Consumer Finance Monitor (Season 4, Episode 42): CFPB Enforcement Action Developments and Trends

Speakers: Alan Kaplinsky, Chris Willis James Kim, Sarah Reise and Sarah Pruett

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor podcast, where we explore important new developments that are of concern to the consumer financial services industry. I'm Alan Kaplinsky, senior council at Ballard Spahr, and I'm the former chair of our Consumer Financial Services Group.

Alan Kaplinsky:

Today, we're going to be talking about a subject of extreme importance and concern to the consumer finance industry, namely the CFPB and more specifically enforcement actions and trends at the new CFPB. And by the new CFPB, I mean the CFPB as it's been a constituted under the new leadership of acting director David Uejio. And Rohit Chopra has now been confirmed by the Senate. Very, very close vote, 50 to 48. And he either, by the time you're hearing this, will be sworn in or his swearing in will be imminent. But really all practical purposes, the leadership under David Uejio and the leadership under Rohit Chopra I don't think there is going to be a material difference, except in some ways that we'll point out during the podcast.

Alan Kaplinsky:

So we did this webinar several weeks ago, not much has changed other than the fact that Rohit Chopra has been confirmed. I've assembled the speakers today on this webinar of four of my colleagues at Ballard Spahr who have a wealth of experience in dealing with the CFPB. First of all, Chris Willis, to whom I will soon turn the program over. Chris is a co-chair of the Consumer Financial Services Group. He succeeded me as chair, along with Mark Furletti. Chris' practice focuses to a great extent on the CFPB and in particular supervision and enforcement at the CFPB. And he's been following the CFPB ever since its inception more than 10 years ago. So he has been handling matters involving the Bureau when it was under the leadership of Richard Cordray and then under the leadership of Mick Mulvaney and Kathy Kraninger and David Uejio, and very soon Rohit Chopra, who we're all very familiar with because he used to have an important position at the CFPB.

Alan Kaplinsky:

Also, James Kim will be joining us. James is an alumnus of the CFPB, and actually was an enforcement attorney there that worked in the Manhattan office of the CFPB before joining us in our Consumer Financial Services Group at Ballard Spahr. And also we have joining us today, two of our other colleagues, Sarah Reise and Sarah Pruett. Sarah Reise is in our Atlanta office. Sarah Pruitt is in our Minneapolis office. And both of them are very active in handling CFPB and, for that matter, FTC consumer finance investigations. So without further ado, it's my pleasure to turn the program over to Chris.

Chris Willis:

We're going to be taking a close look at CFPB enforcement together today, and let's go ahead and get into that. So it makes sense that if you're going to do more as a CFPB enforcement unit, you have to have the resources to do more. During the time of the acting director Mick Mulvaney, and then Kathy Kraninger, when she was director of the CFPB, the Bureau's enforcement unit shrank mainly through attrition. They weren't laying people off or firing people, but they had fewer people because they weren't replacing enforcement lawyers as they left. That trend was reversed immediately when the administration changed and Dave Uejio became the acting director of the CFPB. And so the Bureau was still in the process of rapidly staffing up its enforcement division just to enable it to undertake more investigations and do more because it does need the resources if it wants to do that.

Chris Willis:

So we know that they have hired numerous new people, including several highly experienced lawyers from state attorney generals' offices. I heard of two of those in particular just recently. And then we've also started to see detailees show up in CFPB enforcement investigations who are employed by other federal government agencies, like the OCC, for example. And those people are doing rotations in CFPB enforcement for say a year, and they'll be working to augment the CFPB's personnel in that area while the Bureau hires its own permanent employees.

Chris Willis:

And so we want you all to know that the Bureau is rapidly building capacity to do this sort of activity. And so it will have the capacity to do that. And in fact, we've seen that greater capacity already reflected. In our experience, both from what we're doing and what we hear from clients, the pace of investigations has increased dramatically. There are a lot of new investigations being launched. We've seen quite a few new ones start since the administration change earlier this year. And even in existing investigations that had been going on prior to the change in administration, we see intensified activity and efforts to move them forward as quickly as possible.

Chris Willis:

So it's very true, what Alan mentioned at the beginning of the webinar, that there's greater activity here and there really has been a significant turnaround in the enforcement level of activity of the CFPB. And so we're going to look now at some of the specific subject matter areas that we see the Bureau being interested in from an enforcement standpoint. And the first of those is the Military Lending Act. So Sarah Pruett, why don't you take it away with that?

Sarah Pruett:

Thanks, Chris. So as Chris mentioned, the Military Lending Act is one area in which we've seen increased activity by the CFPB. In 2018, the CFPB stop examining its supervised institutions for compliance with the Military Lending Act on the grounds that it did not have the requisite statutory authority. In January of this year, the acting director of the CFPB publicly shared a statement that he sent to CFPB staff. In this statement, he indicated that the CFPB planned to resume supervisory examinations for MLA compliance and to rescind public statements, conveying a relaxed approach to enforcement made during the previous administration.

Sarah Pruett:

In June, the CFPB issued an interpretive rule formally conveying their change in position that they did have the authority to examine compliance with MLA. In addressing this shift, the acting director stated that to protect military borrowers, the CFPB must supervise financial institutions and hold them accountable. Over the past year, the CFPB has made this and a number of other public statements confirming its heightened interest in MLA compliance enforcement. These statements comport with our experience, as we are aware of numerous MLA investigations.

Sarah Pruett:

Another relatively recent change involving the MLA is the CFPB's decreased focus on auto finance. The MLA has an explicit carve out in that it does not apply to credit transactions to finance the purchase of a vehicle when the credit is secured by that vehicle. In December, 2017, the Department of Defense issued interpretive guidance on the MLA. This guidance advised that the MLA would apply to vehicle loans when a lender extended credit in excess of the vehicle's purchase price, such as financing gap insurance or other ancillary products. The DOD received several formal requests from the industry urging that they withdraw this interpretive guidance. They finally did so in February of 2020.

Sarah Pruett:

Since then, several courts have rejected lawsuits alleging that auto lenders were not exempt from the MLA because they issued loans in excess of the purchase price to cover ancillary products. These courts pointed to the DOD's 2020 withdrawal of its

2017 guidance and the plain language of the MLA statutory exemption to find that auto lenders were not liable for violations of the MLA. We anticipate that because of these cases and the DOD's revised guidance that the CFPB will refocus its MLA enforcement efforts on other industries.

Sarah Pruett:

The next topic that we'll discuss is a big one, fair lending. The CFPB has also taken a renewed interest in fair lending under the Biden administration. Shortly after President Biden appointed Dave Uejio as the acting director of the CFPB, Mr. Uejio announced in January this year that racial equity was one of the two priorities he had for the CFPB. The other priority being COVID-19 relief. Since then, the acting director also stated that fair lending enforcement is a top priority and that it will be emphasized accordingly. Throughout the year, there have been a regular stream of commentary from the acting director and others at the CFPB about an increased focus on fair lending issues. I will touch on a few of these today.

Sarah Pruett:

In March, the CFPB issued an interpretive rule clarifying that the prohibition of sex discrimination under the Equal Credit Opportunity Act in Regulation B includes discrimination on the basis of sexual orientation, gender identity, actual or perceived nonconformity with traditional sex or gender based stereotypes, and an applicant's social or other associations. This interpretive rule is not particularly surprising as the CFPB has taken the position for several years now that prohibition on sex discrimination also encompasses sexual orientation and gender identity.

Sarah Pruett:

Notably, the CFPB also stated that it intends to review and update its examination guidance and other materials to reflect its interpretive rule and to take action where appropriate to hold financial institutions accountable for actions that violate the interpretive rule. This signals that discrimination on the basis of sexual orientation and gender identity may be a focus of the CFPB going forward. The CFPB has also held a number of events and webinars touching on fair lending issues, including a round table in June on home appraisals. This round table discussed research on the use of automated valuation models and how they can combat but also contribute to racial bias. During that event, the acting director stated that addressing inequities and persistent bias is one of his core priorities and that the CFPB will be considering remedies for valuation bias in home appraisals in the coming months.

Sarah Pruett:

In July, the Bureau's Fair Lending director also announced that the CFPB prioritized resources to focus on the role of racial bias in home appraisals. At the beginning of this month, the CFPB proposed a new rule implementing section 1071 of the Dodd-Frank Act. Section 1071 amended the equal credit opportunity act to require financial institutions to collect and report certain data in connection with credit applications made by women or minority owned businesses and small businesses. The proposed rule would require financial institutions to disclose information about their lending to small businesses. The proposed rule applies to financial institutions, including any entity that engage in financial activity, including both depository and non-depository institutions, such as online lenders, platform lenders and commercial finance companies.

Sarah Pruett:

However, the CFPB is considering size based exemptions for depository institutions and activity based exemptions for all financial institutions. The proposed rule only requires a disclosure of information about lending to small businesses. The CFPB indicated that a small business would be defined as one with $5 million or less in gross annual revenue for the preceding year. If finalized, the rule would require lenders to disclose, among other elements, the amount and type of small business credit applied for, the amount of credit extended, and demographic information about the applicants.

Sarah Pruett:

Lenders would be required to report whether the business is minority owned or women owned and the ethnicity, race and sex of the applicant's principle owners. Applicants may of course, decline to answer these questions. The CFPB proposed that if an applicant does not provide any ethnicity, race or sex information for at least one principal owner, the financial institution must collect at least one principal owner's race and ethnicity, but not sex via visual observation and the surname if the financial institution meets in person with any principal owners.

Sarah Pruett:

Finally, lenders would also be required to tell applicants that they cannot discriminate on the basis of the demographic information supplied. In its commentary about the proposed rule, the CFPB has focused on how collected may in particular shed light on credit application outcomes for women owned and minority owned businesses. They have also stated that the data will aid them and other government agencies in their ongoing fair lending, supervisory and enforcement efforts. Given the Bureau's many public statements about prioritizing fair lending, we expect that if this rule is implemented, it will serve as a powerful tool in the CFPB's fair lending, supervision and enforcement activities.

Chris Willis:

Yeah, thanks Sarah. So we have all of this atmospheric activity around fair lending with the CFPB, public statements, the 1071 rule making, et cetera. So where do we think the CFPB is going to be going from a fair lending standpoint in enforcement? So that's what I wanted to talk about here for a minute.

Chris Willis:

So there are some existing areas of focus, things that aren't new to anyone, that we expect to be heavily emphasized during the next several years. These are things, in fact, some of which didn't even go away during the last administration like redlining. The CFPB brought a redlining case against Townstone during the last administration before the administration changed happen. And there's every reason to believe that the Bureau will remain as interested as it has been, and maybe more so, in redlining in the future. So that's an area I think that we're definitely going to see more enforcement in.

Chris Willis:

And in fact, maybe even supervisory exams feeding into enforcement as was the case in some instances during the last administration. And then there are some of the old classic issues like judgemental underwriting and pricing. I think when the Bureau sees that, they will be interested in investigating it for potential disparate impact on members of protected classes. And any steering instances that they may find themselves confronted with, either through consumer complaints or through supervisory exams.

Chris Willis:

And somewhat related to that is equal treatment of limited English proficiency consumers. I'm not talking here about making everything available in non-English languages. I'm talking about the idea of, "Hey, if you don't speak English, then you get different treatment based on whatever, servicing or collections or loan origination, or loan products that are selected for you, et cetera." Which can be a steering issue, or it can just be a disparate treatment issue. And we saw one consent order under the old CFPB days relating to a difference in settlement treatment from people who spoke Spanish, for example, as their first language. So those are all areas that, when the Bureau encounters them, I think it will be more sensitive to those issues and more likely to bring enforcement actions.

Chris Willis:

But then there are several potential new areas of focus that I wanted to share with you. And these are things that we know that the Bureau is interested in and that we know consumer advocates are interested in and it remains to be seen what the Bureau may do here. Will it address it through supervision? Will it do it enforcement? We don't know yet. But these are on the table

for consideration, I think. First one is model development and testing, particularly with machine learning models. That's an area where the Bureau has been very actively interested over the past year. We don't know what the Bureau's going to say or do about it, but it is a subject of major, major focus by consumer advocacy groups, many of whom believe that machine learning models have inherent biases in them that can result in differential treatment on the basis of protected characteristic. So we'll see if the CFPB takes that up and starts to investigate that from an enforcement standpoint.

Chris Willis:

There's the use of alternative data. And of course, alternative data can range from everything from the very conservative, like bank account information, which the CFPB and the other federal banking regulators seemingly blessed about a year and a half ago in that joint statement that they released in January of 2020, to things that are highly controversial like, for example, school specific variables in student lending, which have been the subject of ongoing consumer group criticism and criticism by members of the Senate, most notably Elizabeth Warren, even recently this year. And so it wouldn't surprise me to see the Bureau take aim at the use of some of those school specific variables that are more controversial and that Senator Warren has been attacking from her pulpit in the Senate.

Chris Willis:

Next, we have the issue of targeted advertising. Now, the case law has not been developing well for these targeted advertising claims in private actions in court, you have a lot of courts saying that there's no indication of a consumer injury and therefore no standing. But we know it's an area of significant interest, again, by consumer advocacy groups. The CFPB hasn't said anything about it. But will they? We don't know, we'll have to see. But it could be an area for enforcement.

Chris Willis:

And then finally, another question mark is will the Bureau try to engage in fair lending enforcement related to servicing activities, particularly lost mitigation? We've been looking for that from the CFPB ever since Patrice Ficklin, who's the head of the CFPB's Fair Lending Office, wrote a blog post about it in December of 2016. But we haven't seen any enforcement activity in that area. But will that happen? And can the combination of post COVID expiration of things like mortgage and student loan forbearances coupled with the greater perceived need for other loss mitigation activities give rise to this idea of fair lending analysis of loss mitigation decisions? We don't know, but certainly the times and circumstances seem right for that to happen, if it's going to happen. So we'll see if the Bureau delves into any of those areas.

Chris Willis:

So those potential new areas are question marks for us. We don't know if the Bureau will do them, but we do know that the traditional areas will definitely receive more attention. And so if you haven't done it yet, now is the time to really look hard internally at potential fair lending issues because if there are ones there, best for you to find them before the Bureau comes knocking and starts to inquire about them. So that's what we wanted to tell you about fair lending. Let's talk for a minute about student lending and servicing. And James, I think you're taking that topic.

James Kim:

Yes. Thank You, Chris. So I'm going to spend a few minutes talking about the CFPB's really not expected, it's already started, focus on student lending, student loan servicing, and related education finance issues. So that's the bad news, right? There has been ramped up supervisory and enforcement and activity. Today we're focusing on the enforcement. The good news is I think the past gives us a pretty good roadmap about the types of issues that we should be focusing on. Because the people are all the same people. So let's take a moment to look back, because it will inform our analysis and look forward.

James Kim:

So the nominated director who's expected probably on a 50:50 vote, with a tiebreaker going to the vice president, Director Rohit Chopra, he's been with the CFPB before. His earlier role was the student loan ombudsman. His lieutenant was Seth

Frotman. And when the CFPB changed leadership four plus years ago, Mr. Chopra left and then became a commissioner at the Federal Trade Commission. And that's where he is now as his nomination is pending. Seth Frotman got promoted and became the student loan ombudsman under the Republican led CFPB. That marriage, that forced marriage, did not work out very well. And Mr. Frotman left the CFPB in a noisy fashion. He resigned and basically said that he thought the CFPB was not allowing him to do his job and that the Bureau at that time was not fulfilling its mission to protect students.

James Kim:

He left and he formed his own not-for-profit agency, the Student Borrower Protection Center. It is well staffed by a bunch of former CFPB personnel, as well as some other former regulators. The New York Department of Financial Services, their student loan and point person left New York DFS to join Student Borrower Protection Center relatively recently. So the Student Borrower Protection Center basically became the gadfly, so to speak, for the industry and for the CFPB in certain respects. And if you look at the student borrower protection center and you look at their talking points, the issues they've raised in the last four years, the reports and studies that they have published, and all of them are available on their website, it gives you a pretty good roadmap of the types of issues that they're likely to raise now that they're in the driver's seat at the CFPB.

James Kim:

So whether or not Seth Frotman leaves to join the CFPB is kind of irrelevant. He has the ear of the Bureau, both the acting director, of course he has a close relationship with Mr Chopra. So a lot of the things that that team did in the past, which is take actions against schools and investors, banks and their non-bank service providers, student loan trusts, and debt collectors, meaning the entire ecosystem in the education finance space, have all been targeted to varying degrees in the past. We expect that to return going forward.

James Kim:

And one other very important person that I want to point out here is Richard Cordray. So he had been the director, he was the last Democratically appointed director of the CFPB. He recently was appointed to join the Department of Education as the Chief Operating Officer for Federal Student Aid. So again, I think the theme here is the band is together. People have different roles, but it's the same people wearing slightly different hats, but all likely to do the same things. And so the Republican CFPB termination of the MOU with its Department of Education, that's all in the rear view mirror. We expect close coordination between the Department of Education, Student Borrower Protection Center, other student advocacy groups, and the CFPB to take a page out of what they've done in the past, but continue it going forward.

James Kim:

And so let's take a minute just to talk about what looking forward likely means, what we expect it to mean. First and foremost, and I know we said this in the beginning, the acting director's two priorities to date have been COVID related relief and protecting consumers under these unprecedented circumstances, and racial and gender diversity. So we expect both of those overarching priorities to apply to any asset class for industry, including student lending and servicing. We also expect focus on origination, specifically marketing and representations made about advertising of student loan related products and services, the administration of federal and private benefits.

James Kim:

So again, the largest market here is the servicing of the student loans, the application of military benefits both under the SCRA and Military Lending Act to student loans, cosigner issues. Again, this is something that's been hashed over in the past, a payment allocation and making sure that payments are allocated in a way that's favorable for students and to give them full choice and the option to choose payment allocation. That's been an issue in the past. We expected going forward. And then I think the interesting wrinkle going forward, and I'll pick this up a little bit later, is emerging products in the education space, specifically income share agreements and related emerging products, such as deferred tuition agreements.

James Kim:

So let's talk about that for a second. So this is big news if you're in this space. If you're in the traditional student loan space, I think it's news. But it's bigger news if you're in the income share agreement space. The CFPB recently issued a consent order against a not-for-profit organization that had a direct-to-consumer model. And I think that's very important. So Better Future Forward is a not-for-profit agency that has a direct-to-consumer model, meaning it directly solicits and markets and originates income share agreements to students so that the students can use those funds to attend various educational programs, many of which are traditional Title IV institutions, many institutions eligible for federal student loans.

James Kim:

So the CFPB recently issued a consent order. And the headline here, make no mistake, is that income share agreements, although they are entirely contingent obligations, meaning you only have to repay a certain percentage of your income only if you are employed and only if you make a certain amount. And if you fall out of employment, either permanently or temporarily, your payment obligation is suspended. And again, if you never hit those requirements, then you never have a payment obligation. So they're structured not to be any sort of a credit product. But the CFPB expressly, and they had to in order to have jurisdiction over the product and BFF, concluded without any analysis that income share agreements, at least BFF's income share agreements direct-to-consumer agreements, are extensions of credit subject to Title X of Dodd-Frank. Also, because they're extensions of credit, subject to Truth in Lending, Regulation Z.

James Kim:

And here's the nuance to it, because BFF originates ISAs for students so that they can attend Title IV schools or schools that are subject or eligible for federal student loans, BFF's ISAs are also subject to not just the regular sections of Reg Z that are for closed end, not secured by real property consumer loans, they're also subject to the special sections for private education loans. So there's multiple layers of Reg Z compliance obligations because of the consent order for a Better Future Forward. And BFF had a very peculiar specific to itself mechanism that acted as a penalty for prepayments. And because prepayment penalties are not allowed for private education loans under the special student loans sections of Truth in Lending, BFF had that violation as well in its consent order.

James Kim:

So I think the big news here is the CFPB is staking out its position like it has in the past to assert jurisdiction for emerging products where its jurisdiction is quite ambiguous. In this case, if you were to look at the consent order, and I've studied it carefully, there is no analysis, no discussion of why income share agreements are credit obligations. It just merely states that conclusion and then imposes various Reg Z related and Dodd-Frank UDAAP related violations and compliance obligations that flow from that conclusion that has no analysis. But I think the headline for everybody is the CFPB is back to its old ways of regulating by consent order, so no rule making, no guidance, no perspective guidance for anybody in the income share agreement space. Instead, they went straight to a consent order and they left it for everybody to try to read the tea leaves to understand how you, for example, comply with Reg Z disclosure requirements when the income share agreement product fundamentally does not fit the construct of credit or loans.

James Kim:

But that's, unfortunately, the position we're left in here. So even if you're not interested in income share agreements, this is just a very stark reminder that we're back to regulation by consent order, that you could get a gotcha without having any advanced warning, not just about a practice, but whether or not a particular product or service is even covered by the CFPB. So turning it to Sarah Reise, who's going to talk about other ways in which the CFPB is expected to push the envelope.

Sarah Reise:

Thanks very much, James. I'm going to be addressing another example of where the CFPB may be looking to push the envelope in the future, talking about aiding and abetting liability. So very recently, the Bureau filed a lawsuit in the Central

District of California against a company called Daniel A. Rosen, Inc., doing business as Credit Repair Cloud or CRC, and its owner seeking individual liability for the owner of the company. And the Bureau is seeking injunctive relief, disgorgement and civil monetary penalties. the Bureau is alleging that these defendants sell software to people who want to start and run their own credit repair businesses. So they provide software that provides essentially the platform and client management account management system. And they also provide training and guidance on how to run a credit repair business. And in addition to the training programs, the defendants allegedly provide telemarketing sales scripts, and template marketing materials and template websites.

Sarah Reise:

With respect to the owner of the company, Daniel A. Rosen, the CFPB alleges that he solely controls the company's finances and that he has directly participated in developing and delivering the training programs and marketing the company's software and business systems. The CFPB is alleging that the defendants have encouraged its users to charge consumers who are signing up for credit repair services in advance at the time of enrollment, and also encouraging its users to charge consumers recurring monthly fees. And this is allegedly in violation of the Telemarketing Sales Rule. As a reminder, the Telemarketing Sales Rule prohibits credit repair organizations engaging in telemarketing of its services from requiring or receiving any advanced fee for their services, and fees are only permitted to be charged once the credit repair business provides the promised results.

Sarah Reise:

So here, the CFPB is alleging that the defendants not only encouraged its users to charge these improper fees, but that they either knew or consciously avoided knowing that its users were, in fact, violating the TSR. The claims asserted are alleged violation against both the corporate defendant and the owner of violating the Telemarketing Sales Rule's ban on providing substantial assistance or support to a telemarketer when the TSR bans such support when the person providing the assistance or support knows or consciously avoids knowing that the telemarketer's engaged in conduct that violates the TSR. And there's also an alleged violation of the CFPA, which prohibits service providers from providing a consumer financial services product that is not in conformity with a Consumer Financial Protection law. Here, the law at issue is the Telemarketing Sales Rule.

Sarah Reise:

It's very likely that the CFPB sought to have a much bigger impact and pursued, perhaps, a more efficient route of enforcing Consumer Financial Protection laws by going after this service provider. It's certainly much more efficient to go after the provider of the software system used to start these companies than it would be to go after multiple individual and perhaps smaller credit repair businesses. There'd be a much splashier headline. And certainly we saw the old CFPB really pursuing big name, big ticket, big impact enforcement targets in the past. And of course it's helpful to remember that this action is not entirely unprecedented, going after a service provider.

Sarah Reise:

Back in 2017, the CFPB negotiated a consent order with a company that operated a loan servicing software that allegedly contributed to inaccurate credit reporting. The company was deemed to be a service provider to five auto lenders because the loan servicing software stored consumer information and automated a lot of servicing processes, obviously, including credit reporting. Notably at least two of the company's customers that use this software before 2017 had entered into their own consent orders with the CFPB that included allegations of alleged credit reporting inaccuracies. In the consent order, the CFPB alleged that the software was not capable of accurate furnishing, but perhaps more critically that the company failed to address the defects in the software when it learned of them, and also failed to notify the lenders that used its software that there were problems with the credit reporting function.

Sarah Reise:

So in addition to conduct provisions designed to prevent or timely addressed future software defects, the CFPB also imposed a pretty sizable $1.1 million civil monetary penalty. So given the perceived potential efficiencies from pursuing service

providers that we could expect to see a more aggressive CFPB looking at this strategy in the future. Rather than having to pursue multiple targets, they may be able to get whatever intended outcome or a consumer benefit from just pursuing one. So this is definitely a strategy that we'll watch out for that we could see used more in the future.

Sarah Reise:

So switching gears a little bit here, we're going to talk now about a somewhat rare success in litigating with the CFPB and that's the Consumer Financial Protection Bureau v. Consumer First Legal Group case that recently was decided by the Seventh Circuit. So starting first with a little bit of history of the case, this action's been around for quite some time. Back in 2014, the CFPB sued two mortgage assistance relief companies and four lawyers associated with those companies for alleged violation of Regulation O. Specifically, the Bureau alleged that the companies failed to provide mandatory disclosures, made misrepresentations about the mortgage relief services provided and that they also collected unlawful advanced fees. At the District Court level, the District Court ruled that the companies did in fact violate Regulation O and that the lawyer defendants could be held personally liable and were not exempt from Regulation O because the work that they completed did not qualify as the practice of law.

Sarah Reise:

After finding the defendants liable, the District Court ordered a really significant restitution award of $21.7 million. The District Court also assessed civil penalties, totaling $34.1 million, allocated among the four lawyers, and a civil penalty of $3.1 million against one of the companies. And the District Court also issued a permanent injunction, prohibiting three of the four lawyers from providing any debt relief services in the future. The defendants appealed both the liability and the remedial order to the Seventh Circuit. And earlier this summer, the Seventh Circuit issued its decision. The Seventh Circuit affirmed liability, but significantly it vacated all aspects of the District Court's remedial order. So starting first with the restitution award, the District Court based that huge restitution award on the defendant's net revenues, which is gross receipts minus any refunds that were issued.

Sarah Reise:

The Seventh Circuit agreed with the defendants who argued that the Liu v. SEC case required that any sort of equitable relief be based on net profits after deducting legitimate expenses. The Seventh Circuit agreed, as I said, and it rejected the CFPB's attempt to argue that disgorgement, which is what was that issue in the Liu case, was separate and different and distinct from restitution, which is what the District Court ordered in this case. The Seventh Circuit rejected that argument and found that the Supreme Court has announced a rule that generally applies to all categories of equitable relief. So arguing and attempting to distinguish disgorgement from restitution was not successful there. So on remand, the District Court now needs to revise its restitution award based on the company's net profits.

Sarah Reise:

Looking at the civil monetary penalties, the Seventh Circuit held that it was error to assess second tier civil monetary penalties. As a reminder, the Consumer Financial Protection Act sets forth three tiers of possible civil monetary penalties. The lowest is for strict liability violations, and that is up to $5,000 a day. For reckless violations, the second tier, carries a penalty of $25,000 a day. And the maximum penalty for knowing violations is $1 million a day. So in this case, the District Court imposed civil monetary penalties in the second tier for reckless violations of $25,000 per day. The Seventh Circuit decided that it was a step too far to say that the defendants were reckless. And it announced a standard for what reckless means, and that is, "To be aware of an unjustifiably high or obvious risk of violating the law."

Sarah Reise:

So on remand, the Seventh Circuit has instructed the District Court to apply the lower $5,000 penalty for strict liability violations. Also of note, the District Court used the incorrect time periods to calculate the penalties. It was too favorable to the CFPB and the Seventh Circuit held that the court ignored evidence that the time period during which the violations were occurring was actually narrower than what the District Court accepted. So we can expect to see a much smaller civil penalty

amount after remand. And then finally, with respect to the injunction that was issued, the Seventh Circuit held that injunction was too broad.

Sarah Reise:

To me, this is a really significant ruling because I think it's very unusual. District Courts have pretty broad discretion in terms of setting injunctive relief. So having an injunction deemed to be too broad is somewhat unusual. The basis for the ruling was that the violations in this case included mortgage relief. So the District Court's injunction in joining the defendants from engaging in any debt relief services as a whole was too broad. I think it's especially notable that these attorneys are career bankruptcy attorneys. So being prohibited from engaging in any sort of debt relief was just a step too far. And the Seventh Circuit also held that such a broad injunction was not necessary here to prevent consumer harm, the whole point of injunctive relief under the CFPA, because the companies had gone out of business a long time ago. And the Seventh Circuit specifically noted that the services offered were not a complete sham. A lot of consumers actually did receive the loan mortgage modification and mortgage relief that they sought when they signed up for the service.

Sarah Reise:

So I think we can expect to see, based on trends that we've seen the last few years and based on this case, that litigation with the CFPB is likely to continue to increase. Litigation may become necessary because as the CFPB begins to push the envelope more in terms of theories of liability, enforcement targets may not be willing to accept these creative theories and rule making by enforcement with, as James mentioned, gotcha findings of liability. And also we may start seeing a more aggressive bureau be more demanding and aggressive in terms of the amount of money it may seek in negotiations for a civil monetary penalty. So if the Bureau and the enforcement target are just too far apart, the point of negotiating a consent order, litigation just may become the only viable result of those negotiations. And I think also successes like we saw in the Consumer First case may just make litigation more attractive for more industry participants in weighing the cost-benefit analysis.

Sarah Reise:

So with that, I'm going to turn things back over to James to just make a brief note about what we may expect to see in the future regarding cooperation between the CFPB and state regulators.

James Kim:

Thanks, Sarah.

James Kim:

So this is just a point, again, for me, one of the themes is the CFPB coming full circle to how it operated several years ago under Richard Cordray when I was at the Bureau. And there was a long period where the CFPB worked very closely, mostly behind the scenes, not publicly, to exchange information and feeds with various state regulators and state AGs. But also I think resulting in some very public joint actions. So I fully expect that to have them on a going forward basis. When Director Cordray was in place, he went out of his way to say he wanted the CFPB to be a great partner for its sister state agencies and not have the reputation that some other federal agencies have, which is that... I think there's some perception, I think mostly correct, that a lot of other federal agencies don't play nicely with the states and look down on them and do their own thing. I think Director Cordray very much wanted to be the opposite, wanted to help and work with the states. So I expect that going forward.

James Kim:

And I remind everybody that under Dodd-Frank, state AGs have the right to bring federal actions in federal court alleging UDAAP under federal laws, as opposed to their state laws. And the statute requires some coordination or consulting with the Bureau. So I can't recall, and I haven't done an exhaustive check, but I can't recall a state AG suing under Dodd-Frank when the CFPB was under Republican leadership, but I do recall that it happened a few times at least under Democratic leadership.

So that's another thing to look forward as far as state activity working hand in hand or ramping up in connection with CFPB enforcement. Thank you.

Alan Kaplinsky:

Well, thank you very much, James. And my thanks all to my other colleagues, Chris Willis, Sarah Reise, and Sarah Pruett for covering a lot of territory and getting everybody ready for this new CFPB.

Alan Kaplinsky:

And in fact, one thing I want to mention that may be of interest to some of you listening to this podcast is we have devised a CFPB readiness service, which we have offered to and have actually delivered to several of our clients who were interested in making sure that they were as compliant as they could be in the areas where we thought the CFPB would be focusing. So if you are interested in the service, you can contact me, you could contact Chris Willis, James Kim, Sarah Reise or Sarah Pruett, any of us, and we will tell you how it works.

Alan Kaplinsky:

So just a final reminder that our podcast program also compliments what we write on our blog, which also goes under the name Consumer Finance Monitor. And so for more information about the topic that we talked about today, you should always consult our blog, because there's a lot of material on there. We've been doing the blog for the same period of time that the CFPB has been operational. We release a new podcast show every Thursday, except we take two weeks off during the month of December to celebrate the holidays. Thank you for downloading our podcast today, that's very meaningful to us.