The Chief Compliance Officer Perspective

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Contents

Inside Tips for Demonstrating Compliance and Navigating CFPB Examinations, an *RMA Insights* publication 3

FinTech Compliance Resources and Policy Perspectives 6

The Keys to Managing Regulatory Change 8

CFPB Retrospective—Five Enduring Lessons in the Wake of Cordray's Departure 11

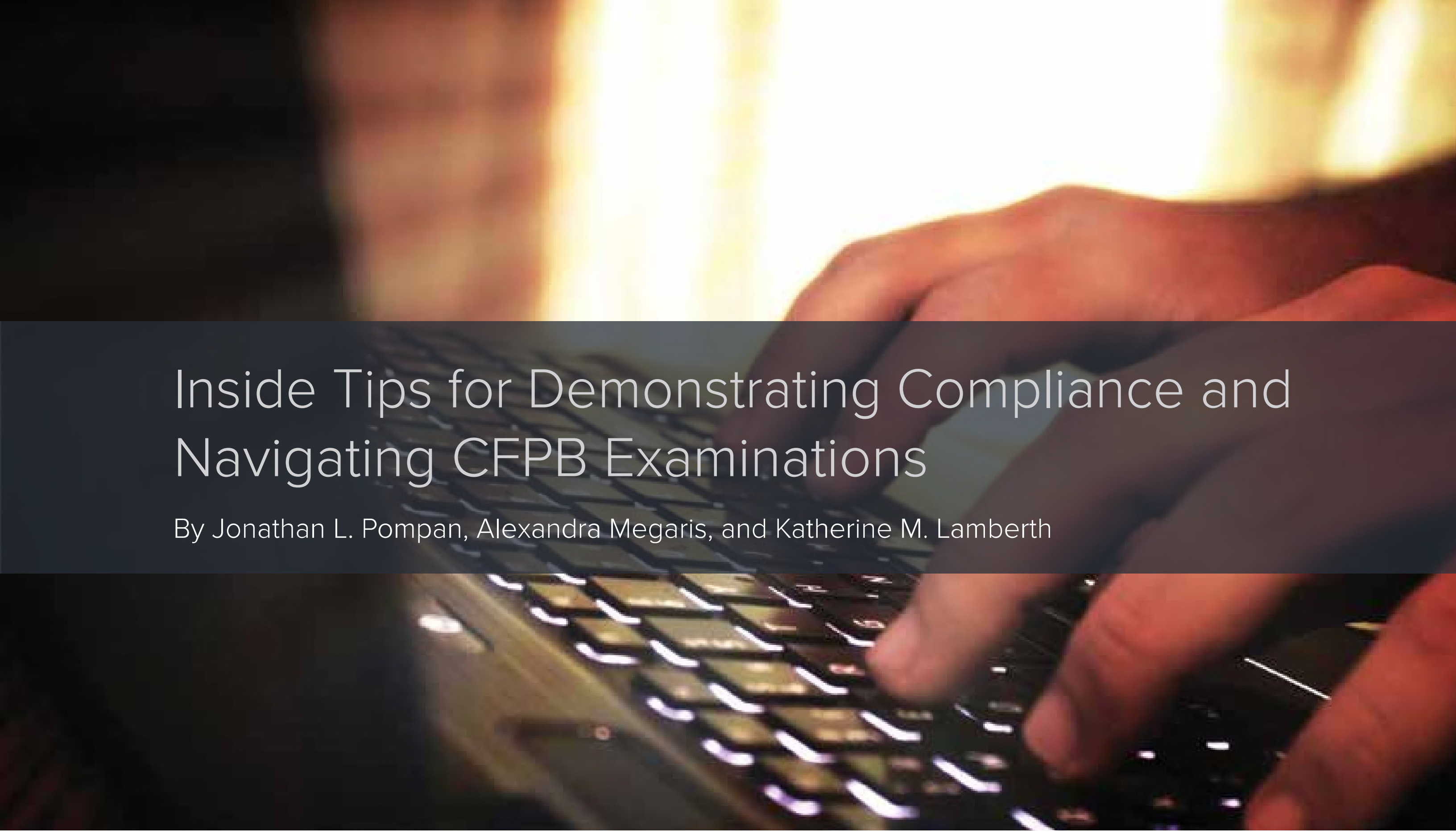
Five Common Consumer Financial Services Legal and Regulatory Due Diligence Mistakes to Avoid in M&A 14

Big Data and Fintech: Avoiding Fair Lending and UDAP Pitfalls 16

A Recap of the California Finance Lender License for FinTech Companies 18

FinTech and Marketplace Lenders Under Scrutiny 20

FTC Releases Staff Perspectives on Lead Generation 23



Inside Tips for Demonstrating Compliance and Navigating CFPB Examinations

By Jonathan L. Pompan, Alexandra Megaris, and Katherine M. Lamberth

Navigating a government examination requires more foresight and vigilance than ever. Between the inception of the Consumer Financial Protection Bureau (CFPB) and heightened scrutiny from state and local regulators, it is no secret that regulatory expectations have increased exponentially over the past several years. Furthermore, even companies that are RMA certified and accustomed to government oversight can find supervisory interactions with federal and state regulators, particularly with CFPB, to be opaque and confusing. As a result, members of the receivables management industry must be careful when navigating an examination. To shed some light on the CFPB's processes for examinations and investigations, as well as the intersection of supervision and enforcement, we obtained several documents from the CFPB through a Freedom of Information Act (FOIA) request, including a copy of the CFPB's internal Supervision, Enforcement, and Fair Lending (SEFL) Examination Playbook (Examination Playbook), SEFL Integration Memorandum (Memorandum), and the Enforcement Policies and Procedures Manual Version 2.0 (Enforcement Manual). In addition to illuminating the key decisions and inputs of various stakeholders that are made throughout the examination and investigation processes, these documents provide details on what a company facing an examination or investigation can expect at each stage.

The Examination Process

The Examination Playbook identifies and describes the key decisions that arise at each stage of the examination process, as well as who within the CFPB is responsible for making and implementing each key decision. The purpose of the Examination Playbook is to provide guidance to CFPB decision makers on their roles and responsibilities, referred to as "decision rights," throughout the examination or target review.

As outlined by the Examination Playbook, the examination process is composed of four stages: scoping, on-site analysis, off-site analysis, and report review.

Scoping

Scoping involves setting examination priorities and schedules across markets and individual institutions. It also includes conducting pre-examination activities such as preliminary information requests and determining the scope of the examination.

- Examination Priorities. The Assistant Directors (ADs) for the

Office of Supervision Policy (OSP) are responsible for determining examination priorities. Resources are allocated using a risk-based assessment that evaluates the potential for consumer harm based on the institution's market share and risks inherent to the institution's operations. Inherent risk factors may include, but are not limited to, previous examinations, regulatory actions, and consumer complaints. Because of the CFPB's risk-based approach for selecting entities to examine, an institution that has a robust compliance management system (CMS) is less likely to be a priority for CFPB examination.

- Specific Scope and Schedule. The Examiner-in-Charge (EIC) is responsible for making decisions regarding the scope of the examination, the preparation of the Information Request, and the examination schedule. These decisions involve determining which activities will be conducted during the examination and relevant modules, and which items of information are pertinent to the examination of the particular institution.

On-Site Analysis

On-site analysis involves conducting interviews, observations, transaction testing, and other examination processes that assess the institution's compliance with federal consumer financial laws and potential violations. After the on-site examination is complete, additional time may be granted for the off-site analysis of relevant factual findings and other information.

- Modifications to Scope. The Field Manager/Senior Examination Manager (FM/SEM) is responsible for making decisions regarding modifications to the scope of the examination once it has commenced.

- Examination Findings. The EIC is responsible for conducting the closing meeting and making related decisions, including any preliminary examination findings, expected corrective actions, recommended rating, and next steps. The EIC is also responsible for preliminary decisions regarding whether an examination is "clean"—i.e., does not involve any potential violations of federal consumer financial laws—and eligible for review on an expedited track. The Assistant Regional Director (ARD), the OSP AD, and the Office of Enforcement (ENF) are responsible for approving review of an examination on an expedited review track.

Off-Site Analysis

Off-site analysis involves escalating potential violations of federal consumer financial laws discovered during the examination and determining whether an enforcement or supervisory action should be pursued. It is at this stage that collected information and findings can lead to an enforcement action.

- Interpretations of Non-Routine Questions of Law. The Legal Division is responsible for determining whether a violation has occurred with respect to non-routine questions of law, except where the question of law involves a regulation – then the Office of Regulations is responsible for the determination.

- PARR Letter. A Potential Action and Request for Response (PARR) Letter notifies the institution that the CFPB is considering whether to propose a supervisory or enforcement action, based on preliminary findings of potential legal violations. The FM/SEM is responsible for determining whether a PARR letter should be sent. The PARR Letter is drafted by the OSP Program Manager and approved by the Regional Director.

- ARC. Decisions on whether potential legal violations should be escalated to the Action Review Committee (ARC) are also made by the FM/SEM. The ARC evaluates over thirteen factors spread among four categories: violation, institution, policy, and justice. The ARC then recommends to the Director whether the matter should be handled through the supervisory process or public enforcement action.

Report Review

Once an examination report is prepared, the review process depends on whether it is scheduled for expedited or full review.

- Expedited Review. Under the expedited track, the examination report is reviewed by the FM/ SEM and the OSP Program Manager and Deputy AD and approved by the RD.

- Full Review. Under the full-review track, the examination report is reviewed by the FM/ SEM, the OSP Program Manager and Deputy AD, the Legal Division, and staff of the Office of Enforcement, and reviewed and ratified by the OSE AD, OSP AD, RD, and SEFL Associate Director.

Key Tips for Navigating and Examination

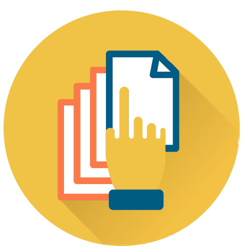
Knowing the CFPB's internal examination policies and processes, and understanding who is responsible for making policy decisions and factual findings is important for developing a strategy for responding to examination information requests. Here are a few important considerations when planning for a CFPB examination:

- Plan with All Stakeholders, but Be Prepared to Defend with Counsel. A culture of compliance starts at the top and is exemplified by an active compliance committee involved in examination preparedness; but when there is a potential that allegations regarding consumer financial law violations or a deficient compliance management system could be raised during an examination, in-house and outside counsel should be included to ensure that rights are protected and legal obligations are interpreted correctly.

- Demonstrate Compliance through a Tailored CMS. Companies that have completed examinations with few or no findings are those that not only comply with legal requirements, but can also effectively demonstrate such compliance through a tailored CMS. Further, institutions that demonstrate a strong CMS are deemed to present a lower risk to consumers and are generally examined less frequently. The RMA certification is a great tool for establishing and maintaining a strong CMS foundation.

- Leverage Participation in Industry Self-Regulation. The RMA certification program promotes rigorous industry standards. The standards are designed to meet federal and state statutory requirements, and many of the RMA standards exceed these requirements and establish best practices for the receivables industry.

- Designate a Leader and Ambassador. A CFPB examination is demanding and requires internal leadership and an "ambassador" who can interface the EIC and other staff. Designate an employee (preferably within the legal or compliance department) to serve as the point of contact for the CFPB examination team and to lead the process for document collection and production.



- Watch Your Flank. Develop a process of working with legal counsel to review all submissions to the CFPB for responsiveness, privilege, and consistency. The overall facts presented during the course of a review will be analyzed and findings of an examination may lead to a recommended course of action (e.g., supervisory or enforcement action).

- Develop Advocates. It is important to prepare employees who likely will interface with CFPB examiners to explain how compliance is addressed among complex operations. Employees can be instrumental in reflecting a compliance culture, and the impression that the EIC and other examiners have about a company's dedication to compliance can affect how information is presented in formal work papers and preliminary examination findings.

- Know the Law. Specific facts and law should be assessed with an eye to differences between the company and the CFPB on legal positions and analysis. This will help inform how alleged violations of federal consumer financial law are addressed.

The key to successfully navigating a CFPB examination is preparation. The companies in the best position to manage regulatory scrutiny are those that understand and follow applicable laws, invested significant time and resources to build their compliance management programs, and have the capacity to proactively identify issues and make corrections when needed.

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January 19, 2017

FINTECH COMPLIANCE RESOURCES AND POLICY PERSPECTIVES

Fintech remains at the forefront of the agenda of many financial services companies, investors, and regulators. The potential to transform how financial services are delivered and to improve underlying processes like payments, platforms, investor opportunities and more, has made fintech one of the most heavily discussed topics in recent years. Balancing the potential for financial innovation with the need to make compliance sense of these new models is the challenge that is front and center in a new publication from the Federal Reserve Bank of Philadelphia. Also, in the closing days of the Obama administration the National Economic Council released a statement of principles as a policy framework for the fintech ecosystem. We take a look at both below.

Consumer Compliance Outlook: Fintech

A collection of articles and features on fintech was released by the Philly Fed's ***Consumer Compliance Outlook*** in January 2017. Here's a rundown of some of the major pieces:

- **Perspectives on Fintech: A Conversation with Governor Lael Brainard** – Brainard shares her take on recent developments in fintech and how regulators and bankers should approach financial innovation.
- **Fintech: Balancing the Promise and Risks of Innovation** – This article discusses how the Fed is analyzing fintech innovations and their impacts in different areas, including supervision, community development, financial stability, and payments, and why bankers and supervisors should care about fintech. This piece by Teresa Curran, former EVP and Director of Financial Institution Supervision and Credit at the San Francisco Fed, provides a Silicon Valley-influenced perspective on how regulators can "ensure that consumers are protected and that the safety and soundness of banks is maintained."
- **FinTech for the Consumer Market: An Overview** – This article provides an overview of four fintech market segments: credit; digital payments; savings, investments, and personal financial management (PFM); and distributed ledger technology. In addition, this article surveys fintech's underlying data and technology ecosystem. Author Tim Marder, FinTech Senior Supervisory Analyst at the San Francisco Fed, includes process diagrams and charts to illustrate how fintech works, including a generic depiction of the alternative lender loan origination process.
- **Laws, Regulations, and Supervisory Guidance** – A table of certain federal laws and implementing regulations for financial services and products that may be relevant to fintech firms and their depository partners is provided, which includes a high-level description and citations.

These articles and more are available at ***Consumer Compliance Outlook***.

The white paper ***A Framework for FinTech*** was released by the White House on January 13, 2017. As explained in a blog post on the White House website:

> This document sets forth Administration policy objectives that reflect widely-shared values and practical expectations for the financial services sector and the U.S. government entities that interact with the sector. It then provides ten overarching principles that constitute a framework policymakers and regulators can use to think about, engage with, and assess the fintech ecosystem in order to meet these policy objectives.

The ten principles for stakeholders are to:

- think broadly about the financial ecosystem;

- start with the consumer in mind;
- promote safe financial inclusion and financial health;
- recognize and overcome potential technological bias;
- maximize transparency;
- strive for interoperability and harmonize technical standards;
- build in cybersecurity, data security, and privacy protections from the start;
- increase efficiency and effectiveness in financial infrastructure;
- protect financial stability; and
- continue and strengthen cross-sector engagement.

The whitepaper is an outgrowth of the **White House FinTech Summit** held in June 2016, where then Cabinet Secretaries and senior officials from across the Administration and independent regulators engaged with stakeholders about the potential for fintech to further myriad policy goals, including small business access to capital, financial inclusion and health, domestic growth, and international development. Since the Summit, government agencies have held a number of events and made several announcements related to fintech, e.g., the Federal Trade Commission's FinTech Series, the Office of the Comptroller of the Currency's Fintech Charter, the Consumer Financial Protection Bureau's Project Catalyst, and more. But, the blog post accompanying the whitepaper cautions that there is still significant work to be done and that "the United States should continue developing a policy strategy that helps advance fintech and the broader financial services sector, achieve policy objectives where financial services play an integral role, and maintain a robust competitive advantage in the technology and financial services sectors to promote broad-based economic growth at home and abroad."

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Below are links to several fintech-related articles by Venable attorneys:

- **OCC Moving Forward with Special Purpose Bank Charters for Fintech Companies**
- **The Future of Online Advertising and Marketing for Consumer and Business Lending**
- **FTC FinTech Forum Part II – Crowdfunding and P2P Payments**
- **"True Lender" Troubles – More Uncertainty for Partner Origination Models**
- **There Is No On-Ramp – Lessons for FinTech from the CFPB**
- **Is the Future of Fintech a Bank Charter?**
- **Understanding the Evolving Legal and Regulatory Landscape for Consumer Marketplace Lending**

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For more information about this and related industry topics, see **https://www.venable.com/consumer-financial-services/publications**.

This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can be provided only in response to a specific fact situation.

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January 18, 2018

THE KEYS TO MANAGING REGULATORY CHANGE

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As the adage goes, the only thing that is constant is change—just ask an attorney or compliance professional servicing the accounts receivables industry. The last decade has ushered in profound changes on the technological, economic, and regulatory/legal fronts, leaving in their wake a reshaped landscape, with only those companies that are able to absorb and adapt to change still standing. This article takes a look at regulatory change management, what it is, and why it is so important for companies engaged in debt collection.

What Is Regulatory Change Management?

Regulatory change management is the process of preparing and adapting to changes in regulatory and other legal requirements. Said differently, regulatory change management is compliance management. Complying with the law requires, naturally, knowing what the law is; but this is easier said than done. Debt collection, and related activities like credit reporting, are highly regulated by multiple, overlapping statutes, rules, court decisions, and government authorities.

Changes to laws and regulations come in many flavors. Legislatures pass amendments or new laws. Executive agencies issue new rules or revise existing ones and issue guidance in various formats that broadcast their expectations, but which also may be binding. Enforcement agencies, such as the Consumer Financial Protection Bureau (CFPB), the Federal Trade Commission (FTC), and state attorney general offices, bring enforcement actions that signal their understanding of what the law requires. Finally, courts frequently weigh in and resolve disputes, making and changing the law.

What Are the Core Elements of a Regulatory Change Management System?

Effectively implementing changes to business processes in order to comply with changes in the law or to incorporate best practices can be challenging, depending on the size and complexity of the change and how many (and which) of the company’s systems, teams, and processes are impacted.

Take the example of out-of-statute debt disclosures. By 2012, the FTC, followed by the CFPB, signaled through enforcement actions that the failure to affirmatively disclose to consumers that any debt being collected that was past the applicable statute of limitations likely would be considered a prima facie case of threatening to sue on out-of-statute debt, in violation of the FDCPA. Meanwhile, several states passed laws or regulations to require such a disclosure. Debt collection companies had to decide whether to proactively implement such a disclosure across the board, even in states where it is not legally required, and further had to decide (1) which letters should include the disclosure, (2) whether to make verbal disclosures, (3) what language to use, and (4) how quickly to roll out, given other legal and business priorities.

Technical implementation of such a new disclosure also involves a series of decisions, such as: (1) What IT systems need to be programmed to properly trigger the inclusion of the disclosure? (2) What vendors need to be involved in updating the letter templates and coding? (3) Who is responsible for drafting and approving the language? (4) Who is responsible for testing that the disclosures are being included in the correct letters? (5) Where should the disclosure be placed, and how does it impact other mandatory disclosures? (6) What policies, procedures, training materials, and quality control processes need to be updated?

As this example illuminates, a robust system must be able to:

- **Identify** developments in law that potentially impact the company's compliance profile;
- **Analyze** these developments to determine applicability and, if applicable, scope of impact;
- **Implement** business process changes to conform to the new or changed requirement/prohibition;

and

- **Document** the changes by updating and drafting written policies and procedures to reflect such changes.

Identification: There is no one-size-fits-all approach for tracking potentially applicable developments. Depending on your compliance and risk profile and budget, there are a variety of resources you can subscribe to, join, or purchase, including:

- Membership in one or more trade associations that monitor regulatory changes in the industry.
- Purchase of a subscription service / database.
- Free alerts from regulatory agencies, law firms, and consulting firms that publish relevant content.
- Retaining one or more law firms or consulting firms with subject-matter expertise.

The key is ensuring there are no material gaps in coverage.

Analysis: The devil is always in the details; once a regulatory development is identified, it must be analyzed carefully against the company's operations to assess whether and how it applies. The nature and scope of the change largely will dictate the resources that will be needed. For example, a change in how often a consumer can be contacted will require considerably different resources than a requirement regarding the type of documentation needed to bring a collections lawsuit. That said, a "first cut" analysis often can be made by compliance or legal counsel.

Ultimately, you need a final, sound determination of whether the regulatory development applies and, where it does, a list of all business processes, departments, systems, and policies and procedures that are impacted and how.

Implementation: After determining application and scope, an implementation plan should be prepared that identifies relevant action items, assigns ownership of each action item, and sets deadlines. In addition, consider whether the change necessitates any type of employee-, consumer-, or client-facing communication or training.

Documentation: The final step is documenting the change(s) by updating written policies, procedures, training materials, etc. to reflect the change(s). In some cases, new documents will need to be prepared. Finally, consider whether any compliance testing or quality controls need to be created or updated to ensure what was changed is working as expected.

Why Is Regulatory Change Management Important?

In an industry where regulatory developments occur weekly, if not daily, the inability to smoothly and effectively manage change could, at a minimum, significantly disrupt day-to-day operations and business performance. At maximum, failure to comply with regulatory requirements or expectations could result in a regulatory investigation, a poor supervisory examination, or a private lawsuit. These events are costly and distracting, regardless of the ultimate outcome.

You may be thinking, "But what about the bona fide error defense available under the FDCPA?" As the Supreme Court found in *Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA*, 130 S.Ct. 1605 (2010), the bona fide error defense does *not* apply to mistakes of law, only mistakes of fact.

Prompt identification and implementation of legal and regulatory developments, even before they become officially "binding," are more critical than ever following *Oliva v. Blatt*, *Hasanmiller, Leibsker & Moore LLC*, 825 F. 3d 788 (7th Cir. 2016). Some background is in order. The FDCPA requires collection lawsuits to be brought in the "judicial district or similar legal entity" where the debtor lives or where the contract sued upon was signed. In a 1996 case, *Newsom v. Friedman*, the 7th Circuit held that Illinois' Circuit Courts constituted "judicial districts," and that the intra-Circuit municipal districts were not separate "judicial districts" for purposes of venue selection under the FDCPA. Eight years later, in *Suesz v. Med-1 Solutions, LLC* (2014), the 7th Circuit overturned *Newsom*, holding that "the correct interpretation . . . is the smallest geographic area that is relevant for determining venue in the court system in which the case is filed."

The firm filed a lawsuit against Oliva in a municipal district, which was permissible under *Newsom*, but not under *Suesz*, which was decided while the action against Oliva was pending. The firm voluntarily dismissed the action after *Suesz*, and Oliva subsequently sued the firm. On appeal, the 7th Circuit held that the "new rule" instituted by *Suesz* applied retroactively and that reliance on *Newsom* was a mistake of law that foreclosed the bona fide error defense. Understandably, this case has set off alarm bells in the industry, but it also reinforces the need for debt collection companies to establish strong regulatory change management programs to promptly identify and adapt to change.

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January 26, 2018

CFPB RETROSPECTIVE—FIVE ENDURING LESSONS IN THE WAKE OF CORDRAY'S DEPARTURE

The resignation of Richard Cordray as director of the Consumer Financial Protection Bureau (CFPB or Bureau) last November marks the end of an era at the often controversial—but never boring—consumer protection agency. Under Cordray's leadership, the CFPB hit the ground running in 2012 and quickly established a reputation as an aggressive regulator through high-profile enforcement actions and tough examinations of financial services providers. With Cordray's departure, and President Trump's appointment of Mick Mulvaney as acting director, it seems the Bureau's focus will shift, at least in the short term.

Even with change afoot, it's clear the Bureau's first five years changed the way consumer financial services providers think about compliance and consumer protection. And while the CFPB may be less aggressive in the near term, the Federal Trade Commission (FTC), banking regulators, and state attorneys general remain active in protecting consumers. The start of 2018 is a good time to review some of the key lessons of the Bureau's first five years. Even in a deregulatory environment, heeding these basic consumer protection lessons makes business sense and can help minimize potential enforcement risk.

1. Minimize Risk by Putting Consumers First

From the beginning, the CFPB pushed a "consumer first" approach that encouraged financial services providers to evaluate how they design, market, and provide services to consumers. The result was a shift, particularly from the compliance perspective, in the way that many companies interact with their customers.

The Bureau's emphasis on empowering consumers is perhaps best exemplified by its consumer complaint database, which allows members of the public to submit complaints through a CFPB portal. While the database remains controversial, and there are frequent calls by industry for it to be abolished, there is little doubt the database has become an integral part of most companies' internal compliance function. Today, well-run compliance departments monitor the database closely, respond to consumers in a timely manner, and use any lessons learned as part of a larger feedback loop used to identify and remediate compliance deficiencies.

Regardless of what happens to the Bureau, or to its complaint database, the lesson of putting consumers first is an important one that should remain a key part of every company's day-to-day operations. By considering the potential impact to consumers at every stage of a product's life cycle, from the design stage to the decision to discontinue a product offering, companies can help minimize risk of consumer harm, reduce consumer complaints, avoid costly investigations and enforcement actions, and build brand and customer loyalty.

2. Substantiation—Say What You Mean and Mean What You Say

The CFPB flexed its muscles in 2012 and 2013, when it filed a series of enforcement actions challenging the deceptive marketing of credit card "add on" products, such as credit monitoring and identity theft protection products. According to the Bureau, consumers were regularly misled about the nature, benefits, and costs of these products. These cases established a recurring theme that the Bureau would follow in almost every subsequent enforcement action: marketers of consumer financial services must provide consumers with clear, accurate, and truthful information.

On its face, this seems like an obvious and easy-to-implement concept. However, as the credit card "add on" product cases demonstrated, marketing representations that are conditional on certain factors or later-to-occur actions—even if technically truthful—can be considered deceptive. This means that those responsible for creating or approving marketing copy, including marketing scripts, must have a line of sight into fulfillment, billing, and other functions that could impact the veracity of a representation or a consumer's ability to utilize the service as it was marketed. The need for advertising to be truthful and substantiated, of course, is not unique to the CFPB, which is why companies should continue to design their products, services, and marketing carefully to avoid UDAAP risk. Even if the CFPB pursues a less aggressive enforcement agenda, the FTC, state attorneys general, and state regulators continue to scrutinize company marketing for false, misleading, or deceptive statements, particularly in the debt collection, lead generation, and lending industries.

3. Maintain a Robust Compliance Management System Across Your Business

Financial services providers have invested substantial resources in building and improving upon their compliance management systems (CMS), an area that the CFPB emphasized through its Cordray-era supervisory and enforcement activities. What now, with Cordray's departure and with the potential for deregulation, at least on the federal level?

Anecdotally, it appears that many providers—while optimistic that the Bureau will become more laissez-faire—are not rushing to dismantle their CMS programs. This may be attributable to the sheer capital investment they made to implement these systems, but additional factors likely are at play. As noted above, other regulatory agencies—state attorneys general, in particular—have rushed, even before Cordray's departure, to fill the perceived void created by a Cordray-less CFPB. These regulators tend to care just as much about compliance as the Bureau did with Cordray at the helm, and they have learned from the blueprint established by the CFPB over the past five years. And of course, class action lawyers have never retreated and will continue to survey the landscape for alleged abuses against consumers. In addition, maintaining a CMS, while expensive, also appeals to companies' bottom line: robust CMS assists corporate boards and other leaders and decision-makers with monitoring, understanding, and improving upon business operations and, frequently, the effectiveness of their corporate vendors and service partners.

4. Be Mindful of Risks Posed by Employee Compensation Programs

The CFPB under Cordray put a spotlight on incentive-based employee compensation programs and the risks they pose. Following the Great Recession, investigations and litigation focused on the lending practices of banks and mortgage originators, especially compensation plans that rewarded employees with commissions and bonuses based primarily on the number of loans they originated rather than the quality of those loans. The CFPB's Loan Originator Rule was designed to combat certain of these practices, including those that made compensation contingent on steering customers to certain types of mortgages.

Incentive programs remained a CFPB focus through 2016, with a shift in focus to "add on" products aggressively promoted by financial services providers. The Bureau emphasized that rewarding the risky behavior of employees with compensation risked running afoul of federal and state laws, and financial institutions that did not carefully monitor incentive compensation programs also risked "private litigation, reputational harm, and potential alienation of existing and future customers." CFPB, *Production Incentives Bulletin* (Nov. 2016). These risks have not vanished simply because Richard Cordray has left the Bureau.

Other agencies, including the Office of the Comptroller of the Currency (OCC), are also evaluating sales practices and are likely to take supervisory action to correct risky activities and improve processes surrounding whistleblower complaints. OCC, Office of Enterprise Governance and the Ombudsman, *Lessons Learned Review of Supervision of Sales Practices at Wells Fargo* (Apr. 19, 2017). And, as with other compliance-related risks, there are the state attorneys generals to contend with. For example, in November 2017, the *New York Times* reported that the New York Attorney General's office had launched an investigation into an investment firm's sales practices, including the firm's use of sales quotas and employee bonuses. This type of scrutiny is likely to continue, with or without an aggressive CFPB in the mix.

5. If You Lie Down with Dogs, You Get Up with Fleas

A final key lesson from the CFPB's first five years is that who you do business with matters. Whether it's a vendor, counterparty, or client, the CFPB made crystal clear that the legal and reputational risk of a transaction with a noncompliant person or entity is significant. In this regard, the Consumer Financial Protection Act gives the CFPB and state attorneys general extraordinary authority to pursue companies and individuals for legal violations committed by their service providers and other third parties. More recently, the OCC issued Bulletin 2017-21, which directs banks to perform rigorous oversight of their third-party relationships, including fintech companies, perceived by some to present higher risk.

As a result of these developments, companies have rolled out robust due diligence and audit programs to properly vet and manage third-party relationships. Regardless of how the CPFB, state attorneys general, and other regulators wield this authority in the future, prudent financial institutions will continue to perform diligence on their partners and condition the award of servicer bids or contracts on such partners' willingness and ability to comply with diligence and audit expectations.

* * * * *

For consumer financial services providers the Cordray era was a blur of heightened enforcement, aggressive supervision, and new expectations for compliance and prudent business practices. While the CFPB may be less aggressive moving forward, consumer financial services providers should remember the lessons they learned during the past five years—there are plenty of other regulators and private litigants that will remain aggressive in protecting consumers from unfair, deceptive, or abusive acts or practices.

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ARCHIVES

2018	2014	2010
2017	2013	2009
2016	2012	2008
2015	2011	

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FIVE COMMON CONSUMER FINANCIAL SERVICES LEGAL AND REGULATORY DUE DILIGENCE MISTAKES TO AVOID IN M&A

Under many federal and state laws, the owner or operator of a consumer financial services provider is responsible for complying with numerous statutes and regulations. The failure to comply with legal requirements can lead to injunctions, consumer refunds, fines, penalties, and, in some instances, void consumer agreements. Often that liability is strict—the consumer financial services company need not have intended to cause the violation to be liable for financial payments and conduct restrictions. When acquiring consumer financial products and services, such as deposit products, lending activities, money transmission, or a business that provides consumer financial products or services, one key to avoiding consumer financial services law liability is to understand the regulatory risk before buying the portfolio or business.

Consumer financial services legal and regulatory due diligence is therefore an essential element of any such transaction. For most prospective buyers, the minimum diligence will include a review of company-provided information, such as a confidential information memorandum (CIM) drafted by the investment advisory firm seeking to market the business and, sometimes, legal and other consultant memos produced at the request of the seller to address specific topics.

But merely reviewing the CIM and other introductory materials provided by a target may not be enough. Information provided by a target may not provide a complete picture of the company's activities, or include third-party materials with conclusions based on an incomplete set of information (or the law). Furthermore, material provided by the target, including its third-party consultants, may not identify all of the potential sources of consumer financial legal and regulatory liability. As a result, consumer financial services regulatory due diligence should include a carefully planned scope of work and a careful review of as much information as possible.

Here are five common issues we see when working with clients in the diligence process.

1. Insufficient Information

As in any diligence, the more information there is to review, the more nuanced the risk analysis. When deciding on the scope for regulatory diligence, prospective buyers should take into account a target's marketing programs, product and service mix, customer base, and other factors, as appropriate. There is no "one-size-fits-all" set of diligence requests when reviewing highly regulated consumer financial products and services. Typically, consumer financial services regulatory due diligence includes a review of target company documents (i.e., policies and procedures for products and services, compliance management system, training, audits, monitoring, compensation, scripts, marketing programs, advertisements, other promotional materials, agreements, org. charts, consumer complaints, and software testing, as applicable); management and policy review (e.g., review of written policies and procedures, customer complaints, internal and external audit reports, and exam reports); and transaction testing / account-level reviews, as appropriate. Depending on the type of products and services offered, there may be exam or audit reports that can be used to efficiently identify areas for deep-dive reviews or to make early decisions to forgo the merger or acquisition.

2. Failing to Understand Consumer Complaints

Consumer complaints can play a key role in the detection of consumer financial services regulatory risk factors. Complaints may be made directly to the company, service providers, government agencies (e.g., the CFPB, FTC, state attorneys general, other federal and state agencies, and online portals and message boards). As a general matter, consumer complaints may highlight weaknesses in a company's compliance management system, including training programs, internal controls, audits, and monitoring. Complaints lodged against subsidiaries, affiliates, and service providers (e.g., marketers, lead generators, servicers, and others) may provide a window into areas that need closer review. When reviewing complaints made against a business or its products and services, how the company addressed the complaint internally and externally may be as important as understanding what the initial cause of the complaint was. The absence of complaints doesn't always mean a company is in compliance with all legal requirements; complaints can be one indication of practices that merit closer review.

3. Missing the Significance of Licensing and Approvals

It may become apparent that a target has failed to comply with some state licensing or other compliance requirements. For example, licensing and related requirements may have changed, the applicability of a statute or regulation may not be black and white (for example, this is possible with loan broker statutes that could apply certain advertising lead generation activities, or potential arguments for an exemption from an otherwise relevant and applicable law, which is often seen in the area of money transmission / money services), or a licensing body has to be informed in advance of (or approve) a change in control. From a regulatory due diligence perspective, it often can be critical to understand the compliance position of the target. When considering licensing and substantive compliance requirements, it is important that state law compliance is reviewed in as much detail as possible. Some state laws, including lending laws, render consumer transactions void or voidable if they are made without a license or by a non-compliant provider.

4. Lack of Anticipating Government Examinations or Investigations

Consumer financial services are highly regulated and are often subject to examination and sometimes investigations. Potentially problematic risk practices are often identified during diligence, which later could be swept up in information and document requests in an examination or investigation. A key source of potential information about a subject of government scrutiny is prospective investors. And, in recent years, government enforcers have sought due diligence materials from investors and potential investors with an eye to assisting in their own investigations. Once the due diligence team has been assembled, consider the communication and work product protocols that will be put in place. What steps will be taken to protect privileged communications, such as legal communications between clients and their legal counsel? Will the information exchanged by lawyers and clients be for legal advice, and will it be shared with non-legal consultants? What protocols will be put in place for requests for legal counsel, non-legal communications among the deal team members, and the creation and retention of work product?

5. Focusing Only on the Past and Not Future Proofing

Buyer diligence inherently involves looking at the past activities of a target. Past and present consumer financial services legal and regulatory landscapes may be very different from each other. Even in a deregulated environment, it may be critical to understand how the target viewed and addressed compliance at the time its business model was developed, and when each consumer transaction took place. The latter can be an especially complex and technical analysis if the potential transaction involves consumer accounts that were purchased by the target. A prospective buyer also will want to understand the potential future legal and regulatory landscape applicable to the business model. While no one has a crystal ball, regulatory regimes are constantly changing, and, frequently, business models for consumer financial services are based on nuanced and specific interpretations of compliance obligations that are subject to interpretation or litigation. What's on the regulatory horizon may be impacted by changes in the law, regulator expectations, or court decisions that affect the target.

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This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can be provided only in response to a specific fact situation.

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2017	2013	2009
2016	2012	2008
2015	2011	

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BIG DATA AND FINTECH: AVOIDING FAIR LENDING AND UDAP PITFALLS

Using alternative data about online lending, computer-assisted underwriting, and artificial intelligence to provide consumer financial services can lead to unintended fair lending and UDAP risks.

"**Keeping Fintech Fair: Thinking About Fair Lending and UDAP Risks**," a detailed primer by Carol A. Evans, published by ***Consumer Compliance Outlook***, details general guideposts for evaluating unfair or deceptive acts or practices (UDAP) and fair lending risks related to Fintech. Using highlights from CFPB, FTC, banking agency, and DOJ enforcement actions, "Keeping Fintech Fair" showcases fair lending and UDAP concepts to "help guide thinking early on in the business development process."

Because of Evans' position as Associate Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, "Keeping Fintech Fair" is a significant resource for regulators, enforcement agencies, industry, and advocates seeking to understand and avoid potential Fintech legal pitfalls.

Here's a look at some of the topics covered.

Fair Lending Risks in Fintech

Evans' central warning is that "Fintech may raise the same types of fair lending risks present in traditional banking, including underwriting discrimination, pricing discrimination, redlining, and steering." The article provides a user-friendly explanation of two fair lending laws, the Equal Credit Opportunity Act and the Fair Housing Act, which broadly prohibit two kinds of discrimination: disparate treatment and disparate impact.

UDAAP and UDAP in Financial Services

If there's one thing we've observed since the passage of the Dodd-Frank Act, it is the CFPB's ability and willingness to bring claims using its enforcement authority to enforce the Dodd-Frank prohibition on unfair, deceptive, or abusive acts or practices (UDAAP). In addition, the FTC, Federal Reserve, and FDIC have similar authority under Section 5 of the Federal Trade Commission Act, and most states have their own UDAP laws.

Ask Questions Early to Evaluate Alternative Data

Using examples from recent enforcement matters, Evans suggests several questions that can be used to begin an analysis of the use of alternative data.

- Is there a nexus with creditworthiness?
- Are the data accurate, reliable, and representative of all consumers?
- Will the predictive relationship be ephemeral or stable over time?
- Are you using the data for the purpose for which they have been validated?
- Do consumers know how you are using the data?
- Is the data being used to determine content shown to consumers?
- Which consumers are evaluated with the data?

None of the highlights above or the **complete article** in ***Consumer Compliance Outlook*** is "a substitute for the careful legal review that should be part of any effective consumer compliance program," writes Evans. *Consumer Compliance Outlook* is a Federal Reserve System publication dedicated to consumer compliance issues.

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Related Articles

- **Understanding the Evolving Legal and Regulatory Landscape for Consumer Marketplace Lending**
- **Fintech and Marketplace Lenders under Scrutiny**
- **The Future of Online Advertising and Marketing for Consumer and Business Lending**
- **FTC Fintech Forum Part II – Crowdfunding and P2P Payments**
- **Fintech Compliance Resources and Policy Perspectives**

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For more information about this and related industry topics, visit our **Consumer Financial Services publications page**.

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2018 2014 2010
2017 2013 2009
2016 2012 2008
2015 2011

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A RECAP OF THE CALIFORNIA FINANCE LENDER LICENSE FOR FINTECH COMPANIES

FinTech companies continue to revolutionize the way financial services companies provide credit and market their products. These new technology-driven models provide a low barrier to entry for startup non-bank financial services companies, but there is a catch: even where you may view your business as a software provider, online marketing platform, or other non-lending model, state regulators may see it otherwise. Many state regulators take the view that non-bank FinTech companies must comply with laws regulating loan origination or brokerage and, thus, subject them to licensure, compliance, and examination requirements. Unfortunately, this view likely means that many non-bank financial services FinTech companies may need to obtain dozens of state licenses to offer services nationwide.

Given the size of the state's market and the breadth of activities it covers, the California Finance Lender (CFL) license can be an absolute necessity for any financial services business. However, determining whether your business is subject to CFL licensing can be difficult, especially given the statute's tautological construction and confusing application to certain business models, particularly marketing and lead generation. Further, the licensing application and approval process can be cumbersome and take months or longer, potentially stalling your next innovation or funding ability. This article provides a refresher on the scope of the license and its application to lenders, brokers, lead generators, and mortgage companies.

Scope: What Businesses Does the CFL Cover?

The CFL law starts from the basic statement that the license is required to engage "in the business of a finance lender or broker." From there, it stretches outward to encompass a wide variety of activities in connection with lending, brokering, lead generation, and mortgage activities for *both* consumer and commercial loans. According to California's Department of Business Oversight (DBO), CFL licensees are the largest group of financial service providers that it regulates.

Usually a discussion of exemptions comes at the end; however, the CFL law is so broad that it is helpful to note entities that are exempt from its coverage as a precursor to discussing the substance of the law. "**Exempt Entities**" include, but are not limited to, the following:

- Banks, trust companies, savings and loan associations, credit unions, and certain other regulated financial institutions;
- Colleges and universities when making student loans (i.e., to permit "a person to pursue a program or course of study leading to a degree or certificate");
- Broker-dealers; and
- Any company that makes, in a 12-month period, (1) five or fewer commercial loans if the loans are incidental to the company's business; or (2) no more than one commercial loan.

Lenders

A "finance lender" is any company engaged in the business of making consumer loans or commercial loans—so if you are extending any type of credit to California residents, you may be covered (some exemptions apply).

A "consumer loan" is any loan of less than $5,000 and any loan where the proceeds are intended for use primarily for personal, family, or household purposes.

A "commercial loan" is any loan of $5,000 or more that is not primarily for personal, family, or household purposes. The CFL law imposes certain requirements on interest, fees, and other terms and conditions for consumer loans, while generally providing greater flexibility for commercial loans.

Brokers

A "broker" includes any company engaged in the business of "negotiating" or "performing any act as broker" in connection with "loans made by a finance lender." In addition, the CFL law prohibits a CFL licensee from compensating an unlicensed company for accepting loan applications or soliciting loans on the licensee's behalf.

In 2016, the DBO provided additional guidance on what constitutes "broker" activities that trigger the license requirement. According to the DBO these include the following:

Category	Activities in Connection with Loans Made by a CFL Licensee
Always "broker" activity	Negotiating loans Counseling or advising borrowers about a loan
May be "broker" activity, depending on facts and circumstances	Participating in the preparation of any loan documents, including credit applications. Contacting the licensee on behalf of the borrower other than to refer the borrower. Gathering loan documentation from the borrower or delivering the documentation to the licensee. Communicating lending decisions or inquiries to the borrower. Participating in establishing any sales literature or marketing materials. Obtaining the borrower's signature on documents.

Note that the CFL statutory language indicates that it only applies to brokering loans for a company that is or should be a licensee. Based on this language, a CFL license is likely not required to broker loans to a bank or other Exempt Entity. However, see the Mortgages section below for certain licensing issues specific to credit secured by real property.

Online Marketplaces and Lead Generators

One of the most challenging aspects of the CFL is how it relates to online marketplaces, lead generation platforms, or other, similar businesses that do not appear to be "broker" businesses. Conventional wisdom and common sense may tell you that your business is not a brokerage, but remember that the statute's triggering activity is to negotiate or "engage in the business of a broker." In other words, the state believes you are required to get a broker's license if the state thinks you are a broker. This gives the state quite a bit of flexibility to interpret the statute's scope broadly.

Even though lead generators are not traditionally considered "brokers," these businesses may perform some of the activities for which a CFL license is required. Further, a CFL licensee cannot compensate an unlicensed third party for accepting applications or soliciting loans. Thus, a lead generator may need to be licensed to get paid for leads of California residents provided to a licensee. For commercial loans only, the CFL law provides a limited exemption and certain conditions that permit a CFL licensee to compensate an unlicensed third party for referring a borrower. Among these, the unlicensed party many not perform *any* of the activities listed above, including those that are not "broker" activity.

While the broker provisions of the CFL law apply to loans made by CFL licensees, an argument can be made that a CFL license is not required to generate leads for (non-mortgage) loans made by Exempt Entities. However, this argument does contain some regulatory risk, as it is fact-specific.

To date, efforts have been made to pass legislation clarifying how lead generators and other marketing services providers fit within the CFL framework. In 2017, **a bill** was introduced in the California legislature that would have clarified the difference between brokers that are required to hold a CFL license and lead generators that would only require a registration filing. To date, that bill has not passed, and lead generators, depending on their activities, may still be subject to broker licensing requirements.

Mortgages

Under California law, a license issued pursuant to the Real Estate Broker (REB) law generally provides authority for the broadest range of mortgage-related activities, including origination, brokering, and servicing. However, many companies have chosen to obtain a CFL license instead. The CFL law allows mortgage-related companies to conduct other non-mortgage credit operations, avoids the need for multiple licenses, and is available to limited liability companies (the REB law does not permit limited liability companies to obtain a license). FinTech companies choosing the CFL route should be aware, though, that the CFL law places important limitations on a licensee's mortgage activities.

For example, a CFL licensee is only authorized to broker mortgage loans to other CFL licensees. Because the REB license is the default authority for mortgage broker activities, a CFL licensee that wants to broker mortgages to entities exempt from the CFL law (e.g., banks) may be required to *also* obtain an REB license. The same is true for lead generation activities; if a license is required, the CFL license is sufficient for non-mortgage loans, but an REB license may be required to solicit mortgages for banks and other entities exempt from the CFL law.

These are only a few of the intricacies of the California licensing laws as related to mortgage activities. We highly recommend a careful review before engaging in regulated activities or applying for licenses, to avoid both unlicensed activity and duplicative licensing.

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2017	2013	2009
2016	2012	2008
2015	2011	

April 14, 2016

FINTECH AND MARKETPLACE LENDERS UNDER SCRUTINY

FinTech and marketplace lenders are fast realizing that the Consumer Financial Protection Bureau (CFPB), Federal Trade Commission (FTC), and even state regulators are focused on their activities. Recent announcements that the CFPB is taking **consumer complaints** on marketplace lenders and has established an office of small business lending means that lenders and service providers should prepare for the possibility of investigations and examinations in the not too distant future. At the same time, the FTC has announced a "**Financial Technology Forum on Marketplace Lending**" series, starting on June 9, 2016, to explore the growing world of marketplace lending and its implications for consumers. And, at the state level, the California Department of Business Oversight recently released a **survey** on marketplace lending in California finding that consumer and small business lending increased by 936% from 2010-2014, to $2.3 billion.

All of these developments point to the potential for increased federal and state regulatory scrutiny of marketplace lending and their service providers. Below are five tips for managing enforcement and compliance risk, along with several hyperlinks to relevant articles and presentations.

- **Increased Scrutiny Means Investigations and Possibly Enforcement Actions:** The CFPB has investigations under way that span the full breadth of the Bureau's enforcement authority over providers of financial products and services and their vendors. The process of responding to a civil investigative demand (CID) from the CFPB (or even the FTC) is challenging and resource intensive, but critical. Your company will have to issue a record retention notice, negotiate the scope of the CID, collect responsive information and materials, respond to the CID, and then wait for the CFPB to make a decision on whether it will bring an enforcement action or close the investigation. All of this can be challenging, but we've got you covered with a primer on **negotiating the scope of the CID** and **navigating examinations**. We also reveal the CFPB's **enforcement settlement principles** to illustrate exactly how the CFPB implements its regulation by enforcement agenda.

- **Advertising, Marketing, and Lead Generation Are Being Scrutinized:** Online lead generation continues to face increased scrutiny and regulation on multiple fronts, including from consumer groups, state regulators, the FTC, and the CFPB. This squeeze is being felt by all participants—publishers, aggregators, and buyers—and, notably, the lines of legal responsibility and accountability continue to blur. Because of this pressure, the viability of some forms of online lead generation is in jeopardy. Our primer, **Government Puts Squeeze on Lead Generation Marketing**, focuses on the three areas we believe regulators will continue to most actively pursue: (1) use of deceptive advertisements to generate leads; (2) how sensitive consumer data is stored and whom it is shared with; and (3) whether, and the extent to which, publishers and lead aggregators are liable for the end users' legal compliance.

- **Service Provider Liability Can Be Minimized by Strong Vendor Due Diligence and Monitoring Compliance Programs:** Federal and state regulators expect lenders to manage their service providers for compliance with applicable laws and regulations. One of the first things the CFPB or a state regulator will ask for during an investigation or examination is a list of the regulated entity's service providers. Failing to conduct vendor due diligence and monitor service providers is a surefire way to put your company at risk. On the flip side, the CFPB has been targeting service providers using its "**substantial assistance**" authority, which allows the CFPB to bring an action against any person it believes knowingly or recklessly provided substantial assistance to actors that fall under the CFPB's jurisdiction. The result is an environment in which covered entities and their service providers are expected to police each other's regulatory compliance.

- **Collecting Accounts Receivable:** The CFPB (teaming with the FTC) has taken aim at first-party and third-party debt collection activities, including enforcement settlements with lenders and collectors. In November, federal, state, and local regulators and enforcement agencies announced Operation Collection Protection, a national initiative that targets debt collectors. This program complements recent CFPB **enforcement**, **supervisory**, and **rulemaking** efforts focused on the debt collection industry, including **first-party creditors and billing services**, and on the intersection of **data furnishing and debt collection**. In addition, the CFPB continues to work on developing proposed rules for debt collection following publication of its **advanced notice of proposed rulemaking** in November 2013.

Need more info? During **our annual kick-off webinar** in January 2016, members of Venable's **CFPB Task Force** provided an outlook on what to expect this year, as well as practical tips and examples from their work on the front lines. We also have a **primer for marketplace lenders** on potentially relevant federal and state consumer protection law for a quick refresher.

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For more information about this and related industry topics, see **www.Venable.com/cfpb/publications**.

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2017	2013	2009
2016	2012	2008
2015	2011	

September 16, 2016

FTC RELEASES STAFF PERSPECTIVES ON LEAD GENERATION

The staff of the Federal Trade Commission's (FTC) Bureau of Consumer Protection released a much-anticipated paper on lead generation on September 15, 2016. The 13-page report provides staff perspectives on the information covered at the FTC's October 2015 workshop on lead generation, "Follow the Lead." Below are a few of the paper's themes:

- The paper describes the *mechanics of lead generation and how it functions* in the modern economy, including such topics as:
  - What is Lead Generation?
  - Who is Collecting Leads Online, and What happens to Them After Consumers Press "Submit"?, with descriptions of leads collected by a publisher or affiliate, leads transmitted to aggregators, leads sold to end-buyer merchants, and leads verified or supplemented with additional information.
  - A deep dive into the online lending sector's "ping tree" model (an auction-style approach) that allows consumers to be quickly matched with lenders that can underwrite and fund loans.
  - Potential benefits to consumers and competition, including allowing interested consumers and merchants to maximally and efficiently connect with each other; and the ability to connect consumers quickly with multiple merchants, and their associated offers, that consumers may not find on their own.
- The paper also covers potential *concerns for consumers and competition*, and shares a number of suggestions to lead buyers and sellers for avoiding consumer protection concerns—and, in some cases, potentially unlawful conduct:
  - Disclose clearly to consumers who you are and how you will share information.
  - Monitor lead sources for deceptive claims and other warning signs like complaints.
  - Avoid selling remnant leads to buyers with no legitimate need for sensitive data.
  - Vet potential lead buyers and keep sensitive data secure.
- The paper promotes the benefits of industry efforts to adopt policies to help protect consumers, including references to the Advertising Self-Regulatory Council's Electronic Retailing Self-Regulation Program established by the Electronic Retailing Association, and the Online Lenders Alliance's "Best Practices."

  > *"As FTC staff has noted previously, for self-regulatory programs to be effective, industry participants should ensure that such programs include mechanisms for robust monitoring and enforcement, such as dismissal from the program and referral to the FTC for companies that fail to comply with the standards outlined in the code."*

Lead generation has become a key marketing technique used in a variety of industries, particularly lending (including credit cards, marketplace, small-dollar/short-term, and mortgage), postsecondary education, and insurance. Considering how common online lead generation is, because of its benefits for consumers and merchants, it is important to understand how it operates, the types of legal and regulatory requirements that potentially apply, and ways to avoid government scrutiny.

Upcoming Event:

Lend360

October 5-7, 2016 | Chicago, IL

The Lend360 conference offers the entire spectrum of the online lending industry, including valuable industry information and targeted networking opportunities. Venable associate **Alexandra Megaris** will be moderating a panel discussion on "The Future of Online Advertising and Marketing for Consumer and Business Lending" on Thursday, October 6th, 4:30 - 5:30 p.m. CT.

Click here to register and to learn more about the conference.

Related Articles and Presentations:

Government Puts Squeeze on Lead Generation Marketing (Article)

Preparing for a CFPB Examination or Investigation (Presentation)

Self-Regulation and the Lead Generation Market (Presentation)

How to Prepare for and Survive a CFPB Examination (Article)

What Do Service Providers Expect From Lenders and What Do Lenders Expect From Service Providers? (Presentation)

Advertising and Marketing Law Fundamentals for Consumer Financial Products and Services (Presentation)

The FTC's Revised .com Disclosures Guide: What Third Party Advertisers and Lead Generators Need to Know (Presentation)

CFPB and FTC Target Mortgage Advertising (Article)

Telemarketing, E-mail, and Text Message Marketing: Tips to Avoid Lawsuits (Presentation)

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