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CFPB Focus

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This is an advertisement.

CFPB Proposes Federal Oversight of Auto Financing Companies

Blair B. Evans, 901.577.2192, bevens@bakerdonelson.com

On September 17, 2014, noting the auto lending discrimination it has uncovered at banks, the Consumer Financial Protection Bureau (Bureau or CFPB) announced its plan to further extend its reach under the Dodd-Frank Act by proposing to amend the Code of Federal Regulations, allowing it to oversee larger non-bank auto finance companies for the first time at the federal level. The new rules would involve the inclusion within the Bureau's supervisory capacity grants of credit for the purchase of an automobile, refinancings of such credit obligations, purchases or acquisitions of such credit obligations, as well as automobile leases, and purchases or acquisitions of such automobile leases.

The CFPB currently has supervisory authority over most large banks and has initiated enforcement actions against several that engage in indirect auto lending. These enforcement actions have resolved alleged violations of federal consumer financial laws. While the Bureau's enforcement actions against banks have resulted in approximately $56 million in restitution and penalties in connection with hundreds of thousands of auto financing transactions, non-bank auto finance companies represent a much larger segment of the auto lending market but have not been subject to federal regulation. Through this proposal, the CFPB seeks to extend its regulatory oversight to financing entities that make, acquire or refinance at least 10,000 loans per year. It estimates that 38 entities meet this level and combined account for 90% of auto loans in the U.S. The CFPB would be supervising these entities to ensure their compliance with federal consumer financial law.

The Bureau states that the purpose of this move to include automobile financing within its jurisdiction and the Bureau's general mission "would be best served by covering automobile leasing more broadly." CFPB Director Richard Cordray justifies the Bureau's proposed rules, stating that they will allow it to "root out discrimination and ensure consumers are being treated fairly across this market." In the Bureau's Summary of the proposed rule, it suggests that the auto leasing market should be included within its supervisory reach "because of the important role that automobiles and related financing play in consumers' lives," noting that cars have become essential for working people and citing that 90% of today's workforce commutes to work via automobile.

By means of inclusion of the automobile financing industry within its supervisory scope, a clear goal of the CFPB appears to be the prohibition of discriminatory pricing in the auto finance market. This objective was previously expressed in the March 2013 *CFPB Bulletin*, which warned indirect auto lenders of the potential for "disparate impact" discrimination caused by dealer participation or "markup" and resulting differences in interest rates to similarly positioned borrowers. Other goals evident in the proposed rules include ensuring that auto lenders:

- Fairly market and disclose auto financing terms.
- Provide accurate information or payment histories to credit bureaus.
- Treat consumers fairly in collection actions.

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In its proposed rules, the CFPB states a number of expected benefits to the subjection of larger participants of the automobile financing market to the possibility of Bureau supervision, including, among other things:

- Creation of an incentive for larger participants to allocate additional resources and attention to compliance with federal consumer financial laws, potentially leading to an increase in the level of compliance.
- Provision of more protections already mandated by law to consumers.
- Incentivizing automobile lenders to comply with regulations consistent with those with which credit unions and depository institutions must already obey.

The Bureau recognizes that increasing compliance results in increased costs, which will likely be passed on to the consumers and could restrict their financing choices. It justifies the increased costs, however, by arguing that the automobile financing market will adjust with smaller financers – who are not covered by the new rule and thus do not incur the increased costs of supervision – offering "more attractive transaction terms" than the larger, covered participants, therefore deterring the larger participants from increasing their prices in response to the proposed rule. This rationalization presumes that the larger participants thus simply absorb the increased cost of supervision without having the ability to pass on the cost to its customers.

In an effort to limit their risks, the CFPB advises auto lenders to internally monitor discretionary pricing policies and address the effects of markup policies, and to limit or eliminate discretionary markups.

The Bureau's proposal was published in the Federal Register on October 8, 2014. As such, the proposed rules will be open for comment until December 7, 2014, 60 days after its publication.

Uncivil Civil Investigative Demands

Dylan W. Howard, 404.589.3406, dhoward@bakerdonelson.com

Responding to civil investigative demands (CIDs) issued by the CFPB is one of the larger challenges faced by financial institutions in acclimatizing to the new regulatory agency. Moreover, the CFPB has demonstrated that it will serve CIDs on smaller companies and individuals, who may have even more difficulty addressing the specific procedural and evidentiary challenges inherent in compliance.

Substantively, the CFPB has authority under the Dodd-Frank Act to issue CIDs requiring documents, responses to interrogatories, tangible items and deposition testimony. Once a CID is served, there is a very short time frame for compliance. The respondent must "meet and confer" with CFPB representatives within 10 days of receipt. At that initial meeting, the respondent must be prepared to discuss any and all issues it has with the CID, including objections. This is a mandatory requirement. The CFPB has stated that it will not consider subsequent petitions to set aside or modify a CID unless the respondent has meaningfully engaged in the meet and confer process, and will only consider issues raised during that process.

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Consumer Financial Protection Bureau

If the respondent wants to object to some or all of the topics or demands included in the CID, there are some very high hurdles to be jumped. The respondent has 20 days from receipt of the CID to file a petition to amend or set it aside. The petition must contain all factual and legal objections to the CID, including all arguments and supporting affidavits or other documentation.

Obviously, this is an extraordinarily tall order for any organization, much less a large company which in civil litigation might require more than 20 days just to identify the appropriate witnesses, investigate and locate responsive documents. Respondents may request extensions from the CFPB, but the decision on such a request is entirely within the CFPB's discretion.

Filing a petition to set aside or amend presents another difficult consequence. While the CFPB generally considers investigations private in their early stages, the agency has announced that once a petition to amend or set aside is filed, the investigation becomes public. Thus, the respondent is faced with having to either address an unduly broad CID privately, or face public scrutiny and potential reputation loss in order to raise legal objections. This is a very significant issue for many companies.

When organizations have requested confidential treatment of their petition to amend a CID, the results have not been favorable. In 2012, the CFPB issued a decision on a request by two companies for confidential treatment and for advance notice of a decision to disclose the existence of the investigation. The CFPB declined the request, holding that the companies had not demonstrated "good cause" for confidential treatment. Basing its analysis on the nondisclosure standards from the Administrative Procedures Act, the CFPB announced that it would agree to keep information confidential when the information includes privileged commercial or financial information obtained from a person or individual. None of the specific information the two companies sought to withhold (i.e., their names, the existence of the investigation and the respondents' corporate documents, including their articles of incorporation) met this standard. The CFPB acknowledged that "good cause" might be met by showing substantial harm to the respondent's competitive position, which could be caused by the disclosure of specific business, strategy or operational plans or structures.

The vast majority of investigations are not going to involve information or documentation that meets this high standard. As a result, financial institutions and other CID recipients should anticipate that a motion to set aside a CID will make the investigation public.

If the respondent opts to file a motion to set aside, there is little reason to be optimistic about the result. The review and determination of the motion is made by the Director of the CFPB. To date, there have been no reports that a motion to set aside was actually granted. As a legal matter, the CFPB states that it will uphold a CID as long as the information sought is relevant to an authorized investigation and the procedural requirements are followed.

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As a result, in the vast majority of cases, the question for a person or entity served with a CID is how best to fully comply while limiting the amount of disclosure required by the CFPB. The best opportunity to limit the scope of a CID is with a genuine, realistic and informed discussion at the "meet and confer" meeting within 10 days of receipt. It is therefore critically important once served to hit the ground running and to engage legal counsel immediately. If the goal is to extend the time frame for compliance, the respondent should send people to the initial meeting who are well versed in the specific challenges the respondent faces in gathering the necessary information, including technical staff or third party vendor representatives for electronically stored information, if necessary. If the goal is to substantively limit the scope of the information and documents sought, the respondent must simply persuade the CFPB that the necessary information can be provided in a different and more streamlined manner. In either case, the respondent is relying on the discretion of the CFPB lawyer. There are certainly cases where investigations have been limited and timelines extended, however, so it is worth the effort and expense to properly prepare.

Finally, if a respondent cannot respond to a CID to the CFPB's satisfaction, the CFPB may decide to bring an action in federal court to enforce compliance. At this stage, the focus for the respondent should be on demonstrating that they attempted in good faith to comply with the CFPB at all relevant times.

CFPB Takes Action for Deceptive Advertisement of "Free Checking"

Jonathan E. Green, 404.221.6518, jegreen@bakerdonelson.com

Although the CFPB has focused its rulemaking and enforcement actions on mortgage servicing and lending, it recently entered into a consent order with M&T Bank regarding the deceptive advertising of free checking. The deceptive activity arose from advertisements made by M&T Bank about its free checking account, which indicated that the free checking account had no fees or minimum balance requirements. While these representations were true, the CFPB found that the ads were deceptive because they failed to disclose that the free checking accounts had a minimum activity requirement, or that the free accounts would be automatically converted into an account with a monthly fee if the account activity requirements were not met. Despite the fact that consumers opening free checking accounts received a document disclosing the minimum account activity requirement and automatic conversion feature, the CFPB still found the advertisements to be deceptive. In addition, consumers whose accounts were converted for a lack of account activity did not receive a formal notification of the conversion and the only notification of the change was that the account type changed on the monthly statement.

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CFPB Takes Action for Deceptive Advertisement of "Free Checking," *continued*

The CFPB found that this constituted deceptive acts and practices under 12 U.S.C. §§5531(a) and 5536(a)(1)(B). The omission of a disclosure regarding the account conversion was considered a violation of Regulation DD, 12 C.F.R. § 1030.8(a)(1). The CFPB found that approximately 80,903 accounts had been converted from free checking accounts and that monthly maintenance fees were assessed from 59,041 accounts. A total of $2.045 million dollars in fees was collected. The CFPB ultimately required M&T to refund all of the fees earned off of account conversions, correct credit where appropriate and pay a $200,000 fine.

One key aspect of this consent order is that the regulatory action did not arise from M&T Bank's free checking program itself being deceptive or improper. The CFPB did not find that the activity requirement or the automatic conversion was improper. Instead, the issue arose from the manner and means by which the program was advertised. If the respective advertisements had contained a satisfactory warning of the activity requirement and automatic conversion process, the CFPB would have taken no action. This is a stark reminder that the CFPB does examine advertisements as part of its supervisory examination process. All advertisements should be vetted to ensure that any necessary warning or disclaimer is included.