The CFPB Goes Mobile

Jake Adams, 601.351.8906, jadams@bakerdonelson.com

The plastic credit card will one day go the way of the flip phone as consumers increasingly adopt innovative digital payment methods, such as Apple Pay, already available to them on their mobile devices. As a result of this trend and America's embrace of the smartphone, more and more financial institutions and non-traditional banking businesses are developing mobile payment products, often referred to as digital wallets.

This trend has not gone unnoticed by the Consumer Financial Protection Bureau (CFPB).

Using the power transferred to it by Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, with its November 2014 proposal to amend Regulation E (Electronic Fund Transfer Act) and Regulation Z (Truth in Lending Act), the CFPB has demonstrated its intent to regulate mobile payments and digital wallets. The proposed rules include the regulation of mobile and digital payment products.

"Consumers are increasingly relying on prepaid products to make purchases and access funds, but they are not guaranteed the same protections or disclosures as traditional bank accounts," CFPB Director Richard Cordray said when the proposed rule was announced. "Our proposal would close the loopholes in this market and ensure prepaid consumers are protected whether they are swiping a card, scanning their smartphone, or sending a payment."

Cordray delivered more pointed remarks in a November 2014 address to The Clearing House (TCH), which provides payment-system infrastructure and helps operate the Automated Clearing House (ACH).

"[W]e have concerns that electronic payment systems can be misused to victimize consumers unless banks and the system administrators work to police and enforce safeguards. We must shine a light on the murkier corners of electronic payment systems and related practices, and we must be vigilant about preserving consumer protections no matter how these approaches may evolve in the future."

The proposed rules include "Know Before You Owe" disclosure rules; limit the consumer's responsibility to $50 for unauthorized charges when a registered card or device is lost or stolen; require card issuers to provide free transaction statements to customers; and regulate the way that card issuers investigate and resolve account errors reported by consumers. The CFPB claims these proposed regulations would provide protections similar to those already enjoyed by consumers with checking accounts.

Continue on next page

The CFPB Goes Mobile, *continued*

Changes in the electronic payment regulatory landscape are more important than ever as a growing number of Americans make purchases from, on and now with their mobile devices. Recent studies indicate that more than 90% of Americans own a mobile device, and mobile commerce is projected to represent 27% of total e-commerce sales in the United States in 2015. These trends clearly project the expanding role of mobile payments in the consumer experience.

American consumers are going mobile, and the CFPB has demonstrated that it intends to go, too.

CFPB's Latest Supervisory Report Signals Enforcement Trends

Kristine Roberts, 901.577.8136, klroberts@bakerdonelson.com

The CFPB's most recent *Supervisory Highlights* report, which covers the second half of 2014, confirms that the bureau is continuing an aggressive focus on debt collection, overdraft fees, mortgage origination, fair lending and consumer reporting agencies. Banks and other consumer financial services providers should remain vigilant in their monitoring of policies and practices in these priority areas.

The CFPB has made the debt collection industry an enforcement priority since 2012. The bureau issued a rule establishing its supervisory authority over large nonbank debt collectors in October 2012 and began accepting debt collection complaints in July 2013. During the most recent supervisory period, the bureau's review of creditors' debt collection activities found that some debt collectors for student loans purportedly overstated the benefits of loan rehabilitation and inaccurately implied that legal action was impending. The CFPB also found a risk of deception based on debt collectors' inconsistent statements regarding the time frame required to cancel or adjust a recurring ACH payment.

In the area of consumer reporting, the CFPB's examinations assess the consumer reporting agencies' (CRAs) compliance with their dispute-handling obligations under the Fair Credit Reporting Act. The bureau previously reported that its examiners had found that some CRAs failed to provide documents submitted by consumers disputing information on their credit reports. In this latest *Supervisory Highlights*, the CFPB commended the CRAs that had improved training and implemented systems to improve the submission of consumers' dispute documents, but criticized the CRAs that did not meet their obligations.

With respect to overdraft protection and deposit accounts, the bureau was critical of financial institutions that switched from a ledger-balance method to an available-balance method to decide whether to authorize certain debit card and electronic transactions, as well as to determine whether a transaction overdrafts an account and whether to assess overdraft fees. The report complained that, in some instances, the available-balance method resulted in additional overdrafts and fees. (A ledger-balance method factors in only settled transactions to calculate account balance. An available-balance method also includes authorized transactions that have not yet settled and reflects holds on deposits.) According to the CFPB, some banks inadequately disclosed changes to their balance calculation methods and/or to their overdraft processing logic.

Continue on next page

CFPB's Latest Supervisory Report Signals Enforcement Trends, *continued*

The bureau's mortgage origination examination findings focused the bureau's rules issued in January 2013 under Title XIV of the Dodd-Frank Act, which have been in effect since January 2014. The examiners found, among other things, that branch managers originating loans were improperly receiving compensation based on the terms of the transactions they originated, that lenders were not providing good faith estimates to prospective borrowers within the required three-business day period, that lenders were failing to include required disclosures in advertisements, that lenders were not providing denial of credit notices in a timely manner or stating the specific reasons for the denial, and that lenders failed to implement effective and robust compliance management systems, including policies and procedures, training, and monitoring and corrective action processes.

Finally, the CFPB examiners identified violations in the area of fair lending. The bureau concluded that certain lenders violated the Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, by failing to consider public assistance and other sources of income in assessing applicants' ability to repay loans. The ECOA prohibits lenders from engaging in a blanket practice of denying applicants' requests for credit on the basis that the applicants' receive public assistance. On November 18, 2014, the bureau issued a bulletin providing guidance for lenders on complying with the ECOA, specifically describing how to verify Social Security disability income.

The bureau also reported that its supervisory activities in the areas of payday lending, mortgage servicing and mortgage origination led to roughly $19.4 million in remediation to consumers during the six-month period covered by the report.

The Elaborate Guessing Game: The CFPB and Its Authority Under the UDAAP

Sabrina Atkins, 678.406.8741, satkins@bakerdonelson.com

Since its inception in July of 2011, the Consumer Financial Protection Bureau (CFPB), in the process of enforcing numerous laws under the Dodd-Frank Act, has focused primarily on "Unfair, Deceptive, or Abusive Acts and Practices" (UDAAP). Under the Dodd-Frank Act, it is unlawful for any covered person or service provider to "engage in any unfair, deceptive, or abusive act or practice."[1] To date, the CFPB has relied on this authority to open investigations, initiate proceedings and enter into a number of broad-ranging consent orders requiring payment of millions of dollars in damages and restitution. As proof of the CFPB's aim, out of more than 40 of the enforcement matters that the CFPB has made public, nearly half of them have allegations of violations of the UDAAP provision of the Dodd-Frank Act. These enforcement matters have garnered nearly $1.7 billion dollars in restitution for injured consumers – a staggering number worthy of creditors' and financial institutions' attention and research.

[1] 12 U.S.C. § 5536.

Continue on next page

The Elaborate Guessing Game: The CFPB and Its Authority Under the UDAAP, *continued*

Notably, the challenge with UDAAP compliance for many institutions is that the standards are intentionally over-broad, flexible and vague.[2] That is to say, federal agencies have even brought UDAAP claims that mirror consumer financial services laws where the laws initially did not apply – effectively expanding their reach and making the UDAAP a catch-all. And if that weren't enough bad news for the financial industry, regulators have expressly stated that compliance with a consumer financial services law is not a defense to a UDAAP violation. However, the CFPB has made it crystal clear to financial institutions that complying with all of the applicable federal consumer protections is not enough to escape the UDAAP's broad reach. Accordingly, because the CFPB and other regulators have refused to issue a comprehensive guide to define prohibited activity under the UDAAP, financial institutions and firms must look to actions filed by the CFPB for guidance.

In reading between the lines, a financial institution can attempt to understand the exercise of the CFPB's authority under UDAAP based upon the allegations in enforcement actions and the statements contained in the CFPB's Examination Manual and agency guide. Other sources that have become valuable resources to financial institutions and providers are:

1. CFPB Consent Orders based on alleged UDAAP violations
2. Agency enforcement actions filed in the federal courts
3. Specific prohibited practices cited in the CFPB's Examination Manual
4. Bulletins and similar informational statements that elaborate on the CFPB's priorities under the UDAAP[3]

However, even these sources cannot provide a well-rounded guideline for compliance officers who wish to have a clear path on which to walk.

However, as mentioned previously, a financial institution can look to sources like previously filed CFPB enforcement actions to help determine what practices and tactics might be considered a violation of UDAAP. For instance, the CFPB recently filed three separate lawsuits against foreclosure relief companies regarding violations of UDAAP. The prohibited actions cited in the lawsuit concern misrepresentations of:[4]

- Consumers' eligibility for a mortgage or loan modification
- The likelihood of success and the savings that a consumer could obtain by modifying their loan
- Charging and collecting illegal upfront fees for promises modifications
- Provisions in agreements concerning legal representation when the consumer never spoke with an attorney or had their modification reviewed by an attorney[5]

[2] "The Bureau may prescribe rules applicable to a covered person or service provider identifying as unlawful unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. Rules under this section may include requirements for the purpose of preventing such acts and practices." Section 1031(b) of the Dodd-Frank Act.

[3] Donald C. Lampe, *United States: The CFPB & UDAAP: A "Know It When You See It"* Standard, Mondaq.com, June 18, 2014.

[4] See Consumer Advisory: Don't Fall For A Foreclosure Relief Scam or Bogus Legal Help, CFPB, http://www.consumerfinance.gov/blog/consumer-advisory-dont-fall-for-a-foreclosure-relief-scam-or-bogus-legal-help/.

[5] *See Complaint, Consumer Financial Protection Bureau v. Clausen & Cobb Management Company, Inc.*, Case No. 2:14-CV-05681 (C.D. Ca., July 22, 2014), available at http://files.consumerfinance.gov/f/201407_cfpb_complaint_clausen-cobb.pdf; *Complaint, Consumer Financial Protection Bureau v. The Mortgage Law Group*, Case No. 3:14-CV-00513 (W.D. WI., July 22, 2014), available at http://files.consumerfinance.gov/f/201407_cfpb_complaint_cfpb-v-tmlg-et-al.pdf; *Complaint, Consumer Financial Protection Bureau v. The Hoffman Law Group*, Case No. 14-CV-80931 (S.D. Fla., July 14, 2014), available at http://files.consumerfinance.gov/f/201407_cfpb_complaint_hoffman-law-group-et-al.pdf.

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The Elaborate Guessing Game: The CFPB and Its Authority Under the UDAAP, *continued*

After an analysis of enforcement actions brought by the CFPB and opinions from the industry, it is clear there are some actions that financial institutions can take to protect themselves from the vulnerability that has been created under the UDAAP:[6]

- Be sure the consumer understands absolutely everything with regard to your product or service, including disclosures and fee structures.
- Enhance scrutiny of your products and services targeted towards low income consumers and individuals who have experienced financial difficult in the past. These individuals will more likely than not be included as those with a lesser degree of financial sophistication.
- Understand the level of education, financial knowledge and vulnerability of your target audience.
- Comb through consumer complaints received by your institution. These complaints drive the regulation and rule-making of the CFPB.

While there are no hard and fast rules available to shield your company from liability under the UDAAP, the industry and institutions can take action in the form of preventative measures to ensure that their vulnerability is at the lowest level possible. This can easily be done through monitoring CFPB enforcement actions, reviewing Consent Judgments and monitoring their own practices.

[6] "*The Coming Influence and Effects of UDAAP*, BAI Learning & Development Whitepaper, https://www.bai.org/libraries/lob-compliance-downloads/

CFPB Proposes New Rules for Payday Loans

Ned Hildebrand, 615.726.5706, nhildebrand@bakerdonelson.com

On March 26, 2015, the Consumer Financial Protection Bureau (the Bureau) proposed new regulations on short-term loans, commonly known as "payday loans," which are typically issued by non-depository institutions. The Bureau identified certain risks to borrowers who utilize these loans, such as a borrower (1) repeatedly rolling over loans to create a seemingly endless cycle of short-term debt, (2) pledging his vehicle as collateral for a short-term loan, or (3) providing a lender with access to deposit accounts and exposing the borrower to costly overdraft fees. Accordingly, the Bureau has crafted these regulations with the goal of reducing these risks and making payday loans safer for consumers.

Short Term Loans

Many of the proposed rules apply to "short-term loans," which the Bureau defines as loans due in full within 45 days, typically in one single installment. According to the proposed rules, no lender could make a short-term loan without first considering the borrower's ability to repay. This "ability-to-repay" analysis requires consideration of the borrower's income, major financial obligations and borrowing history. The Bureau is still considering what should constitute a "major financial obligation," but the current proposal includes in its definition housing payments, debt payments, child support obligations and other legally required payments. In conducting the "borrowing history" portion of the analysis, the Bureau expects lenders to review their own records and utilize "commercially available reporting systems" to determine the borrower's loan history with other lenders. After considering these criteria, the lender then must make a "reasonable determination" regarding a borrower's ability to repay the loan.

Continue on next page

CFPB Proposes New Rules for Payday Loans, *continued*

The proposed rules include certain rebuttable and conclusive presumptions regarding a borrower's ability to repay a short-term loan. If a borrower takes out a short-term loan within 60 days of a prior short-term loan, he is presumed to lack the ability to repay the loan. The borrower can rebut this presumption by demonstrating an improved financial condition, such as a pay raise. However, a borrower may never take more than three short-term loans within a 60-day period, regardless of his financial situation. In such cases, the presumption of the borrower's inability to repay the loan is conclusive.

Recognizing the administrative burdens that lenders may face in underwriting a borrower's ability to repay a short-term loan, the Bureau has also proposed conditions through which a lender could issue a short-term loan without conducting an "ability-to-repay" analysis. To qualify, the following conditions must be met:

1. The lender must verify the borrower's income and borrowing history.
2. The borrower must not have any outstanding short-term loan with any lender.
3. The borrower has not taken more than three short-term loans within 60 days of a prior short-term loan.
4. Following completion of the term for the loan in question, the borrower will have not been in debt on short-term loans for more than 90 days in the aggregate during a rolling 12-month period.
5. The amount financed does not exceed $500.
6. The loan has no more than one finance charge.
7. The consumer does not provide a vehicle for security.
8. The loan is structured to "taper off."

Currently, the Bureau is considering two options for this final "tapering off" requirement. The first requires that the principal be amortized over the course of the three-loan sequence, as opposed to a lump sum due at the end of the sequence. The second option would allow a borrower to stretch the final short-term loan into four installments without incurring any additional fees.

Regulations Governing Collections

Payday lenders often will have access to a borrower's bank account through debit authorizations or post-dated checks to better secure repayment. This can be especially problematic for borrowers. For example, when a borrower fails to pay a short-term loan, the lender may attempt to draw the money directly from the borrower's deposit account, often resulting in costly overdraft fees. This makes repayment even more difficult.

The proposed regulations seek to curb these collection methods. Under the proposed rules, borrowers must receive notice from a lender at least three days before the lender attempts to withdraw directly from a borrower's account. This notice must specify the amount and date of the collection attempt, the channel through which it will be made, and certain additional information about the loan to be paid through the withdrawal. Additionally, lenders may not draw directly from a borrower's account after two previous attempts have failed. In such cases, the lender must obtain new authorization from the borrower before it may attempt another withdrawal from the borrower's account.

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CFPB Proposes New Rules for Payday Loans, *continued*

Steps Before Implementation

Pursuant to the Small Business Regulatory Enforcement Fairness Act (SBREFA),[1] a Small Business Review Panel will meet with representatives from small-loan lenders, consumer advocacy groups and the Bureau itself to consider the issues associated with implementation of the proposed rules. Within 60 days of this meeting, the panel shall issue a report addressing the comments from the various stakeholders. The Bureau will then consider the panel's report, make adjustments as needed and issue final rules for implementation.

Have You Checked Your Vendor Agreements Lately?

Montoya Ho-Sang, 404.443.6733, mho-sang@bakerdonelson.com

In April 2012, the CFPB released a bombshell on financial institutions – not only could they be held responsible for any violations of consumer protection laws, but now they could also be held responsible for the actions of the companies they use as vendors. Financial institutions are now required to proactively assess, measure, monitor and control the compliance of third party vendors they work with to provide consumer financial products or services. The CFPB took no time in enforcing this new regulation and initiated its first public enforcement action against a large credit card provider in July 2012. The company was ordered to pay more than $300 million in refunds to customers because the CFPB found that its vendors used deceptive marketing tactics to mislead consumers into paying for add-on products when activating credit cards.

Many financial service providers may be surprised that they have to now monitor the acts of their default service providers, foreclosure trustees, brokers, payment processors, telemarketers and even law firms! Some of the ways financial institutions can ensure that business arrangements with service providers are compliant with consumer protection laws include:

- Conducting due diligence to verify that the service provider understands and is capable of complying with law.
- Requesting and reviewing their service providers' policies, procedures, internal controls, and training materials.
- Developing written contracts to outline the duties and obligations of each party, as well as appropriate and enforceable consequences for violating any compliance-related responsibility.
- Establishing an ongoing oversight program to determine whether the service provider is fulfilling its duties.

Given that there are significant consequences for third party management weaknesses, financial institutions should ensure that their vendor management program is aligned with the guidance issued by CFPB regulators. An analysis should be conducted to compare the activities of an institution's third party vendors against the regulations. If any gaps are identified, it is crucial that the institution develop an action plan to update its existing programs.

[1] 15 U.S.C. § 609(b).

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Have You Checked Your Vendor Agreements Lately?, *continued*

In the ever-changing world of consumer finance protection laws, it is imperative that financial institutions make sure that not only are they fully compliant with the regulations, but also that their vendors are. So take some time and review your vendor agreements and oversight programs to make sure that everything is in order. If any questions or issues arise, Baker Donelson is fully equipped to handle all of your vendor risk management needs.