Consumer Finance Monitor (Season 6, Episode 9): The Consumer Financial Protection Bureau's Proposals to Create Two Public Registries for Nonbanks: What You Need to Know, Part II

Speakers: Alan Kaplinsky, Rich Andreano, John Culhane, Michael Gordon, and Lisa Lanham

Alan Kaplinsky:

Welcome to our award-winning Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show, brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former Practice Group Leader for more than 25 years, and now Senior Council of the Consumer Financial Services Group at Ballard Spahr, and I will be moderating today's program.

For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted our blog since 2011, when the CFPB became operational, and there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com. If you like our podcast, please let us know about it. Leave us a review on Apple Podcast, Google, or wherever you obtain your podcasts. Also, please let us know if you have ideas for other topics that we should cover or speakers that we should consider as guests on our show.

So today, I am happy to be joined by my colleagues, Rich Andreano, John Culhane, Mike Gordon, and Lisa Lanham. Rich is the Practice Group Leader of our Mortgage Banking Group and the co-chair of our Fair Lending Team in our Washington, DC office. He assists clients with preparing for and handling CFPB mortgage-related examinations and enforcement actions and with a variety of mortgage-related regulatory issues. John Culhane is a partner in our Consumer Financial Services Group, who works out of our Philadelphia office. He's known for his works on advising clients on interstate, direct, and indirect consumer loan and leasing programs. John's practice includes preparing clients for banking agency and CFPB compliance examinations and assisting in the defense of Attorney General investigations and banking agencies and CFPB enforcement actions.

Mike Gordon is a partner in our Consumer Financial Services Group based in our Washington, DC office. Mike is a former senior CFPB official with over two decades of experience in consumer financial services law. Mike focuses on enforcement defense, compliance and exam readiness, et cetera, et cetera. And Mike is one of the two new members of our Consumer Financial Services Group. When I say new, meaning that they joined us last year. And finally, last but not least, I'm happy to introduce Lisa Lanham, who is in our Mortgage Banking Group and our Consumer Financial Services Group, and she co-leads our firm's FinTech and Payments Solutions Team. Her practice focuses on financial services matters related to state licensing and federal approvals that are necessary to conduct business for a variety of asset classes and market participants.

So on our podcast show last week, we covered a repurposing of a webinar that we recently did where we focused on the first of two registry proposals made by the CFPB. In the podcast show last week, we focused on the registry that the CFPB has proposed that would require non-banks that are in the consumer finance business to register with and submit information to the CFPB for publication in an online publicly available database. That proposal, which we went into in detail last week, would require companies to register. When as a result of any final judgment or otherwise or final settlement, those companies become subject to orders from local, state, or federal agencies and courts involving violations of consumer protection laws.

Today, we are going to repurpose the other half of the webinar that we did, which focuses on the other CFPB registry proposal that would require companies to register if they use certain terms or conditions in formed contracts, such as waivers of consumer rights and arbitration provisions, regardless of whether such terms or conditions are lawful. These two proposals,

either by themselves or together, represent a very aggressive attempt by the CFPB to enhance its supervisory and enforcement authority.

We're now going to segue into the second topic that we're going to cover this afternoon, the so-called contracts registry. This was published in the Federal Register on February 1, and comments are due on April 3rd. And as is the case with the so-called orders registry, we are also working with a number of clients who are interested in potentially submitting comments on this registry as well. In fact, I would say I have probably even more clients that are worried about this registry, because this really is, I think, overreach on the part of the CFPB and Rohit Chopra.

So the proposal would establish a system for the registration of supervised non-banks. Not all non-banks, such as are covered under a good part of the registry dealing with orders. This applies to supervised non-banks, those that are subject to examination that use certain terms or conditions that seek to waive consumer rights or other legal protections or limit the ability of consumers to enforce their rights. Wow. That covers a lot of language and a lot of form contracts.

However, this, in my view, and this is now Alan Kaplinsky editorializing, this is, I believe, entirely a result of the arbitration or the lack of success that the CFPB had a while ago in under a different director, Richard Cordray, in promulgating a regulation that would have severely restricted arbitration by banning class action waivers and doing some other things.

So ever since Rohit Chopra got sworn in more than a year ago, as I say, we're going on 14, 15 months, consumer advocates have been lobbying him. I should say that's probably not a forceful enough word. They've been beating down his door to get him to ban the use of arbitration provisions or at least class action waivers contained in arbitration provisions in consumer finance contracts.

Up until now, he wisely resisted that pressure because of the fact of the experience that former director Cordray had in trying to get a regulation on the books that would've severely restricted the use of arbitration. And of course, what happened there is that Congress utilized the Congressional Review Act to override the regulation that was promulgated by the CFPB, one of the final things that Richard Cordray did before he left office to go to Ohio to run for Governor. But the Congressional Review Act, just so I can remind everybody, prohibits a federal agency from promulgating a regulation that is substantially the same as one the Congress has overridden in a Congressional Review Act regulation.

On November 1, 2017, then President Trump signed into law a joint Congressional Review Act resolution passed by the House and the Senate, overriding the CFPB's final arbitration rule that, number one, banned the use of class action waivers in arbitration provisions in consumer finance contracts, and two, this is even more important for purposes of where I believe Rohit Chopra has gone off the rails here, it also required companies to report certain information about consumer financial services arbitrations involving such companies.

In the CFPB's arbitration report on the study it conducted before proposing this final rule, the CFPB concluded the record did not support the promulgation of a rule that would altogether ban arbitration. So what he came up with was the Ban of Class Act, that he wanted to ban class action waivers in arbitration provisions, and he wanted to require companies that were using arbitration to report certain information to the bureau about their use of arbitration. So unfortunately, Director Chopra has caved into the constant pressure of consumer advocates to ban class action waivers in arbitration provisions by proposing this registry for non-banks that are supervised by the CFPB that would require reporting to the CFPB and public disclosure about their use of arbitration provisions and class action waivers contained therein.

So the question at the second bullet point on this slide, this is really I think the important legal point, and that is the proposal an attempt by the CFPB to accomplish indirectly what Congress prevented it from doing directly when it disapproved the bureau's final arbitration rule, that is prohibit the enforcement of class action waivers in consumer arbitration agreements and also provide certain information about the use of arbitration. The authority relied on by the CFPB for this proposal, it's the same authority used by the CFPB for the other registry, that is 1022(b) and (c) of Dodd-Frank and 1024(b) of Dodd-Frank. But here, I believe that the CFPB is on shakier legal ground, because as I said, I think this is a way for him to hopefully appease all the consumer advocates that have been clamoring for him to do something regarding arbitration, to not let that issue die, and this is what he came up with.

And frankly, I think, and frankly and unfortunately, all the other things that required disclosure in this registry, and we're going to get into that in more detail in a couple of minutes, they, I think, were put in there really just to make it appear as if this was not focused just on arbitration. But the reality is what's driving this, I believe, is arbitration and arbitration alone. But some of

the other things he's asking for information about, that's going to require a lot of work and a lot of thinking. So let me now turn it over to Mike Gordon, who's going to do a little more of a deeper dive into this particular registry.

Michael Gordon:

As you will learn about in a moment in more detail, whether arbitration was the driving motivation or not, the covered provisions that this registry would require registration of go well beyond arbitration clauses. But let's first deal with the question of who's covered by this, and I saw a question in the comments box from someone who was understandably confused between what's a supervised entity versus a covered non-bank entity for the purpose of this rule.

For this particular rule, it's focused on the non-bank entities over which the bureau already has supervisory jurisdiction through one of its preexisting means of doing that. And just briefly, the tradition of the bureau has a separate supervisory jurisdiction over banks, but for non-banks, there are certain statutorily dictated types of industry participants that Congress gave the bureau supervisory jurisdiction over. That's the first sub-bullet here.

Secondly, they can write larger participant rules, carving out supervisory authority in new industries for the larger players in those industries, and they've done that for consumer reporting agencies, debt collectors and others. And then finally, they have this until recently dormant authority to pick individual companies that pose some perceived risk to consumers and exercise a form of supervisory jurisdiction over that. So for the terms and condition registry, that's who's covered with some limited exceptions that are essentially threshold, like de minimis type exceptions.

When we were talking about the enforcement registry, there were two parts to that. Remember one part covered the required attestations, and that was for these supervised companies like we're talking about here. But the enforcement order registry also went broader than just supervised entities and had a covered non-bank definition that included many thousands more than are currently under the bureau's supervisory jurisdiction that would be required to file their orders every year, but not necessarily the attestations. So it's a little confusing to understand the bureau's jurisdiction on a good day, and this registry makes it a little more complicated. But in essence, for this terms and conditions registry, we're talking about supervised non-bank entities. And I'll hand it over to Rich at this point.

Rich Andreano:

Thank you, Mike. Now, what we're going to look at is, in fact, who is covered is what is a covered form contract, and basically it's a written agreement between a covered person and a consumer that was drafted before the transaction, that's key, one key element, drafted before the transaction, and then for use in multiple transactions, another key element, and contains a covered term or condition. That'll be the key, as Mike alluded to. It's much broader than mandatory arbitration, and in fact, we will be addressing that in a few slides.

Now, in terms of this, it can be in paper or electronic form. Now as to electronic form, the bureau notes in the preamble that, in fact, let's say someone is applying for a consumer financial product or service on the Internet and has to agree to website terms. Those terms perhaps could, in fact, be a covered form contract if they have a covered term or condition in them. So folks will have to think broadly in terms of what agreements and terms or conditions they have that might be covered by this rule.

Now, it might potentially, they say in the preamble, though they don't go in a whole lot of detail, if there's been an oral agreement and that is recorded or somehow reduced to writing, that potentially may be covered as well. It'd be nice to have a little more guidance on that. Now, let's look at the drafted prior to the transaction element. The bureau address set in the preamble, really saying that suggests two aspects. One, if it's drafted prior to a transaction, it suggests an intent to use it in multiple transactions. It also suggests that probably negotiation is not something that's possible on the part of the consumer, given that it was done in advance. On essence, your typical type of, "Here's an adhesion contract. You want to negotiate it? No."

But it isn't just completely take it or leave it contracts. One thing the bureau does note, well, you might be applying for some sort of credit, and there is an ability to negotiate with a lender on the cost of that credit. However, the document used to implement the transaction, there's no negotiation as to the terms there. There, even though there was negotiation as to the

price, since there wasn't negotiation as to the other terms, it could still be a covered form contract if it has an applicable term or condition in it.

Also, in some cases, there may be a certain ability to opt out or use alternate language, but when all of that is using provisions drafted by the creditor or other party, and the consumer has no input into what those provisions actually say, again, even though there was some ability to change perhaps from the standard version of the agreement to an alternative one that the entity uses, it would still be a covered form contract. Fallout of it, it has to be true negotiation. It's not something standard, and companies usually don't do that simply for ease up of operation. It's hard to have 50,000 different versions of contracts floating around. So that's why they usually are all standardized.

Now, another important exception here for the mortgage industry, however. As we know with if you want to sell loan to Fannie Mae or Freddie Mac, you have to use their standardized documents unless you've negotiated a special transaction with them. And also with HUD, FHA, they have up on their website, as Fannie and Freddie do on their websites, various contract provisions, admitted modifications, and these are publicly available. Because of that, the bureau said if your only use of a contract, covered form contract, that includes covered terms or conditions are these agreements, because they are readily available to the public, and the bureau and consumers can just monitor what's in them in their use, that's excluded.

Now importantly, if you qualify for this exclusion, it only applies to these contracts. If you otherwise use covered form contracts in other manners, then you would be subject to the registry. So again, website terms and conditions and other things might get pulled into this, even if the only contracts used are the Fannie/Freddie notes and security agreements.

They didn't, however, say, though, if, there's an exception, but an exception to the exception, if a party, which would be a lender or a servicer or a holder, went to enforce a provision, a covered term or condition, in one of these agreements, that would not be publicly known, necessarily. So then, the exception wouldn't apply, and you would have to address the fact that you had in fact went in and sought enforcement of the provision.

Now, the Fannie/Freddie standard of security instruments do have a notice of grievance provision, and basically that says, on the part of either the loan holder or the consumer, if either thinks the other party has breached the loan terms, before they may go to court, they have to notify the other party of their belief of the breach and give the other party time to correct the breach, if in fact there is one. So there is a provision in there that would in fact be covered, we think, the notice of grievance, and lenders do at times seek to enforce those provisions. When a borrower believes the servicer perhaps didn't follow the security instrument and they simply file suit without first notifying the servicer of the error, there are cases where the servicer will go into court and ask for enforcement of that provision.

Now, not necessarily mentioned as a reason for the exception, but one thing we have to remember when it comes to the mortgage industry is they are subject to some contract restrictions that don't apply to other parties. In Dodd-Frank provided and the CFPB implemented it in Regulation Z under the Truth and Lending Act, that you can't have mandatory arbitration or similar clauses in mortgage agreements, nor can you have provisions where the consumer waives their right to seek damages or other relief under a federal law. So already, the mortgage industry's subject to somewhat more limitations on the contracts they can use and the contractor provisions that they can use. So that might have been part of the bureau's thinking as well perhaps in offering up this exception, but they didn't specifically say that. Now, I'd like to hand it back to Mike to address when a supervised bank enters into a covered form contract.

Michael Gordon:

So the bureau is trying to cast as wide a net as possible here. They're clearly intending to be as thorough as they can to capture the types of provisions, as to which they have a great deal of skepticism. So whether they're provisions negotiated at the start of the relationship or added later or adopted by others in the course of the life cycle of the product or service, they're trying to capture as much as they can.

So this notion of a supervised non-bank, they entered a covered form contract if it's at the front end when you provide a service that's governed by a covered form contract. If you provide a new product or service that has a pre-existing offending provision here or contract, or if you acquire a product or service that has that covered contract associated with it, and they give examples in the auto industry. So there are more examples of this, but this is just an indication of how broadly they're trying to cast the net for capturing the contracts that they want to see reported.

So here again, if you add a provision later to an existing contract that's one of the provisions of interest, that will bring you within the covered realm, or add a covered form contract to a service that already exists. So again, the notion is, and if this rules becomes final in anything like this form, you'll have to be carefully reviewing your contracting processes and the contracts you acquire and draw lines around those for which registration's going to be required. And I'll hand it back over to John Culhane.

John Culhane:

So I'm going to talk about what are the provisions in your contract that are going to lead to you being subject here to having to register. And as Mike and Rich said, the CFPB has really cast a broad net here. If they mean what they said, they're going to be deluged with contracts, because it's going to get probably every website agreement, it's probably going to get every closed-in loan note or credit agreement. It's really extraordinarily broad and catches a tremendous amount of contractual provisions.

So let's talk about what covered limitations are, and it doesn't matter whether they're legally valid or enforceable. That's not what we're talking about here. So there are, I think, something like eight categories at this point of covered limitations, and contractual terms can and probably will fall into more than one category. Arbitration may fall into all of them.

So at the start, at the outset, precluding the consumer from bringing a legal action after a certain period of time, and that's not just provisions that might shorten a statute of limitation or pre-filing requirements that might have that same kind of effect or notification requirements. Right now, it's actually any deadline, not just one that shortens the statute of limitation. Specifying a form or venue where a consumer must bring a legal action, that's pretty self-explanatory, limiting the ability of the consumer to file a legal action seeking relief for others or seeking to participate in a legal action filed by others. That's not just a class action waiver. That's a provision that might limit participation in a representative action, limit joinder of actions with other ongoing cases, preclude intervening in an ongoing legal action, or preclude consolidation of an ongoing consolidation of cases for an ongoing legal action. Again, really very broad.

And keeping on, limiting liability by capping the amount of recovery or type of remedy. So a provision that says no consequential damages or lost profits, very common in website agreements. Sometimes, you see provisions that will limit recovery to the costs of goods or services that have been obtained, but this also picks up liquidated damages clauses. Regardless of how much of an effort the creditor has made to appropriately estimate what those damages will be, they are deemed to be provisions that cap the amount of recovery or type of remedy.

Waiving the cause of legal action by the consumer or stating that a person is not responsible to the consumer for harm or violation of law, that's fairly straightforward. But it's also very broad, so that if you're outside the scope of the holder and due course rule, but you might have a provision that operates to waive or limit legal actions or recoveries that's picked up. Limiting the ability of the consumer to complain, to make any written oral or pictorial review, assessment or other analysis or statement about the offering or provision of the financial product or services.

The CFPB acknowledges that there is a law that governs this, the Consumer Loan Review Fairness Act, and it has a lot of exceptions that it hasn't incorporated here. It's purposefully not incorporated those exceptions, although it has agreed to accept comments on them. So anything of this sort, any non-disparagement clauses, any provisions that impose a penalty for that sort of thing. Sometimes, you even see provisions that will grant intellectual property rights in a review or statements or an analysis. Those are picked up as well.

Continuing, we've got waiving, whether by extinguishing or causing the consumer to relinquish or not agree to assert any other identified consumer legal protection of any sort. So the CFPB has made it clear that that's a jury trial waiver. Any waiver of a right to receive a disclosure would be picked up. The CFPB has also said that that will pick up a provision that would have the consumer agree that they won't file for bankruptcy protection within a specified number of days, because that limits the exercise of that legal right.

They haven't mentioned this, but it's unclear whether given how broadly this is worded, it would pick up common provisions in notes, waiving the right of presentment, protest, and notice of dishonor. Those kinds of provisions are ubiquitous. Certainly, it would also pick up waivers of defenses based on suretyship. Those are also commonly appearing in certain kinds of consumer contracts. And then lastly, the provision requiring that a consumer bring any type of legal action in arbitration,

and there can be provisions inside the arbitration agreement that would trigger separate reporting as well if they trip one of these other categories. Let me stop there and turn it back to Lisa to talk about registration in this context.

Lisa Lanham:

Well, thank you, John. So before I editorialize on any of this and talk about state level corollaries, we'll just sort of read through what the registration requirements are. So by the annual registration date each calendar year as set by the CFPB, the non-bank is required to provide or update identifying or administrative information to the bureau, together with information about its use of covered terms and conditions in the previous calendar year, and we're going to list out some examples on this slide next.

This information typically includes consumer financial products and services for which the registrant uses covered terms and conditions in each state or jurisdiction, which the products or services are offered or provided. For each covered form contract entered into, various items of information that include the type of covered limitation on consumer legal protections and specified information for each type of limitation. That varies with the nature of the limitation and whether as a party to any legal action, the registrant obtained one or more court or arbitrator decisions regarding enforceability of a covered term or condition in a covered form contract, and if so, certain information relating to such decisions.

So on the state level, there really isn't a one-to-one the same way that we just spoke previously when it comes to disclosure questions and explanations for a registry of orders, right? At the outset, when you apply for a state license or if you renew your license or you update your contracts, you are in some states required to provide model contracts that your state regulators can take a look at. They do need to be in compliance with all state laws.

Typically, that's what they're taking a look at and they'll comment on. You are required to update those periodically, but not on a specified timeline. You're required to update in your record when you update them it on an as needed basis. So when they become out of date, that's when you update your state regulators, or some people just sort of set an annual date of, "Well, when I renew my license, I'm going to see whether or not my contract is out of date, and I'll update my regulators then."

My general comments on this, though, relate more to definitional questions that I have, and I know at least Mike Gordon, we spoke about this earlier, you and I poll chair, when do you need to tell the CFPD? What do you need to tell the CFPD? Are you asking the CFPD what it believes it should be regulated? There's too much subjectivity in here. And so we were sort of hopeful that as this progressed, that there would be more clarity around what it is that you need to talk to the CFPD about. Is there an issue if you don't provide the CFPD with everything that it actually needs when you think that you actually did? And is there risk of over disclosure? So those are just sort of the questions that we're kicking around over here as we parse through this new registration [inaudible 00:36:31].

So a company can submit. Then piggybacking off of what we were just saying, questions about definitional questions, a company can submit a notice of non-registration saying that it is not registering, because it has a good faith basis to believe that it is not a supervised registrant or that it is not registering terms or conditions contained in a contract, because again, it has a good faith basis to believe that the contract is not a covered form contract or that the terms or conditions are not covered terms or conditions. Supervised registrant is a supervised non-bank, not excluded from the registration requirement.

So moving along, in its discussion of both proposals, the bureau states that when a company makes a non-frivolous filing of its good faith belief that it is not required to register, it will not bring an enforcement action based on the company's failure to comply with a registration or attestation requirement, unless the bureau first notified the company that it believed the company did qualify as a covered non-bank or supervised registered entity, or that an order does qualify as a covered order or as a supervised registrant or that its contract terms and conditions are covered terms or conditions and has provided the company with a reasonable opportunity to comply.

So the way we sort of read it, this gives you, in so many words, maybe a get out of jail free card if you messed up and you didn't register when you were supposed to register. But dealing with many state regulators and the CFPD from time to time, I just am always very skeptical of things like that. What is a good faith belief? What is a non-frivolous filing? I have questions about this, because the person, it seems to me at least, that's determining this is the person that would like you to register. So there's always a little bit of bias there that I worry about that things are not what is my understanding of good faith or what is my understanding of something that's non-frivolous is not the same as the bureau's.

So again, just more clarity that we need in terms of what these registration requirements are, and also your seat regulators are handling things like this. So is this superfluous? In my estimation, even though it's not one to one, like the disclosure questions and explanations for the registry, it does seem to be like an added burden on companies, and an unclear one at that. I'll open it up to the floor to my colleagues if there's any sort of closing thoughts or remarks.

Alan Kaplinsky:

Well, Lisa, thank you very much. I guess the only two cents I would add is it would be very difficult, I think, for us to get into a position of advising a client that they don't have to register if it's in some kind of a gray area. Because if you don't register and the CFPD believes that you should have, you're potentially subject to an enforcement action, and that, of course, isn't pretty.

Thanks to all our speakers today, my colleagues in the Consumer Financial Services Group of Ballard Spahr, and to make sure that you don't miss our future episodes, subscribe to our show on your favorite podcast platform, be it Apple Podcast, Google's, Spotify, or wherever you get your podcasts. Don't forget to check out our blog, consumerfinancemonitor.com for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast@ballardspahr.com. Thank you for listening and have a good day.