November 12, 2014

Practice Groups:

Consumer Financial Services;

Government Enforcement;

Global Government Solutions

For more news and developments related to consumer financial products and services, please visit our Consumer Financial Services Watch blog and subscribe to receive updates.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

U.S. Consumer Financial Services and Government Enforcement Alert

By: Jon Eisenberg

Between July 17, 2012 and October 9, 2014, the Consumer Financial Protection Bureau ("CFPB" or "Bureau") brought 60 enforcement actions. According to our unofficial tally, they resulted in settlements requiring the payment of $2.2 billion in restitution, $174 million in CFPB civil money penalties, and, in a few cases, other forms of consumer relief. We discuss below the products and alleged practices that led to those recoveries. Our purpose is simple—what's past is likely prologue when it comes to CFPB enforcement actions. Understanding the conduct that produced the first 60 enforcement actions will help companies avoid becoming one of the next 60 enforcement actions.

We offer 15 observations before turning to the cases themselves:

1. Overwhelmingly, the Bureau's enforcement actions rely on allegations of unfair, deceptive, or abusive practices—extraordinarily imprecise standards that allow the Bureau's enforcement staff to argue, on the basis of subjective judgments, that almost any conduct it does not like is illegal.

2. Credit card and mortgage-related enforcement actions account for well over 90% of the CFPB's recoveries to date. We can expect continued focus by the CFPB in both areas. As of mid-October, the CFPB complaint database (available on its website) contained a total of 304,351 consumer complaints—of which 123,367 related to mortgages and 40,381 related to credit cards. We believe that the levels of consumer complaints are a strong predictor of where the CFPB will focus its very substantial enforcement resources.

3. Credit card add-on products generated the largest recoveries. According to our unofficial calculation, they account for 70% of the CFPB's total restitution, 56% of its total penalties, and 69% of its total hard dollar recoveries. The Bureau is particularly focused on making sure consent is clear, fees are clearly disclosed, the benefits are not overstated, charges are not incurred before members receive the full benefit of the services, and that any qualifications to the statements made are made in a clear and prominent manner. Downplaying required disclosures, such as by speaking more rapidly or using smaller font type, will be problematic.

4. Some of the same concerns that apply to credit card add-on products apply equally to the marketing of the credit cards themselves—with the Bureau focused on any misrepresentations or omissions regarding the benefits of signing up for the card or the costs of the card. Promotional offers that provide less than fulsome disclosure are particularly likely to attract attention. The Bureau will focus on telemarketing scripts, but it will also check for departures from those scripts. Here too the Bureau is focused on omissions (*e.g.*, qualifications to the benefits) and unequal prominence, as well as misrepresentations.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

5.While the credit card enforcement actions tend to focus on allegations of deception, mortgage servicing enforcement actions tend to focus on the underlying practices themselves, including servicing transfers, loss mitigation, payment of referral fees, fee splitting, payments to affiliates, advertising of teaser rates, and incentives to steer consumers to higher interest mortgages.

6. In the referral fee area, even if the fee is characterized as being for other services, the Bureau takes the position it is simply a disguised referral fee if it is above the fair market value for those services.

7. The CFPB has filed only a few discrimination cases, but they have been expensive to resolve—whether in the credit card, mortgage, or other lending spaces. It charged discrimination without any overt evidence of discrimination; instead, it relied on a combination of statistical analyses and loan officer discretion. To the extent that lenders rely on discretion rather than objective credit-related factors, they run the risk that the Bureau will give statistical analyses undue weight in finding discrimination.

8. According to the CFPB's complaint database, the Bureau received over 39,000 complaints regarding credit reporting. Across products, the Bureau will be focused on any evidence that a lender sent inaccurate information to a credit reporting agency. In this area, as well as other areas, the CFPB is unlikely to accept as a defense the fact that the fault lies with a vendor or a computer system glitch.

9. Lending to service members requires special care. They have special statutory protections and the Bureau scrutinizes lending to service members to make sure it complies with these protections.

10. While the Bureau filed only one case principally focused on debt collection practices, we can anticipate that will be a major focus in the future. After mortgages, the second largest category of complaints in the CFPB complaint database is for collection practices. Making an excessive number of calls, disclosing the existence of a consumers' debts to third parties, calling consumers at their workplace after being told such calls are prohibited, making threats, or misrepresenting the facts have the potential to lead to enforcement actions.

11. The CFPB will also continue to come down hard on "robo-signing" in the debt collection area. It defines robo-signing as either not reviewing important documents or having those documents signed by persons other than the persons required to sign them.

12. The student loan cases represent the CFPB at its most aggressive. In the two cases brought to date, it challenged the bases for the colleges' representations regarding job placement rates and the benefits of going to those colleges.

13. The CFPB brought only one case involving a checking account, but that case sends an important message that goes beyond checking accounts. The message is that even when a lender carefully makes sure a consumer has every required disclosure before signing up for a product (free checking), the Bureau may still second-guess the placement, sequence, and prominence of the disclosures. From the CFPB's perspective, a disclosure that appears on the second page may be attacked because it did not appear on the first page; a disclosure

that appears in a footnote may be attacked because it did not appear in the text; a disclosure that appears in a document provided to a consumer may be attacked because it did not appear in an advertisement.

14. Companies in the debt-modification business have been low-hanging fruit for the CFPB. Every CFPB debt modification case alleges that the defendants charged advance fees that are clearly prohibited by statute and made representations that are demonstrably false.

15. Finally, it is worth mentioning that we are still at an early stage in the CFPB's history. The Bureau filed its first enforcement case in July 2012. In the second half of 2012, it averaged one enforcement case a month; in 2013, two enforcement actions a month; in 2014, just under 2.5 enforcement actions a month. The Bureau's budget for Supervision, Enforcement, and Fair Lending increased from $105 million in 2013, to $165 million in 2014, and is scheduled to increase to $175 million in 2015 in order to fund 527 employees (in 2013), 742 employees (in 2014), and 834 employees (in 2015). With that large a budget and that many employees focused on bringing enforcement actions, we anticipate a significantly larger number of enforcement actions in the future.

We turn now to a discussion of the enforcement actions themselves organized principally by product. We cover the enforcement actions in the following order:

1. credit card add-on products;
2. credit card practices;
3. discriminatory credit card practices;
4. mortgage servicing;
5. payment of referral fees to mortgage lenders;
6. discriminatory mortgage lending;
7. mortgage disclosures;
8. financial incentives to steer consumers to higher interest rate mortgages;
9. loans to service members;
10. discriminatory automobile lending;
11. inaccurate reporting by automobile lender to credit reporting agencies;
12. collection practices;
13. checking accounts;
14. student loans;
15. payday loans;
16. loans involving Indian tribes; and
17. debt modification services.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

I. Credit Card Add-on Products

The Pareto Principle predicts that 80% of the CFPB's recoveries will come from 20% of the enforcement actions. For the CFPB, a single cause—similar allegations of deception regarding similar credit card add-on products marketed by large financial institutions and their vendors—produced the following recoveries:

Restitution	CFPB Penalties	Total
$727,000,000	$20,000,000	$747,000,000
$309,000,000	$20,000,000	$329,000,000
$200,000,000	$14,000,000	$214,000,000
$140,000,000	$25,000,000	$165,000,000
$ 59,500,000	$ 9,600,000	$ 69,100,000
$ 56,000,000	$ 3,500,000	$ 59,500,000
$ 47,900,000	$ 5,000,000	$ 52,900,000
$1,539,400,000	$97,100,000	$1,636,500,000

To appreciate how extraordinary this is, consider that *all* of the remaining CFPB settlements combined settled for the following amounts:

Restitution	CFPB Penalties	Total
$663,872,166	$77,322,002	$741,194,168

That means that the credit card add-on product settlements alone produced 70% of the CFPB's total restitution, 56% of its total penalties, and 69% of its total hard-dollar recoveries.

The credit card add-on product enforcement actions generally involved identity theft and credit monitoring services. The Bureau alleged that banks or their vendors:

1. enrolled consumers in programs without their affirmative consent or without adequately disclosing that there was a fee for the services;
2. billed consumers for services that were not performed or were only partially performed;
3. led consumers to believe that the products were required to obtain the credit cards rather than optional;
4. failed to disclose important eligibility requirements for consumers to obtain the benefits of the add-on products; and
5. told consumers that the products would improve their credit scores or increase their credit limits even when they would not.

In CFPB Bulletin 2012-06, issued on July 18, 2012, the CFPB set forth its expectations with regard to the marketing of credit card add-on products. Among other things, the Bureau focused on prohibiting enrollment without clear affirmative consent to purchase add-on products obtained after the consumer has been informed of the terms and conditions; clearly stating any material limitations on eligibility for benefits; limitations on the number of times a telemarketer may attempt to rebut the consumer's request for additional information or to decline the product; making clear (where applicable) that the purchase of add-on products is not a condition of obtaining credit; not deviating from approved scripts; a system of periodic quality assurance reviews (including real-time monitoring and recording of service calls); independent audits of credit card add-on programs; oversight of any affiliated or third-party service providers that perform marketing or other functions related to add-on products; an appropriate channel for resolving consumer complaints related to add-on products; and comprehensive training for employees involved in the marketing, sale, and operation of credit card add-on products.

The Bureau also focused on the prominence of the disclosures. In the same bulletin, it stated that in evaluating the effectiveness of disclosures at preventing consumers from being misled, the Bureau will consider:

1. Is the statement prominent enough for the consumer to notice?
2. Is the information presented in an easy-to-understand format that does not contradict other information in the package and at a time when the consumer's attention is not distracted elsewhere?
3. Is the information in a location where consumers can be expected to look or hear?
4. Is the information in close proximity to the claim it qualifies?

In short, the Bureau will not necessarily accept literal truth as a defense to a deceptive marketing claim; it will look at the prominence and location of the disclosures, as well.

II. Credit Card Practices

In addition to bringing enforcement actions related to credit card add-on products, the CFPB brought two enforcement actions (one of which involved three different complaints against three affiliated entities) related to credit cards themselves. In the largest enforcement action brought to date involving credit card practices (as opposed to the marketing of credit card add-on products), it required three affiliated entities to pay $85 million in restitution and a $14.1 million fine for multiple alleged violations. The Bureau charged that the respondents violated consumer protection laws "at every stage of the consumer experience, from shopping for cards, to applying for cards, to paying charges, and to paying off debt." The Bureau alleged that the respondents:

1. misled consumers into believing they would receive $300 if they signed up for the card;
2. charged consumers a late fee based on their delinquent balances rather than on costs or the safe harbor provided in Regulation Z, 12 C.F.R. § 1026.52(b)(1);

3. represented, even after debts had been charged off and were no longer being reported to credit reporting agencies, that settlement of debts would be reflected on the consumers' credit reports and could improve their credit scores;
4. stated in debt settlement letters that the consumers' remaining debt would be waived or forgiven without prominently disclosing that the consumer had to pay the full debt balance before the bank would process any future credit card applications;
5. for a period of time, inappropriately used a credit scoring system that took a second look at credit card applicants over the age of 35;
6. failed to report to credit reporting agencies that consumers disputed the reported information; and
7. exercised ineffective oversight and monitoring and failed to implement effective employee training.

In a second case, the Bureau required a financial institution to create a $34.1 million reimbursement fund for consumers who were placed in a deferred-interest credit card promotional plan. Under the plan, consumers would pay no interest if they made timely monthly payments throughout the promotional period (from six to 24 months), but were charged a 26.99 percent annual interest rate for the entire period if any portion of the balance was not paid in full when the promotional period ended. The CFPB alleged that many of the cards were marketed through medical providers who failed to accurately explain the deferred interest component (for example, by describing the card as "interest free for 12 months").

In its October 1, 2013 "CARD Act Report," which addresses the effect of the Credit Card Accountability Responsibility and Disclosure Act of 2009, the Bureau identified five concerns in addition to credit card add-on products that "may warrant further scrutiny by the Bureau." The five concerns the Bureau identified are:

1. "Fee harvester cards" in which issuers charge large upfront fees prior to account opening.
2. Deferred interest products that retroactively assess and charge interest if the balance is not paid in full by a specific date. The Bureau stated that for borrowers with subprime credit scores, about 43% are ultimately charged retroactive interest in a lump sum and that the Bureau intends to "assess whether additional action is appropriate to promote a more fair and transparent market."
3. Online disclosures, including warnings related to late fees and the cost to consumers of making only the minimum payment due, in a market in which consumers who pay their bills electronically may not access the monthly statements containing these disclosures.
4. Rewards products to determine whether rewards disclosures "are being made in a clear and transparent manner." The Bureau is focused particularly on the clarity of disclosures regarding the specific actions required to earn bonus points, formulas for

obtaining benefits, the rules governing redemptions, and the rules governing forfeitures.

5. Grace periods with a particular focus on whether consumers understand that once they carry a balance into a new month, interest will be assessed on the unpaid balance from the start of the prior month and that even after consumers pay the full amount shown on their bill they may still owe "trailing interest" for the period from the time the bill was issued until the time the payment was received. In a separate bulletin (CFPB Bulletin 2014-02 issued on September 3, 2014), the Bureau again expressed concern about marketing materials that "do not clearly and prominently convey" that a consumer will lose the grace period on the new purchases if the consumer does not pay the entire statement balance, including the amount subject to the promotional APR, by the payment due date."

Financial institutions should expect that the CFPB will be looking to bring enforcement actions in each of these areas.

III. Discriminatory Credit Card Practices

The CFPB's largest discrimination enforcement action involved self-reported conduct in connection with a credit card promotion. The CFPB alleged that a financial institution excluded customers who preferred to communicate in Spanish or who had a mailing address in Puerto Rico from two credit card promotions. The promotions allowed customers with delinquent accounts to settle their balances by making partial payments. The Bureau required the firm to pay restitution of $169 million. The Bureau stated that it was not imposing a penalty based in part on the company self-reporting the violation, self-initiating remediation for the harm done to consumers, and fully cooperating in the Bureau's investigation.

IV. Mortgage Servicing

While credit card cases (including add-on product cases) produced by far the largest recoveries for the CFPB, mortgages produced the most cases. That is not surprising, since the CFPB receives roughly three times as many complaints about mortgages as it does about any other product.

The CFPB filed three actions (all settled) alleging mortgage servicing violations and collected $207.5 million in restitution and civil money penalties in these cases, as well as additional forms of consumer relief, such as agreements to provide principal reduction. The Bureau alleged that defendants:

1. filed affidavits in foreclosure proceedings without verifying the information in those affidavits;
2. failed to timely process loan modification applications;
3. failed to tell borrowers when their loan modification applications were incomplete;

4. denied loan modifications to borrowers who qualified for modifications;
5. provided inaccurate information to consumers about the status of foreclosures;
6. charged unauthorized fees for default-related services; and
7. failed to timely and accurately apply payments made by borrowers.

The CFPB has issued a number of bulletins regarding mortgage-servicing practices. Its most recent bulletin, CFPB Bulletin 2014-01, issued on August 19, 2014, focuses on the transfer of information during mortgage servicing transfers and properly evaluating loss mitigation applications. It states that the CFPB is focused on service policy and procedures to ensure that the transferors provide all necessary documents and information at loan boarding, develop tailored transfer instructions for "key issues" (such as descriptions of proprietary modifications, data fields, known issues with document indexing, regulatory, or settlement requirements applicable to some or all of the transferred loans), testing protocols, quality control work after transfer to validate transferred data, and potentially splitting the transfer into several smaller transactions to ensure that the transferee can comply with its servicing obligations.

With regard to loss mitigation, the bulletin states that examiners will consider whether the transferor has a process for flagging all loans with pending loss mitigation applications as well as approved loss mitigation plans and whether the transferee requires that the transferor servicers supply a detailed list of loans with pending loss mitigation applications as well as approved loss mitigation plans and requires appropriate documentation for loans with pending loss mitigation applications to be transferred prior to boarding the loans. The bulletin also addresses error resolution procedures, force-placed insurance, early intervention with regard to delinquent borrowers, continuity of contact, and evaluation for all loss mitigation options. Servicers should expect that failure to comply with the guidance provided in the bulletin with regard to service transfers and handling of loss mitigation could lead to future enforcement actions.

V. Payment of Referral Fees to Mortgage Lenders

The CFPB filed 11 actions alleging that various entities paid unlawful referral fees to mortgage lenders in violation of Section 8(a) of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607, and its implementing regulation, Regulation X, 12 C.F.R. Part 1024. Section 8(a) provides:

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

The prohibition against paying or receiving money in connection with real estate settlement services is not absolute; Section 8(c) provides a list of five types of arrangements that RESPA shall not be construed as prohibiting, including,

> the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

Section 8(c) also permits affiliated business arrangements that satisfy certain disclosure and other requirements, including that the consumer is not required to use the affiliate.

All of the Bureau's RESPA referral fee cases to date turn on whether the payments qualify for the exceptions in Section 8(c).

In the one litigated case, currently awaiting decision from Administrative Law Judge Cameron Elliot, the Bureau charged that in exchange for the referral of private mortgage insurance business, a lender received hundreds of millions of dollars of referral fees characterized as reinsurance premiums paid to its affiliate. Although Judge Elliot has not issued a final decision on the merits of the case, he resolved a number of the contested legal issues in denying the respondents' motion to dismiss. Most importantly, he held that the Bureau satisfies its burden of proof under Section 8(a) if it shows: i) a payment, ii) given and received pursuant to an agreement to refer settlement business, and iii) an actual referral. Judge Elliot held that the respondent then bears the burden of proving the elements of the Section 8(c) "affirmative defense" for "bona fide" payments.

Judge Elliot rejected the respondents' argument that Section 8(c) applies as long as the lender is providing at least some service for the payment (other than referrals), and instead held that respondents in that case had the burden of proving that the payments "bore a reasonable relationship to the market value of the services provided—in that case reinsurance." Judge Elliot stated, "If Respondents cannot prove this, but can prove that any reinsurance provided had some market value, then the difference between the ceded premiums and the market value is the amount of the referral fee under Section 8(a), or the unearned fee under Section 8(b)." Judge Elliot may not be the final word on the issues since the parties can appeal his final decision to the Bureau and then to the court of appeals. At least for now, however, the Bureau is likely to take positions consistent with Judge Elliot's decision on the motion to dismiss, including that the burden of showing that the payments are "bona fide" rests on the respondent and that "bona fide" requires some relationship to the market value of the services provided.

The Bureau settled almost all of its other referral fee cases. Those involved alleged payments in the form of i) allegedly above-market mortgage reinsurance premiums; ii) profit distributions involving a homebuilder that created a jointly owned mortgage originator with a bank that provided financing; iii) inflated lease payments in which the monthly rent was tied to loan volume; iv) payments to independent contractors who brought in title insurance business even though the respondent characterized these independent contractors as employees; and v) payments pursuant to "market servicing" agreements ("MSA") that allegedly were based not on the market value of the services rendered but, instead, on the referral of business. In connection with the MSA case, the Bureau took the following positions:

1. Repeated payments connected to the volume or value of business referred are evidence that the payments are made pursuant to an agreement or understanding for the referral of business.
2. If the payment bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided and may be used as evidence of a violation of RESPA.
3. Fair market value for goods or services is based only on the value of the goods or services and cannot include any consideration of the value of any referrals of business incident to real estate settlement services.
4. Payments to non-employees for referrals cannot be bona fide payments for goods furnished or services performed.
5. Respondent did not determine the fair market value for the services it received pursuant to the market servicing agreements.
6. The fees that respondent paid were not a fair market value for the services for which Respondent contracted.
7. Entering a contract is a "thing of value" within the meaning of RESPA "even if the fees paid under the contract are fair market value for the goods or services provided."
8. "Entering a contract with the agreement or understanding that in exchange the counterparty will refer settlement services related to federally related mortgage loans violates RESPA."

The CFPB also brought settled actions alleging RESPA violations for referring consumers to an affiliated title company in one case and an affiliated appraisal company in another case without adequate disclosure. In one case, in which the respondent self-reported to the CFPB that it had split fees with a hedge fund that did not provide services, the CFPB fined the firm $89,000 and required it to enter into an order admitting to the CFPB's findings of fact and conclusions of law.

In short, the CFPB enforcement staff is highly focused on referral fees and other potential conflicts in the mortgage area. Whether or not the parties characterize something as a referral fee or a payment for other services, the Bureau, at a minimum, will look at whether payments to lenders reflect the market value of the services purportedly provided or are, instead, above market-value payments designed to compensate for business referrals.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

VI. Discriminatory Mortgage Lending

The CFPB filed a joint action with the Department of Justice alleging that a bank charged higher interest rates on mortgage loans to African American and Hispanic borrowers than to non-Hispanic white borrowers "not based on creditworthiness or other objective criteria related to borrower risk, but because of their race or national origin." The complaint relied almost exclusively on the allegation that "statistical analyses of retail mortgage loans … demonstrate statistically significant discriminatory pricing disparities in retail mortgage loans based on race and national origin" (ranging from nine to 11 basis points). It alleged that the statistical disparity resulted from policies that i) allowed loan officers to exercise discretion to adjust pricing without regard to borrower risk, ii) did not require loan officers to document the reasons for the charges, iii) failed to adequately monitor for disparities based on race or national origin, and iv) linked loan officer compensation in part to higher rates. The bank paid $35 million to settle the action.

VII. Mortgage Disclosures

The Bureau's one enforcement case that focused principally on mortgage disclosures reflects concerns similar to those it expressed in its credit card disclosure cases—are the disclosures accurate, are any qualifications clearly disclosed, and are the qualifications given adequate prominence? In a settled case in which it required the respondents to pay nearly $15 million in consumer redress and $6 million in penalties, the Bureau alleged that an online mortgage lender attracted borrower interest by advertising low mortgage rates without prominently disclosing that the lowest rates required FICO scores of at least 800. One of the allegations in the complaint was that while the first page of the lender's website provided the lowest quote, the lender "disclosed the other factors the quote was based on, including an 800 FICO score, in a side bar next to the generated quotes, but only on the following page." The Bureau acknowledged that the second page provided the consumer the option of changing his or her FICO score or other loan factors in order to generate a new quote. The Bureau also alleged that by requiring consumers to pay for appraisals and credit reports early in the mortgage application process, Respondents limited consumers' ability to comparison shop. And it alleged that the lender experienced a computer problem that in some cases caused it to list certain lower rates than it was willing to honor.

As in the case of credit cards, the CFPB enforcement staff is focused on whether the representations made to induce consumers to apply for credit give fair weight to any limitations or qualifications to the advertised offer. If the Bureau comes to the conclusion that advertised rates were designed to attract consumers who would not qualify for those rates, it may not be enough that the lender provided a more fulsome picture only later in the process.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

VIII. Financial Incentives to Steer Consumers to Higher Interest Rate Mortgages

The Compensation Rule, codified as 12 C.F.R. §1026.36(d)(1), provides that no loan originator shall receive, and no person shall pay to a loan originator, compensation in an amount that is based on any of the transaction's terms or conditions. The Bureau brought one case in which a mortgage loan company followed an unwritten policy of paying quarterly bonuses to more than 150 loan officers in amounts that varied based on the interest rates of the loans they originated—with higher interest rates producing higher quarterly bonuses. The parties settled by paying $9.2 million and a $4 million penalty.

IX. Loan to Service Members

The CFPB's director stated that the Bureau "has a special mission to protect service members." The Bureau's Office of Service Member Affairs is charged with protecting military personnel, veterans, and their families from improper lending practices. In its March 2014 report entitled, *Complaints Received from Service Members, Veterans, and Their Families*, it disclosed that from July 21, 2011 to February 1, 2014, the CFPB received 14,100 complaints from military consumers—of which 4,700 involved mortgages, 3,800 involved debt-collection practices, 1,700 involved credit cards, 1,500 involved bank accounts, 1,200 involved credit reporting, 600 involved consumer loans, 400 involved student loans, 100 involved payday loans, and 50 involved money transfers. The complaint volume from military consumers grew 148% from 2012 to 2013.

Complaints made by service members are a microcosm of complaints made by other consumers. In the mortgage area, the principal complaints relate to loan modifications, collections, and foreclosures, including confusion regarding document submission timeframes, payment trial periods, allocation of payments, treatment of income in eligibility calculations, and credit bureau reporting during the evaluation period. The most common debt collection complaints, apart from attempts to collect on a debt not owed, are communication tactics, debt collectors taking or threatening an illegal action, disclosure of debts, or false statements or misrepresentations about a debt. With regard to credit cards, the most common complaint is billing disputes. In the credit reporting area, 72% of the complaints involve claims that the information in the credit report is inaccurate.

The Bureau filed five settled enforcement actions involving lending to service members. In one, the CFPB charged that a now-bankrupt lender that provided financing to service members for consumer products had engaged in predatory lending and other violations of consumer protection statutes. The Bureau alleged that the lender, through merchants, hid finance charges in the price of the purchased goods, and that because the prices of the consumer goods were inflated, the disclosures understated the finance charges and annual percentage rates.

In a pair of related actions, the CFPB required a bank and one of its nonbank partner companies to refund approximately $6.5 million to service members who financed their purchase of automobiles through the Military Installment Loans and Educational Services program. The Bureau claimed that a $3 a month fee for processing automatic payroll allotments should have been factored into the calculation of the finance charge, annual percentage rate, and total payments for the loans. It also claimed that the automobile warranties, which were often sold in connection with the financing package, did not "prominently disclose the existence of parts excluded from coverage, beyond a vague six-point-font footnote at the bottom of the page."

In a fourth action, which settled for restitution and penalties totaling $19 million, the CFPB alleged that a payday lender violated the Military Lending Act by overcharging service members and their families. The Military Lending Act provides a 36% cap on the "Military Annual Percentage Rate," prohibits lenders from refinancing the same loan except on terms more favorable than the existing terms, prohibits creditors from requiring service members to waive the protections provided by consumer protection laws, and prohibits creditors from imposing prepayment penalties. That case also involved allegations that the lender engaged in robo-signing—signing documents used in collection litigation without complying with state and court-required signature rules.

Finally, in a fifth action, which settled for $400,000 in restitution and penalties, the CFPB alleged that a lender that financed the purchase of goods sold to service members through retail installment contracts deceived service members into paying a $5 fee. The CFPB alleged that the company led service members to believe that for the $5 fee, they would have an independent representative protect their rights under the Service Members Civil Relief Act. That act allows service members to obtain a delay of debt collection efforts when their military service hampers their ability to defend. In fact, the CFPB alleged, the entity acting as the "independent" representative was financially dependent on the lender as its sole source of revenue and did not provide useful services to the service members.

In short, when it comes to lending to service members, the Bureau is likely to scrutinize practices to ensure that the lending practices are fair, that any fee disclosures are complete, and that the lenders comply with the special statutory protections provided to service members.

X. Discriminatory Automobile Lending

We discussed above two automobile lending enforcement actions that involved loans to service members. The area that has attracted the most attention in the case of automobile lenders, however, has been potential discriminatory lending claims. Much of the CFPB's fair lending guidance in the discrimination area is focused on automobile lenders.

The CFPB filed a joint action with the Department of Justice alleging that an automobile finance company charged higher interest rates to African American, Hispanic, and Asian/Pacific Islander borrowers than to non-Hispanic white borrowers. As was true in its mortgage lending discrimination enforcement action, the only evidence was a statistical analysis. The bank paid $80 million to settle the claim. The CFPB stated that, in addition to its public enforcement action, it has reached supervisory resolutions with indirect auto lenders requiring them to pay $56 million in redress to up to 190,000 consumers for alleged discriminatory lending.

Prior to its enforcement action, the Bureau issued Bulletin 2013-02 (March 21, 2013) on the potential liability for fair lending violations of indirect auto lenders that give discretion to dealers to increase interest rates and that compensate dealers with a share of the increased interest revenues. The Bureau takes the position that an indirect auto lender that provides a risk-based "buy rate," establishing a minimum interest rate at which the lender is willing to purchase the retail installment sales contract, may have potential liability if the dealer exercises its discretion to adjust the buy rate in a way that leads to disparities based on race or national origin. It stated that lenders should consider imposing controls on dealer markup and compensation policies, should monitor and address unexplained pricing disparities on prohibited bases, or should "eliminat[e] dealer discretion to mark up buy rates and fairly compensat[e] dealers using another mechanism, such as a flat fee per transaction, that does not result in discrimination."

In its Summer 2014 "Supervisory Highlights," issued on September 17, 2014, the Bureau stated that after examinations revealing discriminatory pricing, it has directed lending institutions that permit discretionary pricing to take the following actions:

1. Maintain appropriate limits on the maximum rate spread between the institution's buy rate and the contract rate of the auto loan;
2. Send regular communications to all participating dealers explaining the Equal Credit Opportunity Act (ECOA), stating the lender's expectations with respect to ECOA compliance, and articulating the dealer's obligation to mark up interest rates in a nondiscriminatory manner in instances where such markups are permitted;
3. Conduct regular analyses of both dealer-specific and portfolio-wide loan pricing data for potential disparities on a prohibited basis resulting from discretionary pricing policies, including:
    a. using only controls that reflect legitimate, nondiscriminatory factors when analyzing the discretionary pricing adjustments; and
    b. applying a reasonable proxy for race and ethnicity when analyzing loans for disparities based on race or ethnicity;
4. Commence prompt corrective action against dealers when analysis identifies unexplained, statistically significant disparities on a prohibited basis, including:
    a. providing dealer education and training, as well as assisting dealers in developing a strong fair lending compliance management system;
    b. restricting or eliminating the dealer's discretion to adjust the buy rate; or
    c. excluding dealers from future transactions when the disparities cannot be corrected or explained by a legitimate, nondiscriminatory, and demonstrated factor;

5. Promptly remunerate affected consumers when unexplained disparities on a prohibited basis are identified by an institution across its portfolio using a regression model and proxy method that are appropriately designed to identify harmed consumers.

XI. Inaccurate Reports by Automobile Lender to Credit Reporting Agencies

The CFPB brought an enforcement action against a company that extended loans to purchase motor vehicles because it allegedly continued to send inaccurate reports to credit reporting agencies even after it discovered flaws in its system that created inaccurate reports. In the press release announcing the settlement, the CFPB's director stated, "Companies cannot pass the buck by blaming a computer system or vendor for their mistakes." The lender agreed to pay a fine of $2.75 million.

XII. Collection Practices

The Fair Debt Collection Practices Act, 15 U.S.C. § 1601 et seq., sets forth in considerable detail prohibited debt collection activities. In addition, the CFPB issued two separate bulletins, CFPB Bulletin 2013-07 and 2013-08 (both issued on July 10, 2013), detailing its concerns in this area.

The CFPB filed one major collection practice case. It alleged that a payday lender engaged in unlawful collection practices that included the following:

1. Making an excessive number of calls to consumers' home, work, and cellular telephone numbers.
2. Disclosing the existence of consumers' debts to third parties.
3. Continuing to call consumers at their workplace after being told that such calls were prohibited.
4. Misrepresenting that third-party debt collectors would add collection fees.
5. Misrepresenting that third-party debt collectors would report their failure to pay to national credit bureaus.
6. Falsely threatening delinquent borrowers with litigation or criminal prosecution.
7. Training debt collectors to create a "sense of urgency" in which they encouraged delinquent borrowers with an inability to repay their existing loans to take on new loans.

The payday lender settled for $5 million in consumer redress and a $5 million civil money penalty.

The Bureau also filed an action against a law firm and three of its principal partners for operating what the CFPB called "a debt collection lawsuit mill." The Bureau alleged that between 2009 and 2013, the firm filed more than 350,000 debt collection lawsuits in one state alone. It claimed that the attorneys who signed the pleadings did not have any meaningful involvement in the cases, that the firm filed sworn statements that were signed by people who could not have known the details they were attesting to, and that the firm had dismissed over 40,000 lawsuits because it frequently could not substantiate its allegations.

Finally, as noted above, the Bureau included an allegation of robo-signing in an action against a payday lender. The Bureau defined robo-signing as "a practice where important documents that require careful review and a signature from a knowledgeable individual are instead signed by someone else, a machine, or by someone who does not follow appropriate procedures." The Bureau alleged that i) employees in the collections department manually stamped attorney signatures on legal pleadings, and department manager signatures on balance-due and military status affidavits, without prior review, and ii) legal assistants notarized documents without following appropriate procedures.

XIII. Checking Accounts

In its only enforcement action to date involving a checking account, the CFPB alleged that it was misleading for a bank to market a checking account as a "free" checking account without disclosing *in the same advertisement* that there was a minimum activity requirement or that the free checking account would convert into a different account after 90 days of inactivity. The Bureau rejected the argument that it was sufficient that the bank provided a one-page document to customers accurately setting forth the minimum activity requirement to maintain free checking, the automatic conversion feature, and the monthly maintenance fee. The Bureau required the bank to refund the fees charged when the free checking account converted (approximately $2.045 million) and to pay a penalty of $200,000. The CFPB's action is consistent with its actions in the credit card and mortgage areas where it has warned about promotional offers that lure consumers in without disclosing, at the same time, material limitations on the promotional offers and the costs of the product once the promotion ends.

XIV. Student Loans

In its October 28, 2014 *Supervisory Highlights* report, the CFPB expressed a number of specific concerns about student loan servicing growing out of its supervisory examinations. These include i) allocation of payments involving multiple loans in a manner that produced minimum late fees on all of the loans, ii) inflating the minimum payments due by including amounts that were in deferment and not actually due, iii) charging late fees when payments were received during the grace periods, iv) failing to provide accurate information necessary for consumers to deduct their student loan interest payments on their tax filings, v) representing that student loans were never dischargeable in bankruptcy, and vi) making debt collection calls at inappropriate times. Thus far, however, these are not the concerns that have led to enforcement actions.

The CFPB's two enforcement actions in the student loan area both involve claims that for-profit colleges engaged in predatory lending practices. The Bureau alleged, for example, that a defendant "induce[d] prospective students to incur loan obligations necessary to enroll by promising career training and graduate employment opportunities of the type that would enable a consumer to repay his or her debt upon completing [the] program." It also claimed that the college "used misrepresentations about likely student outcomes;" "promised a career, but at best, only helped graduates find temporary employment;" falsified its job placement rate; inflated its placement statistics by falsely classifying graduates as unemployable; and inflated its job placement statistics by paying employers to temporarily hire its graduates. Neither case has settled. A colorfully titled *Wall Street Journal* editorial involving one of the cases ("Regulators of Prey: A Case Study in Tearing a Private Business Limb from Limb," Sept. 26, 2014) expresses the view that the loans at issue were never even intended to turn a profit, that more than 60% end up in default within three years, that the loan portfolio was sold for less than four cents on the dollar, and that the allegations about the calculation of job placement rates are the result of a lack of uniform federal or state guidance rather than wrongdoing by the college.

XV. Payday Loans

The CFPB Payday brought three enforcement actions involving payday loans—short-term loans, generally for $500 or less, that are typically due on the next payday. Two (involving robo-signing, alleged improper debt collection practices, and overcharging service members) are discussed above under the "Collection Practices" and "Loans to Service Members" headings. In a third enforcement action against a payday lender, the CFPB alleged that the lender used information purchased from a third party to access consumers' checking accounts, illegally deposit payday loans, and then withdraw fees without the consumers' consent. The Bureau also alleged that the respondents provided loan documents that set forth the total payments in the text and then "in smaller and less conspicuous text" disclosed that those payments applied only if the consumer declined the refinancing option.

Although the Bureau has filed only three payday loan enforcement actions to date, it is focused on payday lending. In a November 6, 2013, press release, it expressed concern that payday loans could lead to a cycle of indebtedness as borrowers paid off and then immediately took out new loans and that it had expanded its complaint database to accept payday loan complaints about i) unexpected fees or interest, ii) unauthorized or incorrect charges to borrowers' bank accounts, iii) payments not being credit to their loans, iv) problems contacting the lender, v) receiving a loan that they did not apply for, and vi) not receiving money after they applied for a loan.

XVI. Loans Involving Indian Tribes

The Bureau brought one case against an online lender that the Bureau alleged made high-cost consumer installment loans that exceeded interest rate caps. Respondents took the position that they did not have to comply with state interest rate caps because a member of an Indian reservation owned the online lender. The Bureau took the position that the relationship with the tribe did not exempt the lender from having to comply with state laws when it made loans over the Internet to consumers in various states. That case is pending.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

XVII. Debt Modification Services

Finally, the Bureau has filed eleven cases against firms that at least purport to offer debt relief services. These cases generally charge that the debt relief providers (often law firms) charge upfront fees in violation of the October 2010 amendments to the Telemarketing Sales Rule, 16 C.F.R. 310.4, and make misleading claims in advertisements and elsewhere, such as "no more debt," "eliminate your debt," "Call now! And erase your debt." Unlike almost all of the cases discussed above, most of these cases filed against debt relief companies are filed as unsettled actions.

XVIII. A Final Note About Vendors

A large number of the enforcement actions discussed above involved conduct by vendors rather than the financial institutions with whom the Bureau settled. While the Bureau recognizes that banks and nonbanks may outsource functions to service providers, it does not appear to recognize a distinction between whether the financial institution or its vendor engaged in the conduct at issue. As set forth in CFPB Bulletin 2012-03 (April 13, 2013), it expects financial institutions to exercise considerable oversight over its vendors. Thus far, however, it appears to hold financial institutions accountable for the acts of vendors whether or not the financial institutions exercised the appropriate level of oversight.

Conclusion

The CFPB has a mandate to bring enforcement actions for unfair, deceptive, or abusive practices or violations or other consumer protection statutes. The first 60 cases show just how broad that mandate is, covering the waterfront between an advertisement for free checking and a college's representations regarding its job placement rates. Without repeating the 15 observations in the introduction, we offer the following advice that emerges from a review of the 60 enforcement actions:

1. Pay special attention to promotional offers, and consider not only whether they are literally accurate but whether all material qualifications are included and given appropriate prominence. Whether it's a zero interest credit card, a free checking account, an especially enticing mortgage rate, or a promise to eliminate someone's debt, expect the Bureau to scrutinize disclosures that may be literally accurate but not complete. If it sounds too good to be true, and you're the reason it sounds too good to be true, you have a problem.
2. Expect scrutiny of conflicts. Whether it involves a payment to a lender who refers business, or to a loan officer who steers consumers to higher interest loans, or to a title company that is an affiliate of the person recommending it, assume that the Bureau will skeptically scrutinize relationships and disclosures that involve conflicts.
3. In the mortgage area, above all focus on transfers and loss mitigation. The Bureau is particularly focused on the fact that consumers do not choose to transfer their mortgages and should not be adversely affected by the transfer process.

A Hard Rain Has Started to Fall, A Product-by-Product Review of the CFPB's First 60 Enforcement Actions

4. When it comes to lending to service members, recall what Hamlet said to Ophelia: "Be thou as chaste as ice, as pure as snow."
5. Remember that consumer protection statutes do not require proof of culpability. To be sure, CFPB press releases characterize defendants in the most unfavorable light possible. But, almost none of the CFPB's enforcement cases charge defendants with intentional, knowing, reckless, or even negligent misconduct. Keep that especially in mind when it comes to designing procedures and technology to prevent debt collection violations.
6. In the fair lending context, if your lending practices, especially pricing, involve discretionary decisions, be ever so wary of statistical disparities. Know if they exist and address them.
7. Credit reporting agencies are important. Woe to the firm that sends them inaccurate information.
8. Take no comfort whatsoever that you have delegated essential functions to reputable third-party vendors. The Bureau doesn't care.
9. If you're in the debt modification business, consider getting out of the debt modification business.
10. Finally, never forget the extraordinary leeway the Bureau has in arguing that practices it simply does not like are unlawful. There are a number of consumer statutes with very specific requirements. But the Bureau's statutes of choice in the vast majority of its enforcement actions are Sections 1031(a) and 1036(a)(1)(B) of the Consumer Financial Protection Act of 2000 ((12 U.S.C. §§ 5531(a) and 5536(a)(1)(B)). These statutes authorize the Bureau to take action based on "unfair, deceptive, or abusive" acts or practices—concepts that immediately bring to mind words like "ambiguous," "general," "imprecise," "indefinite," "uncertain," and "vague" because they provide virtually no guidance at all.

Author:

Jon Eisenberg
Jon.Eisenberg@klgates.com
+1.202.778.9348

Consumer Financial Services Practice Contact List

K&L Gates' Consumer Financial Services practice provides a comprehensive range of transactional, regulatory compliance, enforcement and litigation services to the lending and settlement service industry. Our focus includes first- and subordinate-lien, open- and closed-end residential mortgage loans, as well as multi-family and commercial mortgage loans. We also advise clients on direct and indirect automobile, and manufactured housing finance relationships. In addition, we handle unsecured consumer and commercial lending. In all areas, our practice includes traditional and e-commerce applications of current law governing the fields of mortgage banking and consumer finance.

For more information, please contact one of the professionals listed below.

LAWYERS

Boston		
R. Bruce Allensworth	bruce.allensworth@klgates.com	+1.617.261.3119
Irene C. Freidel	irene.freidel@klgates.com	+1.617.951.9154
Stanley V. Ragalevsky	stan.ragalevsky@klgates.com	+1.617.951.9203
Brian M. Forbes	brian.forbes@klgates.com	+1.617.261.3152
Andrew Glass	andrew.glass@klgates.com	+1.617.261.3107
Sean P. Mahoney	sean.mahoney@klgates.com	+1.617.261.3202
Phoebe Winder	phoebe.winder@klgates.com	+1.617.261.3196
Gregory N. Blase	gregory.blase@klgates.com	+1.617.951.9059
Ryan M. Tosi	ryan.tosi@klgates.com	+1.617.261.3257
Robert W. Sparkes, III	robert.sparkes@klgates.com	+1.617.951.9134
Charlotte		
John H. Culver III	john.culver@klgates.com	+1.704.331.7453
Amy Pritchard Williams	amy.williams@klgates.com	+1.704.331.7429
Dallas		
David A. Tallman	david.tallman@klgates.com	+1.214.939.4946
Miami		
Paul F. Hancock	paul.hancock@klgates.com	+1.305.539.3378
New York		
Elwood F. Collins	elwood.collins@klgates.com	+1.212.536.4005
Pittsburgh		
Melissa J. Tea	melissa.tea@klgates.com	+1.412.355.8385
San Francisco		
Jonathan Jaffe	jonathan.jaffe@klgates.com	+1.415.249.1023
Seattle		
Holly K. Towle	holly.towle@klgates.com	+1.206.370.8334
Sydney		
Andrea P. Beatty	andrea.beatty@klgates.com	+61.2.9513.2333
Abhishek Bansal	abhishek.bansal@klgates.com	+61.2.9513.2300
Washington, D.C.		
Costas A. Avrakotos	costas.avrakotos@klgates.com	+1.202.778.9075
David L. Beam	david.beam@klgates.com	+1.202.778.9026
Holly Spencer Bunting	holly.bunting@klgates.com	+1.202.778.9853
Melanie Brody	melanie.brody@klgates.com	+1.202.778.9203
Krista Cooley	krista.cooley@klgates.com	+1.202.778.9257
Daniel F. C. Crowley	dan.crowley@klgates.com	+1.202.778.9447
Eric J. Edwardson	eric.edwardson@klgates.com	+1.202.778.9387
Steven M. Kaplan	steven.kaplan@klgates.com	+1.202.778.9204

Consumer Financial Services Practice Contact List

Phillip John Kardis II	phillip.kardis@klgates.com	+1.202.778.9401
Rebecca H. Laird	rebecca.laird@klgates.com	+1.202.778.9038
Michael J. Missal	michael.missal@klgates.com	+1.202.778.9302
Laurence E. Platt	larry.platt@klgates.com	+1.202.778.9034
Stephanie C. Robinson	stephanie.robinson@klgates.com	+1.202.778.9856
Phillip L. Schulman	phil.schulman@klgates.com	+1.202.778.9027
Stephen G. Topetzes	stephen.topetzes@klgates.com	+1.202.778.9328
Kris D. Kully	kris.kully@klgates.com	+1.202.778.9301
Emily Booth-Dornfeld	emily.booth@klgates.com	+1.202.778.9112
Soyong Cho	soyong.cho@klgates.com	+1.202.778.9181
Shanda N. Hastings	shanda.hastings@klgates.com	+1.202.778.9119
Kerri M. Smith	kerri.smith@klgates.com	+1.202.778.9445
Jon Eisenberg	jon.eisenberg@klgates.com	+1.202.778.9348

PROFESSIONALS
Government Affairs Advisor / Director of Licensing
Washington, D.C.

Stacey L. Riggin	stacey.riggin@klgates.com	+1.202.778.9202

K&L GATES

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Moscow Newark New York Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle Seoul Shanghai Singapore Spokane Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises more than 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit www.klgates.com.