Our Perspectives: Commentary on the economy & regulatory policies affecting financial companies

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Designing New Products in the CFPB Era*†

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In the past year, we have had a number of clients express frustration over the development of new products and services. Regulatory uncertainty and risks, especially associated with the Consumer Financial Protection Bureau (CFPB), have become stumbling blocks for many financial institutions. In an effort to remove some of this mystery, we have outlined ten practical tips on how institutions should think about regulatory risks so they can continue to be innovative and meet the evolving needs of their customers. Uncertainty and regulatory risk cannot be removed completely, but can be managed and need not block innovation.

Product Design Tip 1: Put Regulatory Risk in Perspective

Our first tip is to put regulatory risk in perspective. This includes gaining a better understanding of the CFPB.

The CFPB is a relatively new agency. It is just five years old, and it gained the vast majority of its authority four years ago. In comparison, the OCC is over 150 years old, the Federal Reserve Board is over 100 years old, and the FDIC is over 80 years old.

One problem bankers have with the CFPB is that it does not operate like the OCC, Fed, or FDIC. The banking agencies traditionally have relied upon the examination process to identify and correct compliance issues, using enforcement as a last resort. Those agencies also use the formal public notice and comment process to set policy.

The CFPB is different. In its short tenure, it has relied heavily upon its enforcement powers as a means to set policy. The agency's recent series of actions related to indirect auto lending is an example of this.[1]

*This article is based on a ***presentation*** we gave this month at the American Bankers Insurance Association Annual Conference.

†The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

[1]See American Banker series of articles by Rachel Witkowski regarding these enforcement actions: ***CFPB Overestimates Potential Discrimination, Documents Show*** (Sept. 17, 2015), ***The Inside Story of the CFPB's Battle Over Auto Lending*** (Sept. 24, 2015), and ***CFPB's Outside Expert on Disparate Impact Also Advises Banks*** (Sept. 28, 2015).

In those cases, the agency clearly has sought to alter the contractual relationships between lenders and auto dealers, rather than through rulemaking.

This approach to policymaking through enforcement can be a source of confusion. We have analyzed the various enforcement actions related to the marketing of debt protection products and no two orders are the same. Nor are the orders necessarily consistent with the OCC's debt cancellation regulation. Thus, a number of institutions remain confused over how to offer debt protection products.

In understanding the CFPB, it is important to appreciate that the agency relies upon consumer complaints in setting its agenda. The CFPB also is willing to take a new look at some old laws. Below we provide more insight into those aspects of the agency's operations.

The bottom line is that there is a new type of regulatory risk posed by the CFPB. Yet, the CFPB recognizes the importance of innovation for consumers.

CFPB Director Cordray has said that the CFPB wants "to collaborate with innovators seeking to advance consumer-friendly innovation. These collaborations help [the Bureau] better understand what works and does not work to improve life for consumers in the marketplace."[2] For example, in 2014, the CFPB proposed a no-action letter process in an effort to reduce regulatory uncertainty for emerging products or services that would benefit consumers. The theory behind this policy is to create a way for innovators to explore new products that have substantial consumer benefit but for which the application of current laws is uncertain.

In another example, the CFPB has established a trial disclosure program to allow an institution to test a new disclosure or method of disclosure with a legal safe harbor. That program is part of the CFPB's larger Project Catalyst, which is a way for the CFPB to work directly with innovators to better understand consumer behavior and what innovators are doing in this space. Under Project Catalyst, CFPB has engaged with stakeholders to better understand consumer behavior and positively impact it. For example, CFPB has teamed up with H&R Block to evaluate practices to promote consumer saving behavior during tax time.

While these are steps in the right direction, they are not without their limitations. For example, there is no indication on the CFPB's website that an institution has successfully applied for a trial disclosure program. Also, as proposed, the no action letter policy was very limited in scope, as it would only apply to new, not existing, products and would not address UDAAP questions. Still, the CFPB has made great strides in focusing on innovation and reaching out to the industry, such as with the establishment of the industry liaison's office, and through the work of the CFPB Ombudsman. One of these avenues may make sense to pursue as a financial institution designs a new product or financial service. At the very least, the institution needs to consider the consumer benefits of the product, as that is what the CFPB will do.

Product Design Tip 2: Understand CFPB's Authority

Our second tip is to better understand the scope of CFPB's powers. The agency's powers are far-reaching. It has supervision and examination authority over certain specific categories of institutions, such as banks with more than $10 billion in assets. Additionally, it has separate authority to write consumer protection

[2] ***CFPB Launches Project Catalyst to Spur Consumer-Friendly Innovation***.

regulations, such as under TILA. Further, it has the power to pursue legal actions against any financial institution that offers a financial product, or any service provider to that institution, if the product is offered in an unfair, deceptive, or abusive manner.

The CFPB's authority, however, is not unlimited. The CFPB cannot impose price controls. Moreover, Congress carved out a number of specific industries from the CFPB's jurisdiction. For example, the CFPB lacks jurisdiction over the "business of insurance."

As a financial institution considers new products or services, it is important to have a good understanding of the CFPB's scope of authority.

Product Design Tip 3: Adopt a Consumer Mindset

The CFPB puts itself in the shoes of the consumer when examining products, services, and acts and practices related to those products and services. A financial institution developing a new product needs to do the same thing.

For example, think through how disclosures will appear — are they clear and conspicuous? Think through marketing practices — do they impact misleading information? Are they overly aggressive? Also, a designer of a product must ensure that the product terms fit the needs of the consumer. Consider how complex or simple the terms are and how easy a consumer can understand them. If the product provides a benefit to the consumer, how easy is it for the consumer to get the benefit? If the consumer has a dispute, what is the dispute process?

Also, it is worth noting, that the CFPB is particularly concerned in instances where the consumer does not have a choice in providers. For example, a consumer cannot choose their service provider or a debt collector. That lack of consumer choice is important to consider as an institution designs a new product.

Product Design Tip 4: Review Consumer Complaint Database

The CFPB has established a consumer complaint system that provides an opportunity for consumers to file a complaint about a consumer financial product or service. It also serves as a means for the CFPB to identify potential trends that may result in enforcement actions or supervisory bulletins. The CFPB projects itself as a "data-driven" agency, and this is one of the key ways in which the agency receives input from consumers.

The CFPB has received nearly 700,000 complaints to date. It publishes certain information about the complaints including, beginning this past summer, consumer narratives. These narratives, while not verified beyond the existence of a relationship between the consumer and financial institution, provide an insight into what the CFPB is hearing from consumers.

As a financial institution designs a new product, it is worth reviewing the CFPB complaint database. If a financial institution is considering offering a new product, the institution should look at how that product fares in the complaint database. Are there many complaints filed on that product? What are consumers saying the issues are? Is it a lack of understanding of the terms or benefits? Is it not being able to reach a representative to resolve an issue?

Likewise, a financial institution must have a good handle on complaints filed against them. Beyond the necessary importance of resolving complaints and having adequate compliance management systems, it is important for an institution to trend spot across its products and services. This will help determine if there are institution-wide issues that need to be resolved to avoid any negative impact on a new product.

Product Design Tip 5: Review UDAAP Enforcement Actions

To put it mildly, the CFPB sends strong signals through its enforcement actions. The debate on the merits of that is for another time. The point is that much can be learned by reading those enforcement actions, especially if they touch on products or services a financial institution is considering offering. We have engaged in exercises with clients in reviewing the enforcement actions to create a blueprint for offering certain products that would likely pass a UDAAP analysis. Pay particular attention to the remediation requirements in the actions. Those provide an insight into the CFPB's expectations of all consumer financial products and services providers, such as the level of board involvement, extensive training of employees, compliance programs, and oversight of third parties.

Product Design Tip 6: Managing Third-Parties

Managing third-parties dovetails with the review of UDAAP enforcement actions. Many of those enforcement actions focused on the actions of third-party service providers, such as telemarketers. While the CFPB recognizes the usefulness in outsourcing some functions, outsourcing does not absolve a financial institution of responsibility to comply with the law.

Service providers can play a variety of roles, such as designing, administering or marketing a product, or providing payment services. As a financial institution considers whether and how they will engage with service providers, it must keep the CFPB's viewpoint in mind. The CFPB is concerned about the potential for consumer harm in outsourcing activities, so an institution should pay particular attention to functions that are consumer facing. The CFPB, as well as the prudential regulators, have issued guidance on the oversight of third party service providers which is important to review prior to making any decisions about using third parties.

Product Design Tip 7: Disclosures

Clear and conspicuous disclosures are often the key difference between deceptive and not deceptive marketing practices.

It is critical that a financial institution discloses all fees, costs, charges and billing arrangements. Additionally, the disclosure must include any material conditions, limitations or restrictions related to the product. Finally, the disclosures must be formatted so they are clear and not hidden.

Product Design Tip 8: Sales and Marketing Practices

Many of the CFPB's enforcement actions have focused on sales and marketing practices related to consumer financial products or services.

To that end, financial institutions need to ensure they obtain a consumer's affirmative consent prior to purchasing the product. Marketing scripts must be carefully written and telemarketers must adhere to those scripts. Additionally, telemarketing calls should be recorded and independently monitored to ensure there are no deceptive marketing practices taking place.

Product Design Tip 9: Practices to Avoid

These are lessons learned from the CFPB's UDAAP enforcement actions.

- Do not tell a consumer that there is a "free" trial period if that "free" period is subject to conditions that could result in a cost to the consumer.
- Do not sell a product to a consumer if the consumer is ineligible for the product benefits.
- Do not condition the sale of a product on an extension of credit.

Product Design Tip 10: Think Outside the Box

CFPB is looking at existing legal requirements through a new lens. The best example of this is the ongoing PHH case, which our colleague, Bob Barnett, wrote about here. While many in the industry are closely watching that case, a financial institution needs to take a new look at old laws. Practices that have been accepted or routine can suddenly become inappropriate.

In summary, the CFPB is not going anywhere. The CFPB's mindset is here to stay. The CFPB cares most about the experience of the consumer, and as a financial institution designs a new consumer financial product or service, it needs to embrace that and look at everything through the lens of the consumer.

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