Consumer Finance Monitor (Season 5, Episode 11): A Close Look at Lead Generation and the Compliance Risks for Lead Generators and Lead Buyers

Speakers: Alan Kaplinsky, Rich Andreano, John Socknat, and Matt Morr

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer finance. I'm Alan Kaplinsky, senior council at Ballard Spahr, and I'm the former chair of our consumer financial services group at Ballard Spahr.

Alan Kaplinsky:

Today, we're going to be devoting our podcast show to a topic that we recently covered in some depth during a recent webinar that we did. The topic is lead generation. What do we mean by lead generation, and in particular, online lead generation? What we're talking about are companies whose business is to refer potential applicants for loans, all types of loans, to various lenders, either more typically non-banks, but it could involve banks.

Alan Kaplinsky:

It deals with a full range of lending products, including non-mortgage products and mortgage products. The use of lead generation has continued to receive regulatory scrutiny, particularly from the Federal Trade Commission, but also to some extent from the CFPB. As a result, it's necessary for both lead generators and lead buyers to have an understanding of the legal mosaic that exists, and the compliance risks that can arise from lead generation.

Alan Kaplinsky:

Today, we're going to examine the key compliance issues that could be targeted by regulators, such as privacy and data security issues, Fair Credit Reporting Act, Telephone Consumer Protection Act, telemarketing sales rule issues, fair lending issues, the Real Estate Settlement Procedures Act, and state licensing issues. Let me introduce our presenters today.

Alan Kaplinsky:

First, Rich Andreano. Rich is the practice group leader of our mortgage banking group. He is the chair of our fair lending team, who works out of our Washington DC office. Second is John Socknat. John is the co-leader of our consumer financial services group, along with Dan McKenna. He's also the managing partner of our Washington DC office. John, while he wears several hats in the firm, today, he will be focusing and wearing his licensing hat, and focusing on licensing issues that arise out of lead generation.

Alan Kaplinsky:

Finally, Matt Morr, who is a consumer financial services litigation partner in our Denver office. He represents a wide range of companies in very important litigation matters. He often defends violations of federal consumer protection statutes, like the Fair Credit Reporting Act, Fair Debt Collection Practices Act, and the Telephone Consumer Protection Act, and has litigated many cases involving lead generation.

Alan Kaplinsky:

With that, I will turn the program over to Matt.

Matt Morr:

Hi, I'm here to talk about the lead generation ecosystem. I'm also going to talk about some laws that are impacted by the lead generation ecosystem, including the FCRA, the TCPA, and the telemarketing sales rule. The goal behind lead generation is to connect consumers who are interested in a financial product or service, or other products or service, and connect them with a lender or other financial institution that offers those products or services in the marketplace.

Matt Morr:

Regulators have concerns, and are watching lead generation closely. Lead generation is often something that's happening behind the scenes, in a very complex way, and utilizes big data in ways that consumers don't have any insight to. We're going to talk first about how lead generation works, and some of the potential pitfalls that arise.

Matt Morr:

The main takeaway I'm hoping that everyone walks away with is that if you're participating in the lead generation ecosystem, whether or not that's as a collector of lead data, a seller of leads, or a purchaser of leads, you need to be mindful that there are potential compliance risks and potential liability. We will start by talking about the type of consumer data that's collected and used and shared between participants within the lead generation ecosystem.

Matt Morr:

The goal, of course, is to identify the right consumers for the right products, and to connect those consumers to the right provider of those products or services. Ultimately, a lead generator is selling leads to a financial institution that it can then convert into an actual financial transaction. The first type of lead we're going to talk about is a direct lead.

Matt Morr:

That is when the consumer expresses direct interest in the product. This is often by submitting some sort of direct expression of interest, like filling out a web form, where you go online and fill out a form that says, "I'm looking for a loan. Here's some basic information. Can you point me in the direction of some lenders that would make sense for me to work with?"

Matt Morr:

There's also situations where there are indirect leads. The consumer takes some action that indicates that there's a potential opportunity, but not necessarily as clear as, I'm looking for a loan, connect me with a lender. Say, for example, someone indicates online that they're looking to buy a home. An assumption could be made that person might also be interested in a mortgage loan. That would be an indirect lead.

Matt Morr:

Next, let's talk about members of the lead generation ecosystem. On the consumer facing side, there are the marketers. The marketers are an affiliated network of entities all across the internet that collect data. The entities that collect the data may sell that data directly to buyers, or they may then sell the data to what are known as aggregators. That's the second entity we're going to talk about.

Matt Morr:

The aggregators are essentially intermediaries. They analyze the collected data, identify who are the most valuable or relevant leads for a particular buyer, package those leads into a portfolio to sell to a buyer. Aggregators are often using big data, automated, instantaneous, auction style processes, sometimes known as ping trees. They use the ping trees to sell leads to lenders, or even to other aggregators, who may further modify those leads into separate packages for different types of buyers.

Matt Morr:

The buyers themselves are who purchase these leads. They will then take the leads and contact consumers directly with additional marketing materials. For example, they may communicate to them, we understand you're looking for a particular product or a particular service. Here's some more specific information about the products or services we offer, and here's how you can apply or otherwise qualify.

Matt Morr:

Buyers specify to either the consumer facing entity or the aggregators, who are again, running analytics of the type of specific criteria or filters they would like to put into place, to further tailor the types of leads that they receive. Then once the buyers purchase the leads, that's when they reach out to consumers.

Matt Morr:

Data brokers are another player in this marketplace. Data brokers often sell data that is used to supplement leads. This can be data used to verify the accuracy of data that consumers may have entered into a web form, or it could be some other way to help buyers determine which lead would make the most sense for them to purchase. Data brokers are not in the direct flow, but they are very much related to and involved in the ecosystem.

Matt Morr:

The lead generation ecosystem concerns regulators. There is an assertion that many of the consumer facing entities, the affiliate networks, or the marketers that may be using deceptive practices at the point of collections. Regulators are concerned that someone in this ecosystem is making claims to consumers to entice them to submit their personal information, but they're doing so fraudulently.

Matt Morr:

The lack of understanding and transparency to the consumers about how the process works greatly concerns the regulators. For example, consumers will often fill out a form expressing interest in a loan. They think that they're giving their data to one company or to an affiliate network, but they may not realize that their information could be going to five, 10, or maybe more lending entities, or other companies who may be using that data for purposes that aren't the same as the consumers request, so something other than seeking a loan.

Matt Morr:

A tip for lead buyers: please keep in mind that you should be doing due diligence on your sellers, the entity that actually is collecting and selling data to you for the leads. You want to make sure that you're reviewing the claims made by those sellers, to make sure that none of them are deceptive with regard to the data that was collected and then sold to you as a lead.

Matt Morr:

Data sellers also need to make sure that they're doing appropriate due diligence. Data sellers need to be looking at buyers, and making sure that their buyers have a legitimate use, and are actually the data for the purposes that they say. For example, a data seller should confirm that a buyer who says that their goal is to find leads to extend consumer loans, isn't actually using that data for some other purpose, like engaging in fake collection calls, or making unauthorized charges against consumer accounts.

Matt Morr:

These are the types of things that arise when looking at how data flows through the lead generation ecosystem. There's many federal laws that fit in to this lead generation ecosystem that folks need to be careful with and to make sure that they're in compliance. First, I'm going to talk about the Fair Credit Reporting Act, or the FFCRA. The Fair Credit Reporting Act has been around since the 1970s, and has a process in place for how consumer data in the form of consumer reports can be used for marketing purposes.

Matt Morr:

Unless a financial institution has a permissible purpose under the Fair Credit Reporting Act, they cannot obtain a consumer report, and a consumer reporting agency cannot provide them with one. This includes lists of consumers that match a specified set of characteristics. However, the FCRA has established a framework where a financial institution can obtain a pre-screen consumer list, if the financial institution intends to extend a firm offer of credit to each consumer on the list.

Matt Morr:

This means that a consumer would look at the offer, and essentially say, "I accept this offer," and there's no other steps or underwriting that needs to be done to complete the loan. This has raised a lot of questions about whether or not the lead generation industry, in what it does with regard to data driven, analytical assessments of consumers, whether or not that's profiling, categorizing, inserting them into various trigger lists, whether or not that should be subject to the protections under the FCRA.

Matt Morr:

This has not been determined yet. The FTC has been looking at this closely, has been evaluating this question in a variety of lead generation workshops over the years, but it has not yet come out with a definitive statement of whether lead generation lists that have been fine tuned to determine if people are qualified for the types of loans would fall under the restrictions of the Fair Credit Reporting Act.

Matt Morr:

That leads to the question: are these lead lists, are they consumer reports? Is the type of scoring that is done on these lead lists to say whether or not the person is most likely to enter into a loan or qualify for a loan, is that the type of scoring that is similar to a credit score? Should it be subject to the same level of protections that a typical consumer report has under the FCRA?

Matt Morr:

Is a decision about whether or not to offer a loan the same as whether or not to offer a marketing piece about a loan? Who gets a loan versus who gets an offer for a loan may be just as relevant, and may be seen under the Fair Credit Reporting Act as the same as an eligibility decision. To the extent that any of these eligibility decisions are made, should notices of adverse actions be sent out to the lead generation ecosystem?

Matt Morr:

These are open questions that are still being considered by regular, and we fully expect that we'll see future developments in this space. Next, I'm going to talk about the TCPA, the Telephone Communication Protections Act. Many of you are probably familiar with the TCPA. It has become a favorite of the plaintiffs' bar. It has huge potential liability for companies that are making phone calls, because very often, companies are making lots of phone calls.

Matt Morr:

The plaintiffs' bar has two main theories. The first is that someone is calling someone without their consent using an automated telephone dialing system. The second is calling someone without their consent using a prerecorded voice. In April of 2021, the Supreme Court in the Facebook case narrowed what constituted an automated telephone dialing system. This has reduced some of the litigation about calls made from an automated telephone dialing system.

Matt Morr:

Even with that Supreme Court order, the district courts are still going back and forth about what constitutes an automated telephone dialing system. The plaintiffs' bar picked up on some dicta in a footnote of the Facebook decision, and is still coming up with new theories about why dialing systems that companies use should be considered an automated telephone dialing system.

Matt Morr:

Now, while the cases around automated telephone dialing systems have potentially decreased, we've seen a big uptick in lawsuits regarding the use of prerecorded voices. Overall, you want to avoid TCPA lawsuits. The discovery can be very expensive, and it can be very invasive. The cases often require an expert to look at the type of dialing system that was used to make calls. If there is liability, the damages can be huge, where lots of calls are being made, and the damages can range from $500 to $1,500 per call.

Matt Morr:

The plaintiffs' bar has picked up on this. When they file these cases, whenever possible, they try to file them as class actions, so they can pressure an outsized settlement. The question becomes, can you avoid liability under the TCPA by using a lead generator to make your calls? Can you avoid the TCPA by having somebody else make the initial contact with these consumers? An example would be a finance company hires another company to obtain leads.

Matt Morr:

That company creates a potential purchaser list, and they contact those people. If they're interested, the people will then be true, transferred directly to the finance company, either in a hot live transfer, or they'll put them in touch some other way. What if this downstream company is using an automated telephone dialing system, or is calling people without consent with a dialing system that uses a prerecorded voice? Can the finance company that hires them be liable under the TCPA?

Matt Morr:

The answer is maybe. The company can be vicariously liable for the downstream caller under traditional theories of agencies. The question is, is the company making the calls, the finance company's agent? You think about law school principles, actual authority, apparent authority, were their actions ratified?

Matt Morr:

Ultimately, if the court of the jury finds that the finance company was using the downstream caller as an agent, or knew what they were doing, what the downstream caller was doing, then the finance company should have stopped them from making illegal calls, and that they still ratified those actions. Then the finance company can be liable for the downstream caller's calls.

Matt Morr:

The ninth circuit looked at this issue a couple years ago in the Christiansen versus Credit Payment Services case. In the case, the ninth circuit held that Credit Payment Services was not liable for unlawful text messages that were sent by a third party lead generator, but it left open the possibility that there could be liability if the lender had ratified their acts, or if they knew or should have known about the illegal text messages.

Matt Morr:

Beyond the potential liability exposure, the concern is also whether someone is acting as your agent, or whether you've ratified their acts, is an expense of matter to fight about. There will be a lot of discovery and inquiry into how you were doing business and what your relationship was with the downstream caller. It becomes very important that as you're coming up with agreements with lead generators, with the downstream callers, that you protect yourself.

Matt Morr:

The agreements need to be clear that the lead generator is not your agent and is acting as an independent contractor. You also want to find out where the lead generators are getting their leads, and whether the people on those lead lists have given their consent to be called. It may very well be, as we discussed earlier, that the company you hire is getting their list from someone else. You want to know in your agreement and know upfront that the leads that you are purchasing are leads that are TCPA compliant, meaning that those are people that have made consent to receive calls.

Matt Morr:

Any agreement you enter should contain representation warranties regarding the TCPA, regarding that the people on the leads lists have consented to be contacted, and also include record retention requirements, so that you make sure if there's a lawsuit down the line, that you can prove that the person on that lead list that is receiving the call had consented to that call.

Matt Morr:

What you don't want to have happen is a litigation starts, and you need to get proof that the recipient of the call consented, and that proof is nowhere to be found. In addition to the consent record requirements and consent record retention requirements, you want to be able to audit or monitor the calls to make sure that they comply with the TCPA and other laws. Then you want to include big indemnity protections, in case you find yourself on the wrong side of one of these lawsuits.

Matt Morr:

Another place where folks need to be careful is the telemarketing sales rule. This rule prohibits deceptive and abusive telemarketing acts and practices. It has a long list of things that telemarketers are prohibited from doing. It prohibits making repeated or continuous calls that are annoying or abusive. It prohibits calling people on the do not call registry. It prohibits interfering with a person's right to be on the do night call registry.

Matt Morr:

It contains restrictions on when people can be called. For example, they can't be called before 8:00 AM or after 9:00 PM. If you're dealing with lead generators or downstream callers that are making calls for you, you need make sure and have in your agreements, that these companies comply with all of these requirements. If you have a lead generation company that's offshore, that's calling into a different time zone, you need to make sure that they are honoring that local time zone as to when they're allowed to make calls.

Matt Morr:

The FTC has taken a very big interest in lead generators, and has been very clear that a company, and this is a quote, "Can't skirt the law by outsourcing illegal conduct to your service providers." A couple years ago, the FTC settled a dispute for $30 million with a group of post-secondary schools. The schools were using a lead generation company that was trying to get people to enroll, but as part of their campaign, and they were falsely telling consumers that they were affiliated with the US Military, or that they were connected to a job finding service.

Matt Morr:

They created official sounding military websites, like Army.com, and then encouraged consumers to serve their countries in ways other than joining the military by obtaining higher education. People would go to the websites like Army.com, and they would put their names into the website. As part of that, they would consent to receive phone calls, thinking that they would receive phone calls about the Army.

Matt Morr:

If you looked at the fine print, it would say you were consenting to be contacted regarding educational and other opportunities, and that you were essentially agreeing to being contacted by these schools. The FTC did not like this bait and switch, where people thought they were signing up to receive calls for one thing, but receiving them for another. Another issue in this case was the telemarketers that were calling were harassing consumers, even consumers that were on the do not call registry.

Matt Morr:

The FTC was very concerned here that the telemarketers had a monthly quota, and that they would lose their jobs if they didn't meet that quota. The result was that people were receiving hundreds of calls and receiving up to six calls a day. The bottom line is the FTC said, "You cannot get around the law by outsourcing lead generators," and that they would hold the top company, the ultimate company, liable for lead generators deceptive or illegal practice.

Matt Morr:

The FTC also said, "We expect companies purchasing leads to implement strong vendor management programs, and stay on the right side of the law." Here again, when you're entering into contracts with lead generators, you need to make sure that they require compliance and provide for oversight. You need to make sure that there's a right to make sure that the lead generators are doing the things that they're supposed to be doing, to stay on the right side of the rules.

Matt Morr:

This isn't the only case where the FTC has gone after the lead generation ecosystem. The FTC has been very active in this space. There's a 2022 case against a lead generator called IT Media, where the FTC said that IT Media was that they were selling consumer leads into a network of trusted lenders. However, the FTC concluded that 84% of the leads IT Media was selling were not being sold to lenders, but instead being sold to other types of entities, like debt relief companies, credit repair companies, or other companies that were not actually lenders.

Matt Morr:

The FTC said that this lead generator also violated the Fair Credit Reporting Act by supplementing the data it was selling with credit scores pulled down from the credit bureaus, and adding that as part of the list that it was selling. The FTC issued a $1.5 million civil penalty. That however is relatively small, compared to a $114 million settlement against Lead Express from a few years ago. There was also a judgment against Blue Global for $104 million.

Matt Morr:

The FTC claimed that this company's lead generators were operating dozens of websites that were, as the FTC characterized, as enticing consumers to submit their information, but not actually selling those consumers' data to lenders, and not matching consumers to lenders based on loan rates or terms, or other indicators of what the consumers were actually looking for.

Matt Morr:

In addition to the FTC, the CFPB has also been active in this space, focusing on lead generation. They brought a claim against T3 Leads, a lead generator that they alleged was offering and selling leads to entities that were not what they characterized as following the rules, making offers to make loans that did not comply with state law. For example, that charged higher interest rates than those lenders might otherwise have been able to under certain states.

Matt Morr:

The CFPB is also looking at lead as part of its examinations. If the CFPB is performing an examination, if you're offering student loans or payday loans, the CFPB will be asking you about your use of lead generators, and whether or not you're using lead generators in a compliant manner.

Matt Morr:

In sum, if you're using lead generators or you're the lead generator, you need to make sure that you are in compliance. If not, you may find yourself being looked at by the FTC, the CFPB, or dealing with individual lawsuits under the TCPA. With that, I'm going to turn it over to rich.

Rich Andreano:

Thank you very much, Matt. Now with that addressed were laws of general application that really you have to consider with any type of lead, regardless of the product or service. I'll be addressing laws that are specific to the mortgage loan and settlement service, residential real estate related areas.

Rich Andreano:

First, starting out with our friend, the Real Estate Settlement Procedures Act. Now, whenever you're involved in mortgage lending or providing other settlement services, you have to be concerned about the referral fee and fee splitting prohibitions of respite. Quite broad, basically, the referral fee prohibition is no person may pay, and no person may accept a referral fee for the referral of settlement service business.

Rich Andreano:

The key is that there's a federally related mortgage loan. That's a very broad term that covers most types of mortgage loans purchased refi first or subordinately. There's also a corollary prohibition that you cannot split any part of a settlement service fee with someone, other than for services actually rendered. Now, those are broad prohibitions, and the industry really couldn't operate without having an exception.

Rich Andreano:

There are several, but one of the key exceptions is more of the general goods or services provided exception, whereas nothing in the referral fee or fee splitting prohibition shall be construed as prohibiting a bonafide salary or compensation for goods or facilities actually furnished, or for services actually rendered. In the end, that is where lead generation and a lot of other arrangements focus is on that exception.

Rich Andreano:

The thought is that with lead generation, by a lead generator, often in one way or another, putting a consumer in contact with a lender could be ruled as a referral, perhaps in some cases as a fee split, but the theory is they're not being paid for the referral, because you cannot pay for a referral, but you can pay for good, services, and facilities. That's the theory that applies here.

Rich Andreano:

Now, when you look around though for guidance, other than the statute itself, you don't find a whole lot. You can go back to old informal HUD interpretations. HUD actually used to respond to specific fact situations that people would write in, and give its response in an informal manner. Now, it wasn't binding. Wouldn't protect you conclusively against either HUD or in a court of law, but it offered an insight to HUD's thinking.

Rich Andreano:

Often a lot of these interpretations were well reasoned. It was a reasonable interpretation of the prohibitions and the exceptions. Now, a number of those issued before November 2nd, 1992, were withdrawn in connection with a rule that was adopted on that date. Then there were informal interpretations posted that date. They did not transfer to the bureau, because they were informal. The guidance we have really doesn't exist in the world of the CFPB.

Rich Andreano:

Doesn't mean the guidance, though, is irrelevant because it does show how a regulator would look at an interpretation. Now, importantly, though, what HUD addressed were very plain, simple lead arrangements that existed. The internet existed then. It didn't exist in its current form, and the type of lead arrangements that exist today weren't known to HUD, because they didn't exist and couldn't have been probably even conceived by HUD.

Rich Andreano:

It was dealing with very basic arrangements. That makes some of the guidance very limiting, but it'll give you an idea. One thing they thought in general when you looked at their informal interpretations is they thought the sale of what they refer to as prospect lists, what we call leads nowadays, was okay if the payment, the lead purchaser payment to the lead seller, was simply forgetting the list, that it wasn't conditioned on anything else, such as, were you able to contact anyone on the list? Were you able to sell a product alone, or other settlement service to anyone on the list?

Rich Andreano:

There was no other consideration. In other words, the lead seller didn't endorse in some way the lead purchaser. In formally talking with HUD about that, I said, "I think I know why you said that." They said, "Well, yes, because if there's an endorsement, that sounds like a referral. Then we can't distinguish a lead sale with an endorsement from a referral." I said, "Makes sense."

Rich Andreano:

One particular situation they addressed, which became the prospect list type of arrangement, is simple real estate brokers, when you used to go into their offices, now it's often virtual, but they'd have a guest book. You'd sign that in with name and contact information. What some enterprising real estate brokers did was realize that was a list of prospects that they could sell to mortgage lenders. They would do that.

Rich Andreano:

HUD addressed that in informal interpretation and found it was okay, because they were just selling the list for a fixed price. That was it. It was all behind the scenes. They didn't endorse the lender to any of their customers. The sale just occurred, and suddenly a customer got contacted by a lender. I called the person who wrote the interpretation and said, "Fill me in on some of your thinking."

Rich Andreano:

They said, "Well, we thought this was similar to what was common at the time, where magazine publishers would have a lot of information on their subscribers. They would often collect data through customer subscriber information cards. That was valuable data. If you're interested in selling a particular product, let's say you sell sporting goods. You might want to go to various sporting magazine publishers and purchase lists. Even they often could tell you subscribers who are male or female, with a certain age range, who might be more interested in your product."

Rich Andreano:

This was all behind the scenes. It was a set price for the list. Here's the company trying to sell goods or services. Here's the price for my list. Knock yourself out, trying to sell, contact these people in the first place, or sell goods or services to them. It was all behind the scenes, no endorsement or anything. HUD said, "That's very similar to what the real estate brokerage firm is doing here behind the scenes, selling a list of people walking in."

Rich Andreano:

Obviously if you make mortgage loans, the fact that someone has visited real estate broker's office means they're either looking at buying a home, which means they're probably going to need a mortgage loan, or selling a home, which means they're probably then going to purchase another home, and also will be looking for a mortgage loan. They thought that was fine. The key though is there was no identification of the lead purchaser to the lead sell seller.

Rich Andreano:

That was very important. Now, we have that. We have that guidance. What else do we have? Well, there are two statements of policy, 1999-1 and 2001-1, they're somewhat. As we'll get into with John, lead generators in the mortgage space often are considered mortgage brokers in the generic context, particularly licensing context. These statement of policies address the minimum service that a mortgage broker must perform to get paid for a lender on a per transaction basis.

Rich Andreano:

Not exactly analogous, but what it does is come up with the theory is the broker had to perform a certain level of services to get paid at all. Then once they could get paid, you still had to look at what they were getting paid. What they were getting paid had to be reasonable in relation to the value of the services that they were providing, or goods they were providing, without regard to any referral value.

Rich Andreano:

Now those, since they're formal statements, policy did transfer to the bureau, but they're not really specific to the lead generation context. We're at a bit of a loss when it comes to specific guidance. A lot of times people assume, since lead generation in the mortgage and settlement service industry is so popular, that there must be a lot of guidance here authorizing the conduct that occurs.

Rich Andreano:

What I like to say is the whole lead generation industry in the RESPA covered world is built on a foundation that does not exist. What we're really using is general concepts of section eight to analogize to something that's compliant, but we're really doing it without much guidance, and having some guidance would be really helpful. What you do is use basic section eight principles and look at the structure of the arrangements. Different structures we think have different risk profiles.

Rich Andreano:

One is it's the old style. It's just a prospects list. That lead generator somehow gathers people who may be interested in a mortgage loan or other settlement services. They'll get contact information on those individuals. They'll simply sell those lists behind the scenes to someone who offers mortgage loan or other services. That seems a lot like what HUD had addressed, and seems pretty vanilla and not much of an issue.

Rich Andreano:

Where that sometimes becomes an issue, however, is based on the laws that Kim and Matt address. Often what you're trying to do, even if you're going to sell a prospect's list, is get the consent of the consumer as the lead generator to have a lender contact you, and often a specific lender to contact you. Now, what you've done is you have identified the lead purchaser to the consumer, which was something that HUD appeared to think was an issue.

Rich Andreano:

Obviously those laws that require this didn't exist when HUD was addressing the situation. Never got the chance to address it in today's context, where you have these legal restrictions that you must maneuver around, and the bureau really has never addressed either. That presents an issue, although the prospects list is one arrangement. Different model is the matching, where the consumer comes in, provides various information about what they're seeking in terms of a mortgage loan, and a system then has a lot of lenders in it, and matches the consumer with the lenders that best fit what the consumer is looking for.

Rich Andreano:

We've seen a lot of these models and often they identify three and sometimes more. Now, these are a little different in not only are they in a way providing leads to the lenders that are identified, but it's also in a way providing a service to the consumer, and helping them shop for the lenders that might be best, that have the best products for them. It is a little different in that regard.

Rich Andreano:

There's a view in the industry when you have this type of arrangement, and you at least have three providers that are identified, that that sort of less any type of referral value and makes it compliant. We do think, although there's no specific guidance for that, we do think there's merit to that position. We do think that the service to the consumer also has to be viewed in how these arrangements are analyzed.

Rich Andreano:

Again, it's something we have no specific guidance on from either HUD, when it was around and handling RESPA, or the bureau. Then there are some arrangements that actually are filed literally while they identify a consumer, and they then actually get the consumer in touch with the specific lender, through a referral of some sort or a warm handoff. Those appear to present the greatest risk in terms of RESPA, and really require a lot more analysis.

Rich Andreano:

In the end, all of these arrangements depend on one thing: if you ignore any referral value, was the amount paid to the lead generator reasonable, in terms of the good, services, and facilities they provided, again, without regard to any referral value? That's the core analysis. You're back to very basic RESPA analyses without a heck of a lot of guidance out there for how to do it.

Rich Andreano:

A few things people think that are helpful: the earlier the lead fee is triggered, the better. The thought is the further the lead fee is way from any actual success, such as contacting the consumer, or selling a good to the consumer, the better. Then it seems more like a lead as a referral, if you will. Again, you don't want to tie this to any success. That's clearly a no-no in terms of the HUD guidance. While it was informal, doesn't apply officially today. We think that's very good guidance, and it would be an issue.

Rich Andreano:

Now, what about are all leads created the same in terms of value? This is another thing to look at. Sometimes you have consumers that, well, here's a list of a consumer that indicated on our website that they might be interested at some point in purchasing a home. Okay. We know a lot of those are lookie-loos, whether they're really interested in the near term in getting a mortgage loan so they can purchase a home, questionable; as opposed to someone who I know has visited a real estate broker's office.

Rich Andreano:

Much more likely that that person is going to need a mortgage loan. That type of person is probably a more valuable lead. You'll see the industry look at that, not based on any referral value, but what is the likelihood of the consumer actually being interested in purchasing my product in the near term? You do see valuations of leads vary by that. If done appropriately, we think that's actually appropriate. In the end, it comes down to do the goods and services provided by the lead generator support the lead fee, without regard to any referral value?

Rich Andreano:

Not a heck of a lot of guidance in there, but there are ways to get about it. Those are things to focus on as you look at these arrangements when you're in the area that in fact is covered by RESPA, which is mortgage loans and many other settlement services. Now, let's shift gears a bit to fair lending and also fair housing. Two key laws, Equal Credit Opportunity Act, which applies to most types of credit, Fair Housing Act, which applies to mortgage, residential real estate credit, and many services related to residential real estate.

Rich Andreano:

You have to think about these in terms of how is the lead generator sourcing the leads? Particularly, what a lot of people use today is use artificial intelligence to select what consumers will see in an advertisement that's trying to attract them to a website to become a lead, or using that. There's two ways it's used, we see. One is this way to draw someone in through advertising. Who gets to see the lead?

Rich Andreano:

Now, what is in that black box of that algorithm? Is there a prohibited basis in there? Are there proxies for a prohibited basis in there? What's in that box? If you don't know, as the lead purchaser, the lead generator could be, and it may be someone innocently, they may not be really aware that they're doing something inappropriate, excluding certain people on a prohibited basis factor.

Rich Andreano:

If they're excluding certain people on a prohibited basis factor, and then you're excluding them from your outreach through lead contacts, are you engaging in what CFPB director Chopra would refer to as digital redlining? Using algorithms, you're excluding certain people from your outreach. It's a developing area of law, but the director Chopra, in recent redlining initiatives announced by the Department of Justice, also made some very pointed statements in terms of digital redlining, saying that algorithms can remove bias, but blackbox underwriting algorithms are not creating more equal playing field.

Rich Andreano:

They exacerbate the biases fed into them. He has concluded that these algorithms have discriminatory factors built into them, and they're causing problems. While one thing we're seeing in terms of underwriting, he also notes, we're seeing it in terms of advertising decisions that have been turned over to algorithms. He refers this, which I think is a bad analogy, but to give you an idea of his concern, the robo-signing crisis of the past decade. He said, "We shouldn't assume that algorithms are free of bias. To move forward, we have to have algorithms that don't have it."

Rich Andreano:

To give you an idea of how concerned they are, they more recently reached out tech industry employees and said, "If you're aware of biases built into the algorithms that your companies are producing, we want you to be a whistleblower." Developing area of law, but you need to know as an advertiser how your lead generator is sourcing leads. If they're doing it in a way that's improperly excluding certain people on a prohibited basis, you could be deemed by the bureau or others to be engaging in redlining.

Rich Andreano:

With that, I'd like to turn over the presentation to John Socknat, who will address the very important issue of licensing.

John Socknat:

Thanks, Rich. As Rich said, we're going to talk about some state licensing considerations. Following along, Rich's was more focused on the settlement services industry, I'm going to be a little bit more focused on the settlement service industry, but a lot of what I'm going to say is going to have equal application to other asset classes.

John Socknat:

The reason we're going to focus on the settlement services industry is because of, in particular, RESPA, and all the complexities that Rich just walked through. All right. Again, assuming you can get comfortable with various regulatory issues that my partners have been discussing, you've still got to deal with state licensing requirements. Like a number of the issues that we've discussed, there's a certain amount of uncertainty about exactly what licenses are required to act as a lead generator.

John Socknat:

Because of the licensing process can be onerous and lengthy, certain license types can take months and months to obtain. It's an issue that you actually have to address before launching a lead generation business, not after. That's important if you are going to be generating and selling leads, or if you're purchasing leads, making sure that you're doing your appropriate diligence and vetting of lead sources.

John Socknat:

The extent to which a license is required or potentially required for generating and selling leads related to a settlement service is going to depend on a variety of factors, including the type of lead, so the different rules for mortgage real estate and insurance. Again, we're focusing on these because of the federal law overlay that Rich talked about. These same issues generally are going to apply to other asset classes.

John Socknat:

Another factor is what type of information the lead generator collects and how? Is it simply self-reported information? Is it a mini application? Is it just contact information? Then the other issue is when and how a lead generator gets paid. Rich discussed how getting paid earlier can be helpful from a RESPA perspective, but as is often the case, solving or attention to solve for a federal regulatory issue can create other issues.

John Socknat:

In this context, there are states that would trigger the need for a license, or a license could be triggered if one receives compensation early in the process, as opposed to receiving compensation only upon successful issuance of a loan. In the mortgage context, Rich has talked about how that can create significant RESPA issues. You're definitely a mortgage broker if you're getting paid on a closed loan basis.

John Socknat:

All right. These different factors make it really difficult for entities that want to try to turn potential customers for a settlement service into leads for multiple settlement services, or to take a customer contact and attempt to monetize that contact. I've already touched on the various parties in the lead generation ecosystem. It's important to keep in mind that licensing can apply both to lead generators and to the sources that funnel leads to aggregators. I'm sorry I said lead generators. I mean aggregators.

John Socknat:

Again, licensing can apply both to the lead generators as well as to the lead aggregators. The lack of a license, where required by a lead generator, doesn't get cleansed if a lead has passed through an aggregator that happens to be licensed where that's required. All right. Let's start with mortgage leads in part, because that presents the most significant licensing obstacles.

John Socknat:

Roughly half of the states require a mortgage broker license to act as a lead generator. For the purpose of this discussion, let's assume that doesn't mean an entity that's actually taking an application. Taking an application makes you a mortgage broker. We're talking about an entity that's collecting some amount of information that it then sells to a third party. The exact number of licenses required is going to depend on various factors, including, as I talked about, how much information is collected, and candidly, which way the wind is blowing in a particular day in certain states.

John Socknat:

Some states have specifically addressed this in the law. Arizona, for example, expressly defines mortgage brokering to include providing the identity of potential borrowers. That means anyone who gets paid for simply passing along a name would need to be licensed as a mortgage broker, as it relates to Arizona consumers. As part of their exam process, the Arizona regulator asks licensees to identify their lead sources, and then will impose fines and penalties on licensee who buy leads from unlicensed lead generators.

John Socknat:

A number of states have issued some public guidance, but many have not, which again, makes it difficult to try to navigate this issue. New York, for example, has issued guidance, which one would think would be helpful. The guidance essentially says if what a lead generator collects and then passes along to a third party is enough for that third party to make a credit decision, then that's considered lead generation.

John Socknat:

Perhaps not surprisingly, New York takes a really broad view of what constitutes enough information to make a credit decision, including in cases when the information actually stops well short of what a creditor would actually need or could, without violating federal and state law. There are other states that condition the need for licensing based on what information is collected, such as a social security number. Stopping short of collecting that may allow you to avoid licensure in some states, but certainly that's not universal.

John Socknat:

The number isn't every state, and it isn't no states, but depending on what information one collects, it can be a majority of the states. I think it's fair to acknowledge that there are lots and lots of folks there that are generating mortgage leads who aren't licensed. All right, let's turn to real estate leads. As a general rule, licensable activity in the real estate space doesn't expressly include lead generation. The issue in the real estate space is the general prohibition on real estate brokers paying or splitting a commission with an unlicensed entity.

John Socknat:

Unlike mortgage laws, both RESPA and many state real estate laws include an express carve out for real estate referrals, subject to certain conditions, including that the referring entity is licensed in its home state. Unlike the mortgage space where we have some old guidance that Rich talked about, about paying for leads, and that potentially not constituting the RESPA violation, we don't have that sort of guidance in the real estate space.

John Socknat:

That leaves us with RESPA prohibiting the payment of referral fees, but carving out co-brokerage arrangements, and then state law that sometimes provides that same carve out, but not always, but also generally prohibiting sharing or splitting of commissions. I think the takeaway for real estate leads is that while licenses arguably aren't technically required for real estate lead generation, being licensed does provide some helpful RESPA and state law coverage.

John Socknat:

Insurance leads. As many of you are likely aware, most states have adopted the National Association of Insurance Commissioner Producer Licensing Model Act, the model law. Under that act, an insurance producer is defined as someone who is required to be licensed to sell, solicit, or negotiate insurance. Just let me quickly touch on those definitions. Negotiate means conferring directly with, or offering advice directly to a purchaser, or perspective purchaser, of a particular contract of insurance.

John Socknat:

Sell means to exchange a contract of insurance by any means. Solicit means attempting to sell insurance, or urging a person and to apply for a particular kind of insurance, from a particular company. Of those three activities, the only one that reasonably could be interpreted to include lead generation is solicitation. If the state has adopted verbatim the model language, there would need to be a focus on the part of the definition of endorsement or urging of a particular company.

John Socknat:

Depending on how a lead is passed along, there may or not be a focus on endorsement of a particular company. Of course, the extent to which a state has adopted language that differs from the model act can also impact the extent to which a license is potentially required. I think it's fair to say as a practical matter with the exception of mortgage leads, licensing is not a significant impediment to lead generation in this context, or at least in the settlement services space.

John Socknat:

As we've heard, that doesn't necessarily mean that you don't have a host of other regulatory issues to contend with. Just real quick, as it relates to other asset classes, there are some states that have amended their existing laws or enacted new laws to specifically cover lead generation. In the consumer and commercial installment loan space, Connecticut relatively recently amended their Consumer Loan Act to specifically cover lead generation and defined it. Vermont a couple of years ago enacted a loan solicitation license that applies to both consumer and commercial.

John Socknat:

With that, let me turn it back to Alan.

Alan Kaplinsky:

Well, I all want to thank first of all, all my colleagues at Ballard Spahr for their participation in today's podcast show, but I particularly want to thank all of our listeners today who downloaded the show. Let me just remind you of a couple of things. Our podcast show gets released weekly on Thursday, and you also, if you are enjoying our podcast show, you certainly would want to subscribe to our blog, which also goes by the same name, Consumer Finance Monitor.

Alan Kaplinsky:

In our blog, we cover in great detail a lot of the issues that we cover during our podcast show. You'll find if you go on our blog, and you do a search under lead generation or lead generator, you'll find a number of blog entries where we deal with developments in that area. That's it for today. Hope everybody enjoys the rest of their day. Thank you again.