading and deceptive data security statements
 - No data breach– alleged deceptive statements about data security
 - FTC approaches cyber security on many fronts
 - *Wyndham* case affirmed FTC’s authority to require reasonable security protections
 - More specific requirements and obligations as compared to previous consent decrees (see “**Rulemaking by Enforcement**”)
 - The FTC released “Start with Security: a Guide for Businesses “ based on the lessons learned from more than 50 FTC data security enforcement actions



Privacy and data-security enforcement

- **European Commission announces the US EU Privacy Shield to replace Safe Harbor**
- **Reasonable and Appropriate:** In 2016, regulators are giving new meaning to the “reasonable and appropriate” requirement to secure consumer PII
 - California AG “recommends” CIC 20 Critical Security Controls
- **“Go Big or Go Home”:** Regulators set their sights on “Big Data” as early as 2014.
 - Will new legislation or FTC enforcement actions change the industry?
 - Potential for rules governing unregulated “data broker” industry



Questions?



Thank you!



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