Adjusting Your Operations and Compliance for UDAAP Risks

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Today’s Session

1. Sources of UDAAP Risk

2. The Evolving Application of UDAAP

3. Challenges: Asset Classes and Practices

4. Tools and Policymaking

5. Adjusting Risk Tolerances, and Minimizing Legal and Regulatory Risk
   a) RMAi Certification Standards – Steps you can take today!
   b) What’s on the horizon?

6. Wrap Up
Backdrop: CFPB and Divided Congress
The 118th Congress and the Biden Administration

- Return of divided government and continued narrow majorities in both chambers
  - House – Republicans flip majority (mirror image of 117th Congress)
  - Senate – Democrats retain control and gain a seat for outright majority
  - Overall, this was the best midterm performance by President’s party since 2002

- What does this mean?
  - House – a slim majority is still a majority
    - Aggressive oversight
    - RIP Biden legislative agenda
  - Senate – no more veto power for any one senator
    - Biden maintains control over judicial nominations and personnel – agency leaders are able to implement
    - Counterbalance to House Republican oversight
  - Biden administration – no course correction (including banking agencies)
  - CFPB Remains in the driver’s seat, but with backseat drivers!
CFSA v. CFPB: 5th Circuit and What’s Next?

• 5th Circuit held that the CFPB is funded in an unconstitutional manner.

• The court reasoned that the Constitution’s framers sought to create separation of powers by placing the power of the purse exclusively in Congress’s purview, articulated through the Appropriations Clause in the Constitution.

• When Congress combined authority (rulemaking, supervision, enforcement) over consumer financial services with the ability to self-fund into one agency, Congress violated the principle of separation of powers and the Appropriations Clause.
Impact of Fifth Circuit Decision and What’s Next

S.Ct. Conference on February 17, 2023
Sources of UDAAP Risk
What is UDAAP Risk?

• Unfair, Deceptive, or Abusive Acts or Practices (UDAAPs) – can cause significance financial injury to consumers, erode consumer confidence, and undermine the financial marketplace.

  • Consumer Financial Protection Act (UDAAP)
  • Section 5 of the Federal Trade Commission Act (UDAP)
  • Mini-State FTC Acts
  • Additional federal and state laws include UDAAPs / UDAPs
CFPA: UDAAP Deeper Dive

• The Dodd-Frank Act renders it unlawful for a “covered person” or a “service provider” to engage in any unfair, deceptive, or abusive act or practice. That is, the Act’s UDAAP prohibitions only apply to individuals and entities that are “covered persons” or “service providers.”

• The Dodd-Frank Act defines “service provider” as:
  
  • any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that-- **

  • (ii) processes transactions relating to the consumer financial product or service (other than knowingly or incidentally transmitting or processing financial data in a manner that such data is undifferentiated from other types of data of the same form as the person transmits or processes)
Relationship to Other Laws

- A UDAAP may also violate federal or state laws
  - Truth in Lending Act
  - Equal Credit Opportunity Act

- A transaction, practice, or product may be in technical compliance with other federal or state laws, but may violate the prohibition on UDAAPs.

- A violation of a consumer financial law may be a UDAAP
  - FDCPA
Substantial Assistance Risk

• Section 1036 of the Dodd-Frank Act renders it unlawful for any person to “knowingly or recklessly provide substantial assistance” to a covered person or service provider committing a UDAAP.

• On January 10, 2022, the Consumer Financial Protection Bureau (CFPB) filed a complaint in federal district court against three affiliated debt-buying businesses and the individuals who founded and operated them for "knowingly and recklessly [placing debts with and selling them to] debt collection agencies that used threats and misrepresentations to coerce payments from consumers."
The Evolving Application of UDAAP
Bulletin 2013-07: Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts

- Collecting or assessing a debt and/or any additional amounts in connection with a debt (including interest, fees, and charges) not expressly authorized by the agreement creating the debt or permitted by law.

- Failing to post payments timely or properly or to credit a consumer’s account with payments that the consumer submitted on time and then charging late fees to that consumer.

- Taking possession of property without the legal right to do so.

- Revealing the consumer’s debt, without the consumer’s consent, to the consumer’s employer and/or co-workers.

- Falsely representing the character, amount, or legal status of the debt.

- Misrepresenting that a debt collection communication is from an attorney.

- Misrepresenting that a communication is from a government source or that the source of the communication is affiliated with the government. Misrepresenting whether information about a payment or nonpayment would be furnished to a credit reporting agency.

- Misrepresenting to consumers that their debts would be waived or forgiven if they accepted a settlement offer, when the company does not, in fact, forgive or waive the debt.

- Threatening any action that is not intended or the covered person or service provider does not have the authorization to pursue, including false threats of lawsuits, arrest, prosecution, or imprisonment for non-payment of a debt.
UDAAP and Targeting Discrimination

“The CFPB will examine for discrimination in all consumer finance markets, including credit, servicing, collections, consumer reporting, payments, remittances, and deposits. CFPB examiners will require supervised companies to show their processes for assessing risks and discriminatory outcomes, including documentation of customer demographics and the impact of products and fees on different demographic groups. The CFPB will look at how companies test and monitor their decision-making processes for unfair discrimination, as well as discrimination under ECOA.”

Source: CFPB Press Release (Mar. 16, 2022)

- Controversy, litigation, and examination observations
Bulletin 2022-05: Unfair and Deceptive Acts or Practices That Impede Consumer Reviews

• According to the CFPB reviews of products and services help to promote fair, transparent, and competitive markets.

• When firms frustrate the ability of consumers to post honest reviews of products and services that they use, they may be engaged in conduct prohibited by the CFPA.
First Party Creditors: FDCPA and UDAAP

- Creditors that collect third-party debt using an assumed name are covered.
- Banks that use third-party collectors have vendor management responsibilities
- Banks can engage in violations of Section 5 of the FTC Act / CFPA
- Vendors face substantial assistance risk
Asset Classes and Practices
Bulletin 2022-04: Mitigating Harm from Repossession of Automobiles

• The Bureau intends to hold loan holders and servicers accountable for UDAAPs related to the repossession of consumers’ vehicles.

• Wrongful repossession of consumers’ vehicles
  • Misrepresentations
  • Servicers incorrectly coded consumers as delinquent
  • Servicer representatives failed to cancel repossession orders that had previously been communicated to repossession agents
  • Repossession agents failed to confirm that the repossession order was still active prior to repossessing a vehicle.

• Other practices causing wrongful repossession (e.g., bankruptcy automatic stay)
True Lender, Competition, Scale and Technology Under the Microscope

- **“True Lender”** – CA DFPI v. OppFi (and OppFi v. CA DFPI), putting the “predominate economic interest test” to the test.

- **CFPB scrutiny of competition, scale, and technology in the consumer finance infrastructure, and its connection to relationship banking**
  - “Local financial institutions depend on core services providers being agile, responsive, and cost-effective in order to compete and serve their clients and customers in their communities.” – CFPB Director Rohit Chopra, Opening Remarks to the Community Bank and Credit Union Advisory Councils (April 7, 2022)

- **Bank Partnerships Getting a Closer Look** – “Some lenders employing rent-a-bank schemes have unusually high default rates, which raise questions about whether their products set borrowers up for failure. And our complaints database reveals a range of other significant consumer protection concerns with certain loans associated with bank partnerships.” – CFPB Deputy Director Zixta Martinez’s Keynote Address at the Consumer Federation of America’s 2022 Consumer Assembly (June 15, 2022)
Integrated “super apps”
Provide users with a wide array of financial, payments, and commerce functions within a single app; nearly every capability needed to conduct their online life
May be convenient, but may limit consumer product and service choice

Embedded commerce
Purchase options ranging from QR code payments on a restaurant check or screen to contactless transactions at the points of sale and payments fully embedded in a social media feed
Transaction is enabled with very little activity from the consumer, increasing the risk of an unwanted purchase

Buy Now, Pay Later (BNPL)
Four-payment, no interest loans; now have their own apps with rewards and social media platforms
Hidden charges (late fees), potential overextension of credit, concern over data use highlight the discussion
Other Areas of Scrutiny in 2023?

• Focus on Junk Fees
• AI and Machine Learning
• Credit reporting – furnishing and reporting
• “Banking as a service” and “payments as a service” will continue to grow, which will allow additional fintechs and services providers to offer bundled services to customers.
• Continued expansion of buy now, pay later, along with heightened regulatory scrutiny
• Continued enforcement against companies that engage in UDAAP affecting consumers and small businesses
• Focus on “dark patterns,” user interfaces and subscription / continuity services
• Protecting financially distressed consumers
• Privacy and data security practices
Tools and Policymaking Developments
The CFPB is developing a rule under its authorities at 12 U.S.C. 5512(b) and (c) and 5514(b) that would require nonbanks that are under certain final enforcement orders:

- to register with the CFPB via a public registry that the CFPB would create for such purposes;
- to submit copies of public orders to the same; and, where such persons are supervised by the CFPB,
- to prepare and submit annual reports and other statements regarding such orders for use in connection with the CFPB’s supervisory functions.

The public registry created by the CFPB would identify institutions subject to registration and include public enforcement orders and information regarding those orders.

Status: NPRM
Nonbank Registration of Consumer Terms and Conditions

• January 11, 2023 - CFPB published a proposed rule that would require supervised nonbank entities to register and provide information about their use of certain terms and conditions in standard-form contracts.

• In particular, the CFPB is targeting the following types of terms:
  ◦ waivers of claims a consumer can bring in a legal action;
  ◦ limits on the company’s liability to a consumer;
  ◦ limits on the consumer’s ability to bring a legal action by dictating the time frame, forum, or venue for a consumer to bring a legal action;
  ◦ limits on the ability of a consumer to bring or participate in collective legal actions such as class actions;
  ◦ limits on the ability of the consumer to complain or post reviews; certain other waivers of consumer rights or other legal protections; and arbitration agreements

• Status: NPRM
Privacy and Data Security

• **CFPB Announcements:** Recent rulemakings by the CFPB demonstrate an increased focus on digital marketing and consumer data rights—topics of key interest to privacy advocates.

• **New State Privacy Laws:** UDAAP continues to be a significant tool used by states, but comprehensive state privacy laws in California, Virginia, Colorado, Connecticut, and Utah have already gone, or will go, into effect in 2023. All five laws have exemptions relevant to financial institutions.
  ◦ Financial institutions should continue to comply with state privacy laws for any consumer data that is not exempted.
  ◦ Additionally, financial institutions should be prepared to comply with obligations under the California Privacy Rights Act related to personnel and business contacts.

• **Federal Privacy Activity:** Both Congress and the FTC actively took steps to develop new privacy frameworks in 2022, and it is likely such efforts will continue this year.

• **Upgraded Safeguards Rule** for non-bank financial institutions (some exceptions for entities with info for less than 5k customers) effective June 9, 2023.
State Developments: UDAAP

• State AGs to remain active on consumer protection matters related to economic distress and vulnerable consumers.

• CFPB partnering and reminder to states to utilize Consumer Financial Protection Act / UDAAP.

• Alleged violations of law and regulations involving advertisements, websites, and social media sites utilized by mortgage companies, and lenders.

• NMLS Modernization in process
  ◦ single source of standardized data that all regulators require; supports interdependent reviews by state agencies based on uniform standards that allow agencies to rely on one another’s work, eliminating redundancies.
  ◦ Piloted with MSB licenses.
  ◦ Growing number of debt collection licenses
  ◦ How will this fit with CFPB enforcement order database?
Adjusting Risk Tolerances, and Minimizing Legal and Regulatory Risk
Certification and building on your CMS....steps you can take today....
Standard A1 – Laws & Regulations

Laws & Regulations. A Certified Company shall comply with all local, state, and federal laws and regulations concerning:

(a) collection activity on consumer accounts,
(b) the rights of consumers,
(c) debt buying, and
(d) financial services as they may apply to debt collection companies. In the United States, these laws shall include, but not be limited to, the Fair Debt Collection Practices Act, the Telephone Consumer Protection Act, the Fair Credit Reporting Act, the Servicemembers Civil Relief Act, the Electronic Fund Transfer Act, the United States Bankruptcy Code, section 5 of the Federal Trade Commission Act, and sections 1031 and 1036 of the Dodd-Frank Act.
Standard A5 – Consumer Complaint and Dispute Resolution

**Consumer Complaint and Dispute Resolution.** A Certified Company shall establish and maintain written Consumer Complaint and Dispute resolution policies and procedures that instruct employees how to handle, document, process, and attempt to resolve Consumer Complaints and Disputes in compliance with the Certification Program and applicable laws and regulations, including but not limited to the Fair Debt Collection Practices Act and the Fair Credit Reporting Act. It is within a company’s discretion as to whether the policy will apply to accounts that are in active litigation. A reasonable policy shall include, but not be limited to, measures taken to ensure:

(a) When a Consumer Complaint or Dispute is received, active collection activity shall be paused until
   (i) the complaint or dispute is investigated and a response has been transmitted to the consumer following the investigation;
   (ii) it has been determined the complaint or dispute is a duplicate where the consumer has already received a response; or
   (iii) it has been determined that the consumer appeared in court and admitted to the debt.

On accounts purchased on or after January 1, 2017, when a consumer questions the accuracy or validity of a debt, the company should confirm such accuracy and/or validity through the use of Original Account Level Documentation or a copy of a valid judgment;
Standard A5 – Consumer Complaint and Dispute Resolution

Continued

(b) When a consumer provides an FTC identity theft report, the company shall immediately cease all collections on applicable accounts and refer the affidavit to compliance or legal for review prior to resuming collections;

(c) A consumer-friendly approach to communications is emphasized with employees.
Standard A13 – Chief Compliance Officer

Chief Compliance Officer. A Certified Company shall create and maintain the position of “Chief Compliance Officer” with a direct or indirect reporting line to the president, CEO, board of directors, managing partner, or general counsel (unless the Chief Compliance Officer is the president, CEO, managing partner, or general counsel). The Chief Compliance Officer’s documented job description shall include, at a minimum, the following responsibilities:

(a) Maintaining an electronic or physical copy of the Certified Company’s most recent application for the Certification Program;

(b) Maintaining the Certified Company’s official copy of the Certification Standards Manual;

(c) Identifying policies, procedures, or activities of the Certified Company that are out of conformity with the Certification Standards;

(d) Either directly or indirectly:
   (i) receiving Consumer Complaints,
   (ii) investigating the legitimacy of Consumer Complaints, and/or
   (iii) overseeing the complaint process, including complaint activity, root cause analysis, and timely response;
Standard A13 – Chief Compliance Officer Continued

(e) Developing recommendations for corrective actions when the Certified Company is not conforming with the Certification Standards and providing them to his or her direct and indirect report(s);

(f) Interacting as the point of contact, unless designated otherwise by the company, for the CFPB, FTC, state and local consumer regulatory agencies, and state and federal attorneys general regarding the oversight and accountability of the Certified Company’s Consumer Complaint and Dispute Resolution Policy and the CFPB’s Consumer Complaint System; and

(g) Maintain his or her status as a Certified Individual pursuant to section 5.5(A) of the Governance Document
Standard A15 – Vendor Management

Vendor Management. In order to identify and retain qualified third-party vendors and to assure appropriate oversight of such vendors, a Certified Company shall:

(a) Establish and maintain vendor management policies and procedures with defined due diligence and/or audit controls. The Chief Compliance Officer or a designee shall perform an annual assessment of these policies and procedures and provide any recommendations for improvements to his or her direct and indirect report(s);

(b) Perform an annual assessment of the company’s third-party vendors to determine whether they continue to meet or exceed the requirements and expectations of the company. As part of the annual assessment, the Certified Company may need to perform additional due diligence, including by way of example rather than limitation, confirmation of certification status, vendor audits, review of policies and procedures maintained by vendors, and review of consumer complaints related to the vendor (including the data publicly available on the CFPB’s consumer complaint system); and

(c) Obtain the certification number when contracting with a vendor claiming to be an RMAI Certified Company or RMAI Certified Vendor and confirm the vendor’s certification status on RMAI’s website.
Standard B3 – Due Diligence

Due Diligence. A Certified Company shall conduct reasonable due diligence on entities the company seeks to contract with for the purchase or sale of receivables prior to the transmission or receipt of any account level data.

Reasonable due diligence shall include, but not be limited to, reviewing:

(i) publicly available financial statements associated with United States Securities and Exchange Commission filings, if applicable,

(ii) the entity’s reputation and experience,

(iii) adverse litigation and/or consent orders against the entity in the prior two years; and

(iv) the volume and nature of consumer complaints filed with the CFPB’s consumer complaint system and the Better Business Bureau against the entity in the prior two years.

In addition, when the originating creditor is not a party to the contract for the purchase or sale of receivables, reasonable due diligence shall also include reviewing:

(i) the entity’s financial strength,

(ii) the data security measures the entity has adopted to preserve the integrity and privacy of Consumer Data, and

(iii) adverse information concerning the entity and the entity’s principals.
Expanded Supervision / Focus on Repeat Offenders

- Nonbanks whose activities the CFPB has reasonable cause to determine pose risks to consumers. Expands nonbank exams beyond
  - mortgage, private student loan, and payday loan industries, regardless of size
  - “larger participants” in other nonbank markets for consumer financial products and services (i.e., consumer reporting, debt collection, student loan servicing, international remittances, and auto loan servicing)
- Continued Release of Consumer Financial Protection Circulars and advisory opinions:
  - make our positions on statutory authorities clear to covered entities, the public, and other consumer protection enforcers
  - transparency by launching a new way for the public to petition for rulemakings
- Emerging Trends from the Trenches: Perpetual exams for certain nonbanks vs. cadence of risk-based exams, payment processing fees, scrutiny of AI, concerns with failure to consider all available options (dark patterns), debt collection / loss mitigation, credit reporting, privacy, and more

“Supervision is *increasing its focus on repeat offenders*, particularly those who violate agency or court orders.

As part of that focus, Supervision has created a **Repeat Offender Unit**.

- reviewing and monitoring the activities of repeat offenders;
- identifying the root cause of recurring violations;
- pursuing and recommending solutions and remedies that hold entities accountable for
- failing to consistently comply with Federal consumer financial law; and
- designing a model for order review and monitoring that reduces the occurrences of repeat offenders.”

Source: CFPB Supervisory Highlights Fall 2022
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