

Enforcement Authority Granted to the Consumer Financial Protection Bureau and its Potential Impact on Student Lending



August 8, 2011
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Consumer Financial Protection Bureau (CFPB)

—Overview

- Created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
- Housed in (and funded by) the Federal Reserve, but independent from the Fed
- Vested with rulemaking authority for numerous financial protection laws as of July 21, 2011, including the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, and the Fair Debt Collection Practices Act, among others
- Rulemaking authority for new consumer financial protections created by the Dodd-Frank Act

Consumer Financial Protection Bureau—Responsibilities

- Defining and regulating unfair, deceptive, or abusive acts or practices (UDAAP)
 - Unfair and deceptive practices
 - Abusive acts or practices
- Consumer complaints—Private Education Loan Ombudsman
- Financial education and financial literacy—Office of Financial Education
- Financial protection for military and older Americans
- Fair lending regulation and supervision (other than Fair Housing Act)
 - Unlike federal bank regulators, CFPB does not need to use DOJ to pursue fair lending claims

Consumer Financial Protection Bureau— Jurisdiction

- Covered Persons
 - Anyone who engages in offering or providing a consumer financial product or service
 - Service providers to covered persons, and affiliates who act as service providers
 - Exclusions: most merchants and retailers; motor vehicle dealers; brokers
- Examination Jurisdiction
 - Insured Depository Institutions with total assets of greater than \$10 billion
 - Institutions below this threshold will continue to be examined by their current regulator for compliance with consumer protection laws using regulations promulgated by the CFPB
 - Certain non-depositories that provide financial products and services
 - Mortgage lenders
 - Payday lenders
 - Providers of private education loans
 - Larger providers of other products and services
 - Others found to cause consumer harm

CFPB Authority Over Private Student Lenders

- One of only three categories of nondepository entities enumerated by the Dodd-Frank Act as subject to CFPB supervision (others can be added via rulemaking)
 - “any covered person who offers or provides to a consumer any private education loan, as defined in section 140 of the Truth in Lending Act”
- Depository institutions with over \$10 billion in assets also subject to CFPB supervision; smaller banks will continue to be supervised by primary federal regulator using CFPB regulations. *However...*
- Some confusion in statutory language—the definition incorporated from TILA includes both depository and nondepository institutions, potentially opening the door to an argument that all banks, not just those over \$10 billion, are subject to CFPB supervision with respect to student lending (unlikely though that is). Rulemaking will clarify.
- Unclear whether private servicers are included or would have to be added by a rulemaking.

CFPB Authority Over Private Student Lenders (cont'd)

- CFPB must require reports from and conduct examinations of private student lenders on a periodic basis to
 - assess compliance with federal consumer financial law
 - obtain information about activities and compliance systems
 - detect and assess risks to consumers and to markets for consumer financial products and services
- CFPB has exclusive enforcement authority for federal consumer financial laws
 - other agencies authorized to enforce federal consumer financial laws may recommend to CFPB that an enforcement proceeding be initiated
 - a more elaborate role-sharing arrangement is contemplated between the FTC and CFPB

Consumer Financial Protection Bureau— Relation to Federal Trade Commission

- Federal Trade Commission (FTC) retains rulemaking authority under the FTC Act and other consumer protection laws except for those federal consumer financial protection laws whose authority is transferred to the CFPB
- FTC retains authority to enforce CFPB regulations against persons subject to FTC jurisdiction under the FTC Act
- CFPB and FTC required to negotiate an agreement to coordinate their enforcement jurisdiction

CFPB Enforcement Options

- Investigations
- Administrative Adjudications
- Civil Actions
- Criminal Referrals

CFPB Enforcement—Who Can be Sanctioned?

- Covered Person
- Service Provider
- Related Person
 - Deemed to be a “covered person” for all purposes
 - Any director, officer, agent, managerial employee of controlling shareholder
 - Any shareholder, joint venture partner, consultant, or other person who *materially participates* in the affairs of a covered person
 - Any independent contractor who *knowingly or recklessly* participates in a violation of law or breach of a fiduciary duty

CFPB Enforcement—Available Remedies

- **Cease and Desist Orders**
 - Including temporary cease and desist orders
- **Civil Money Penalties**
 - Up to \$5,000 per violation, per day
 - Up to \$25,000 for reckless violations; \$1 million for knowing violations
- **Other Available Remedies**
 - Rescission or reformation of contracts
 - Refund of money or return of real property
 - Restitution
 - Disgorgement of compensation for unjust enrichment
 - Damages or other monetary relief
- **Recovery of Civil Action Costs**

State Enforcement of Title X of the Act

■ State Enforcement Actions

- State Attorneys General—May bring civil actions to enforce Title X of the Dodd-Frank Act or CFPB regulations promulgated under Title X
- State Regulators—May bring civil actions or “other appropriate proceedings”

■ Exception for National Banks and Federally-Chartered Thrifts

- A state *may* not bring an action to enforce the provisions of the Statute
- But, *may* bring an action to enforce a CFPB regulation

■ Consultation Required

- A state AG or regulator must consult with CFPB before bringing action
 - Unless in an emergency
- CFPB may intervene and remove to federal court

Preemption of State Law by the Act and Other Federal Consumer Protection Laws

- The Act's consumer protection mandates and the CFPB's implementing regulations will preempt only "inconsistent" state laws, and only to the extent of the inconsistency
 - State laws providing greater protection for consumers are not considered "inconsistent"
- Preemption by existing federal "enumerated consumer laws" (e.g., TILA) is largely unchanged

Possible Litigation Consequences

- Increased consumer class actions
- New state attorney general actions
- Judicial uncertainty about reliance on current preemption jurisprudence
- Less uniformity in preemption rulings by courts

Evolution of UDAP/UDAAP

- Section 5 of the Federal Trade Commission Act
 - Enacted in 1938; application to banks clarified in 1975
 - Prohibits unfair or deceptive acts or practices (UDAP)
 - Enforced by the FTC for non-banks and by the federal banking agencies for banks
 - Considerable FTC/bank regulatory agency precedent on what is “unfair” or “deceptive”
 - Note: There are comparable state statutes

Evolution of UDAP/UDAAP (cont'd)

- Changes Made by Title X of the Dodd-Frank Act
 - Added the “abusive” standard (thus “UDAAP”)
 - Granted rule-making and enforcement authority to CFPB
 - Codified law specifically for financial institutions

What is “Deceptive”?

- Not defined in Dodd-Frank or FTC Act, but FTC guidance states
 - a product, service, or activity may be “deceptive” if it involves a material representation, omission, or practice that is likely to mislead
 - a “material representation” is one that is likely to affect a consumer’s choice of conduct, such as express or implied claims, and may include omitted information
 - a “material representation” includes a statement related to purpose, cost, or performance/quality
 - “Reasonable Consumer” test
- Unknown if CFPB will apply FTC precedent

“Reasonable Consumer” Test (per FTC)

- Focus is on the consumer’s interpretation and whether the consumer is “likely” to be misled—actual deception need not have occurred
- If a particular audience is being targeted, that audience will be the standard for determining whether a consumer’s interpretation is reasonable
- “Net Impression” is the key—in determining whether a practice is deceptive, the entire advertisement, transaction, or course of dealing will be considered

“Deceptive” Case Examples

- Providian National Bank (2000)
 - OCC found that Providian had
 - advertised a “No Annual Membership Fee” credit card but failed to disclose that the card required the purchase of credit protection for \$156 a year
 - failed to disclose adequately to consumers the limitations in the credit protection program it marketed
 - represented to consumers that they would save money by transferring their balances to a Providian credit card, despite the fact that the interest rate on the card was higher than what many were paying with other products
 - instructed employees to provide misleading or false information to complaining customers
 - Providian agreed to pay at least \$300 million to consumers harmed by the identified practices

“Deceptive” Case Examples (cont’d)

- Advanta Bank Corporation (2009)
 - FDIC found that
 - Advanta’s “Cash Back Reward” program advertised a cash back percentage for credit card usage that was effectively impossible to achieve because of the tiered structure of the cash back payments
 - Advanta’s solicitations made material representations that were likely to mislead a reasonable customer, and that therefore the Bank had engaged in a pattern of deceptive acts or practices in violation of Section 5 of the FTC Act
 - Advanta agreed to an order to cease and desist, to pay restitution of approximately \$14 million, and to pay a civil money penalty in the amount of \$150,000

What is “Unfair”?

- Dodd-Frank Act adopts the FTC Act’s definition of “unfair,” suggesting similar interpretations
- An act or practice may be “unfair” if it results in a consumer injury that is substantial, not outweighed by any offsetting consumer or competitive benefits, and not reasonably avoidable
- The harm must be injurious in its “net effects” for a practice to be “unfair” (“injury” is typically economic)
- Goal is not to second-guess consumer choices, but to prevent behavior that “unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.”

“Unfair” Case Examples

- Woodforest Bank (2010)
 - OTS alleged that the savings association failed to impose a reasonable limit on aggregate overdraft fees assessed under an automatic-enrollment overdraft program and failed to provide consumers overdrawn on their accounts with a reasonable opportunity to cease the imposition of additional daily fees for remaining overdrawn
 - Woodforest agreed to deposit at least \$12 million into a restitution fund and to pay a \$400,000 civil money penalty

“Unfair” Case Examples

- Advanta Bank Corporation (2009)
 - FDIC found that
 - Advanta had increased the APR on accountholders who had neither exceeded their credit limits nor were delinquent with their payments
 - Advanta's rate increases had been implemented in an unfair manner, as Advanta had failed to adequately notify accountholders of the APR increase, the amount of the increase, the reason for the increase, the procedures to opt-out, and the consequences of an opt-out
 - the repricing caused substantial injury to customers
 - Advanta withheld and/or provided inadequate information that could have enabled the customer to reasonably avoid the injury
 - Advanta's actions provided no benefit to the customer or competition
 - Advanta agreed to an order to cease and desist, to pay restitution of \$21 million to accountholders whose accounts were repriced, and to pay a civil money penalty in the amount of \$150,000 (previously noted)

What is “Abusive”?

- New standard added by the Dodd-Frank Act
- Defined as an act or practice that
 - materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
 - takes unreasonable advantage of
 - a consumer’s lack of understanding of the material risks, costs, or conditions of the product or services;
 - a consumer’s inability to protect his or her interests in selecting or using a consumer financial product or service; or
 - a consumer’s reasonable reliance on a covered person to act in the interests of the consumer

What is “Abusive”? (cont’d)

- Practices that have been labeled “abusive” in other contexts:
 - Prepayment penalties
 - Automatic interest rate changes upon default
 - Balloon payments
 - Negative amortization
 - Failure to consider borrower’s ability to pay
- CFPB is authorized to promulgate regulations to clarify what is “abusive”

What is “Abusive”? (cont’d)

- Richard Cordray, the administration’s current nominee for director, has stated that student loans are high on his enforcement agenda
- Mr. Cordray has suggested in public remarks that the following may be “abusive”:
 - Teaser rates
 - Sloppy underwriting
 - Loan documentation that obscures actual terms
 - Incentives for pushing loans that borrowers cannot afford
- Elizabeth Warren’s “business models built on tricks and traps”

Possible Consequences of the New Standard?

■ Increased Paternalism?

- Both the “inability to protect” and the “reasonable reliance” standards suggest that service providers, to some degree, could be expected to substitute their judgment for that of consumers.
- Ensuring that consumers make a fully informed decision may no longer be sufficient. If a product is determined to have “harmed” a consumer, the product could be deemed abusive, even if the consumer knew of the possible “harm” and chose to use the product anyway.

■ Creation of a Suitability Standard?

- Will service providers be required to determine whether financial products are (or are not) “suitable” for specific consumers or specific classes of consumers?
- Will a fiduciary duty arise to look out for the best interests of consumers?
- Fair lending implications?

Potentially Problematic Practices

- “Steering” customers towards more expensive products when lower-cost alternatives are available
 - Encouraging a private loan as a better alternative to a government grant?
- Selling financial services or products with nontraditional features to unsophisticated consumers
 - Giving adjustable-rate, negatively amortizing, or balloon-payment loans to students who may not understand them?
- Lending funds in excess of what is needed for educational purposes
 - For example, so-called “latte loans”
- “Excessive” fees or interest rates that bear little relation to actual costs or risks

Other Issues on the Horizon

- Private Education Loan Ombudsman
 - Will receive and follow up on complaints from consumers
 - Consistent with the consumer complaint function of the CFPB
 - Could lead to investigations (similar to FTC process and OCC CAG)
- Comprehensive report to be prepared for Congress on private education loans and private educational lenders (due July 21, 2012)
 - To be prepared by the Director of the CFPB and the Secretary of Education, in consultation with the Commissioners of the FTC and the Attorney General of the United States
 - Among its focuses are underwriting and pricing practices and effectiveness of consumer protections
 - Could result in changes in rules, guidance, and enforcement policy