



CONSUMER FINANCIAL SERVICES COMMITTEE NEWSLETTER

November 2016

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Important Dates

[Business Law Section Spring Meeting](#)

April 6-8, 2017
New Orleans, LA

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Membership Minute

CFSC by the Numbers: As of September 2016, total members = 1,481. This represents a 0.8% increase since September 2015. Keep up the good work in spreading the word about joining the ABA's CFSC - encourage your clients and colleagues to check it out!

CFSC Joins Social Media: Publications and Communications Subcommittee secured approval from the Business Law Section for the Consumer Financial Services Committee to launch and manage its own social media profiles. Details to come!

CFSC Website: Did you know you can find links to helpful information on the website, including past newsletters, meeting materials and non-CLE Webinars? To learn more, visit the [CFSC website](#).

Get Involved in the CFSC: Want to get more involved in the CFSC? Feel free to contact [Grace Powers](#) and [Judy Mok](#), CFSC Membership Subcommittee Chair and Vice-Chair, for information.

Leadership Message



Andrew Smith, Chair
Consumer Financial Services Committee

In this Chairman's Message, we will provide details of our upcoming Winter Meeting in sunny California; recount our Committee's successes at the Business Law Section Annual Meeting in Boston; and regale you with stories of other accomplishments, including a new financial literacy initiative, another successful Consumer Financial Services Institute, and a comment letter filed with the CFPB on its recent proposal to amend its confidentiality rules.

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Subcommittee Spotlight

Pro Bono Subcommittee's Spring Financial Literacy Project

By Jennifer Newton, Shutts & Bowen LLP

The Pro Bono Subcommittee has made the promotion of consumer financial literacy one its principal goals, and encouraged pro bono activity around this very important issue.

Most recently, at the Business Law Section's Annual Meeting in September 2016, the Pro Bono Subcommittee, in conjunction with the Credit Union and the Pro Bono Committee of the Business Law Section ("Section"), assembled a panel consisting of financial education leaders and experts, including staff from the Consumer Financial Protection Bureau ("CFPB"), to discuss the most effective approaches for improving financial literacy among seniors, veterans, youth, and those who are economically disadvantaged. The panel discussion included a comprehensive overview of the financial literacy resources and tools currently available to support the development of financial literacy projects by Section members.

The Pro Bono Subcommittee is putting these resources and tools into action by collaborating with the CFPB and the Section to develop a financial literacy project that will take place during the Section's Spring Meeting in New

Upcoming Meetings



Join us for the 2017 Consumer Financial Services Committee Meeting January 12-15, 2017 in Carlsbad, CA!
[Register and reserve your hotel room now.](#)

Legal Features

Using Machine Learning to Optimize Lending: the Risks and the Rewards

By Shara Chang and Alexandra Alvarez, Product Counsels at Affirm, Inc.

Machine learning has fueled innovation in nearly every aspect of our daily lives, such as anti-spam filters, web search capabilities, online recommendations from Amazon and Netflix, self-driving cars, speech recognition, and predicting emergency room wait times. And now, emerging FinTech lending companies claim that they can make smarter underwriting decisions and better detect fraud by applying machine learning algorithms to larger, and in some cases, alternative datasets.

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A Survey of Activities Identified as Unfair, Deceptive, or Abusive Under the Dodd-Frank Act

By Adam D. Maarec, Davis Wright Tremaine LLP and John C. Morton, Gordon Feinblatt LLC

This is our latest article in a series that surveys activities identified as unfair, deceptive or abusive acts or practices (UDAAPs) by the Consumer Financial Protection Bureau (CFPB), and state attorneys general and consumer financial services regulators, using federal UDAAP powers created by the Dodd-Frank Act. This article covers relevant

Orleans. The financial literacy project is still in the planning stages, but will likely involve an outreach/educational event at a local high school, library or senior center. The project is open to all Section members and members are encouraged to invite their colleagues to participate. To prepare attendees for participating in the financial literacy project, the Pro Bono Subcommittee, in conjunction with the CFPB and the Section, will be presenting a ninety (90) minute training program during the Consumer Financial Services Committee ("CFSC") Winter Meeting.

While additional details regarding the financial literacy project and the training program are pending, members who wish to participate in the financial literacy project should plan to attend the training program at the CFSC Winter Meeting, and arrive to New Orleans on the Wednesday morning of the Section's Spring Meeting. For more information, please contact Nikki Munro (nmunro@hudco.com) or David Esquivel (desquivel@bassberry.com).

UDAAP activity that occurred between January 1, 2016 and June 30, 2016. This survey includes enforcement actions and other statements by the CFPB in reports that discuss UDAAP violations. These activities provide insight into the specific types of practices that could be considered UDAAP violations in the future.

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Supreme Court Positioned to Resolve Growing Circuit Split on the Scope of the FDCPA

By Jolina Cuaresma and Katherine Lamberth, White & Case LLP, and Brent Yarborough, Maurice Wutscher, LLP

On March 23, 2016, in *Henson v. Santander Consumer USA Inc.*, the United States Court of Appeals for the Fourth Circuit contributed to a growing circuit split on when a lender is considered a "debt collector" for purposes of the Fair Debt Collection Practices Act ("FDCPA"). Specifically, the circuits are divided as to whether FDCPA obligations attach when a lender purchases debt in default and attempts to collect on that defaulted debt.

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National Institute Summary

Another Great National Institute

By Lynette I. Hotchkiss, Rabobank, N.A.

The Seventh Annual National Institute on Consumer Financial Services Basics was held October 17-19, 2016 in the beautiful Waterview Conference Center in Arlington, Virginia. The Institute boasted a full classroom, with 73 registered students and several faculty members who were available to answer questions at lunch and during the breaks. The diverse student body included representatives of regulatory agencies, law firms, and in-house counsel.

This year, the Institute included an additional half day of programming to allow more time to get to know the regulators in the Meet the Regulators panel the first afternoon and to permit time for new courses. The new courses covered Researching Consumer Financial Services Law, the Servicemembers Civil Relief Act and the Military Lending Act, and the Regulatory Landscape for FinTech Products and Services. Of course, the full ABC's of consumer finance law also were covered throughout the course of the Institute. In the lively UDAAP course, presenters Malini Mithal and Larry DeMille-Wagman even provided candy prizes for correct answers to UDAAP quiz questions.

On day two, our keynote speaker, William Alvarado Rivera, from the AARP Foundation, spoke to us about the financial difficulties and threats faced by elderly consumers, and ways in which the Foundation is working to help these consumers. Mr. Rivera helped make us all more aware of the issues faced by this vulnerable class of consumers and the resources available to assist them.

The Institute closed with a rousing discussion of "How Technology is Changing Consumer Finance" in the Perspectives on Consumer Finance panel, moderated by Andrew Smith, Chair of the Consumer Financial Services Committee.

Planning is underway for next year and we look forward to

Comment Letter

Business Law Section Raises First Amendment Concerns About CFPB Proposal

By Ori Lev, Mayer Brown LLP

In mid-October, the Business Law Section ("Section") submitted comments on behalf of the Consumer Financial Services Committee and the Banking Law Committee in response to important First Amendment issues raised by a Consumer Financial Protection Bureau ("CFPB") proposed rule. The Section's comments are available [here](#). The President of the American Bar Association ("ABA") submitted separate comments, available [here](#), raising the ABA's concerns about the implications of other aspects of the proposed rule for attorney-client privilege.

The Section was moved to comment by a provision of the proposed rule, which was published in August and is available [here](#), that would prohibit private persons in possession of CFPB "confidential investigative information" from disclosing the information without the prior permission of the CFPB's Associate Director for Supervision, Enforcement, and Fair Lending. [Proposed § 1070.42\(b\)](#). The proposed rule only included a few limited exceptions from this requirement.

"Confidential investigative information" would be broadly defined in [Proposed § 1070.2\(i\)](#) to include a wide array of documents connected with investigations, including but not limited to civil investigative demands ("CIDs") and Notice and Opportunity to Respond and Advise ("NORA") letters, [81 Fed. Reg. at 58,316](#). Under the proposed rule, therefore, recipients of CIDs from the CFPB would be prohibited from disclosing their existence other than in narrowly-defined circumstances or with the CFPB's blessing.

As the Section's comments explained in detail, this aspect of the CFPB's proposal appears to violate the First Amendment. Simply put, our constitutional system presumes that ordinary citizens do not need to obtain the permission of a government official before they choose to

seeing you there!

speak about government activities.

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Leadership Message

In this Chairman's Message, we will provide details of our upcoming Winter Meeting in sunny California; recount our Committee's successes at the Business Law Section Annual Meeting in Boston; and regale you with stories of other accomplishments, including a new financial literacy initiative, another successful Consumer Financial Services Institute, and a comment letter filed with the CFPB on its recent proposal to amend its confidentiality rules.

Business Law Section Annual Meeting

We had a successful meeting in September in Boston. We had outstanding participation from the CFPB and FTC, in terms of speakers and attendance. We had 13 hours of CLE programming, including an unprecedented three hours on Saturday morning.

One day of programming focused exclusively on Fintech, and we got many compliments and high program attendance, with four of the five best-attended programs:

- Empirical analysis of CFPB law enforcement – 134 attendees
- Fintech: top 10 legal issues – 129 attendees
- CFPB's proposed arbitration rule – 115 attendees
- Class actions after *Spokeo* – 109 attendees

Program materials from the Boston meeting are located [here](#), and materials from Beer & Basics can be found [here](#).

CFPB Comment Letter

CFSC members recently led the effort to draft a [comment letter](#) from the ABA Business Law Section on the CFPB's recent proposed amendments to its rules regarding confidentiality of information. The letter focused on a proposed prohibition on the disclosure of "confidential investigative information," including the mere fact of a CID, by the targets of CFPB investigations. The letter argued that such a restriction would constitute an unconstitutional prior restraint on speech.

The letter proved influential, and others, including the ACLU, joined a chorus of organizations protesting what came to be called the agency's "gag rule." According to the Business Law Section letter, "our legal system presumes that ordinary citizens are free to discuss government activities and presumes that government efforts to restrain such speech are unconstitutional."

The letter is discussed in more detail in an article by Ori Lev in this Newsletter.

National Institute on CFS Basics

Our Committee hosted the Seventh Annual National Institute on Consumer Financial Services Basics on October 17-19 in Arlington, Virginia. It was another sell-out crowd thanks to the organizational efforts of Meeting Chair Becki Kuehn and her team. We had several speakers from the FTC, CFPB and

banking agencies, in addition to our usual passel of industry experts, academics and consumer advocates.

The program is designed for lawyers who are new to consumer financial services, but every year we find several experienced lawyers who attend and benefit from the presentations. Keep your eyes out for next year's program, which will probably be scheduled for October 2017.

Financial Literacy Initiative at New Orleans Meeting, April 2017

At the [Business Law Section Spring Meeting in New Orleans](#), to be held April 6-8, 2017, our Committee is organizing a financial literacy program, likely at local high schools, libraries and/or senior centers. At the Winter Meeting, we will hold a special meeting, featuring our friends from the CFPB, to prepare attendees for the New Orleans Project. The name of the program is "Financial Literacy Training: Spring Meeting Pro Bono Service Project."

Stand-Alone Winter Meeting Details

We are convening again January 12-15, 2017, at the [Park Hyatt Aviara Resort](#) in Carlsbad, California. You can [register](#) for the meeting here, and [click here](#) for additional details.

As you make your travel plans, please plan to arrive on Thursday afternoon and depart on Sunday afternoon:

- Our meetings will begin on Thursday, January 12 at 4:00 PM PT, with Beer & Basics, followed by our Welcome Reception.
- CLE programming will begin at 7:30 AM PT on Friday, January 13.
- Our meetings will conclude by 12:30 PM PT on Sunday, January 15.

Details will follow on registration for the Committee Dinner, which will be held on Friday, January 13.

We are planning a terrific program, including 12+ hours of CLE, and a separate Mortgage Track on Saturday, January 14. Program topics include:

- The CFPB's Prepaid Card Rule
- *Inclusive Communities* and the Future of Disparate Impact
- Practical Guide to California's Privacy Laws
- Military Status and Personal Property Financing
- Individual Liability
- Rule 68 Offers of Judgment
- The CFPB's Efforts to Overhaul the Debt Collection Industry
- Electronic Contracting
- The Future of Bank-Sponsored Lending Programs
- Mortgage Servicing (Mortgage Track)
- RESPA Update (Mortgage Track)
- HMDA: Another Deep Dive (Mortgage Track)
- And so much more ...

Using Machine Learning to Optimize Lending: the Risks and the Rewards

By Shara Chang and Alexandra Alvarez, Product Counsels at Affirm, Inc.

Machine learning has fueled innovation in nearly every aspect of our daily lives, such as anti-spam filters, web search capabilities, online recommendations from Amazon and Netflix, self-driving cars, speech recognition, and predicting emergency room wait times. And now, emerging FinTech lending companies claim that they can make smarter underwriting decisions and better detect fraud by applying machine learning algorithms to larger, and in some cases, alternative datasets. A machine learning algorithm is one in which an analyst provides any number of variables with known outcomes and allows a computer to extrapolate the most predictive signals from the dataset.¹ Machine learning employs an iterative process where the algorithm gets “smarter” as it is exposed to new data. Because of its ability to gather meaningful insights from an abundance of data—in real time—FinTech lenders are turning to machine learning to enhance antiquated lending processes and serve consumers unable to obtain credit via traditional outlets.

While few observers could deny machine learning’s potential to expand access to credit while using actionable insights from real-time data to reduce costs and deliver efficiencies to the business, the use of complex algorithms raise important legal and compliance considerations.

In this article, we share common applications of machine learning to optimize lending and briefly discuss some of these key considerations.

I. Primary Machine Learning Applications in Lending

While machine learning techniques can be applied in some manner at any stage of the credit lifecycle, FinTech companies commonly use them in credit underwriting, early fraud detection, and marketing activities.

Credit Underwriting. The use of big data and machine learning has significant potential to expand access to affordable credit. Traditionally, creditors have relied heavily on FICO and similar scores to determine an applicant’s creditworthiness. The Consumer Financial Protection Bureau (CFPB), however, conducted a study in 2015 that highlights why this is a flawed approach.² According to the study, as of 2010, 26 million consumers in the United States did not have credit records with a nationwide credit reporting agency—these consumers are also known as “credit invisible.”³ An additional 19 million consumers had

¹ In 1959, Arthur Samuel, a pioneer in artificial intelligence research, defined machine learning as a science that “gives computers the ability to learn without being explicitly programmed.”

² The Consumer Financial Protection Bureau Office of Research, Data Point: Credit Invisibles (2015).

³ *Id.* at 6.

credit records that were treated as unscorable due to insufficient credit histories.⁴ The study also identified a strong relationship between income and possessing a credit score. Almost 30 percent of consumers in low-income neighborhoods were credit invisible and an additional 15 percent had unscorable records.⁵ Furthermore, the study found discrepancies based on race and ethnicity—Blacks and Hispanics were more likely than Whites or Asians to be credit invisible or to have unscorable credit records.⁶

Through new technology, including the ability to process large amounts of data sets in real time, creditors have the opportunity to design predictive risk scoring models that consider data beyond traditional credit scoring sources. Sophisticated models will allow creditors to reach creditworthy consumers previously denied access to credit, or at least affordable credit, because they are credit invisible, unscorable, or have a relatively low credit score. Additionally, with increased experience, these models gain valuable insights about expected repayment that can be leveraged to offer the best terms and rates to both new and existing consumers.

Early Fraud Detection. The U.S. Department of Justice found that personal identity theft totaled \$24.7 billion in 2012 alone.⁷ In a world of constantly evolving methods of perpetrating fraud, big data analytics and machine learning are especially powerful tools in the hands of creditors. If designed well, they can help creditors quickly adjust to fraudsters' new techniques and help ward off huge dollar losses. Some companies rely on rule-based systems that use simple "if, then" logic to detect fraudulent versus non-fraudulent transactions. These systems are driven by data analysts who manually identify fraudulent transactions to create threshold rules based on trends they observe in those transactions. Rule-based systems can only consider a few fraud signals⁸ at once and cannot adapt to new patterns in data without the creation of new rules. On the other hand, machine learning overcomes these limitations because these models consider any number of fraud signals at once, and in real time, to predict fraud with a higher degree of precision. These models also have the advantage of promptly detecting novel fraud schemes that may go completely unnoticed by data analysts or take months to unearth. Not only do these improvements benefit creditors, they help protect identity theft victims against further attacks.

Marketing. Both creditors and consumers may benefit from the application of data science and use of big data algorithms in marketing. With the appropriate compliance controls in place, a data-driven approach to marketing can help businesses efficiently and effectively engage consumers about credit-related and financial management products and services that may be of interest to them. For instance, using data over anecdotes, these companies can use machine learning to assess whether consumers prefer to learn about financial products and services via email, search ads, or social media. Big data analytics can also help identify important insights about their consumers' online experience. Notably, analyzing metrics such as "bounce rates" and "drop-off" rates can lead to enhancements in disclosures about product offerings and features that better resonate customers. As a result, consumers receive offers they find relevant and easy-

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ Bureau of Justice Statistics, 16.6 Million People Experienced Identity Theft in 2012 (Dec. 12, 2013).

⁸ Fraud signals may involve, for example, the last five transactions on an account, geographical location of a transaction, or amount of a transaction.

to-understand, and creditors spend marketing dollars in a way that makes the most financial sense, building long term value with consumers.

II. Legal and Compliance Considerations

Ultimately, the value that machine learning can contribute to the financial services industry hinges on the quality of the application of these complex techniques and a keen eye toward compliance.

Explaining Credit Decisions. Federal law requires creditors to meet certain disclosure requirements when denying applications for credit. Under the Equal Credit Opportunity Act (ECOA), applicants who are denied credit must receive, in writing, the specific denial reasons.⁹ Additionally, under the Fair Credit Reporting Act, creditors are required to provide the source of information when the decision is based on information from a consumer report.¹⁰ If the decision is based on information from a third party other than a consumer reporting agency, applicants are entitled to receive the nature of the information from the creditor.¹¹

The ECOA and FCRA disclosure requirements promote transparency in the application process and empower consumers to correct any inaccurate information that may have been used to make a credit decision. However, they also present new challenges for creditors as the basis for decisions becomes increasingly complex through the use of big data and machine learning. When thousands of data points contribute to a decision, creditors must be able to understand the key factors driving the decision and communicate this information to consumers.

Avoiding Unintentional Discrimination. ECOA also prohibits creditors from discriminating against applicants based on a protected class, including “race, color, religion, national origin, sex or marital status, or age” and the receipt of public assistance.¹² If a creditor’s practices have a “disparate impact” on a protected class—meaning that the creditor’s facially neutral practice has a disproportionate adverse effect or impact on a protected class¹³—the creditor may be violating ECOA.

While the use of big data and machine learning have the potential to expand access to credit, the risk of unintended discrimination also exists. Seemingly neutral data points could result in discriminatory outcomes. Creditors should evaluate the inputs of their analytics models, design algorithms with an intent towards preventing disparate impact, and continually test model outputs for disparate impact—especially with ever-evolving models.

Additionally, using big data analytics and machine learning to target advertisements to certain customers raises ECOA concerns. The Federal Trade Commission (FTC) has warned creditors to “proceed with

⁹ 15 U.S.C. § 1691(d)(3).

¹⁰ 15 U.S.C. § 1681m(a).

¹¹ 15 U.S.C. § 1681m(b).

¹² 15 U.S.C. § 1691(a).

¹³ Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266-01, 18268 (Apr. 15, 1994).

caution” here.¹⁴ Specifically, the FTC states that “[a]dvertising and marketing practices could impact a creditor’s subsequent lending patterns and the terms and conditions of the credit received by borrowers, even if credit offers are open to all who apply.”¹⁵ Creditors should carefully consider the impact of targeted marketing and whether there is a legitimate business need for it, and conduct testing of marketing campaign results for disparate impact.

Evaluating the Data. As decisioning functions increase in sophistication, companies have an obligation to understand what is driving decisions and monitor results. Producing accurate and nondiscriminatory outputs through complex algorithmic systems begins by carefully selecting the data inputs. This includes, but is not limited to, evaluating whether (1) data is representative or if certain groups are under or overrepresented; (2) biases are being coded into algorithms—companies should proactively avoid perpetuating these biases; and (3) correlations found in data are actually meaningful—if they are not, inaccurate predictions may result. Even after data inputs are selected, companies should view its models with skepticism and constantly test outputs to ensure data inputs continue to be complete, predictive, and relevant. Companies who use machine learning in any aspect of their lending processes should ensure that data scientists work closely with their legal and compliance teams to achieve smarter, compliant decisioning.

IV. CONCLUSION

Innovations in lending, servicing, and marketing by way of big data and machine learning have the power to increase consumer access to affordable credit, predict fraud with greater precision, and improve the quality and relevancy of product offerings. New technologies, however, may not fit neatly within regulatory frameworks and requirements established well before the emergence of such technologies. Discussions regarding regulatory oversight of FinTech companies have gained momentum among regulators, industry, consumer advocates, and other groups. In a recent speech at a marketplace lending conference, Thomas J. Curry, the Comptroller of the Currency, discussed policy implications of lending by tech companies and shared plans for a possible national FinTech charter.¹⁶ As this discourse continues, it is increasingly important for companies to educate regulators on how these advancements are changing the way companies assess credit and fraud risk, and interact with consumers. This open communication is key to fostering a regulatory environment that provides both important protections to consumers and meaningful guidance to companies on responsible innovation.

¹⁴ THE FEDERAL TRADE COMMISSION, BIG DATA: A TOOL FOR INCLUSION OR EXCLUSION? UNDERSTANDING THE ISSUES 21 (2016).

¹⁵ *Id.*

¹⁶ Thomas J. Curry, Remarks by Thomas J. Curry Comptroller of the Currency Before the Marketplace Lending Policy Summit 2016 (Sept. 13, 2016) (available at <https://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-111.pdf>).

A Survey of Activities Identified as Unfair, Deceptive, or Abusive Under the Dodd-Frank Act

by

Adam D. Maarec, Davis Wright Tremaine LLP

John C. Morton, Gordon Feinblatt LLC

American Bar Association Consumer Financial Services Committee
Compliance Management and Federal and State Trade Practices Subcommittees

September 19, 2016

I. Introduction

This is our latest article in a series that surveys activities identified as unfair, deceptive or abusive acts or practices (UDAAPs) by the Consumer Financial Protection Bureau (CFPB), and state attorneys general and consumer financial services regulators, using federal UDAAP powers created by the Dodd-Frank Act.¹ This article covers relevant UDAAP activity that occurred between January 1, 2016 and June 30, 2016. This survey includes enforcement actions and other statements by the CFPB in reports that discuss UDAAP violations.² These activities provide insight into the specific types of practices that could be considered UDAAP violations in the future.³

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. §§ 5301 *et seq.* (the “Dodd-Frank Act”); *see, e.g.*, 12 U.S.C. § 5552 (2016).

² We have attempted to make this survey as comprehensive as possible; however, it is not exhaustive and there may be other relevant actions that are not discussed in this paper. Also, it must be noted that this area of law is rapidly evolving and new actions are arising regularly.

³ The term “unfair” is defined in the Dodd-Frank Act as an act or practice that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers [and the] injury is not outweighed by countervailing benefits to consumers or to competition.” 12 USC § 5531(c)(1). The term “deceptive” is not statutorily defined, but it is defined in the CFPB’s examination manual as “a material representation, omission, act or practice that misleads or is likely to mislead a consumer, provided the consumer’s interpretation is reasonable under the circumstances.” CFPB Examination Manual V.2, UDAAP 5 (October 2012), available at http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf. The Dodd-Frank Act introduced the new term “abusive” and defined it as an act or practice that either:

[1] materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or

[2] takes unreasonable advantage of [either]:

(A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;

(B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or

(C) the reasonable reliance by the consumer on a covered person [such as a bank or other financial institution] to act in the interests of the consumer. 12 USC § 5531(d).

We intend to publish periodic updates to this article cataloging new UDAAP activity and related state enforcement actions using federal UDAAP powers.

II. Overview: Identification of Unfair, Deceptive, or Abusive Acts or Practices

Between January 1, 2016, and June 30, 2016, the CFPB engaged in 13 public enforcement actions involving alleged UDAAP violations. Past UDAAP actions can provide a road map for industry participants to identify and better understand acts or practices that are considered problematic by law enforcement authorities. UDAAP enforcement actions during the period of this summary involved marketing, debt collection/settlement, data security, payment processing, and information brokering. The CFPB highlighted other UDAAP issues involving student loan servicing and mortgage servicing in its Supervisory Highlights reports. During this period there was one enforcement action filed independently by state regulators or attorneys general alleging violations of the federal UDAAP prohibition.

The summaries of each UDAAP action below appear in chronological order and are intended to provide a straightforward identification of the specific acts or practices that were alleged to be unfair, deceptive, or abusive by the CFPB, state attorneys general and/or state regulators.

III. CFPB Enforcement Actions

a. Y King S Corp d/b/a Herbies Auto Sales – January 2016 (Marketing)⁴

Herbies Auto Sales is a buy-here pay-here used car dealer. The CFPB alleged in a consent order, in addition to violations of the Truth in Lending Act (TILA)⁵, that the company engaged in deceptive and abusive acts or practices.

Specifically, the CFPB alleged that the following practices were deceptive:

- Misrepresenting credit information by requiring the purchase of an automobile repair policy and GPS payment reminder device but not including the cost of those items in the disclosed finance charge, and advertising lower APRs than consumers actually received.
- Failing to disclose the cost of paying by credit. The company allegedly would negotiate prices with customers paying with cash but would refuse to negotiate with customers using credit. The incremental costs of credit were not included as part of the finance charge in disclosures, allegedly making the promoted APR inaccurate.

The CFPB alleged that the company's financing scheme was abusive because the company:

- Advertised inaccurately low APRs in marketing materials;
- Failed to post sticker prices or otherwise reveal the asking prices of cars offered to consumers until after consumers indicated that they would purchase a car;

⁴ *In the Matter of: Y King S Corp., also doing business as Herbies Auto Sales*, File No. 2016-CFPB-0001, Consent Order (January 21, 2016).

⁵ 15 USC 1601 et seq. and its implementing regulation, Regulation Z, 12 CFR Part 1026.

- Failed to disclose complete and accurate credit terms when providing payment figures and before offering a car for sale; and
- Failed to disclose accurate finance charges and APRs in TILA disclosures.

Pursuant to the consent order, the company agreed to pay \$700,000 in redress to consumers and a suspended civil money penalty of \$100,000.

b. Citibank, N.A. – February 2016 (Debt Sales/Debt Collection)⁶

Citibank, N.A., entered into a consent order with the CFPB relating to the sale of charged-off consumer debts to debt buyers that addressed allegedly deceptive and unfair acts or practices. The CFPB claimed that the company provided substantial assistance to debt buyers (covered persons) and engaged in deceptive acts or practices by overstating the APR for accounts it sold to the debt buyers. The CFPB also alleged that the company engaged in unfair acts or practices by: (1) overstating the APR for accounts sold to debt buyers; (2) failing to identify and remit to debt buyers post-sale payments made by consumers to the company; and (3) delaying sending to debt buyers such post-sale payments. Pursuant to the consent order, the company agreed to pay \$4.89 million in restitution to consumers and a \$3 million civil money penalty.

c. Citibank, N.A., Department Stores National Bank, and CitiFinancial Servicing, LLC – February 2016 (Debt Sales/Debt Collection)⁷

Citibank, N.A., two of Citibank, N.A.'s affiliates, DSNB and CitiFinancial Servicing, LLC, and two debt collection law firms retained by Citibank, N.A., entered into a consent order with the CFPB to resolve allegations that affidavits filed in debt collection lawsuits by its lawyers were altered. The law firms (which were subject to independent enforcement actions, discussed below) allegedly altered the dates and/or the amount of the debt on the affidavits, which violated the Fair Debt Collection Practices Act, and such false representations constituted deceptive acts or practices. Upon learning that one of the firms had altered affidavits, Citibank, N.A., ceased referring accounts to that firm and requested that a New Jersey court dismiss related pending actions. Under the consent order, the companies agreed to comply with a New Jersey state court order requiring refunds of \$11 million and the cessation of collection activities on an additional \$34 million in debts. In light of the companies' remediation efforts, and consistent with the CFPB's Responsible Business Conduct bulletin, the CFPB did not impose civil money penalties.

d. Solomon & Solomon, P.C.⁸ and Faloni & Associates, LLC – February 2016 (Debt Sales/Collection)⁹

Solomon & Solomon, P.C., is a law firm engaged in debt collection activities in New York. Faloni & Associates, LLC, is a law firm engaged in debt collection activities in New Jersey. Both companies acted as a service provider to a bank in connection with credit card debt

⁶ *In the Matter of: Citibank, N.A.*, File No. 2016-CFPB-0003, Consent Order (February 23, 2016).

⁷ *In the Matter of Citibank, N.A., Department Stores National Bank, and CitiFinancial Servicing, LLC*, File No. 2016-CFPB-0004, Consent Order (February 23, 2016).

⁸ *In the Matter of: Solomon & Solomon, P.C.*, File No. 2016-CFPB-0005, Consent Order (February 23, 2016).

⁹ *In the Matter of: Faloni & Associates, LLC*, File No. 2016-CFPB-0005, Consent Order (February 23, 2016).

collection litigation.¹⁰ In separate but nearly identical consent orders, the CFPB alleged that the law firms engaged in deceptive conduct by altering the amounts owed or dates on hundreds of affidavits which were filed in court. The alterations allegedly amounted to misrepresentations about the facts to which affiants had attested, including the amount of debt owed. The law firms represented in litigation that the affidavits were “supported by Competent and Reliable Evidence” and that the amount owed was accurate, both of which were allegedly false as a result of the alterations. These activities were also considered a violation of the Fair Debt Collection Practices Act. Solomon & Solomon agreed to pay a \$65,000 civil money penalty, and Faloni & Associates agreed to pay a \$15,000 civil money penalty.

e. Dwolla, Inc. – March, 2016 (Marketing/Data Security)¹¹

Dwolla, Inc., is a digital payment company that operates an online payment system. In its first action involving data security, the CFPB alleged that the company engaged in deceptive marketing by making false claims regarding its data security practices.

Specifically, the CFPB alleged that the company engaged in deceptive practices by:

- Falsely claiming its data security practices “exceed” and “surpass” industry security standards when, in fact, the company did not adequately protect consumer data;
- Falsely claiming its “information is securely encrypted and stored,” when, in fact, the company did not encrypt all sensitive consumer personal information and failed to test the security of certain applications prior to releasing such applications to the public;
- Failing to:
 - Adopt and implement reasonable and appropriate data-security policies and procedures for the organization;
 - Use appropriate measures to identify reasonably foreseeable security risks;
 - Ensure that employees who have access to or handle consumer information received adequate training and guidance about security risks;
 - Use encryption technologies to properly safeguard sensitive consumer information; and
 - Practice secure software development, particularly with regard to consumer-facing applications developed at an affiliated website.

Pursuant to the consent order, the company agreed to pay a \$100,000 civil money penalty.

f. Student Aid Institute, Inc. – March 2016 (Debt Relief)¹²

The Student Aid Institute, Inc., offered debt relief services to consumers with student loans. In a consent order with the company and its CEO, the CFPB alleged that the company engaged in deceptive conduct by making the following misrepresentations:

¹⁰ The bank was also subject to a consent order in connection with its debt collection practices. See footnote 6.

¹¹ *In the Matter of: Dwolla, Inc.*, File No. 2016-CFPB-0007, Consent Order (March 2, 2016).

¹² *In the Matter of: Student Aid Institute, Inc., Steven Lamont*, File No. 2016-CFPB-0008, Consent Order (March 30, 2016).

- That consumers were required to pay the company a fee to enroll in federal student loan repayment programs;
- That consumers would save certain amounts of money without a basis for the savings claims, e.g., “You are eligible to reduce your current payment of \$595 to \$63 which may save you \$63,900 over the term of your loan;”
- That student loan “forgiveness and forbearance are available on most federal loans” without explaining the conditions applicable to those programs;
- That consumers were preapproved for repayment programs and their loans were eligible for the “Student Loan Reform Act” when preapproval and eligibility determinations were not actually made; and
- Implying that the company was “endorsed, sponsored by, or affiliated with the Department of Education.”

The company and its CEO were also held responsible for violations of the Telemarketing Sales Rule’s prohibition on the collection of advanced fees for debt relief services and Regulation P’s requirement to deliver privacy notices.

The company and its CEO agreed to void all of its existing debt relief agreements, stop charging consumers any fees, shut down its operations, and pay a \$50,000 civil money penalty.

g. Dmitry Fomichev and Davit Gasparyan (T3Leads) – April 2016 (Marketing)¹³

D and D Marketing, Inc., doing business as T3Leads, provided lead aggregator services to payday and installment lenders. The CFPB alleged in a December 2015 civil complaint that the company and two of its then-current individual owners/operators engaged in unfair and abusive acts or practices when it failed to perform due diligence on companies it paid to generate leads (lead generators) and on the payday and installment lenders to whom it sold leads (purchasers).¹⁴ The individuals were held responsible for knowingly and recklessly providing substantial assistance to the company’s allegedly unfair and abusive acts or practices.

In April 2016 the CFPB filed separate civil complaints against one of the company’s co-founders who formerly held roles as the chief executive officer and chief technical officer, and against one of the company’s other co-founders who formerly held roles as the chief financial officer and chief marketing officer. The CFPB alleged that these individuals had significant responsibility for establishing T3Leads’ policies and practices that resulted in allegedly unfair and abusive practices and had substantial control over the company’s operations. In their respective roles, these individuals allegedly provided substantial assistance to the company’s unfair and abusive acts and practices.

These cases were not resolved at the time of publication.

¹³ *Consumer Financial Protection Bureau v. Dmitry Fomichev*, Case No. 2:16cv2724 (C.D. Ca. April 21, 2016) and *Consumer Financial Protection Bureau v. Davit Gasparyan, a/k/a David Gasparyan*, Case No. 2:16cv02725 (C.D. Ca. April 21, 2016).

¹⁴ For a complete summary of the alleged UDAAP violations in the December 2015 T3Leads case, see page 17 of our January 15, 2016 survey.

h. Pressler and Pressler/New Century Financial Services, Inc. – April 2016 (Debt Collection)¹⁵

Pressler & Pressler, LLP, is a New Jersey-based debt collection law firm. New Century Financial Services, Inc., is a debt buyer that buys and collects defaulted consumer debts and passes those accounts to Pressler & Pressler, LLP, which then attempts to collect the debt through lawsuits. The CFPB entered into a consent order with Pressler & Pressler, LLP, its principal partners, and New Century Financial Services, Inc., to resolve allegations of unfair and deceptive acts or practices in connection with the companies' debt collection practices.

The CFPB alleged that the parties engaged in unfair and deceptive practices by:

- Filing lawsuits against consumers without a sufficient basis, including with false or empty allegations and without adequately reviewing the information or documents that supposedly supported the allegations.
- Filing debt collection lawsuits based on information that was known to be unreliable or false.
- Harassing consumers with unsubstantiated court filings generated by an automated claim-preparation system.

Pursuant to the consent order, Pressler & Pressler, LLP, and its named partners agreed to pay a \$1 million civil money penalty, and New Century agreed to pay a \$1.5 million civil money penalty.

i. All American Check Cashing, Inc. – May 2016 (Check Cashing/Payday Loans)¹⁶

All American Check Cashing, Inc., and Mid-State Finance, Inc., offer check-cashing services and payday loans in Mississippi, Alabama, and Louisiana. The CFPB entered into a consent order with the companies and their individual owner and president in connection with allegations that the companies engaged in unfair, deceptive, and abusive check-cashing and payday loan practices.

The CFPB alleged that the following acts or practices were unfair:

- Failing to notify consumers who overpaid on a loan of such overpayment and then failing to return consumers' overpayments. If a consumer did not request a refund, credit balances were deleted from consumers' accounts.

The CFPB alleged that the following acts or practices were deceptive:

- Promising lower fees than competitors when such fees were not always lower.

¹⁵ *In the Matter of: Pressler & Pressler, LLP, Sheldon H. Pressler, and Gerard J. Felt*, File No. 2016-CFPB-0009, Consent Order (April 25, 2016); *In the Matter of: New Century Financial Services, Inc.*, File No. 2016-CFPB-0010, Consent Order (April 25, 2016).

¹⁶ *Consumer Financial Protection Bureau v. All American Check Cashing, Inc.; Mid-State Finance, Inc.; and Michael E. Gray*, Case No. 3:16cv356WHB-JCG (S.D. Miss. May 11, 2016).

- Misrepresenting that a multiple loan program was financially beneficial to consumers in comparison with obtaining a 30-day loan from a competitor, when, in fact, the company’s multiple loan program was never the financially beneficial option.

The CFPB alleged that the following acts or practices were abusive:

- Hiding fees associated with its check-cashing services through policies explicitly designed to prevent consumers from learning of the fees. And, if consumers attempted to cancel or reverse a check-cashing transaction after learning of the fee, falsely telling consumers that the process of reversing a transaction takes a long time or that the transaction could not be cancelled.

This case was not resolved at the time of publication.

j. Intercept Corporation – June 2016 (Payment Processing)¹⁷

Intercept Corporation is a third-party payment processor that facilitates the movement of funds through the Automated Clearing House (ACH) network between consumer bank accounts and other providers of consumer financial services, namely payday lenders, debt collectors, and auto title lenders. The CFPB filed a civil complaint against Intercept and its individual owners and operators¹⁸ alleging UDAAP violations.

The following practices were allegedly unfair:

- Ignoring warnings from industry, consumers, and law enforcement that the companies for whom it was performing payment processing services were engaged in illegal or fraudulent conduct; and
- Failing to conduct reasonable due diligence to detect their customers’ unlawful conduct.

By processing payments from consumers’ accounts despite the above red flags, the company allegedly caused, or engaged in conduct that was likely to cause, substantial consumer injury that was not reasonably avoidable and not outweighed by other benefits.

The company’s individual owners and operators were also held responsible for knowingly and recklessly providing substantial assistance with respect to the company’s UDAAP violations “by establishing, directing, and managing Intercept’s operations, including managing client and banking relationships, and exercising substantial control over Intercept’s operations on a day-to-day basis.”

This case was not resolved at the time of publication.

¹⁷ *Consumer Financial Protection Bureau v. Intercept Corporation, d/b/a InterceptEFT, Bryan Smith, and Craig Dresser*, Case No. 3:16cv00144-ARS (E.D. ND. June 6, 2016).

¹⁸ The CFPB alleged that the individuals’ material participation in the company’s operations rendered them “related person[s]” under the CFPA. The CFPB also alleged that each individual directly engaged in providing payment processing services.

IV. CFPB Supervisory Highlights

The CFPB periodically issues Supervisory Highlights reports that summarize its supervisory activity over a period of time and identify, among other things, allegedly unfair, deceptive or abusive conduct that may not have otherwise been publicly disclosed in enforcement actions.

a. Winter 2016 Supervisory Highlights (published in March 2016)¹⁹

The CFPB's Winter 2016 Supervisory Highlights report identified UDAAPs in connection with remittance payment services²⁰, namely deceptive statements leaving customers with a false impression regarding the conditions placed on designated recipients in order to access transmitted funds. The report also identified UDAAPs in the student loan servicing industry as described in the bullets below:

- One or more servicers engaged in unfair practices relating to auto-default provisions by auto-defaulting both a borrower and co-signer if either filed for bankruptcy;
- Failing to disclose a significant adverse consequence of forbearance; and
- Servicing conversion errors (in connection with change in ownership of loans) resulting in inaccurate interest rates that were deemed an unfair act or practice.

b. June 2016 Supervisory Highlights – Mortgage Servicing Special Edition²¹

The CFPB issued a special edition of Supervisory Highlights that focused on mortgage servicing issues. The following practices were considered unfair:

- Sending loss mitigation offer letters with response deadlines that had already passed or were about to pass;
- Imposing substantial delays between the successful completion of a loan modification trial period and conversion to a permanent loan modification, imposing additional interest costs and continuing to report the consumer as delinquent on consumer reports; and
- Failing to honor trial loan modifications that were in place at the time of a servicing transfer and imposing substantial delays before honoring loan modifications, causing incremental interest costs.

The following practices were considered deceptive:

- Sending loss mitigation acknowledgment notices stating that homes would not be foreclosed on prior to a stated deadline to submit documents, but initiating foreclosures before the stated deadline;

¹⁹ CFPB Supervisory Highlights, Issue 10 (March 2016), available at http://files.consumerfinance.gov/f/201603_cfpb_supervisory-highlights.pdf.

²⁰ Regulation E implements the Electronic Fund Transfer Act (EFTA).

²¹ CFPB Supervisory Highlights, Issue 11 (June 2016), available at http://files.consumerfinance.gov/f/documents/Mortgage_Servicing_Supervisory_Highlights_11_Final_web_.pdf.

- Stating that outstanding fees, charges, and advances could be deferred until the maturity date of the loan when these charges were assessed after a modification agreement was signed;
- Sending loan modification agreements to consumers with inaccurate terms (namely, the payment amount), receiving loan modification agreements signed by the consumer but not executing them and, instead, sending revised loan modification agreements with different terms to the consumer for signatures;
- Representing that consumers would receive a permanent loan modification after making three trial modification payments without disclosing in the modification offer letter that the permanent loan modification was contingent on a title search;
- Stating that deferred interest on a daily simple interest mortgage would be repaid at the end of the loan term when it was actually collected immediately after the deferment;
- Sending foreclosure notices to consumers who were current on a home equity line of credit; and
- Requiring a waiver of “defenses, set-offs, and counterclaims” that, although not related to the mortgage, were impliedly related to the mortgage when such waivers were prohibited by Regulation Z.

The following practices were considered abusive:

- Including language in a modification offer that made it impossible for consumers to understand how and when charges would be incurred.

c. June 2016 Supervisory Highlights²²

The CFPB’s Summer 2016 edition of Supervisory Highlights identified UDAAP issues in connection with debt collection and deposit reconciliation practices. Specifically, the CFPB indicated that it was an unfair practice to sell debt without properly reflecting that the accounts were in bankruptcy, were the product of fraud, or were settled in full.

The CFPB also noted that interagency guidance was issued with respect to deposit reconciliation practices.²³ The guidance builds upon an enforcement action against Citizens Financial Group²⁴ (summarized in our January 2016 survey) and concludes that a “financial institution’s deposit reconciliation practices for transaction and non-transaction accounts may, depending on the facts and circumstances, [constitute an unfair practice if they] result in credit discrepancies.”

²² CFPB Supervisory Highlights, Issue 12 (June 2016), available at http://files.consumerfinance.gov/f/documents/Supervisory_Highlights_Issue_12.pdf.

²³ Interagency Guidance Regarding Deposit Reconciliation Practices (May 18, 2016), available at http://files.consumerfinance.gov/f/documents/201605_cfpb_interagency-guidance-regarding-deposit-reconciliation-practices.pdf

²⁴ *In the Matter of RBS Citizens Financial Group, Inc. (N/K/A Citizens Financial Group, Inc.); RBS Citizens, N.A. (N/K/A Citizens Bank, N.A.); and Citizens Bank of Pennsylvania*, File No. 2015-CFPB-0020, Consent Order (Aug. 12, 2015).

V. Other Litigation

a. Commonwealth of Pennsylvania v. Think Finance, Inc., et al.²⁵

The Pennsylvania Attorney General filed a lawsuit against Think Finance and a series of other companies involved in the promotion, sale, and collection of loans that allegedly exceeded the state's interest rate cap through "rent-a-bank" and "rent-a-tribe" arrangements. Along with a series of claims under state law, the Attorney General alleged the following violations of the Federal UDAAP law under 12 USC 5536(a)(1)(B). In a January 2016 order, several of the allegations were dismissed.

- That it was unfair to condition the quick receipt of loan proceeds via electronic direct deposit on the consumer's agreement to electronic repayment, where the option to repay by mail was given but subject to a longer disbursement period. This allegation was denied by the court which found that the incentives to make electronic payments were not coupled with a lack of consumer understanding or any consumer injury.
- That it was unfair and deceptive to induce consumers to provide personal information, which in turn made them "vulnerable to future improper use." This allegation was denied by the court because it failed to specify consumer harm.
- That it was abusive to: 1) fail to disclose the terms of a loan; and 2) take advantage of consumers' lack of understanding about the legality of a loan. The first allegation was denied by the court for failing to meet the definition of "abusive" conduct under the statute, but the second allegation survived the motion to dismiss with the court reasoning that alleged misrepresentations regarding the legality of offered loans could have allowed the company to take unreasonable advantage of the consumer's lack of knowledge regarding the loans' purported illegality.

This case was not resolved at the time of publication.

²⁵ *Commonwealth of Pennsylvania v. Think Fin., Inc.*, No. 14-CV-7139, 2016 WL 183289 (E.D. Pa. Jan. 14, 2016).

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Supreme Court Positioned to Resolve Growing Circuit Split on the Scope of the FDCPA

By Jolina Cuaresma and Katherine Lamberth, White & Case LLP, and Brent Yarborough, Maurice Wutscher, LLP*

On March 23, 2016, in *Henson v. Santander Consumer USA Inc.*,¹ the United States Court of Appeals for the Fourth Circuit contributed to a growing circuit split on when a lender is considered a “debt collector” for purposes of the Fair Debt Collection Practices Act (“FDCPA”). Specifically, the circuits are divided as to whether FDCPA obligations attach when a lender purchases debt in default and attempts to collect on that defaulted debt. Consistent with the Ninth and Eleventh Circuits—but in contrast to the Third, Sixth, and Seventh—the Fourth Circuit held that a consumer finance company seeking to collect debt acquired in default is not a debt collector under the FDCPA. The *Henson* court reasoned that the company neither regularly collects debts “owed or due another,” nor is the company’s “principal purpose” debt collection.

On September 16, 2016, the Supreme Court was asked to review the *Henson* decision and to resolve this circuit split over the applicability of FDCPA to first-party creditors when they acquire debt in default. With the Consumer Financial Protection Bureau expected to issue FDCPA regulations in the next year, a resolution from the Supreme Court would provide much needed clarity on the FDCPA’s reach.

The FDCPA sets forth seemingly clear definitions.

According to legislative history, Congress did not intend for the FDCPA to apply to creditors such as banks and other consumer lenders. Unlike debt collectors, these institutions have a “desire to protect their good will when collecting past due accounts” which acts as an intrinsic restraint against abusive behavior.² As a result, the FDCPA only applies to “debt collectors,” who Congress found “are likely to have no future contact with the consumer and often are unconcerned with the consumer’s opinion of them.” Thus, when passing the FDCPA in 1977, Congress was explicit that the Act is meant to target “third parties who regularly collect consumer debts for *others*.”³

Debt collector

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¹ *Henson v. Santander Consumer USA Inc.*, 817 F.3d 131 (4th Cir. 2016).

² S. Rep. 95–382, 1977 U.S.C.C.A.N. 1695, 1696.

³ S. Rep. 95–382, 1977 U.S.C.C.A.N. 1695, 1698.

The definition of “debt collector” under the FDCPA is two-pronged: the first prong sets forth a threshold definition of who is a “debt collector” while the second prong excludes certain persons from the threshold definition.

1. Under the threshold definition, the following persons are “debt collectors”:
 - Any person whose *principal purpose* is to collect debt (“principal purpose test”);
 - Any person who *regularly* collects debts *owed to another* (“regularly collects test”); or
 - Any person who collects *its own debts*, using a *name other than its own* (“false name test”).⁴
2. A person is *not* a debt collector if, among other exceptions, they are “collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity concerns a debt which was *not in default* at the time it was obtained by such a person.”⁵

Creditor

Similarly, the FDCPA’s definition of “creditor” is two-pronged with the first prong defining who is a creditor and the second prong excluding those who are not.

1. The following persons are “creditors”:
 - Any person who “offers or extends credit creating a debt”; or
 - Any person “to whom a debt is owed.”
2. A person is not a creditor if they “receive[] an assignment or transfer of a debt *in default* solely for the purpose of facilitating collection of such debt for another.”

A circuit split arose because the definitions did not anticipate the current marketplace for secondary loans and debt.

Since 1977, the composition of the market for consumer loans and debt has changed drastically. As noted by the Consumer Financial Protection Bureau, Congress could not have foreseen “[t]he advent and growth of debt buying” when it enacted the FDCPA in 1977.⁶ In addition to the rise of debt buyers who purchase defaulted debt for collection purposes, Congress also did not anticipate that banks and other consumer creditors would sell and purchase portfolios of consumer loans in the ordinary course of business. Thus, courts have struggled to align the intent of Congress with the definitions of “creditor” and “debt collector” under the FDCPA.

The “Mutually Exclusive” Approach and Default Status of Debt

⁴ FDCPA § 803(6); 15 U.S.C. § 1692a(6).

⁵ FDCPA § 803(6)(F)(iii); 15 U.S.C. § 1692a(6)(F)(iii).

⁶ Consumer Financial Protection Bureau, Fair Debt Collection Practices Act: CFPB Annual Report 2014, at 7 (March 2014), available at http://files.consumerfinance.gov/f/201403_cfpb_fair-debt-collection-practices-act.pdf.

The Third, Sixth, and Seventh Circuits have held that an entity that acquires a debt and subsequently seeks to collect on it must be either a “creditor” or “debt collector” under the FDCPA with respect to that debt, as those terms are mutually exclusive. In these circuits, an entity is a creditor, and exempt from the FDCPA’s requirements, if it originated the subject debt or if it purchased the subject debt when such debt was not in default. On the other hand, the entity is a debt collector if it purchases a debt that is in default at the time of the transfer.⁷

Thus, under the mutually exclusive approach, an entity that fails to meet either the “principal purpose” test or the “regularly collects” test may nevertheless be considered a debt collector for FDCPA purposes if it obtains debt that it is in default at the time of assignment and subsequently attempts to collect upon that debt. The Seventh Circuit best explained the justification for the mutually exclusive approach in *Schlosser v. Fairbanks Capital Corp.*, where the court found that a company that “acquire[s] [performing] debt [and] continues to service it . . . is acting much like the original creditor” whereas a company that acquires defaulted debt must have “acquire[d] the debt for collection [and] is acting more like a debt collector.”⁸

The Other Approach

On the other side of the divide, the Fourth, Ninth, and Eleventh Circuits have found that an entity must meet either the “principal purpose,” “regularly collects,” or “false name” test in order to be considered a “debt collector” for FDCPA purposes.⁹ Accordingly, a company that acquires defaulted debt in the ordinary course of business and seeks to collect upon such debt is not classified as a “debt collector” where it does not meet any of the three tests set forth under the threshold definition. However, a company whose principal business is acquiring defaulted debt for collection purposes, such as a debt buyer, will be classified as a “debt collector,” even though it may also meet the definition of “creditor.” By virtue of meeting the FDCPA’s definition of “debt collector,” such a company is subject to the FDCPA’s restrictions on collection activity. Thus, unlike the mutually exclusive approach, this view recognizes that not every entity acquiring debt in default “acquires the debt for collection.”¹⁰

In *Davidson v. Capital One Bank (USA)*, the Eleventh Circuit explicitly rejected the view that a company that acquires a debt in default must be a debt collector for FDCPA purposes, stating that “the statutory definition of ‘debt collector’ applies without regard to the default status of the

⁷ Though the Fifth Circuit and D.C. Court of Appeals have noted that the default status of acquired debt is operative for classifying the acquiring entity as a creditor or debt collector under the FDCPA, that position was ancillary to the courts’ decisions and precluded the courts from contemplating whether such an entity must meet the threshold definition of “debt collector” to be subject to the FDCPA. *See Perry v. Stewart Title Co.*, 756 F.2d 1197, 1208 (5th Cir. 1985) (explaining that defendants acquired the loans before default and thus were not debt collectors under the FDCPA because that term “does not include . . . an assignee of a debt, as long as the debt was not in default at the time it was assigned”); *Logan v. LaSalle Bank Nat’l Ass’n*, 80 A.3d 1014, 1021 (D.C. 2013) (finding the FDCPA inapplicable because subject debt was “not in default at the time it was obtained” and thus defendants were not “debt collectors”). Thus, these courts have not conclusively held that a consumer finance company—which neither has a “principal purpose” of debt collection nor regularly collects debts “owed or due another”—that acquires defaulted debt in the normal course of business is a “debt collector.”

⁸ *Schlosser v. Fairbanks Capital Corp.*, 323 F.3d 534, 536 (7th Cir. 2003).

⁹ *See Henson*, 817 F.3d at 136; *Davidson v. Capital One Bank (USA), N.A.*, 797 F.3d 1309, 1314 (11th Cir. 2015); *Schlegel v. Wells Fargo Bank, N.A.*, 720 F.3d 1204, 1208 (9th Cir. 2013).

¹⁰ *See Davidson*, 797 F.3d at 1317 n.8 (“An entity that may collect on a debt owned by and owed to it in the course of doing business falls outside of the Act’s intended scope. But an entity whose “principal purpose” is the collection of “any debts,” is subject to the FDCPA under the first definition of ‘debt collector.’”).

underlying debt.”¹¹ According to the court, the FDCPA should not be interpreted “to bring entities that do not otherwise meet the definition of ‘debt collector’ within the ambit of the FDCPA solely because the debt on which they seek to collect was in default at the time they acquired it.”¹² Thus, where a person obtains “debt [that] was in default at the time it was acquired . . . , the person may be a debt collector, but the person is not undoubtedly a debt collector; one of two statutory standards still must be met.”¹³

A similar conclusion was reached by the Ninth Circuit in *Schlegel v. Wells Fargo Bank*, which held that a company that acquires and subsequently seeks to collect upon debt in its own name *must* meet either the “principal purpose” or “regularly collects” test in order to be considered a “debt collector” subject to the FDCPA.¹⁴ In reaching its conclusion, the Ninth Circuit explicitly rejected the mutually exclusive view, stating that it “fails to differentiate between debts ‘owed to another’ and debts originally owed to another but now owed to [the acquirer].”¹⁵

Likewise, in *Henson v. Santander Consumer USA*, the Fourth Circuit “conclude[d] that the default status of a debt has no bearing on whether a person qualifies as a debt collector under the threshold definition set forth in [Section 803(6) of the FDCPA].” The court further held that such a “determination is ordinarily based on whether a person collects debt on behalf of others or for its own account, the main exception being when the “principal purpose” of the person’s business is to collect debt.”¹⁶

The Supreme Court should grant certiorari in *Henson*.

The federal courts of appeals are clearly divided over the scope of the FDCPA and its application to companies that purchase and collect on defaulted debt. In urging the Court to grant certiorari, Petitioners address both the significance of the existing circuit split over the definition of “debt collector” under the FDCPA and also argue that the Fourth Circuit decided *Henson* incorrectly.

Petitioners mainly argue that the Fourth Circuit interpreted the phrase “owed or due another” too strictly in assessing whether Santander met the threshold definition of “debt collector” under the regularly collects test. According to Petitioners, because the phrase “owed or due another” does not say whether the debt must be due another at the time of collection or at the time of origination, the ambiguity should be resolved by reference to the rest of the definition. Specifically, the phrase should be interpreted in conjunction with Section 803(6)(F)(iii) of the FDCPA, which excludes from the definition of “debt collector” any “person collecting or attempting to collect any debt . . . owed or due another to the extent such activity . . . concerns a debt which was not in default at the time it was obtained by such person.”

Petitioners’ argument—consistent with case law in the Third, Sixth and Seventh Circuits—directly contradicts case law in the Ninth and Eleventh Circuits. Petitioners assert that under the precedent of the Fourth, Ninth, and Eleventh Circuits, the FDCPA does not apply to “debt buyers.” However, Petitioners fail to distinguish between “debt collector[s] that purchase the

¹¹ *Id.* at 1314.

¹² *Id.* at 1315.

¹³ *Id.* at 1315 (referring to the “principal purpose” and “regularly collects” tests – the “false name” test was not at issue).

¹⁴ *Schlegel*, 720 F.3d at 1208.

¹⁵ *Id.* at 1210.

¹⁶ *Henson*, 817 F.3d at 138.

defaulted debt [they are] seeking to collect” and consumer finance companies, such as Santander, that purchase a portfolio of debts (some of which may be in default) in the normal course of business.¹⁷

One thing is certain, however: Supreme Court review of *Henson* is warranted because “the question whether the FDCPA applies to those who purchase defaulted debt . . . is of vital importance.”¹⁸ With courts on both sides of the circuit split reasoning that their conclusions are compelled by statute, “there is no prospect that a federal agency could resolve the dispute by issuing regulations.”¹⁹

¹⁷ Petition for Writ of Certiorari at 10, *Henson v. Santander Consumer USA Inc.*, No. 16-349 (US Sept. 16, 2016).

¹⁸ *Id.* at 10.

¹⁹ *Id.* at 18.

Business Law Section Raises First Amendment Concerns About CFPB Proposal

By Ori Lev,¹ Mayer Brown LLP

In mid-October, the Business Law Section (“Section”) submitted comments on behalf of the Consumer Financial Services Committee and the Banking Law Committee in response to important First Amendment issues raised by a Consumer Financial Protection Bureau (“CFPB”) proposed rule. The Section’s comments are available [here](#). The President of the American Bar Association (“ABA”) submitted separate comments, available [here](#), raising the ABA’s concerns about the implications of other aspects of the proposed rule for attorney-client privilege.

The Section was moved to comment by a provision of the proposed rule, which was published in August and is available [here](#), that would prohibit private persons in possession of CFPB “confidential investigative information” from disclosing the information without the prior permission of the CFPB’s Associate Director for Supervision, Enforcement, and Fair Lending. [Proposed § 1070.42\(b\)](#). The proposed rule only included a few limited exceptions from this requirement.

“Confidential investigative information” would be broadly defined in [Proposed § 1070.2\(i\)](#) to include a wide array of documents connected with investigations, including but not limited to civil investigative demands (“CIDs”) and Notice and Opportunity to Respond and Advise (“NORA”) letters, [81 Fed. Reg. at 58,316](#). Under the proposed rule, therefore, recipients of CIDs from the CFPB would be prohibited from disclosing their existence other than in narrowly-defined circumstances or with the CFPB’s blessing.

As the Section’s comments explained in detail, this aspect of the CFPB’s proposal appears to violate the First Amendment. Simply put, our constitutional system presumes that ordinary citizens do not need to obtain the permission of a government official before they choose to speak about government activities.

To put it more technically, the proposal would appear to be a “prior restraint” on speech, because the speaker needs the prior permission of a government official. It also appears to be a “content-based restriction,” because the government is restricting speech based on the topic discussed. Because of these factors, the proposal should be considered “presumptively unconstitutional” and can only be justified if: (1) it satisfies certain stringent procedural safeguards, including

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expeditious judicial review, as “the censor must bear the burden of going to court to suppress the speech”; and (2) the restriction is narrowly tailored to serve a compelling government interest.

The Section’s comment letter explains that in light of these core First Amendment principles, other agencies—like the Securities and Exchange Commission, the Federal Trade Commission, and even the Federal Bureau of Investigation in national security matters—do not attempt to impose blanket nondisclosure requirements of the type proposed by the CFPB when they conduct investigations. To the extent that other agencies have imposed nondisclosure requirements in connection with their investigations, they have done so pursuant to specific statutory authority that the CFPB lacks; they have made individualized determinations that a nondisclosure requirement is necessary in the specific case; and they have been required to initiate prompt judicial review.

Further, as members of the Consumer Financial Services Committee who have been involved in CFPB investigations know from their experience, the CFPB has had a very active enforcement program to date, without relying on a blanket nondisclosure requirement. Although it is possible to read the CFPB’s current regulations at [12 C.F.R. 1070.41\(a\)](#) as prohibiting disclosure of confidential information, including confidential investigative information, the CFPB does not include any such instruction in its voluminous CID instructions. Further, in the case of CID recipients who are not the main subject of an investigation, in our experience the CID instructions simply ask for the “voluntary cooperation” of the CID recipient in maintaining the confidentiality of the investigation. These practices undermine any claim that the CFPB has a compelling government interest in imposing a blanket nondisclosure requirement in all of its investigations.

The Section’s comments urge the CFPB to reconsider its proposal and state affirmatively that CID recipients may disclose confidential investigative information if they choose. CID recipients will often choose to maintain the confidentiality of CFPB investigations, for example in order to avoid the unwarranted tarnishing of their reputations. But they may wish to share the existence of a CID for commercial reasons (*e.g.*, with commercial lenders or in connection with a proposed sale of the company) or to air their concerns to elected officials. The First Amendment protects their right to speak if they so choose.

A diverse range of other commentators, ranging from the [American Civil Liberties Union](#) to the [U.S. Chamber of Commerce](#), also raised First Amendment concerns about the proposed rule.

The Consumer Financial Services Committee is proud to have played a role in raising these important First Amendment issues. We wait for the CFPB to issue a final rule, which typically takes several months, in order to find out how the CFPB responds to these concerns.