

Payment Processors in the Regulatory Crosshairs: Updates on Regulatory Scrutiny and Best Practices for Compliance

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FTC Enforcement Authority Against Payment Processors

FTC Enforcement Mechanisms

- **Investigations** – Generally not public.
- **Administrative Adjudications** – A quasi-judicial, trial-like proceeding that is held before an administrative law judge.
- **Direct Litigation for Rule (and Some Statutory) Violations** – Section 19 of the FTC Act (15 U.S.C. § 57) authorizes the FTC to go directly to federal court to obtain redress for violations of rules (and some statutes).
- **Referrals to Department of Justice** – The FTC can refer the case to the Department of Justice to commence a lawsuit for civil penalties.
- **Penalty Offense Authority** – Section 5(m)(1)(b) of the FTC Act authorizes the FTC to seek civil penalties against a defendant where the defendant has engaged in conduct it actually knew to be unfair or deceptive because the FTC identified it as unfair or deceptive in a prior, unrelated proceeding.
- **Section 13(b) for Preliminary and/or Permanent Injunctions** – Limited to preliminary and permanent injunctive relief after the Supreme Court’s decision in *AMG Cap. Mgmt., LLC v. FTC*, 141 S. Ct. 1341 (2021).

FTC Legal Theories to Pursue Payment Processors

Section 5 Unfairness Claims: Section 5(a) of the FTC Act provides that “unfair or deceptive acts or practices in or affecting commerce . . . are . . . declared unlawful.” 15 U.S.C. § 45(a)(1).

- **“Unfair” Element**: When an act or practice “causes or is likely to cause *substantial injury* to consumers which is *not reasonably avoidable* by consumers themselves and *not outweighed by countervailing benefits* to consumers or to competition.” 15 U.S.C. § 45(n).
- **Common “Unfair” Violations**: Unfair billing practices.

Telemarketing Sales Rule (TSR), 16 C.F.R. Part 310:

Common Payment Processing TSR Violations:

- **Remotely Created Payment Order**: When seller/telemarketer, directly or indirectly, creates or causes to be created a “remotely created payment order” (e.g., RCC) as payment for goods or services offered or sold through telemarketing. 16 C.F.R. § 310.4(a)(9).
- **Assisting and Facilitating**: When a person substantially assists or supports a seller/telemarketer and “knows or consciously avoids knowing” that the seller/telemarketer engages in an act or practice that violates the TSR.

In re Electronic Payment Systems, LLC

■ A Little Background

- Electronic Payment Systems, LLC (EPS) is an independent sales organization (ISO).
- The FTC originally filed a lawsuit in federal district court in 2017.
- After *AMG*, the court denied the FTC's request for a permanent injunction and equitable monetary relief as to certain defendants.
- The Commission then voted to file an administrative complaint.

In re Electronic Payment Systems, LLC: The FTC's Allegations

- FTC Act Section 5 Violations (Unfair Credit Card Laundering):
 - EPS's independent sales agents allegedly falsified merchant applications.
 - EPS approved and opened fake merchant accounts with straw owners intended to conceal the underlying merchants' true identities.
 - EPS processed transactions through multiple fake merchant accounts, even after accounts should have been closed.
- TSR Violation (Assisting and Facilitating):
 - “[EPS] provided substantial assistance or support to [merchants] that [EPS] knew, or consciously avoided knowing, were engaged in credit card laundering acts or practices.”

In re Electronic Payment Systems, LLC: The Proposed Settlement

- The FTC and EPS entered into a proposed consent agreement on March 15, 2022.
- The proposed settlement was available for public comment through the end of April.
- On May 12, 2022, the Commission voted to approve the settlement 4-0.
- Because of the Supreme Court's decision in *AMG*, the settlement does not include any monetary relief.

In re Electronic Payment Systems, LLC: The Proposed Settlement (cont.)

- Restrictions on the types of merchants for whom EPS can process:
 - No merchants that misrepresent the total cost of a product/service
 - No shell companies
 - No merchants that misrepresent their line of business
- Enhanced screening of certain merchants, including those involved in telemarketing, debt collection and relief, and money-making opportunities, regarding:
 - business or products that they market or advertise,
 - ownership structure,
 - the transactions they process where a consumer's credit card is not physically presented to the merchant, and chargeback rates.

In re Electronic Payment Systems, LLC: The Proposed Settlement (cont.)

- Additional monitoring requirements for certain merchants:
 - Review merchant websites and telemarketing scripts
 - Review and investigate consumer complaints
 - Monitor transactions for unusual trends, values, transactions, and volume
 - Monitor merchant account use
 - Calculate chargeback rates on a monthly basis
 - Initiate investigation (including secret shopping) when chargeback rates exceed 1% or 55 per month in any two months of a six-month period
- Monitoring and termination of independent sales agents:
 - Monitor sales agents' past referrals and existing portfolio
 - Terminate relationships with any sales agent that has referred merchants that the agent knew, or should have known, engaged in unlawful conduct

Recent FTC Actions Against Payment Processors

FTC v. Universal Guardian Acceptance, LLC and Universal Account Servicing, LLC:

- FTC alleged that UGA and UAS unlawfully funded and serviced ineffective and deceptive investment training offerings for a merchant, violating Section 5.
- Obtaining monetary relief in the post-AMG enforcement world:
 - The settlement agreement also resolves the FTC's previously unalleged TSR violation.
- Settlement terms:
 - Must forgive debt for impacted consumers
 - Must obtain evidence of certain prospective clients' cancellation rate for the past 12 months
 - Must investigate earnings claim complaints and cancellation rates in excess of 5% or 50 total in two consecutive months.

Recent FTC Actions Against Payment Processors (cont.)

FTC v. Automatic Funds Transfer Services, Inc.:

- FTC alleged AFTS processed \$31 million in consumer payments for an allegedly fraudulent student loan debt relief scheme in violation of the TSR.
- Settlement Terms:
 - AFTS banned from payment processing for debt relief services and student loan entities.
 - Stringent monitoring requirements, including:
 - Investigate chargeback where total rate exceeds 2.5% or monthly rate exceeds 1% or 40 chargebacks in a month.
 - Ordered to pay \$500,000, with remaining \$27,084,969 suspended because of inability to pay.

Recent FTC Actions Against Payment Processors

FTC v. Hornbeam Special Situations, LLC:

- FTC alleged that iStream Financial Services, the payment processor for merchants selling allegedly fraudulent discount club memberships, assisted and facilitated TSR violations and engaged in unfair billing practices in violation of Section 5 by processing unauthorized RCC payments.
- Settlement Terms:
 - iStream agreed to cease using remotely created payment orders, including RCCs.
 - iStream agreed not to process payments for any business involving outbound telemarketing, discount clubs, or payday loans.
 - Stringent monitoring requirements, including:
 - Reviewing marketing materials, and searching for NACHA and law enforcement activity or placement on a mandated chargeback monitoring program
 - Ordered to pay \$2,300,000.
 - Samuel Levine, director of the BCP, acknowledged that the settlement was regrettably small (compared to the \$40 million initially sought) because of the Supreme Court's decision in *AMG*.

Court-Appointed Receiver Action against Financial Intermediary

- ***McNamara v. Wells Fargo:***

- FTC brought unrelated lawsuits against Triangle Media and Apex Capital for consumer protection violations.
- The court appointed a receiver, Thomas McNamara, to oversee the assets of both defendants (at the FTC’s request).
- McNamara then sued Wells Fargo—the bank both defendants used—in one complaint for two different receiverships, alleging:
 - Aiding and abetting fraud, violating California’s UCL, and other violations.
 - Wells Fargo ignored red flags, including (1) that the deposit accounts were set up for shell companies for a high-risk business (“free trials”), (2) high chargeback rates, and (3) corporate policies and the law.
- The case is pending. Wells Fargo’s motion to dismiss was granted in part.



CFPB Enforcement Authority Against Payment Processors

CFPB Enforcement Mechanisms

- **Early Warning Notice** – The CFPB may elect to send a warning letter to potential subjects of enforcement actions before initiating an enforcement action.
- **Investigation** – The CFPB is authorized to investigate potential violations of “any provision of Federal consumer financial law.”
- **Enforcement Actions.**
 - Litigation in federal court.
 - Administrative adjudication.
- **Non-bank Supervision & Examination** – The CFPB has the power to assert supervisory authority over non-bank consumer financial services companies it has “reasonable cause to determine . . . [are] engaging, or [have] engaged, in conduct that poses a risk to consumers.” 12 U.S.C. 5514(a)(1)(C).
 - Once a non-bank is subject to the CFPB’s supervisory authority, it may become the subject of a supervisory exam, which can be a grueling process.
 - The CFPB has not exercised this authority since the passing of the Dodd-Frank Act, but Director Rohit Chopra recently signaled the Bureau’s intention to start invoking it.

CFPB Legal Theories for Pursuing Payment Processors

Unfairness Claims: Section 1031(c)(1) of the Consumer Financial Protection Act (CFPA)

- When there is a “reasonable basis” that an act or practice: (1) causes or is likely to cause consumers substantial injury; (2) that is not reasonably avoidable by them; and (3) “such substantial injury is not outweighed by countervailing benefits to consumers or to competition.” 12 U.S.C. § 1031(c)(1).
 - Strikingly similar to the FTC Act’s standard

Telemarketing Sales Rule

- The CFPB, like the FTC, also enforces the Telemarketing Act and its implementing rule, the TSR.
- The CFPB relies on many of the same TSR violations as the FTC, but also frequently invokes violate an additional provision of the TSR:
 - **Advance Fee Rule**: When collecting fees before performing debt relief services. 16 C.F.R. § 310.4(a)(5)(i).

In re RAM Payment, LLC

- The CFPB investigated debt-relief payment processors, RAM Payment and Account Management Systems, as well as the company's co-founders, for CFPB and TSR violations in connection with the companies' relationships with student loan and traditional debt-relief merchants.

Investigation Findings:

- RAM collected advance fees for debt relief services in violation of the TSR
- RAM violated the CFPB by falsely representing that it was independent third-party companies, despite Winters & Chaya owning an affiliated financing company.
- RAM violated the CFPB by failing to return unearned fees for student loan debt relief services after consumers had canceled services.

The May 11, 2022 Consent Order

- \$8.7 million refund to consumers enrolled in student loan debt relief services.
- \$3 million civil money penalty to Bureau's victim relief fund.
- Industry bans:
 - AMS, Winters, and Chaya banned from debt-relief payment processing and account maintenance industry.
 - RAM Payment banned from providing services to student loan debt-relief and traditional debt-relief companies receiving funding from an affiliated financing company.

CFPB v. BrightSpeed Solutions, Inc.

- On March 3, 2021, the CFPB sued BrightSpeed Solutions, Inc., a third-party payment processor, and the company's owner individually, Kevin Howard, alleging CFPA and TSR violations in connection with BrightSpeed's processing of remotely created checks for merchants selling expensive and unnecessary antivirus software and technical support services to consumers.
- BrightSpeed positioned itself as a processor for "high-risk" telemarketing business
- Complaint alleged that BrightSpeed:
 - was aware of high complaint volume (including complaints directly to BrightSpeed), return rates between 22% and 24%, and concerns voiced by banking partners.
 - failed to meaningfully vet and monitor merchants.

January 2022 Stipulated Judgment

- Banned from payment processing, consumer lending, deposit-taking, and financial advisory services industries.
- Banned from engaging in debt collection and telemarketing activities in connection with consumer financial products and services.
- Howard ordered to pay a \$500,000 civil money penalty to the Bureau's Civil Penalty Fund.
- \$54 million in monetary relief and damages suspended because of inability to pay.

CFPB & New York v. MoneyGram International

On April 21, 2022, the CFPB and NY AG jointly sued MoneyGram International and MoneyGram Payment Systems, alleging MoneyGram unlawfully failed to deliver funds in a timely manner to recipients and failed to develop policies and procedures to ensure compliance with money transfer laws.

- Alleges MoneyGram violated the CFPA, Electronic Funds Transfer Act, the Remittance Rule, and New York law regarding violations of the Remittance Rule.

Prior Knowledge of Violations:

- CFPB alleges that MoneyGram knew it was violating the Rule because of CFPB examinations dating back to 2014 but failed to make the necessary changes.

Repeat Offender Allegations:

- MoneyGram settled fraud charges brought by the FTC in 2009, agreeing to pay \$18 million and to implement an anti-fraud and agent-monitoring program.
 - Had to pay \$125 million in 2018 after failing to comply with the 2009 Order.
- In 2012, MoneyGram forfeited \$100 million to the DOJ, admitting it criminally aided and abetted wire fraud and failed to maintain an AML program.

The case is pending. The response to the Complaint is due May 20.



Common Red Flags for Regulators & Best Practices

Common Red Flags in the On-Boarding Process



1. Merchant engaged in high-risk business activities, such as outbound telemarketing or using remotely created checks or payment orders.
2. Law enforcement or other regulatory actions against merchants.
3. Deficient merchant applications, with vague or nonexistent descriptions of business and product(s)/services(s) sold.
4. One merchant opening numerous merchant accounts/locations without offering different products/services.
5. Concerns regarding owner financial viability, including low credit scores and large outstanding debts.
6. Merchant marketing materials contain inconsistent disclosures or other potentially deceptive/confusing material.

Common Red Flags In Ongoing Monitoring



7. Merchant accounts opened with shell companies or straw owners.
8. Evidence transaction volume is being spread across multiple merchant accounts (“load balancing”).
9. Excessive rates of transactions returned by consumers (“chargebacks”) or cancellations.
10. Merchant transaction activity is inconsistent with expectations or historical trends.
11. High levels of consumer complaints against merchants.
12. Discrepancies between dates and amounts debited from what consumers authorized.

Best Practices

1. **Maintain Strong Culture of Compliance.**

- The board, management, and senior officers must understand and take an active role in overseeing and monitoring compliance.
- Enact written policies regarding screening prospective merchants, monitoring existing merchants, and investigating and removing merchants that fail to comply with policies and the law.
- Employ competent, experienced compliance personnel.

2. **Sufficient Personnel and Technological Resources to Manage Monitoring and Compliance Needs.**

3. **Recordkeeping.**

4. **Strong Onboarding Process.** Merchants should be subject to prescreening before acceptance, including KYC/Identity Verification, prior legal actions, business and operational model, web/marketing content, consumer complaints, OFAC checks, and credit risk underwriting checks.

Best Practices continued...

- 5. Ongoing Monitoring and Regular Risk Assessments.** Conducting regular monitoring and audits to identify potential bad actor merchants, including:
 - At least monthly monitoring of:
 - Unusual activity, such as transactions out of the merchant's normal business area
 - Spikes in activity, such as exceeding transaction thresholds
 - High chargeback or cancellation rates
 - Consumer complaints and legal action
 - Regularly updating KYC/Identify Verification information.
 - Regularly reviewing merchants' websites, marketing materials, and telemarketing scripts (if applicable).
- 6. Suspending and Terminating Bad Actor Merchants**



What to Expect When Under Investigation

When Regulatory Eyes Are Watching You

Why us?

- Enforcement targets are typically identified through consumer complaints, whistleblower tips, referrals from other agencies, supervisory exams, or the Agency's own fact-gathering.

Formal versus informal investigation

- Informal investigation: Collecting information and evidence from a variety of sources, including other enforcement agencies, ISPs, and disseminated advertisements.
- Formal investigation: Generally made via a civil investigative demand.
 - Can include requests to answer written questions, produce documents, and testify at in-person investigational hearings.

Tips for Responding to an FTC or CFPB Investigation

- Be thorough and thoughtful—responses and documents could be used in a subsequent enforcement action.
- Engage experienced counsel.
- Preserve responsive materials.

Advocacy before the Agency via White Paper Submissions

Challenging or Failing to Respond to a CID

- Petition to quash.
- Motion to compel a response.

Next steps

Questions?



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