



# CONSUMER FINANCIAL SERVICES COMMITTEE NEWSLETTER

March 2016

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## Important Dates

[Business Law Section Spring Meeting](#)  
April 7-9, 2016  
Montréal, QC, Canada

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## Leadership Message



Andrew Smith  
Chair  
Consumer Financial Services Committee

Dear CFSC Members:

In this message, I recount our Committee's recent successes at the Winter Meeting in Park City, Utah; exhort all of you to join us for the [Spring Meeting](#) in lovely and historic Montréal on April 6-9; and remind

you of the many ways that you can be more involved in the Committee.

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## Upcoming Meetings



Join us for 2016 Business Law Section Spring Meeting April 4-7, 2016 in Montréal, Canada! [Register and reserve your hotel room now.](#)

## Subcommittee Spotlight

### Federal Trade Commission and Consumer Financial Protection Bureau Remedies

By Katherine Armstrong, Drinker Biddle & Reath LLP; Adam Maarec, Davis Wright Tremaine LLP; and Nicholas Smyth, Reed Smith LLP

The Federal Trade Commission's ("FTC") remedial powers have evolved over the agency's 100 years, but the core of its authority is found in Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices. Amendments to the FTC Act and other statutes have given the Commission additional authority to obtain monetary relief and to bring actions in district court. For example, Section 13(b) of the FTC Act allows the FTC to obtain extraordinary relief such as asset freezes and temporary restraining orders, in proper cases. In general, the FTC seeks to prevent the unlawful conduct from occurring in the future and, where appropriate to provide redress to injured consumers, disgorge ill-gotten gains, or pay civil penalties to the U.S. Treasury.

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### Fair Lending and UDAAP Issues in Credit and Marketing Models

By Heather Klein, Ballard Spahr LLP

Credit and marketing models are integral to lenders' businesses but they create challenges for complying with laws governing fair lending and unfair, deceptive, or abusive acts or practices ("UDAAPs"). Two economists and two lawyers spoke about these issues at the January 2016 CFSC Winter Meeting during a panel moderated by Brad Blower, VP, Principal Compliance Leader, Consumer Practices at American Express and Chair of the Fair Access to Financial Services Subcommittee.

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### Winter Meeting Mortgage Track - A New Experiment

By Christine Acree, Ellie Mae, Inc.; Michael Flynn, Goodwin Procter LLP; Lynette Hotchkiss, RaboBank, N.A.; Heather Thayer, Thayer Legal Services PLLC; and Dave Wiese, Hinckley, Allen & Snyder LLP

At this year's CFSC Winter Meeting in Park City, Utah, the Committee experimented with a new concept in

## Legal Features

### Increasing Transparency in the Forum Selection Process: When Should the CFPB Use Its Administrative Forum?

By Jolina Cuaresma and Katherine Lamberth, White & Case LLP

Those critical of the Consumer Financial Protection Bureau ("CFPB") assert that the CFPB has an unduly broad amount of discretion to use the administrative adjudication process whenever it sees fit. To be sure, when Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), it did not expressly limit the CFPB's administrative adjudication authority. In fact, Congress eroded the differences between judicial and administrative proceedings involving the CFPB, by making clear that the relief available in federal court is also available in the administrative forum.

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### Courts Wrestle With Vicarious Liability for a TCPA Violation by a Third Party

By Eric Tsai, Maurice Wutscher LLP

The U.S. District Court for the Southern District of New York in *Melito v. Am. Eagle Outfitters, Inc.*, recently dismissed a putative class action alleging violation of the federal Telephone Consumer Protection Act ("TCPA") against a marketing company that conducted a mass text message advertising campaign on behalf of a national retail clothing store.

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### Daily Fantasy Sports: A Regulatory Dilemma Worth Resolving

By Richik Sarkar, Member, McGlinchey Stafford PLLC

When ("if" can no longer be fairly used) the Daily Fantasy Sports industry becomes regulated, Ethan Haskell, a content manager for DraftKings who earned \$350,000 in one FanDuel contest after posting information that appeared to give him a competitive advantage, will be a central figure of the regulatory origin story. Following his "insider trading" incident in September 2015, many state and federal regulators began considering whether daily

programming - separate "tracks" for mortgage and non-mortgage issues. One full day of programming was dedicated to this "dual tracking" approach, with four programs held in each track. Thanks to the herculean efforts of Programs Chair Sandy Shatz and Vice-Chair Dave Wiese, as well as Committee Chair Andrew Smith, the experiment was a great success. This article includes a brief discussion on each of the four separate programs held as part of the mortgage track, which hosted an overflow crowd of attendees.

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fantasy sports constitute gambling and whether it can be regulated.

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**Tailored to Suit: Drafting a Client's Compliance Management System**

By Chris Chamness and Webb McArthur, Hudson Cook LLP

As consumer finance attorneys, we spend the majority of our time explaining compliance obligations to our clients. Equally important, especially to the Consumer Financial Protection Bureau ("CFPB"), is our work to ensure day-to-day compliance with those obligations. To that end, we create compliance management systems ("CMS") for our clients.

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### Winners of The ACCFSL 2016 Annual Writing Competition

The American College of Consumer Financial Services Lawyers ("The ACCFSL") is pleased to announce the winners of its 2016 Annual Writing Competition. Each year The ACCFSL seeks to recognize written contributions to the field of consumer financial services law. This year's winner in the Professional Category is Professor John Campbell, Hughes-Ruud Research Professor, University of Denver Sturm College of Law, for his article, *Where Kafka Reigns: A Call for Metamorphosis in Unlawful Detainer Law*. Daniel O'Connell, a student at The Catholic University of America, Columbus School of Law, is the winner of the Student Category for his article, *Confounded Collectors, Confused Consumers: Time to Close the Circuit Split on Whether the Fair Debt Collections Practices Act Requires a Consumer to Dispute a Debt in Writing*.

Founded in 1996, The ACCFSL is a professional association of lawyers particularly skilled and experienced in handling consumer financial services matters and dedicated to the improvement and enhancement of the skill and practice of consumer financial services law and the ethics of the profession. The College brings together into an association qualified members of the profession who, by reason of their character, skill and ability, will contribute to the accomplishments and good fellowship of the College.

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## Chairman's Message

Dear CFSC Members:

In this message, I recount our Committee's recent successes at the Winter Meeting in Park City, Utah; exhort all of you to join us for the [Spring Meeting](#) in lovely and historic Montréal on April 6-9; and remind you of the many ways that you can be more involved in the Committee.

### Business Law Section Spring Meeting

We will begin the festivities on the afternoon of **Wednesday, April 6**, at 4:00 PM with Beer and Basics, followed by a joint reception with the **Banking Law Committee**. The Committee Dinner will be held **Thursday, April 7**, at L'Atelier D'Argentine. All of our meetings will be held at the **Fairmont Queen Elizabeth Hotel**. Here are the links you will need to register:

- [Meeting Registration](#)
- [Dinner Registration](#)

But the meeting won't be all beer, basics and carousing. We also have several timely and high-quality panel presentations, including the Fred Fisher Memorial Program, a fixture at the Spring Meeting and a perennial crowd-pleaser. This year, the topic of the Fisher Program will be "Is Fair Lending Enforcement Fair for All?" Other programs include

- a comparison of mortgage regulation in the US and Canada;
- recent developments in debt collection and loan servicing;
- hot topics in mortgage loan servicing and collection;
- an update on the TCPA and what is happening at the FCC;
- a comparison of the US and Canadian responses to the financial crisis;
- a program on the compliance issues faced by community banks, and the regulatory environment for community banking; and
- a program on AML/BSA and the evolving environment for economic sanctions.

Several of these programs will be jointly sponsored with our friends at the Banking Law Committee, and, in fact, the entire Friday program will be joint BLC/CFSC. So, make sure that your passport is up-to-date, brush up on your high school French, and join us April 6-9, in Vieux Montréal.

### Consumer Financial Services Committee Winter Meeting

The Winter Meeting at The Canyons in Park City, Utah was another rousing success. We had 280 attendees, the largest number ever for a "cold weather" meeting. For the first time in many years, the snow cooperated, and the skiers among us were treated to a brand-new ski lift connecting The Canyons to Park City Mountain Resort. We had several well-planned and well-attended programs, nearly all of which included speakers from the CFPB, FTC, consumer advocate community, or academia. And, for the first time, we had a separate "mortgage track" --a full slate of programs devoted to mortgage developments and geared toward the sophisticated mortgage practitioner.

The audio recordings and materials from the Winter Meeting can be located [here](#).

## How to Get Involved in CFSC

Another first at the Winter Meeting was a “Town Hall” geared toward updating CFSC members on what’s happening in the Committee, and letting them know how they can get more involved. Part of the message was this very succinct and helpful summary of how to get involved in the Committee prepared by Carolyn Hann and Grace Powers, the Chair and Vice Chair of the Membership Committee:

- **Attend a CFSC Meeting** – Not only do the meetings educate you on the latest CFSC developments, they also offer an excellent way to network and get involved! Our committee meets 3 times a year (January, April, and September), so visit our [Committee Page](#) to register for our next meeting.
- **Show off Your Writing Prowess** – Do you love to write? We are always looking for fabulous writers to contribute to our CFSC newsletter or work on other publications. Check out our latest [CFSC Newsletter](#) and contact Co-Editors [Yolanda Gamboa](#), [Adam Maarec](#), or [Judy Mok](#). We are also planning a CFSC book publication, so contact the Publications and Communications Subcommittee: [Rachel Marin](#) (Chair), [Scott Adams](#) (Co-Vice Chair), and [Mark Emanuelson](#) (Co-Vice Chair) to see how you can get involved.
- **Join a Subcommittee and Volunteer** - Does Truth-In-Lending or Privacy get you fired up? We have more than 20 subcommittees, both administrative and substantive, to engage you! Check out our [Committee Page](#) for a list of subcommittees and join the listserv. If you’re interested in volunteering to help a particular Subcommittee, you can contact the Subcommittee’s Chair and Vice Chairs directly.
- **Pitch a CLE or non-CLE Program** – Do you have a great CLE or non-CLE idea or want to speak? Contact our Programs subcommittee leaders [Sandy Shatz](#) (Chair), [Dave Wiese](#) (Co-Vice Chair) or the leaders of the substantive subcommittee that cover that legal space to pitch your program idea.
- **Check out our CFSC Young Lawyers Subcommittee** – We have an energetic [Young Lawyers](#) subcommittee who are always looking for new young lawyer recruits to pen Series 101 articles and serve as Young Lawyer Liaisons to the CFSC subcommittees. To get involved with the Young Lawyers Subcommittee contact [Dan McKenna](#) (Chair) or Co-Vice Chairs [Robert Savoie](#) and [Marci V. Kawski](#).

*Andrew Smith, Chair  
Consumer Financial Services Committee*

## A Tribute to Nikki Munro

Performed by CFSC Leadership at 2016 ABA CFSC Winter Meeting

Hello Nikki

Well, Hello, Nikki  
Yes, Hello, Nikki  
As our committee chair  
You truly did excel

You were so swell, Nikki  
You did so well, Nikki  
You brought young folks in  
And made them feel at home

Take a bow, Nikki  
You made us all go Wow, Nikki  
You expanded our sphere  
To places never gone

Oh,

You got more people involved, Nikki  
You gave out more real jobs, Nikki  
We'll never let you go away  
You're always in our hearts to stay

Wherever we are will  
Forever be your home!

# Federal Trade Commission and Consumer Financial Protection Bureau Remedies

FTC section by Katherine Armstrong, Drinker Biddle & Reath LLP  
CFPB section by Adam Maarec, Davis Wright Tremaine LLP and Nicholas Smyth, Reed Smith LLP

The Federal Trade Commission's ("FTC") remedial powers have evolved over the agency's 100 years, but the core of its authority is found in Section 5 of the FTC Act, which prohibits unfair or deceptive acts or practices. Amendments to the FTC Act and other statutes have given the Commission additional authority to obtain monetary relief and to bring actions in district court. For example, Section 13(b) of the FTC Act allows the FTC to obtain extraordinary relief such as asset freezes and temporary restraining orders, in proper cases.<sup>1</sup> In general, the FTC seeks to prevent the unlawful conduct from occurring in the future and, where appropriate to provide redress to injured consumers, disgorge ill-gotten gains, or pay civil penalties to the U.S. Treasury.

The Consumer Financial Protection Bureau's ("CFPB" or "Bureau") remedial powers are found in Section 1055 of the Consumer Financial Protection Act ("CFPA").<sup>2</sup> The statute permits the CFPB to pursue "any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law" in state or federal court or in an administrative proceeding.<sup>3</sup>

For the FTC, the remedy is dependent on the facts, the forum, and the specific statute under which the action is brought. The CFPB's remedial authority is not limited by the forum or statutory violation because the CFPA specifies the relief available for violations of the Federal consumer financial laws.

What follows is a brief summary of each agency's remedial authority.

## Federal Trade Commission

The remedies used by the FTC can be divided into the following categories: prohibition of unlawful conduct, informational or other affirmative obligations, and monetary relief.

### Prohibition of Unlawful Conduct

The purpose of injunctive relief is to enjoin illegal conduct alleged in the complaint and prevent future violations of the law.<sup>4</sup> Injunctive relief is a staple of both FTC administrative and district court orders. For example, when a complaint alleges that a particular representation is false, the order will prohibit the respondent from making the false claim in the future. When a representation is alleged to be unsubstantiated, the order will prohibit the claim unless it can be properly substantiated. The proper level of substantiation may also be included in the order such as the requirement that certain health claims be supported by two clinical trials.<sup>5</sup> Courts will scrutinize Commission orders to ensure that there is a "reasonable fit" between the order's requirements and the government interest.<sup>6</sup> When a complaint alleges a violation of another statute enforced by the FTC, such as the Fair Credit Reporting Act (FCRA),<sup>7</sup> the order will prohibit future violations of the statute.

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<sup>1</sup> 15 U.S.C. § 53(b).

<sup>2</sup> 12 U.S.C. § 5565.

<sup>3</sup> 12 U.S.C. § 5565(a)(1).

<sup>4</sup> *U.S. v. Colgate-Palmolive Co.*, 380 U.S. 374 (1965).

<sup>5</sup> *Thompson Medical Co.*, 104 F.T.C. 648, 826 (1984); *aff'd*, 791 F.2d 189 (D.C. Cir 1986).

<sup>6</sup> *POM Wonderful, LLC v. FTC*, No. 13-1060 at p. 45 (D.C. Cir. January 30, 2015).

<sup>7</sup> 15 U.S.C. § 1681 *et seq.*

When appropriate an order may also include "fencing-in relief which broadens the coverage of the order beyond the specific prohibitions. For example, if the conduct alleged to be unlawful can be easily transferable to other products that a company sells or within a specific industry, the order's injunctive relief may cover "all products" the company sells. The goal of fencing-in relief is to ensure that the order may not be by-passed with impunity.<sup>8</sup> The factors the Commission will consider in determining the appropriate fencing-in relief include the seriousness of the violation, the violator's record with respect to deceptive practices, the deliberativeness of the conduct, and the potential transferability of the illegal practice to other products.<sup>9</sup>

### **Informational or Other Affirmative Obligations**

When the Commission determines that injunctive relief alone may not prevent the recurrence of the unlawful conduct, it may impose additional affirmative obligations. These obligations may include affirmative disclosures, corrective advertising, and in the privacy and data security area, the development and implementation of privacy or data security assessments.

#### *Affirmative Disclosures*

Affirmative disclosures are required when the Commission determines that in order to prevent future deception, consumers need more specific information. For example, specific language may be required to be disclosed when certain claims are triggered or when the claims relate to health, safety, or financial issues. For example, in a case involving the marketing of St. John's Wort, in addition to prohibiting the company from making unsubstantiated claims about the efficacy of the product, a warning was required for all advertising and promotional materials.<sup>10</sup>

Any disclosure required by an order must be made in a clear and conspicuous manner, which incorporates the concepts of placement, prominence, and proximity. A fine print disclosure at the bottom of a page or screen would not be clear and conspicuous. What is clear and conspicuous is contextual and Commission orders often specify how disclosures are made in marketing online and on smaller screens and devices. In the TALX settlement, the Commission required that in electronic media certain disclosures required by the FCRA be provided in a "clear and prominent" manner which was defined to be:

... (a) unavoidable; (b) of a size and shade, and shall appear on the screen for a duration, sufficient for an ordinary consumer to read and comprehend it; (c) easily printable; and (d) presented on the principal screen or landing page where the disclosure is relevant.<sup>11</sup>

The FTC provides important guidance on how to communicate effective online disclosures through its business education materials.

#### *Corrective Advertising*

Corrective advertising is a remedy that goes beyond the prohibition of unsubstantiated or false claims and requires that affirmative statements be included in advertising and marketing for a set period of time. It is used as a remedy when the Commission has determined that the challenged ads have "substantially created or reinforced a misbelief and the misbelief is likely to linger into the future without the dissemination of a truthful message to counteract the beliefs created by the deceptive claims."<sup>12</sup>

In 2000, the Commission ordered Novartis, the maker of Doan's Pills, to run ads to correct misbeliefs resulting from their unsubstantiated claim that Doan's Pills are superior to other over-the-counter analgesics for treating back pain. Specifically, the Commission's order required advertising and packaging to carry the message, "Although Doan's is an effective pain reliever; there is no evidence that Doan's is more effective than other pain relievers for back pain."<sup>13</sup> While the Commission's authority to order corrective advertising has been upheld on

<sup>8</sup> *FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952).

<sup>9</sup> *Sears, Roebuck & Co. v. FTC*, 676 F.2d 385, 391 (9th Cir. 1982).

<sup>10</sup> *Panda Herbal Int'l, Inc.* 132 F.T.C 125 (2001).

<sup>11</sup> *U.S. v. TALX Corp.*, No. 4:09-cv-01171 (E.D. Mo. July 9, 2009).

<sup>12</sup> *FTC v. Novartis Corp.*, 127 F.T.C. 580, 697 (1999); *aff'd* 223 F.3d 783 (D.C. Cir. 2000).

<sup>13</sup> *Id.* The Commission's order was issued after an Administrative Law Judge upheld the complaint allegations that the claims were unsubstantiated

appeal, it is not a remedy that is frequently used.

#### Direct Notifications

Direct notification to consumers or others of a particular Commission action is a remedy used when the purchasers of products or services are known and the alleged misrepresentation concerns a health or safety risk. For example, the manufacturer of a fitness device was required to notify purchasers that the device posed a safety hazard.<sup>14</sup>

#### Biennial Reports and assessments

Many of the Commission's data security' and privacy settlements require the establishment and maintenance of a comprehensive privacy or data security program.<sup>15</sup> Such a program must include, among other things: the designation of employees to coordinate and be accountable for the program; procedures for identifying risks that could result in the unauthorized collection, use or disclosure of consumer information; design and implementation of reasonable privacy controls and procedures; the development and use of reasonable steps to select and retain service providers; and processes to evaluate and adjust the program through testing and monitoring. Most data security and privacy orders also require biennial audits for up to 20 years from an independent third party professional approved by the Commission.<sup>16</sup>

#### *Deletion of Consumer Information*

Another remedy in the privacy area is the deletion of consumer information. This remedy is used when the Commission has alleged that certain consumer information has been obtained improperly. The order will require that all information within the respondent's possession, custody, or control and which was acquired prior to the date of the order be deleted.<sup>17</sup>

#### *Bans and Bonds*

On occasion, individuals have been banned from certain industries or have been required to post bonds before engaging in business in order to ensure compliance with the orders. Generally these actions have involved fraud and have been filed in district court.

#### *Trade name excision*

Another example of the FTC's broad remedial authority is the use of excision of trademarks or trade names. Such a remedy is used when the marks or names are considered to be inherently deceptive. One example is the Commission's action against Thompson Medical Company and its "Aspercreme" product.<sup>18</sup>

### **Monetary Relief**

#### *Redress and Disgorgement*

In the mid-1970's the Commission was given statutory authority to seek redress pursuant to Sections 13(b) and 19(b) of the FTC Act.<sup>19</sup> While the initial focus of Section 13(b) was on anticompetitive merger cases, the FTC began using this authority in in the 1980's to challenge fraudulent conduct. The remedies available pursuant to an action brought under Section 13(b) rely on the court's equitable powers and upon a proper showing allow the district court to issue injunctive relief and allows for ancillary relief necessary to accomplish complete justice including monetary relief in the form of redress to injured consumers.<sup>20</sup>

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and false, but did not impose a corrective advertising remedy sought by complaint counsel. On appeal to the Commission, the Commission imposed the corrective advertising remedy. The D.C. Circuit Court of Appeals upheld the Commission's order.

<sup>14</sup> *Consumer Direct, Inc.*, 113 F.T.C. 923 (1990).

<sup>15</sup> *See, Snapchat, Inc.*, File No. 132 3078 (December 31, 2014) and *Goldenshores Technologies, LLC, and Erik M. Geidl*, File No. 132 3087 (April 9, 2014).

<sup>16</sup> *Id.*

<sup>17</sup> *See, Goldenshores Technologies, LLC, and Erik M. Geidl*, File No. 132 3087 (April 9, 2014).

<sup>18</sup> *Thompson Medical Co.*, 104 F.T.C. 648 at 837-39 (1984).

<sup>19</sup> 15 U.S.C. §§ 53(b), 57b(b).

<sup>20</sup> *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1102 (9th Cir. 1994).

Section 19(b) redress is confined to administrative actions and was added as part of the Magnuson-Moss Act to improve the FTC's consumer redress powers. Section 19 requires there final administrative cease and desist order where the conduct was found to be 'dishonest or fraudulent" and then a separate action in district court where the court determines the appropriate redress for consumers.<sup>21</sup>

Restitution is generally not viewed as a prospective remedy and therefore not available in administrative settlements.<sup>22</sup> However, respondents often consent to paying restitution in administrative settlements without establishing that the conduct was "dishonest or fraudulent." Disgorgement is used when redress is impracticable, but monetary relief is deemed appropriate.<sup>23</sup>

### *Civil Penalties*

Civil penalties can only be obtained under specific statutory provisions. For example, the Commission can recover up to \$16,000 per violation for violations of administrative orders.<sup>24</sup> Civil penalties are also available for violations of certain trade regulation rules<sup>25</sup> or specific statutes, such as the FCRA.<sup>26</sup> Section 5(m) allows the Commission to bring an action against a non-respondent for knowing violations of a previous administrative cease and desist order to which it was not a party and which defines an act or practice to be deceptive.<sup>27</sup> This third avenue for obtaining civil penalties has not been widely used and has proven to be somewhat cumbersome because it requires ensuring that non-respondents have knowledge of the specific conduct that the Commission has found to be unfair or deceptive.

The civil penalty amount depends on a variety of factors including the extent of the violations, the history and duration of the conduct, as well as the respondent's ability to pay.<sup>28</sup> The Commission will also rely on its own precedent when in terms of what has been obtained in other actions when arriving at the appropriate amount. Other statutes enforced by the FTC, such as the FCRA have specific sections relating to civil penalties. For example, the FCRA requires that that the court consider the degree of culpability, any history of such prior conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.<sup>29</sup>

Civil penalty actions are referred to the Department of Justice for filing and if the Department chooses not to file the action, the Commission has authority to file the matter in its own name.<sup>30</sup> Civil penalties are paid to the U.S. Treasury.

## **Consumer Financial Protection Bureau Remedies**

The CFPA identifies various types of relief for violations of Federal consumer financial law,<sup>31</sup> including, "without limitation":

- Rescission or reformation of contracts;
- Refund of moneys or return of real property;
- Restitution;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages or other monetary relief;
- Public notification regarding the violation. including the costs of notification;
- Limits on the activities or functions of the person; and

<sup>21</sup> *FTC v. Figgie Inc.*, 994 F.2d 595 (9th Cir. 1993).

<sup>22</sup> *Heater v. FTC*, 503 F.2d 321 (9th Cir. 1974) (Injunctive relief under Section 5 of the FTC Act is prospective and does not include restitution.)

<sup>23</sup> See, *Equifax Information Services LLC*, File No. 132 3252 (March 15, 2013).

<sup>24</sup> 15 U.S.C. § 45(l).

<sup>25</sup> 15 U.S.C. § 45(m).

<sup>26</sup> 15 U.S.C. § 1681s.

<sup>27</sup> 15 U.S.C. § 45(m)(1)(B)(1).

<sup>28</sup> See, *U.S. v. J.B. Williams Co.*, 498 F.2d 414, 438 (2nd. Cir. 1974).

<sup>29</sup> 15 U.S.C. §1681s(a)(2)(B).

<sup>30</sup> 15 U.S.C. § 56.

<sup>31</sup> The CFPA defines "Federal consumer financial law" to include the CFPA itself, the 18 "enumerated consumer law[s], the laws for which authorities are transferred under subtitles F and H, and any rule or order prescribed by the Bureau under this title, an enumerated consumer law," or one of such transferred authorities. 12 U.S.C. § 5481(14).

- Civil money penalties ("CMPs") of:
  - Up to \$5,000 for each day of a violation of a law, rule, or final order or condition imposed in writing by the CFPB;
  - Up to \$25,000 for each day of a reckless violation of a Federal consumer financial law; or
  - Up to \$1,000,000 for each day of a knowing violation of a Federal consumer financial law.<sup>32</sup>

The CFPA does not empower the CFPB to impose exemplary or punitive damages.<sup>33</sup>

Any civil money penalty sought by the Bureau must take into account "mitigating factors" including "the size of financial resources and good faith of the person charged; the gravity of the violation or failure to pay; the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided; the history of previous violations; and such other matters as justice may require."<sup>34</sup>

### **Credit for Responsible Business Conduct**

In addition, the CFPB issued a bulletin in 2013 identifying specific features of "responsible business conduct" that the Bureau "may favorably consider in exercising its enforcement discretion."<sup>35</sup> The bulletin identified four categories of responsible business conduct, which it emphasized were "not exhaustive":

- Self-policing — the implementation of compliance management systems that promote the prompt identification and correction of potential violations, which can be reflected in a "culture of compliance" set by the "tone at the top" of the organization.
- Self-reporting — special emphasis is placed on prompt and complete reporting to the Bureau of significant violations and potential violations *before* discovery of the issue through supervisory or other actions becomes imminent.
- Remediation — prompt correction of errors including "full redress" to consumers for any injuries, taking steps to prevent violations from recurring including sanctions on individuals responsible for misconduct, and changing practices to protect or benefit consumers.
- Cooperation — when an investigation of a potential violation occurs, "substantial and material steps above and beyond what the law requires" should be taken to provide information identifying the problem and the company's response.

If a company faced with an enforcement investigation for a potential violation of law engages in "responsible business conduct" as described above, the Bureau has discretion to favorably alter its approach. Examples of favorable courses of action include a non-public enforcement action, treating the conduct as a "less severe type of violation", reducing the number of violations pursued, or reducing the amount of sanctions or penalties.

### **Application of the CFPB's Remedial Powers**

The majority of the CFPB's enforcement actions have been in the form of administrative or judicial settlements whereby the remedial provisions are executed upon agreement of the parties and without an admission from the settling party that violation of law occurred.<sup>36</sup> Since the CFPA requires the CFPB to take into account the "mitigating factors" described above, the three tiers of CMPs serve as upper bounds for any settlement negotiation between the CFPB and an

<sup>32</sup> 12 U.S.C. § 5565(a)(2).

<sup>33</sup> 12 U.S.C. § 5565(a)(3).

<sup>34</sup> 12 U.S.C. § 5565(c)(3).

<sup>35</sup> CFPB Bulletin 2013-06, Responsible Business Conduct: Self-policing, Self-Reporting, Remediation, and Cooperation (June 25, 2013), available at [http://files.consumerfinance.gov/f/201306\\_cfpb\\_bulletin\\_responsible-conduct.pdf](http://files.consumerfinance.gov/f/201306_cfpb_bulletin_responsible-conduct.pdf).

<sup>36</sup> When the CFPB believes its case merits enforcement action and it cannot reach a negotiated settlement, the agency typically files a complaint in federal district court. The CFPB has approximately 19 cases pending in courts around the country (as of December 1, 2015) and it has resolved several other litigated cases through settlements. By comparison, the CFPB has filed only two contested actions in its administrative proceeding: *In Re: PHH Corp.*, which is on appeal before the D.C. Circuit Court of Appeals, and *In Re: Integrity Advance, LLC*, which it filed on November 18, 2015.

entity under investigation. In the course of negotiations, the CFPB's Office of Enforcement may mention the theoretical maximum penalty amount that it could impose for a particular violation, and it may use this amount as leverage in persuading defendants to settle. But the final CMP amount in most settlements is well below the theoretical limit. This is one reason defendants have generally been reluctant to challenge the CFPB in court or administrative proceeding; a court or administrative law judge could order much higher CMPs in a litigated judgment.

The public record does not provide much guidance on how the Bureau applies the CMP tiers and the mitigating factors in agreeing to CMP numbers below the theoretical limits. But it is clear that the CFPB weighs the statute's mitigating factors and the responsible conduct factors. In some public settlements, where the factors weighed strongly enough in favor of the defendant, the CFPB has agreed to take no CMPs at all.<sup>37</sup>

Moreover, application of the CFPB's remedial powers has been hard to predict over the short course of the CFPB's tenure. By way of example, the CFPB has issued enforcement actions against nine banks and two service providers for allegedly unfair and deceptive acts in connection with the sale of credit card add-on products during telemarketing calls. *See chart below.* The allegations in each of these actions revolved around similar allegedly deceptive telemarketing practices and unfair billing practices, but the civil penalties and restitution amounts were significantly different in each case. Based on the public aspects of these enforcement actions, it is difficult to determine how or why the civil money penalty and restitution amounts were determined.

### CFPB Credit Card Add-On Product Enforcement Actions

Date Filed	Company	Product/Service	Civil Penalties	Restitution	Notes
07/17/12	Capital One Bank, N.A.	Credit card debt protection and credit monitoring	\$25 million	\$140 million	Coordinated action with OCC
09/24/12	Discover Bank	Credit card debt protection, identity theft monitoring, and credit score tracking	\$14 million	\$200 million	Joint Consent Order with FDIC
09/18/13	JPMorgan Chase Bank, N.A.; Chase Bank USA, N.A.	Credit card identity theft monitoring	\$20 million	\$309 million	Coordinated action with OCC
12/24/13	American Express Travel Related Services Company	Credit card debt protection and identity theft monitoring	\$4 million	None	
12/24/13	American Express Centurion Bank	Credit card debt protection and identity theft monitoring	\$3.6 million	\$40.9 million	Coordinated action with FDIC
12/24/13	American Express Bank, FSB	Credit card debt protection and identity theft monitoring	\$2 million	\$18.6 million	Coordinated action with OCC
04/09/14	Bank of America, N.A.; and FIA Card Services, N.A.	Credit card debt protection and identity theft monitoring	\$20 million	\$727 million	Coordinated action with OCC

<sup>37</sup> See *In Re: Dealers Financial Services, LLC*, Consent Order, File No. 2013-CFPB-0004, available at [http://files.consumerfinance.gov/f/201306\\_cfpb\\_enforcement-order\\_2013-0589-02.pdf](http://files.consumerfinance.gov/f/201306_cfpb_enforcement-order_2013-0589-02.pdf).

06/19/14	GE Capital/Synchrony Bank	Credit card add-on products	\$3.5 million	\$56 million	
09/25/14	US Bank, N.A.	Credit card identity theft monitoring	\$5 million	\$48 million with a \$25.5 million floor	Coordinated action with OCC
07/01/15	Affinion Group Holdings, Inc.	Credit monitoring	\$1.9 million	\$6.76 million	
07/01/15	Intersections Inc.	Credit monitoring	\$1.2 million	\$55,000	
07/21/15	Citibank, N.A., Department Stores National Bank, and Citicorp Credit Services, Inc.	Credit card debt protection and credit monitoring; expedited payments	\$35 million	\$675 million	
09/28/15	Fifth Third Bank	Credit card debt protection	\$500,000	\$3 million	
<b>Total</b>			<b>\$180.7 million</b>	<b>\$2.2 billion</b>	

### Civil Penalty Fund

In contrast to the FTC, which returns any money collected in civil penalties to the U.S. Department of the Treasury, the CFPB is required by the CFPA to deposit any CMPs into a civil penalty fund, the proceeds of which may be used only to

- 1) Pay compensation to consumers harmed by violations of a law for which the CFPB is authorized to obtain relief and who have not yet been compensated through restitution or another form of redress, or
- 2) If all victims in settlements that fall in a given time period have been compensated, the CFPB may allocate funds for consumer education or financial literacy purposes.<sup>38</sup>

The CFPB promulgated a rule in 2013 that implements the fund, and it updated this rule in 2015.<sup>39</sup>

### Conclusion

The civil penalty authority is the biggest difference between the FTC and the CFPB. It is likely that in drafting the CFPA Congress took advantage of some lessons learned from the FTC's enforcement history which is evidenced in the streamlined remedy approach of Section 5565. There is rising concern that companies that could be subject to the jurisdiction of either agency will pay larger penalties if the CFPB brings the action. That is likely true both in light of Section 5565, but also because the FTC is constrained somewhat by its past precedent when negotiating civil penalties, though it appears that the FTC is getting more aggressive.

While monetary relief is important to the FTC injunctive relief has almost always been included in FTC consumer protection orders whether the matter is filed administratively or in district court. Perhaps because monetary relief was not the original remedy of the FTC Act, over the years the FTC has ordered other informational or affirmative obligations when injunctive relief will not completely remedy the unlawful conduct. These remedies are not insignificant.

<sup>38</sup> 12 U.S.C. § 5497(d).

<sup>39</sup> 12 CFR Part 1075.

# Fair Lending and UDAAP Issues in Credit and Marketing Models

By Heather Klein, Ballard Spahr LLP

Credit and marketing models are integral to lenders' businesses but they create challenges for complying with laws governing fair lending and unfair, deceptive, or abusive acts or practices ("UDAAPs"). Two economists and two lawyers spoke about these issues at the January 2016 CFSC Winter Meeting during a panel moderated by Brad Blower, VP, Principal Compliance Leader, Consumer Practices at American Express and Chair of the Fair Access to Financial Services Subcommittee.

Joining Brad on the panel were Marsha Courchane, VP and Practice Leader at Charles River Associates; Bryce Stephens, Section Chief, Compliance Analytics and Policy at the CFPB; Eric Sublett, Associate at Relman, Dane & Colfax; and Karen Barnes, Director and Senior Counsel at Discover Financial Services. This article provides a synopsis of the issues discussed, although it does not attribute any specific point to a particular panelist. To hear from the speakers themselves, I encourage you to listen to the recording posted on the committee's website.

An overarching theme of the panel, as is the case in so many fair lending discussions, was how to design and monitor marketing and credit models in a way that expands access to credit without having a disparate impact on protected classes. For background, marketing models identify potential customers, while credit models predict applicants' risk of default. To manage the risks that models will be found to discriminate against protected classes or treat consumers in a manner that could be a UDAAP, lenders must make strategic decisions about which variables to include in models and about how and when to conduct UDAAP and fair lending testing and analysis.

## Model Construction: Challenges with Big Data, Machine Learning and Third-Party Vendors

Lawyers and statisticians face relatively new challenges from the use of alternative data sources as well as from the advanced computer programming techniques used to model such data.

Alternative or non-traditional data—for example, data derived from a consumer's online behavior—can expand access to credit by providing insights into the repayment risk of the 26 million "credit invisibles" (individuals who do not have credit records maintained by any of the three nationwide credit reporting agencies) and the additional 19 million individuals lacking a credit score.<sup>1</sup> Yet such data also may discriminate against low-income consumers or consumers in protected classes by using information about one's social network or Internet browsing habits to target advertisements or price credit.<sup>2</sup> Moreover, it may perpetuate a lack of access to credit for those consumers having a limited or no digital footprint. To compound these risks, newer industry participants who rely on non-traditional data, like marketplace lenders, may not be aware of the accompanying consumer protection issues.

The use of alternative data exacerbates a longstanding tension between lenders and their vendors who supply proprietary data or scores. Where a model includes data from third party vendors, lenders must decide how far to press the third party to obtain access to the underlying variables and how they are derived. Often, vendors will be resistant to share the kind of

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<sup>1</sup> See Consumer Financial Protection Bureau Office of Research, *Data Point: Credit Invisibles* (May 2015), at [http://files.consumerfinance.gov/f/201505\\_cfpb\\_data-point-credit-invisibles.pdf](http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf).

<sup>2</sup> See Federal Trade Commission, *Big Data: A Tool for Inclusion or Exclusion?* (Jan. 2016), at <https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf> (hereinafter "FTC Report on Big Data").

information that would be meaningful for a fair lending and UDAAP analysis. Absent the ability to directly analyze vendor-provided data, lenders should obtain sufficient information about the vendor's own model development and monitoring practices.

Before transitioning fully into a discussion of monitoring and testing models, a final point related to model construction: Just as technology has expanded the data sources available for model development, it also has affected the way models read and analyze the relationships between this data. Models built with "machine learning"—which refers to algorithms that automatically adapt and update themselves when new data becomes available—can potentially increase UDAAP and fair lending risks by obscuring the relationship between model inputs and outputs. Without transparency about how models generate their predictiveness, it becomes possible that the underlying data is interacting in a way that has a disproportionately negative effect on certain groups of consumers.

### Assessing Models to Manage Disparate Impact and UDAAP Risk

Combined with these relatively new evolutions in data sources and model construction, the risk of a disparate impact claim is greater today than just a few years ago. The Supreme Court has ruled that disparate impact is a cognizable claim under the Fair Housing Act,<sup>3</sup> and federal agencies such as the Department of Justice and CFPB, which have an active fair lending docket,<sup>4</sup> now regularly plead the disparate impact theory in their fair lending actions.<sup>5</sup>

To manage fair lending as well as UDAAP risk, lenders should assess variables for possible inclusion in a model during development and "post-test" outcomes from the use of the models to determine if there is disparate impact. The extent of fair lending assessments both before and after an institution uses a model depends on the institution's size, resources and risk management strategies.<sup>6</sup> As part of a lender's determination of its risk tolerance, a lender should balance (1) the need to create and preserve documentation of model testing to show the causal relationships between data and demonstrate they are using it to meet legitimate business needs that cannot be achieved by less discriminatory alternatives,<sup>7</sup> with (2) the chance that such documentation may be discoverable by plaintiffs and regulators, notwithstanding measures that can be taken to preserve privilege. Additionally, statistical testing involves a certain degree of estimation error due to difficulties in measuring which consumers are members of protected classes, and the conclusions may vary depending on the methodology employed by the person conducting the test.<sup>8</sup>

Model testing inevitably will find a disparate impact. In deciding how to deal with predictive variables that are highly correlated with protected characteristics, lenders need to determine whether removing such variables would increase credit

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<sup>3</sup> *Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Comtys. Project, Inc.*, 135 S. Ct. 2507 (2015).

<sup>4</sup> *See, e.g.*, Department of Justice, *The Attorney General's 2014 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act Amendments of 1976* (Apr. 2015), at <http://www.justice.gov/sites/default/files/crt/legacy/2015/04/13/ecoareport2014.pdf>; *Fair Lending Report of the Consumer Financial Protection Bureau* (Apr. 2015), at [http://files.consumerfinance.gov/f/201504\\_cfpb\\_fair\\_lending\\_report.pdf](http://files.consumerfinance.gov/f/201504_cfpb_fair_lending_report.pdf).

<sup>5</sup> *See e.g., Consumer Financial Protection Bureau and United States of America v. Hudson City Savings Bank, F.S.B.*, No. 15-7056 (D. NJ. Sept. 24, 2015).

<sup>6</sup> For example, a statistical analysis may not be appropriate for smaller and less complex institutions. *See, e.g., CFPB Supervisory Highlights*, Issue 9 (Fall 2015) at 28, at [http://files.consumerfinance.gov/f/201510\\_cfpb\\_supervisory-highlights.pdf](http://files.consumerfinance.gov/f/201510_cfpb_supervisory-highlights.pdf) (explaining that institutions should limit the risk of ECOA violations due to disparate outcomes in underwriting by monitoring underwriting practices for potential discrimination and that, "depending on the size and complexity of the institution, [it should] consider using statistical methodologies to understand potential disparities."). Likewise, the frequency of testing depends, among other things, on the extent of growth in a lender's portfolio. A start-up that uses dummy data to build its model may find that its own performance data tells a very different fair lending story.

<sup>7</sup> The panel noted that lenders can often effectively assess variables prior to model deployment to determine which ones will have a less discriminatory impact because they can consider development data, such as predictiveness of default. For background on the "least discriminatory alternative" defense, *see, e.g.*, Comment 6(a)-2 to Regulation B.

<sup>8</sup> *See, e.g.*, Arthur P. Baines and Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market* (Nov. 19, 2014), at <http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf> (concluding that "[t]he methods commonly used by regulators to proxy race and ethnicity, including the recently applied Bayesian Improved Surname Geocoding (BISG) method, are conceptually flawed in their application and subject to significant bias and estimation error," and "[t]he use of biased race and ethnicity proxies creates significant measurement errors, which likely result in overstated disparities and overstatements of alleged consumer harm.").

risk intolerably or, conversely, whether retaining the variables poses legal risk. The key here is to be able to establish the causal relationships between model variables and model outcomes. Correlation between data and outcomes is not enough (nor, of course, is relying on one's "gut"). As the FTC Report on Big Data notes, "If companies use correlations to make decisions about people without understanding the underlying reasons for the correlations, those decisions might be faulty and could lead to unintended consequences or harm for consumers and companies."<sup>9</sup>

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The Fair Access to Financial Services Subcommittee's mission, as reflected in its January 2016 marketing and credit model panel, is to explore topics related to fair access to financial services, including both discrimination and UDAAP issues. At the October 2015 meeting in Chicago, the subcommittee discussed Access to Financial Services for Limited English Proficiency (LEP) communities. Please contact Brad Blower, [Brad.Blower@aexp.com](mailto:Brad.Blower@aexp.com), with ideas for future panels or to become involved.

# Winter Meeting Mortgage Track – A New Experiment

By Lynette Hotchkiss, Rabobank

At this year's CFSC Winter Meeting in Park City, Utah, the Committee experimented with a new concept in programming – separate “tracks” for mortgage and non-mortgage issues. One full day of programming was dedicated to this “dual tracking” approach, with four programs held in each track. Thanks to the herculean efforts of Programs Chair Sandy Shatz and Vice-Chair Dave Wiese, as well as Committee Chair Andrew Smith, the experiment was a great success. This article includes a brief discussion on each of the four separate programs held as part of the mortgage track, which hosted an overflow crowd of attendees.

## TRID: The View from Non-Lenders

By Dave Wiese, Hinckley, Allen & Snyder LLP

The Truth-in-Lending Subcommittee sponsored a program entitled "*TRID: The View from Non-Lenders.*" Since the final "Know Before You Owe" rule was published more than two years ago, much of the public focus has been on lenders and their compliance responsibilities. However, lenders are not the only players in the home financing process. Other industry stakeholders, including settlement agents, mortgage brokers, and real estate agents, have all felt the impact of TILA-RESPA Integrated Disclosure rule (TRID).

With the effective date in the rear view mirror, and three months of implementation experience under their belts, a panel representing non-lenders offered their perspectives on how the home buying, loan origination, and closing process has changed since October 3, 2015. The panel included Charles ("Chuck") Cain, Executive Vice President, WFG National Title Insurance Company, Finley Maxson, Senior Counsel, National Association of Realtors, and Heather Hutchings, partner, Bradley Arant Boult Cummings LLP. As a general matter, the panelists largely agreed that consumers seemed to like the new disclosures. They suggested that consumers appeared to have a better understanding of closing costs and loan terms, because the disclosures are delivered earlier and are easier to understand.

Notwithstanding this apparent good news, the panelists did mention a number of concerns that have emerged under the new disclosure regime. For one thing, it was reported that the timeframe to close often takes longer (often 30 to 40 days longer). Perhaps this might change as industry participants become more comfortable with the new rules. Panelists also noted that there are still wide variations in TRID readiness across the country. In this regard, some lenders have apparently handled their interactions with settlement agents better than others. Many of the large lenders appear to have been well prepared to produce the Closing Disclosure and handle last minute adjustments in the midst of the closing process. They have been able to effectively use technology solutions to communicate with closing attorneys, title companies, and other stakeholders.

In contrast, many small creditors have apparently struggled with the new rules and often turn to settlement agents looking for assistance in preparing the Closing Disclosure. It appears that many of these small creditors lack the knowledge base and technology solutions available to larger creditors. At least one of the panelists suggested that settlement agents are not in a position to produce the Closing Disclosure and should not be called upon to do so by lenders. Given the demands of the new law, coupled with increased lender scrutiny over service provider relationships, there was speculation that there would be a contraction in the number of settlement agents looking to remain in the business. It was also observed that many mortgage brokers are now dealing with fewer lenders because of the logistical difficulties of producing timely and accurate Loan Estimates. And it appears that very few lenders are permitting mortgage brokers to produce Loan Estimates on their behalf. There were also a number of comments concerning the frustrations experienced by Realtors when they are unable to obtain copies of the relevant disclosures because of GLBA privacy concerns. All panelists agreed

that it would be a long time before all the kinks can be ironed out. Concerns were also expressed regarding the inevitable exposure to civil liability risks as the industry continues to iron out the kinks.

## Mortgage Servicing and Bankruptcy Trustee Update

By Heather Thayer, Thayer Legal Services PLLC

On the morning of January 11, I had the pleasure of sharing the podium with a panel of breathtaking experience and insight, against which my inadequacy as moderator was all too stark a contrast. The panel discussed the recent enforcement actions and investigations by the Office of the United States Trustee related to servicing and bankruptcy deficiencies by mortgage servicers.

Gail Geiger has served as the Creditor Enforcement Coordinator of the Office of the US Trustee since 2010 and she laid out numerous concerns of that office:

- Proofs of Claim: Missing, inaccurate, or inconsistent information; missing or inaccurate attachments; excessive, unreasonable, or impermissible loan default fees and charges; or loan default calculation errors.
- Payment Change Notices: Failure to properly or timely file when homeowners' mortgage payments changed post-bankruptcy; accuracy.
- Notice of post-petition fees and charges: Excessive or unreasonable loan default fees and charges; failure to file notices timely; and missing, incomplete, or inaccurate information or data.
- Escrow accounting and statement issues.
- Asserting an inaccurate post-discharge default after a debtor emerges from bankruptcy.
- Robo-signing: Personnel signing the documents did not actually review the documents for accuracy or were using "borrowed" CM/ECF credentials.

As might be expected, a lively discussion ensued. While all agreed that there have been deficiencies in bankruptcy mortgage servicing, Michael Bates of Lindquist & Vennum pointed out that complying with the complex and sometimes impossible rules is more challenging than it can seem on the face of it. For example, Mike noted that one large servicer he worked for had identified at least eighteen different scenarios that could result in a payment change, so Payment Change Notices are needed for more than the obvious escrow and ARM adjustments – requiring attention and coordination by many different areas. Mike also pointed out, and Gail agreed, that the rules do not work well for simple daily interest loans such as most home equity products and such products were not considered when the rule was enacted. Another issue is that it can be impossible to give prior notice of payment changes as a result of loan modification, since loan modifications are often retroactive. Mike suggested that creditors get more involved in the bankruptcy rulemaking process to provide early practical input.

Perry Napolitano of Reed Smith capped off the panel (again with animated input from all – seriously, maybe a little less caffeine next time) by talking about what a servicer should do if contacted by the US Trustee's Office. First, and more importantly – take any inquiry seriously, but approach it with an attitude of cooperation. Gail emphasized that the US Trustee's Office is prepared to litigate these matters and will do so if pressed; however, if the servicer approaches the office with open dialogue, investigation requests and deadlines can be negotiated to lessen the impact on the servicer's day to day operations. Consensual settlements are better for everyone, particularly as the proper damages for violations of these bankruptcy provisions are not clear – if the parties can agree on the proper measure of damages it is best for all. In discussions before the presentation, Ms Geiger did say that enforcement of consumer bankruptcy requirements is likely to be a high priority for the Office of the US Trustee from now on. Therefore, anyone who represents creditors who service consumer loans in bankruptcy, particularly mortgage loans, should familiarize themselves with these issues, and ensure that their clients have strong compliance programs for bankruptcy.

## RESPA Update: Lighthouse, and PHH, and MSAs, oh my

By Michael Flynn, Goodwin Procter LLP

The *RESPA Update* panel addressed the status of Marketing Services Agreements (MSAs) under the Real Estate Settlement Procedures Act in light of the CFPB's Lighthouse order, the appeal by PHH of Director Cordray's order in the PHH administrative proceeding, and the CFPB's recent guidance regarding MSAs. In the CFPB's enforcement action against PHH, the CFPB alleged RESPA violations in regard to captive reinsurance contracts. The Administrative Law Judge issued an order with an award of approximate \$6 million against PHH. Both sides appealed that decision, and in his order from that administrative appeal, Director Cordray increased the amount of the award to approximately \$109 million. PHH then appealed Director Cordray's order to federal court in the DC Circuit Court of Appeals. To present a variety of perspectives about the PHH matter and the other recent developments in this area, the panel consisted of a litigator at a law firm that practices in the consumer space, a senior in-house counsel at a large mortgage originator, an in-house litigation counsel for a consumer association, and a senior regulatory counsel for a mortgage industry trade association.

Irene Freidel of K&L Gates LLP set forth the legal background, including the longstanding perception of RESPA Section 8(c) as an exemption to RESPA sections 8(a) and (b), the Lighthouse order, and the PHH appeal. She discussed possible impacts if the CFPB is able to reject longstanding regulatory interpretations and resulting industry practices without notice and comment in a formal rulemaking context.

Jeffrey Rodgers of Flagstar Bank discussed his perception as an in-house counsel that it is difficult for counsel to advise business managers what is now acceptable behavior in regard to MSA. He noted that many institutions have simply moved away from the use of MSAs.

Julie Nepveu of AARP Foundation Litigation expressed her disagreement that there was a long standing definitive regulatory position on RESPA Section 8(c). She commented further that she believes that the best reading of Section 8(c) is that it is not an exemption to the requirements of Sections 8(a) and (b).

The final speaker, Ken Markison of the Mortgage Bankers Association, noted the comments of the three previous speakers, stating that their remarks highlighted the need for clarity and certainty in statutory and regulatory interpretation and application by the regulators. He stressed that the regulators need to understand industry practices and legitimate industry concerns on regulatory issues, and stated that this is why notice and comment is a required part of rulemaking. He stated that his organization is more than willing to work with regulators to enhance dialogue on all key mortgage related regulatory issues.

## The Revised HMDA Rule: Changes, Challenges and Litigation

By Christine Acree, Ellie Mae, Inc.

The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 and implemented in 1976. The statute and the implementing regulation have been updated several times since then. The purpose of HMDA is to help show whether financial institutions are serving the needs of their communities, assist public officials in distributing public-sector investment to attract private investment where it is needed, and assist with the identification of possible discriminatory lending patterns and the enforcement of anti-discrimination laws.

The Dodd-Frank Wall Street Reform and Consumer Protection Act amended HMDA in 2010 to add new reporting requirements and other information that the Consumer Financial Protection Bureau (CFPB) chose to require. The CFPB issued the HMDA final rule on October 15, 2015 implementing provisions of the Dodd-Frank Act. The final rule includes modifications to the institutions and transactions covered as well as to the reporting requirements themselves over the next several years.

During the panel presentation, Elena Grigera Babinecz, Senior Counsel with the CFPB, gave a brief history of HMDA, a basic overview of the final rule including institutions and transactions covered, data reporting requirements, modifications and additions to the data points collected, and changes to the reporting requirements under the final rule. David Kogut, Principal with Charles River Associates, provided further detail on characteristics of additional HMDA reportable data,

underwriting/pricing factors, loan characteristics, and rates and fees. He also discussed fields that are currently problematic for some lenders. Joseph Lynyak, Partner with Dorsey & Whitney LLP, also briefly reviewed some of the new reporting and disclosure requirements. He discussed data reporting challenges, concerns with identification of the loan applicant, and privacy. Thomas J. Kearney, Partner with Akerman LLP, discussed big-picture issues with timing, privacy, pricing, and fair lending. He also discussed preparation necessary for changes to policies, procedures, forms, systems, and business lines, as well as other compliance challenges related to the property address and Automated Underwriting Systems that will be necessary before various parts of the new rule go into effect.

# Increasing Transparency in the Forum Selection Process: When Should the CFPB Use Its Administrative Forum?

By Jolina Cuaresma and Katherine Lamberth\*, White & Case LLP

Those critical of the Consumer Financial Protection Bureau (“CFPB”) assert that the CFPB has an unduly broad amount of discretion to use the administrative adjudication process whenever it sees fit.<sup>1</sup> To be sure, when Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”), it did not expressly limit the CFPB’s administrative adjudication authority.<sup>2</sup> In fact, Congress eroded the differences between judicial and administrative proceedings involving the CFPB, by making clear that the relief available in federal court is also available in the administrative forum. To the same extent as federal judges, under section 1055 of the Dodd-Frank Act, the agency has jurisdiction in the administrative forum to “grant *any* appropriate legal or equitable relief,” which “may include, *without limitation* rescission or reformation of contracts; refund of moneys or return of real property; restitution; disgorgement or compensation for unjust enrichment; payment of damages or other monetary relief; public notification regarding the violation, including the costs of notification; limits on the activities or functions of the person; and civil money penalties.”<sup>3</sup> Accordingly, there appears to be a lack of clear statutory restriction on the agency’s exercise of its administrative adjudicatory powers.

In addition to Congress’ silence on the scope of the CFPB’s administrative adjudication authority, Congress was silent as to the organizational placement of the Office of Administrative Adjudication (“OAA”). Currently, the CFPB’s organizational chart has the OAA office under the Director, which results in the administrative law judge (“ALJ”) reporting directly to the Director. In this way, the CFPB’s organizational placement of the OAA<sup>4</sup> mirrors the placement of the Securities and Exchange Commission’s (“SEC”) Office of Administrative Law Judges.<sup>5</sup> However, unlike the SEC, the CFPB does not have a nonpartisan commission structure and instead has a single Director. Nonetheless, the CFPB has stated that the OAA is “an independent judicial office within the CFPB.”<sup>6</sup>

Testing the scope of this adjudicative authority, and effectively its organizational structure, in June 2015 the CFPB issued its first final ruling in a contested administrative proceeding.<sup>7</sup> Upholding the ALJ’s November 2014 Recommended Decision only in part, in the final order, Director Richard Cordray held, among other things, that enforcement actions

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\* Jolina Cuaresma is Counsel in the Washington DC office of White & Case LLP, and a member of the Firm’s Financial Institutions Advisory (FIA) group. Jolina was at the Consumer Financial Protection Bureau where she served as a regulatory attorney in the Office of Regulations and, previously, the Office of Consumer Response and Office of Supervision Policy. Katherine Lamberth is an associate of White & Case, and member of the Firm’s FIA group. The authors would like to thank Evan Zhao, also an associate of White & Case, for his assistance in the preparation of this article. The views expressed herein are the authors’ and do not necessarily reflect the views of White & Case LLP.

<sup>1</sup> See Neomi Roa, Professor, George Mason, Statement before the US Senate Committee on the Judiciary, The Constitution: Dodd-Frank at Five Years (July 23, 2015), available at <http://www.judiciary.senate.gov/imo/media/doc/07-23-15%20Rao%20Testimony.pdf>; but cf. Adam J. Levitin, Professor, GULC, Written Testimony before the Senate Judiciary Committee, The Administrative State v. The Constitution: Dodd-Frank at Five Years (July 23, 2015), available at <http://www.creditslips.org/files/levitin-senate-judiciary-testimony-7-23-15.pdf> (supporting the constitutionality of the CFPB).

<sup>2</sup> See 12 U.S.C. 5563.

<sup>3</sup> 12 U.S.C. 5565(a) (emphasis added).

<sup>4</sup> The CFPB’s organizational chart is available at <http://www.consumerfinance.gov/the-bureau/>.

<sup>5</sup> The SEC’s organizational chart is available at <http://www.sec.gov/images/secorg.pdf>.

<sup>6</sup> The CFPB’s OAA website is available at <http://www.consumerfinance.gov/administrativeadjudication/>. Given the lack of a nonpartisan commission structure, there may not be a right answer to the OAA’s organizational placement.

<sup>7</sup> To date, the CFPB has brought three contested actions administratively, one of which ultimately settled (3-D Resorts-Bluegrass, LLC, CFPB No. 2013-CFPB-0002 (Dec. 3, 2013)), and another of which is still pending (Integrity Advance, LLC and James R. Carnes, CFPB No. 2015-CFPB-0029).

brought administratively are not subject to a statute of limitations.<sup>8</sup> However, perhaps most troubling to industry observers is that the Director increased the \$6.4 million dollar disgorgement penalty recommended by the presiding ALJ to \$109 million. With a single Director authorized to initiate enforcement proceedings *and* issue the final administrative rulings, it is unsurprising that the respondent promptly appealed to the D.C. Circuit Court of Appeals, in part on constitutional grounds.<sup>9</sup>

The procedural basis underlying this controversial ruling highlights, in part, the concerns of CFPB critics, who have long advocated for a commission structure similar to that of the Federal Trade Commission and the Securities and Exchange Commission (“SEC”).<sup>10</sup> Solely adopting a commission structure, however, does not eliminate every concern underlying the use of administrative proceedings. For example, the SEC’s use of administrative proceedings is also currently under scrutiny. At the same time that Congress granted the CFPB broad adjudication authority under the Dodd-Frank Act, Congress also expanded the SEC’s ability to bring certain enforcement actions administratively. In response, the SEC announced that it intended to bring more actions, both contested and noncontested, in the administrative forum.<sup>11</sup> The SEC filed roughly 81% of all enforcement actions in an administrative forum during the 2014 fiscal year, up from 63% prior to passage of the Dodd-Frank Act in 2010.<sup>12</sup> Unsurprisingly, critics argued that the SEC is seeking an unfair advantage by increasingly trying contested actions before “in-house” judges.<sup>13</sup>

In May 2015, presumably in response to criticism that the forum selection process was unfair and opaque, the SEC’s Division of Enforcement released a list of four criteria that it considers when selecting the appropriate forum for its contested actions.<sup>14</sup> In order to preempt similar criticism, it may be instructive for the CFPB to review these criteria to understand the merits of each and whether and how similar criteria could be applied in the context of the CFPB’s forum selection process. Although the CFPB does not have a nonpartisan commission structure, the SEC’s criteria provides a *starting point* to develop a transparent and objective approach to forum selection, which could prove to alleviate industry concern over the breadth of the CFPB’s adjudicatory authority.

## SEC Criteria<sup>15</sup>

### 1. *Availability of Desired Claims, Legal Theories, and Forms of Relief*

Although the SEC’s administrative remedial powers are largely comparable to the equitable powers of federal courts, there are certain causes of action and remedies that are exclusively available in either an administrative proceeding or district court action.<sup>16</sup>

In contrast, the CFPB is generally not subject to similar limitations. The CFPB is, however, constrained by case law. For example, whether the Fair Debt Collection Practices Act (“FDCPA”) applies to certain conduct turns on whether the section 803(4) definition of “creditor” and the section 803(6) definition of “debt collector” are

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<sup>8</sup> PHH Corp., CFPB No. 2012-CFPB-0002 (June 4, 2015).

<sup>9</sup> See *PHH Corp. v. CFPB*, Case No. 15-1177 (D.C. Cir. June 19, 2015).

<sup>10</sup> Advocates for reforming the CFPB assert that the single director structure leads to deprives the agency of necessary internal checks that typically arise from bi-partisan deliberation and compromise. See Roa, *supra* note 1.

<sup>11</sup> Gretchen Morgenson, *At the SEC, A Question of Home-Court Edge* (Oct. 5, 2013), available at <http://www.nytimes.com/2013/10/06/business/at-the-sec-a-question-of-home-court-edge.html>.

<sup>12</sup> Gilley et al., *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW360 (May 27, 2015), available at [http://www.law360.com/articles/659945?utm\\_source=rss&utm\\_medium=rss&utm\\_campaign=articles\\_search](http://www.law360.com/articles/659945?utm_source=rss&utm_medium=rss&utm_campaign=articles_search).

<sup>13</sup> Jean Eaglesham, *SEC Wins with In-House Judges* (May 6, 2015), available at <http://www.wsj.com/articles/sec-wins-with-in-house-judges-1430965803>. Lawsuits by plaintiffs in pending SEC ALJ proceedings have in some instances succeeded in preliminarily enjoining the SEC from proceeding with its administrative action against them on the grounds that the SEC’s process for selecting ALJs is likely flawed. See *Duka v SEC*, (cite) and *Hill v. SEC*, (cite). The plaintiff in *Duka*, a former executive of a credit reporting agency, has argued that the SEC should not have “unbounded authority” to require plaintiffs to defend themselves in an SEC administrative proceeding before having the right to contest “patently unconstitutional or unauthorized administrative charges” in federal court.

<sup>14</sup> Division of Enforcement Approach to Forum Selection in Contested Actions (“SEC Forum Selection”), available at <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf>.

<sup>15</sup> In instances where these four factors may conflict, the CFPB could employ a balancing test taking into consideration the relative merits of each factor.

<sup>16</sup> As explained by the Division of Enforcement, “charges of failure to supervise or causing another person’s violation can only be pursued in the administrative forum; liability as a controlling person or as a relief defendant can only be pursued in district court actions.” *SEC Forum Selection* at 1.

mutually exclusive terms under the statute, which is far from settled law.<sup>17</sup> Consistent with case law in the U.S. Seventh Circuit, the CFPB sued a for-profit college chain in the Northern District of Illinois, alleging that it was a “debt collector” under the meaning of the FDCPA. Such an argument, however, likely would not have been fruitful in other U.S. Circuits where only entities that either have a principal purpose to collect debt or regularly collect debt owed to others would be subject to the FDCPA.<sup>18</sup> When confronting such circuit splits, the CFPB could consider using the administrative forum to avoid further disparities in the application of law, particularly given that the agency will be better able to apply the law both consistently and in the manner it deems most appropriate based on its own reading of the law.

## 2. *Source and Scope of Agency Jurisdiction*

Prior to choosing a forum, the SEC evaluates its source and scope of jurisdictional authority over the charged party.<sup>19</sup> As the SEC notes, “[r]egistered entities and associated persons have long been subject to the Commission’s regulatory oversight, which has long included Commission administrative proceedings.”<sup>20</sup> As a result, the SEC typically pursues sanctions against registered entities in administrative proceedings, and cases against non-registered entities have traditionally been within the purview of federal courts.<sup>21</sup>

Much like the SEC, the CFPB’s enforcement authority extends over more entities than its supervisory authority.<sup>22</sup> The CFPB may want to consider limiting its use of the administrative forum in contested actions by bringing contested administrative proceedings against only those entities over which it has supervisory *and* enforcement authority. When bringing contested actions against entities that are merely subject to the CFPB’s broader enforcement authority, the judicial forum may be a more equitable choice. In this way, the full impact of the CFPB’s administrative adjudicatory authority would be limited to those entities that are also expressly subject to the full extent of the CFPB’s jurisdictional authority.

## 3. *Agency Resource Efficiencies and Effectiveness*

According to the SEC, its choice-of-forum decisions consider the “cost-, resource-, and time-effectiveness of litigation in each forum.”<sup>23</sup>

In comparison to the Federal Rules of Civil Procedure that govern district court actions, the CFPB Rules of Practice for Adjudication Proceedings provide for, among other things, an expedited and streamlined pre-trial process. Notably, once the CFPB has officially commenced an administrative proceeding by filing charges, it has

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<sup>17</sup> Compare *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534, 536 (7th Cir. 2003) (“[T]hese two categories—debt collectors and creditors—are mutually exclusive”) with *Davidson v. Capital One Bank, N.A.*, 2014 WL 4071891, \*5 (N.D. Ga. 2014) (“A determination that a person is a ‘creditor’ for FDCPA purposes does not itself foreclose that the creditor can also meet the definition of ‘debt collector’ for purposes of coverage under [section 803(6)] of the FDCPA”), *aff’d*, 797 F.3d 1309 (11th Cir. 2015) In *Schlegel v. Wells Fargo Bank*, 720 F.3d 1204, 1208 (9th Cir 2013), the Ninth Circuit rejected the argument that a person who meets the definition of “creditor” is per se not a “debt collector,” stating that “this per se rule...finds no support in the text of the FDCPA.”

<sup>18</sup> See e.g., *Schlegel*, 720 F. 3d. 1204.

<sup>19</sup> SEC registered entities and associated persons have long been subject to the SEC’s regulatory oversight, including administrative proceedings, and registrants are well aware that the SEC may bring enforcement actions against them administratively. After the passage of the Dodd-Frank Act, the SEC began bringing administrative matters against non-registrants, such as insider trading cases against non-registered entities that are traditionally considered within the purview of federal courts. This practice drew intense criticism from certain sectors of the securities industry, including a federal judge. Perhaps in an attempt to avoid future criticism, the SEC’s Director of Enforcement, in October 2015, purportedly instructed senior attorneys to bring contested actions alleging insider trading in federal court, unless there is good reason to bring a case administratively.

<sup>20</sup> Division of Enforcement Approach to Forum Selection in Contested Actions (“SEC Forum Selection”), available at <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf>.

<sup>21</sup> See Judge Jed S. Rakoff, S.D.N.Y., Keynote Address at the PLI Securities Regulation Institute: Is the SEC Becoming a Law unto Itself? (Nov. 5, 2014), available at <http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf>.

<sup>22</sup> Under the CFPB’s enforcement authority, it may investigate *any* covered person whose conduct may constitute a violation of any provision of federal consumer laws (generally, Title X of the Dodd-Frank Act and the eighteen enumerated consumer laws). In contrast, under the agency’s supervisory authority, the CFPB may only supervise certain covered persons such as very large depository institutions and participants of certain markets for consumer financial products or services. Section 1025 of the Dodd-Frank Act gives the CFPB supervisory authority over depository institutions with over US\$10 billion in net assets and their affiliates, and section 1024 gives the agency supervisory authority over only certain nondepository or nonbank institutions. The CFPB has supervisory authority over all nonbank covered persons, regardless of size, that offer or provide three types of consumer financial products or services: (1) origination, brokerage or servicing of consumer loans secured by real estate and related mortgage loan modification or foreclosure relief services; (2) private education loans; and (3) payday loans. However, for all other consumer financial products or services, the CFPB must first engage in rulemaking under section 1024(a)(1)(B). To date, the agency has finalized only five such larger participant rules: credit reporting, debt collection, student loan servicing, international money transfers and automobile financing.

<sup>23</sup> *SEC Forum Selection*, at 2.

300 days to conduct the hearing and issue a recommended decision.<sup>24</sup> Under such a compressed schedule, respondents may find it difficult to conduct the full range of discovery that they would otherwise be able to as defendants in civil actions. This can become a significant issue in cases where the crux of the CFPB's evidence is witness testimony. Further, any judicial review of an administrative decision in district court must defer to the ALJ's factual findings, thus underscoring the potential harm from limited discovery.

Pursuant to this criterion, the CFPB could carefully consider all of the relevant factors in determining where to bring an action, and evaluate whether the procedural efficiencies in an administrative proceeding outweigh the protections afforded in a judicial forum.

#### 4. *Administrative Expertise*

Finally, the SEC considers the "fair, consistent, and effective resolution of securities law issues and matters," which is closely tied to the first factor. The SEC argues that its nonpartisan Commission, which is comprised of five members (no more than three of which may be from the same political party), and the ALJs have unparalleled technical knowledge to resolve complicated issues of laws. The Division of Enforcement claims that where "a contested matter is likely to raise unsettled and complex legal issues under the federal securities laws, or interpretation of the Commission's rules, consideration should be given to whether, in light of the Commission's expertise concerning those matters, obtaining a Commission decision on such issues, subject to appellate review in the federal courts, may facilitate development of the law."<sup>25</sup> At least one federal judge, however, has taken the opposite approach, asserting that the SEC hinders the "balanced development of the securities laws" when it brings such cases administratively instead of before a federal court.<sup>26</sup>

In comparison, the CFPB does not have a nonpartisan Commission to impart technical knowledge and a diversity of views. To date, the CFPB has not hired a dedicated ALJ who brings subject-matter expertise to actions involving novel legal issues.<sup>27</sup> In fact, because many of the laws the CFPB is charged with enforcing have been within the realm of federal courts for decades, there may be many instances in which a federal court judge has more subject-matter expertise than an ALJ within the CFPB's OAA. Accordingly, the CFPB may want to consider both the relative subject-matter expertise necessary to hear the case and the ultimate effect administrative adjudication would have on the development of law.

Taking into account the unique structure of the CFPB, and in light of concerns expressed by critics, the CFPB may want to carefully evaluate its use of the administrative forum. To this end, in order to increase transparency in its use of its administrative adjudication authority, the CFPB could issue a bulletin setting forth its framework for choice-of-forum decisions in contested actions. Such a bulletin could increase the integrity and objectiveness of administrative enforcement proceedings.

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<sup>24</sup> 12 C.F.R. § 1081.400(a).

<sup>25</sup> Division of Enforcement Approach to Forum Selection in Contested Actions, available at <http://www.sec.gov/divisions/enforce/enforcement-approach-forum-selection-contested-actions.pdf>.

<sup>26</sup> Jed S. Rakoff, *Keynote Address at the PLI Securities Regulation Institute: Is the SEC Becoming a Law Unto Itself?* (Nov. 5, 2014), available at <http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf>.

<sup>27</sup> According to the CFPB's organizational chart, the position remains vacant.

# Courts Wrestle With Vicarious Liability for a TCPA Violation by a Third Party

By Eric Tsai, Maurice Wutscher LLP

The U.S. District Court for the Southern District of New York in *Melito v. Am. Eagle Outfitters, Inc.*,<sup>1</sup> recently dismissed a putative class action alleging violation of the federal Telephone Consumer Protection Act (“TCPA”)<sup>2</sup> against a marketing company that conducted a mass text message advertising campaign on behalf of a national retail clothing store.

In so ruling, the Court held that a plaintiff must plead that the company actually placing and sending the text message is under the seller’s direction and control, to such a degree that the company is the seller’s agent, to state a claim for vicarious liability under the TCPA.<sup>3</sup>

## *The FCC and Vicarious Liability Under the TCPA*

The Federal Communications Commission (“FCC”) is charged with implementing certain portions of the TCPA.<sup>4</sup> In 2013, the FCC defined the contours of vicarious liability under the TCPA, stating that “a seller is not directly liable for violations of the TCPA unless it initiates a call, but may be held vicariously liable under federal common law agency principles for a TCPA violation by a third-party telemarketer.”<sup>5</sup>

The FCC explained that “the seller is in the best position to monitor and police TCPA compliance by third-party telemarketers [because] allowing the seller to avoid potential liability by outsourcing its telemarketing activities to unsupervised third parties would leave consumers in many cases without an effective remedy for telemarketing intrusions.”<sup>6</sup> Thus, “[a] seller would be responsible under the TCPA for the unauthorized conduct of a third-party telemarketer that is otherwise authorized to market on the seller’s behalf if the seller knew (or reasonably should have known) that the telemarketer was violating the TCPA on the seller’s behalf and the seller failed to take effective steps to force the telemarketer to cease that conduct.”<sup>7</sup>

The discussion in *In re Dish Network* regarding vicarious liability did not expressly contemplate the situation of a third-party entity, whose actions lie between the seller<sup>8</sup> and the telemarketer<sup>9</sup> that physically made the call or sent the text message.

## *The Ruling in Melito*

The plaintiffs in *Melito* brought a putative class action against American Eagle Outfitters and AEO Management Co. (collectively, “AEO”) and Experian Marketing Solutions, Inc. (“Experian”) for violations of the TCPA by sending

<sup>1</sup> Nos. 14-CV-02440 (VEC), 15-CV-00039 (VEC), 15-CV-02370 (VEC), 2015 U.S. Dist. LEXIS 160349 (S.D. N.Y. Nov. 30, 2015).

<sup>2</sup> 47 U.S.C. § 227.

<sup>3</sup> *Melito*, at \*28.

<sup>4</sup> See, e.g., *Mais v. Gulf Coast Collections Bureau, Inc.*, 768 F.3d 1110, 1117 (11th Cir. 2014).

<sup>5</sup> *In re Dish Network, LLC*, 28 FCC Rcd 6574, 6582 (2013).

<sup>6</sup> *Id.*, 28 FCC Rcd at 6588.

<sup>7</sup> *Id.*, 28 FCC Rcd at 6592.

<sup>8</sup> A “seller” is defined as “the person or entity on whose behalf a telephone call or message is initiated for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services.” 47 C.F.R. § 64.1200(f)(9).

<sup>9</sup> A “telemarketer” is defined as “the person or entity that initiates a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services.” 47 C.F.R. § 64.1200(f)(11).

unsolicited or “spam” text messages using an automatic telephone dialing system (“ATDS”) to consumers’ cellular phones without their prior express consent.<sup>10</sup>

AEO sold clothing, accessories, and personal care products under different brand names.<sup>11</sup> Experian provided marketing services such as mass text message advertising.<sup>12</sup> The plaintiffs alleged that AEO hired Experian to send spam text messages on its behalf, and Experian caused the text messages to be sent to the consumers’ cellular phones through a third party.<sup>13</sup>

According to the plaintiffs, AEO provided Experian with the campaign instructions and a list of numbers to which text messages were sent.<sup>14</sup> Experian sent the information to Archer USA, Inc.’s (“Archer”) texting platform, and scheduled the text messages to be sent.<sup>15</sup> The plaintiffs also alleged that AEO approved the content before Experian caused Archer to send the text messages, and provided AEO with reports on the text messages sent.<sup>16</sup>

The plaintiffs argued that Experian had control over the text messages sent and was therefore directly liable or, alternatively, vicariously liable for the actions of Archer.<sup>17</sup> Archer was not a named defendant due to its bankruptcy.<sup>18</sup>

Experian moved to dismiss the complaint for failure to state a claim upon which relief may be granted, arguing that even accepting the complaint’s factual allegations as true, the complaint failed to state a plausible claim for either direct or vicarious liability on the part of Experian.<sup>19</sup>

The TCPA makes it unlawful for anyone: “(A) to make any call (other than a call made for emergency purposes or made with the prior express consent of the called party) using any automatic telephone dialing system or an artificial or prerecorded voice — . . . (iii) to any telephone number assigned to a . . . cellular telephone service . . . or any service for which the called party is charged for the call.”<sup>20</sup>

Parsing the language of the complaint, the Court in *Melito* concluded that “[t]he absence of an allegation of who actually ‘made’ or physically placed the text message is not lost on the Court. Plaintiffs’ conclusory assertions that Experian sent or caused the text message to be sent is simply a legal conclusion devoid of further factual enhancement.”<sup>21</sup> Because the plaintiffs did not plead that Experian “‘made,’ *i.e.*, physically placed or actually sent, the text messages, the complaint fails to state a claim that is plausible on its face under section 227(b)(1)(A)(iii) of the TCPA.”<sup>22</sup>

Having determined that the complaint failed to state a claim for direct liability against Experian, the Court turned to the issue of vicarious liability. The parties disputed whether vicarious liability for a TCPA violation was available only against “sellers” of goods and services, like AEO, or more broadly against any company that offers telemarketing services like Experian.<sup>23</sup>

The Court in *Melito* did not address the issue. Instead, the Court held that the plaintiffs failed to adequately plead any agency relationship between Experian and Archer or another third party entity, and thus, failed to assert vicarious liability under section 227(b)(1)(A)(iii) of the TCPA.<sup>24</sup>

More specifically, the Court held that “[e]ven assuming that there is vicarious liability for a violation of section 227(b) of the TCPA, Plaintiffs fail to plead facts establishing that Archer was Experian’s agent.”<sup>25</sup> The Court ruled that it

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<sup>10</sup> *Id.*, at \*5.

<sup>11</sup> *Id.*, at \*6.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*, at \*6-7.

<sup>14</sup> *Id.*, at \*7.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*, at \*8.

<sup>18</sup> *Id.*, at \*8, fn. 4.

<sup>19</sup> *Id.*, at \*12, \*20.

<sup>20</sup> 47 U.S.C. § 227(b)(1)(A)(iii).

<sup>21</sup> *Melito*, 2015 U.S. Dist. LEXIS 160349, at \*17-18.

<sup>22</sup> *Id.*, at \*17-18.

<sup>23</sup> *Id.*, at \*21.

<sup>24</sup> *Id.*, at \*23.

<sup>25</sup> *Id.*, at \*20-21.

was not enough to allege in conclusory fashion that Experian controlled Archer’s texting platform. Instead, the Court held that the plaintiff must allege “some facts regarding the relationship between an alleged principal and agent (or an alleged agent and sub-agent).”<sup>26</sup>

### *Unfavorable Rulings Before Melito*

Before the *Melito* ruling, some courts had denied motions to dismiss where the complaint did not contain any allegations regarding the right to control the telemarketer’s activities that allegedly violated the TCPA, a hallmark of agency.

For example, in *Keim v. ADF Midatlantic, LLC*, the plaintiff alleged that Pizza Hut, Inc. (“Pizza Hut”), an international restaurant franchise, and various entities that owned and operated Pizza Hut franchises in the United States (“Pizza Hut Franchisees”), hired text message marketing companies Songwhale, LLC (“Songwhale”) and Cellit, LLC (“Cellit”) to promote the Pizza Hut brand.<sup>27</sup> The plaintiffs filed a class action lawsuit alleging violations of the TCPA based on unsolicited text messages containing Pizza Hut advertisements sent by Songwhale and Cellit.<sup>28</sup>

The Court in *Keim* held that complaint stated a claim for vicarious liability for Songwhale and Cellit’s alleged TCPA violations because the plaintiff alleged that: (1) the Pizza Hut Franchisees hired Songwhale and Cellit to promote the Pizza Hut brand, and Songwhale and Cellit’s marketing programs resulted in the TCPA violations; and (2) Pizza Hut “approved or authorized” Songwhale and Cellit to promote the Pizza Hut brand.<sup>29</sup> Relying on *In re Dish Network*, the Court in *Keim* held that these allegations alone were sufficient to plead Pizza Hut’s and Pizza Hut Franchisee’s vicarious liability for Songwhale and Cellit’s alleged TCPA violations.<sup>30</sup>

Similarly, in *In re Monitronics Int’l, Inc.*, the plaintiff alleged that the defendant alarm system manufacturer, alarm system dealers, and alarm monitoring company engaged in a scheme to make unsolicited calls to consumers attempting to sell the alarm system, in violation of the TCPA.<sup>31</sup>

The plaintiff in *In re Monitronics Int’l, Inc.* alleged that the alarm manufacturer: (1) permitted its dealers to use its trade names and trademarks; (2) gave the dealers access to its customer service database; (3) authorized dealers to place calls on its behalf pursuant to a contract with the dealers for distribution; (4) knew for years that the dealers have been the subject of complaints from consumers and government agencies; and (5) stated on its website that it only sold products to “authorized distribution channels.”<sup>32</sup>

The Court in *In re Monitronics Int’l, Inc.* held the plaintiff plausibly alleged an agency relationship between the alarm manufacturer and the dealers, and that the alarm manufacturer was vicariously liable for the telemarketing calls made by the dealers.<sup>33</sup> Accordingly, the Court denied the alarm manufacturer’s motion to dismiss.<sup>34</sup>

### *Concluding Thoughts*

Whenever a TCPA lawsuit involves more than one entity allegedly involved in the making of a call or text message, two key issues likely to arise in the litigation are: (1) what must be pleaded to state a claim against each party; and (2) who bears liability for the alleged TCPA violation.

However, a plaintiff should not be permitted to rely exclusively on conclusory allegations of agency, “just as every bar which advertises that they sell a particular brand of beer is not the agent of the brewery whose name they advertise.”<sup>35</sup>

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<sup>26</sup> *Id.*, at \*27.

<sup>27</sup> *Keim v. ADF Midatlantic, LLC*, 2015 U.S. Dist. LEXIS 159070, at \*2-3 (S.D. Fla. Nov. 10, 2015).

<sup>28</sup> *Id.*, at \*3.

<sup>29</sup> *Id.*, at \*25-26.

<sup>30</sup> *Id.*

<sup>31</sup> *In re Monitronics Int’l, Inc.*, 2015 U.S. Dist. LEXIS 56514, at \*6 (N.D. W.V. April 30, 2015).

<sup>32</sup> *Id.*, at \*8, \*23.

<sup>33</sup> *Id.*, at \*24.

<sup>34</sup> *Id.*

<sup>35</sup> *Leon v. Caterpillar Indus.*, 69 F.3d 1326, 1336 (7th Cir. 1995).

The *Melito* ruling is a step toward reducing TCPA exposure because, under *Melito*, a plaintiff must allege that the seller or the marketing company had the right to control the sending of the text message that supposedly violated the TCPA. *Melito* requires a plaintiff to allege more than a passive involvement in the telemarketing activity to state a claim for vicarious liability for a third party's alleged TCPA violation.

# Daily Fantasy Sports: A Regulatory Dilemma Worth Resolving

By Richik Sarkar, Member, McGlinchey Stafford PLLC

When (“if” can no longer be fairly used) the Daily Fantasy Sports industry becomes regulated, Ethan Haskell, a content manager for DraftKings who earned \$350,000 in one FanDuel contest after posting information that appeared to give him a competitive advantage, will be a central figure of the regulatory origin story. Following his “insider trading” incident in September 2015, many state and federal regulators began considering whether daily fantasy sports constitute gambling and whether it can be regulated.

DraftKings and FanDuel are the two biggest players in an estimated \$3.1 billion industry that put on contests (they say of “skill”) where participants pay to select actual players in a wide variety of sports (baseball, basketball, football, etc.) to compete in a one-day league or directly against another team. The daily outcomes are based upon real sporting results, with winners earning (sometimes) thousands in prize money, and losers often resetting to play the next day. The industry has built its near-billion dollar business by associating with the National Basketball Association, the National Hockey League, Major League Baseball and the National Football League. While some of the professional sports leagues may be rethinking these relationships in light of increased scrutiny, every daily fantasy sports site is evaluating its model going forward. In so doing, the industry and regulators are in a classic dilemma -- a difficult choice must be made between two or more (potentially undesirable) alternatives.

## **The Exclusion That Launched A Thousand (And Likely More) Leagues**

At the federal level, the Unlawful Internet Gambling Enforcement Act of 2006 (“UIGEA”) (which was part of homeland security legislation) prohibits web-based payments for illegal bets and makes transactions from banks or similar institutions to online gambling sites illegal. However, the UIGEA excludes:

(ix) participation in any fantasy or simulation sports game or educational game or contest in which (if the game or contest involves a team or teams) no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization (as those terms are defined in section 3701 of title 28) and that meets the following conditions:

(I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.

(II) All winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(III) No winning outcome is based—

(aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or

(bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.

31 U.S.C. § 5362(1)(E)(ix).

The industry relies on this specific provision of the UIGEA to establish the legality of its business and to “prove” daily fantasy sports are games of skill, not gambling. Of particular importance, under the heading of “Interstate horseracing,” 31 U.S.C. § 5361(10)(D) contains the only mention of the preemption prohibition, providing that “[n]othing in this subchapter may be construed to preempt any State law prohibiting gambling.” This begs the critical question of whether this preemption prohibition only applies to “Interstate horseracing” (which is subject to the Interstate Horseracing Act of 1978) or if it applies to state efforts to regulate daily fantasy sports leagues.

### **Are Such Efforts to Regulate on the State Level Legal?**

With respect to state efforts, though new states are being added to the list, as of the writing of this article, daily fantasy sports leagues are considered illegal in 11 states. Some states, like New York and Texas, assert that daily fantasy sports leagues violate state gambling laws, while Nevada asserts that such sites cannot operate without a gambling license. In at least 16 other states, government entities are either reviewing the legality of such activities or are seeking to further clarify the law and/or to allow daily fantasy sports to continue with additional oversight. The rest of the states have either expressly made daily fantasy sports legal or have not addressed the issue.<sup>1</sup>

However, rather than analyze what states are doing, we should first ask what they can actually do. The Professional and Amateur Sports Protection Act of 1992 (PASPA)<sup>2</sup>, which is focused on prohibiting state-regulated sports betting on the outcomes of professional and amateur sporting events, makes clear under the heading of “Unlawful Sports Gambling” that:

It shall be unlawful for --

(1) a governmental entity to sponsor, operate, advertise, promote, license, or authorize by law or compact, or

(2) a person to sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity,

a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly (through the use of geographic reference or otherwise) on one or more competitive games in which amateur or professional athletes participate, or are intended to participate, or on one or more performances of such athletes in such games.

28 U.S.C. §3702.

Accordingly, the PASPA plainly prohibits a “governmental entity” from sponsoring, operating or promoting any betting or wagering scheme based directly or indirectly on the performance of an athlete or group of athletes in games in which amateur or professional athletes participate. As daily fantasy sports leagues are certainly based upon individual performances, the question becomes whether states can legalize or regulate daily fantasy sports leagues as such activity, based upon the plain language of the statute, is prohibited sponsorship, operation, and/or promotion of a betting or wagering scheme. Thus, per PASPA, state efforts with respect daily fantasy sports leagues are likely in a binary state – they can be banned, but not legalized or regulated.

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<sup>1</sup> For a complete census of state of daily fantasy sports efforts across the country, review the Legal Sports Report compilation at <http://www.legalsportsreport.com/daily-fantasy-sports-blocked-allowed-states/>.

<sup>2</sup> Four states are exempted from PASPA: Delaware, Montana, Nevada and Oregon and (1) Montana already operates fantasy sports through its state lottery; (2) Delaware only writes NFL parlay cards though, citing its exemption, has attempted to establish sports betting but was stymied by a 2009 decision ruling that Delaware could only offer the same type of betting it did before PASPA was enacted; (3) Nevada has the ability to legalize nearly any form of sports betting; and (4) Oregon’s sports betting was similar to Delaware’s, except that it has also spread NBA parlays. Oregon, however has not reentered the sports betting market since its Sports Action lottery ceased after the 2006 NFL season.

## **Payment Processors As De Facto Regulators?**

However, a different obstacle may be much more difficult to overcome: payment processors refusing to facilitate daily fantasy sports league transactions. Vantiv Entertainment Solutions, a credit card payment processing company, recently informed its daily fantasy clients that it would suspend processing all daily fantasy sports payment transactions as of February 29, 2016 because, while acknowledging arguments to the contrary, many state attorney generals have determined that daily fantasy sports sites participate in illegal gambling.<sup>3</sup>

Per the New York Times, many legal experts cite the UIGEA, which, again, specifically excludes fantasy sports from its purview as their “outcomes reflect the relative knowledge and skill of the participants,” as requiring payment processors like Vantiv to prohibit transactions when a state says that a sports website is offering gambling services. However, the New York Times (citing Vantiv’s letter to customers) reported that Vantiv has made clear that as “payments experts in the online gaming space, Vantiv will continue to work with stakeholders for a long-term solution to the ongoing [daily fantasy sports] controversy. When there is better clarity and long-term certainty around the regulatory and judicial landscape related to [daily fantasy sports], Vantiv may decide to resume processing these types of payment transactions.”

If other payment processors follow Vantiv’s example (and Vantiv is a leader in the payment processing industry) the question of how the industry is regulated will become moot because, without a convenient form of payment, many players will not participate. However, some more cynical experts might think that payment processors are looking into alternative payment systems so they can take higher fees to reflect increased risk; akin to a virtual “rake.” Again, payment processors are placed in a legal dilemma: choosing between lucrative daily fantasy sports payment fees and bowing to regulatory efforts that may, or may not, be preempted. Vantiv has already made its choice, and others may follow.

## **A Proposed Framework for Resolution**

In resolving these various legal dilemmas, a clear path of choices has emerged:

First, the question of whether the UIGEA preempts states from regulating daily fantasy sports must be conclusively resolved. Again, broad preemption language exists, but its deliberate placement in the statute under a specific sub-section, separate from the one addressing daily fantasy sports, indicates that state regulation of daily fantasy sports leagues is preempted.

Next, if the UIGEA does not preempt state regulation, does PASPA require that the states can only choose between banning daily fantasy sports league or doing nothing? And who will police the daily fantasy leagues to ensure that they are operating fairly so “insider trading” and other abuses do not occur while ensuring a byzantine, multi-participant, regulatory scheme governing mostly interstate transactions does not reign?

Finally, if regulations are not preempted, and certain states can ban daily fantasy sports activity, how can payment processors legally facilitate payments? Based upon Vantiv’s assertion, payment alternatives are being considered, but how will they evolve? Will each daily fantasy sports league offer different tokens, like casinos offer chips?

In resolving these issues, the most logical path would be to first determine that the UIGEA preempts state regulation; especially since PASPA requires a Hobson’s choice of banning daily fantasy sports leagues or not, a choice that seems unworkable given the popularity of such daily fantasy sports leagues. Then the Federal Trade Commission (“FTC”) – the only regulator with the dual mission to protect consumers and promote competition – should be charged with monitoring business practices and reviewing industry consolidation. Such a resolution allows a competitive daily fantasy sports industry to exist, while still ensuring that potential unfair, abusive, and/or deceptive practices are policed. This is also an optimal scheme because the FTC has become the country’s primary cyber-regulator, critical for any entity charged with regulating on-line industries.

Regardless of how these dilemmas are resolved, considering the state of the law, the popularity of fantasy sports, and the sheer size of the industry, the predicted demise of daily fantasy sports is likely overstated.

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<sup>3</sup> “Payment Processor to Stop Working With Daily Fantasy Sports Clients,” New York Time, January 29, 2016 (<http://www.nytimes.com/2016/01/30/sports/draftkings-fanduel-vantiv-daily-fantasy.html>).

# Tailored to Suit: Drafting a Client's Compliance Management System

By Chris Chamness and Webb McArthur, Hudson Cook, LLP

As consumer finance attorneys, we spend the majority of our time explaining compliance obligations to our clients. Equally important, especially to the Consumer Financial Protection Bureau (“CFPB”), is our work to ensure day-to-day compliance with those obligations. To that end, we create compliance management systems (“CMS”) for our clients.

Developing and implementing a robust CMS for a client is an ongoing process that clients should undertake well before a CFPB examiner shows up. As a compliance lawyer drafting individual policies and procedures in a CMS, you should tailor each policy to your client’s business, products and services, as well as to the CMS as a whole. In this article, we address some considerations, issues, and landmines you might encounter in developing and implementing a CMS for your client. We begin by defining a CMS and explaining the goals of a CMS; then, we suggest strategies to tailor a CMS to your client’s industry and individual business operations. Lastly, we address some challenges that arise when tailoring a CMS and offer suggestions.

What is a “compliance management system”? A CMS is how a company establishes its compliance responsibilities, communicates those responsibilities to employees, and ensures that the company monitors and audits its efforts to meet its compliance obligations. The CMS should focus on the risks of non-compliance faced by a particular company and its products and services. A CMS should be comprehensive, addressing all compliance obligations for the entire lifecycle of the product and service handled by the client. A CMS may encompass legal obligations other than consumer finance laws and regulations, or those other legal compliance issues may be addressed elsewhere.

A CMS is a “system” because it is more than just a collection of individual policies and procedures addressing consumer credit law obligations. In addition to individual policies and procedures (often collectively referred to as the “compliance program”—think of an assortment of individual policies and procedures), the CMS should contemplate a holistic strategy for compliance. A CMS should have provisions on board and management oversight, a complaint management system, and an audit program. A CMS must include procedures for how a company’s compliance obligations are incorporated into business processes. A CMS should also include training procedures on compliance obligations, how compliance obligations are monitored, what corrective action is undertaken when compliance issues are uncovered, and how the CMS is updated. The individual policies and procedures should, in a sense, speak the same language of compliance and speak to one another. Policy and procedure documents should be organized in similar ways, should use the same language when discussing similar and related compliance obligations, and should integrate the methods of compliance into business processes in similar ways so that compliance functions minimally impact the provision of a company’s products and services.

As an example, the CFPB expects companies to have a separate compliance function instead of embedding compliance within each business line.<sup>1</sup> This gives the compliance function independence. Compliance efforts at a company need to be coordinated across the business lines to ensure consistency, timely response to compliance failures, and comprehensive monitoring. This oversight should be multi-layered. In addition to oversight by the board and senior management, a company might consider embedding monitoring functions in specific policies and procedures to which the monitoring procedures are tailored as well as developing an independent audit function across the various procedures. Monitoring and independent audits are extremely important to the CFPB, and a CMS that simply states policies and procedures without providing a mechanism to ensure that those policies and procedures are followed could be viewed by the CFPB as deficient.

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<sup>1</sup> CFPB Supervisory Highlights – Summer 2013, at 6, *available at* [http://files.consumerfinance.gov/f/201308\\_cfpb\\_supervisory-highlights\\_august.pdf](http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf) (hereinafter “CFPB Highlights 2013”).

Before you begin the process of drafting a CMS, you should step back and make sure you understand the consumer finance industry in which the company works, as well as how your client's business operates, as the CFPB expects that its supervised entities have a CMS adapted to its business strategy and operations. The goal of this exercise is not only to get a sense about how to draft specific policies and procedures, but also to know what sorts of policies and procedures are needed in your client's CMS.

As part of any review of your client's industry, ask yourself what policies and procedures other industry participants are including in their CMS. If possible, you should obtain copies of other CMS to review the policies and procedures other industry participants have included. If the CFPB has obtained a consent order against an industry participant, then consider the CMS deficiencies that the CFPB discussed, if any. You should also review the CFPB's Supervision and Examination Manual and apply the CFPB's instructions regarding a CMS to your client's business.<sup>2</sup> Pay special attention to the Examination Objectives published for each CMS section and to areas of focus described in other CFPB notices and publications. For example, the CFPB has regularly placed emphasis on auditing—the CFPB expects that a CMS will include independent consumer compliance audits.

An effective CMS must reflect your client's individual business in every respect. This includes providing specific policies and procedures that account for your client's products and services, target customers, organizational structure, and regulatory requirements. Because this is not a "one size fits all" proposition, it is important that you manage client expectations about the time and amount of communication required to effectively draft a comprehensive and robust CMS.

In particular, you should focus on your client's current practices, identify lapses in compliance, and develop a solution that your client can implement. At each stage of the drafting process, your client should review the proposed policy and procedures and obtain feedback from management and the teams that will need to implement that portion of the CMS.

One drafting strategy is to request that one of your client's employees take notes about every stage of a task that she is involved in, and then use those notes to construct procedures. This process offers a real-world perspective about how employees implement compliance objectives and may identify weaknesses to address in the new CMS.

The CFPB has consistently stated that the size and complexity of a regulated entity will determine the complexity of a CMS and the CFPB's supervisory expectations.<sup>3</sup> Despite these assurances, the CFPB has provided no detail regarding how a smaller entity may limit the scope and complexity of its CMS. The CFPB has indicated that its supervisory expectations are not uniform but are "principles-based" in recognition of the differing size and complexity of organizations.<sup>4</sup> However, the CFPB has also stated that it will apply consistent standards using the same procedures to examine different supervised entities—to the extent possible. Therefore, absent a clear articulation of how a small supervised entity may limit the scope and complexity of a CMS, a compliance attorney limits the scope of the CMS at her peril.

With smaller organizations, which may include already over-worked employees and a small legal budget, a compliance attorney may need to prioritize the completion of many different CMS sections. When deciding whether to complete a portion of a CMS immediately or postpone its creation until the client is larger or has a bigger compliance staff (and presumably with a larger legal budget), do a risk analysis with your client when considering any omissions. When thinking about the prioritization of CMS sections, you and your client should consider the risks of non-compliance, including potential examinations, lawsuits for statutory violations or for unfair and deceptive acts and practices.

Finally, we offer three final recommendations. First: although you will have to draft individual policies one by one, because you may issue-spot and improve your approach to drafting a CMS later in the process, you should revisit the entire suite of policies and procedures at the end of the process to ensure all of the separate parts of the CMS work well together. Second: federal law only requires companies to have a few written policies in a few areas (for example, a red flags policy), but a more effective CMS encompasses all compliance obligations, including state law obligations, which

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<sup>2</sup> CFPB Supervision and Examination Manual, Version 2 – October 2012, *available at* [http://files.consumerfinance.gov/f/201210\\_cfpb\\_supervision-and-examination-manual-v2.pdf](http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf).

<sup>3</sup> *See, e.g.*, CFPB Highlights 2013; CFPB Supervisory Highlights – Spring 2014, *available at* [http://files.consumerfinance.gov/f/201405\\_cfpb\\_supervisory-highlights-spring-2014.pdf](http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf).

<sup>4</sup> Prepared Remarks by Peggy L. Twohig at the NMLS Users Conference, February 7, 2012, *available at* <http://www.consumerfinance.gov/newsroom/prepared-remarks-by-peggy-l-twohig-at-the-nmls-users-conference/>.

may include record retention rules, mini-Fair Debt Collection Practices Acts, or identity theft rules. And third: developing a CMS is an on-going process because the CFPB expects a CMS to be updated, not only for changes in the law, but also for changes in the company's business processes. Therefore, an effective CMS must specify how the company will update the CMS and who will do it.