Beyond Regulation:
What the CFPB Expects from Payment Processors

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Legal Underpinnings: Who is Targeted? Covered Person

- "Covered person" (12 U.S.C. § 5481(6)):
  - (A) any person that offers or provides a consumer financial product or service;
    - Relevant "financial product or service": "extending credit" (12 U.S.C. § 5481(15)(A)(i)) or "providing payments or other financial data processing products or services to a consumer by any technological means" (12 U.S.C. § 5481(15)(A)(vii)).
  - (B) any affiliate of any person described in (A) if such affiliate acts as a service provider to such person.
- "Related person" (12 U.S.C. § 5481(25)):
  - "shall be deemed to mean a covered person"
  - Broad definition mainly encompassing those with control of, or material participation in, the conduct of a covered person

Legal Underpinnings: Who is Targeted? Service Provider

- "Service provider" (12 U.S.C. § 5481(25)):
  - Provides "material assistance to a covered person" in connection with a consumer financial product or service
    - Participating in the design, operation, or maintenance of the product or service
    - Processing transactions relating to the product or service
      - Carve-out for unknowing or incidental transmission or processing
  - Exceptions
  - Shall be deemed a covered person to the extent the entity offers or provides its own consumer financial product or service

Legal Underpinnings: Common Legal Theories Unfairness

- Unlawful practice (12 U.S.C. § 5536(a)(1)(B)):
  - It shall be unlawful for a covered person or service provider to engage in any <u>unfair</u>, deceptive, or abusive act or practice (UDAAP).
- Unfairness (12 U.S.C. § 5531(c)):
  - (A) "the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and"
  - (B) "such substantial injury is not outweighed by countervailing benefits to consumers or to competition"

Legal Underpinnings: Common Legal Theories Substantial Assistance

- Unlawful practice (12 U.S.C. § 5536(a)(3)):
  - It shall be unlawful for any person to knowingly or recklessly provide substantial assistance to a covered person or service provider.
- Substantial assistance
  - Scienter requirement
  - What constitutes "substantial assistance"?
    - *CFPB v. Universal Debt & Payment Solutions, LLC*, No. 15-cv-0859 (N.D. Ga. Mar. 26, 2015)

The Cases: *Universal Debt*

- Phantom debt collectors allegedly assisted by payment processors and ISOs
- Unfairness and Substantial Assistance claims
- Failure to follow policies and procedures:
  - prohibited merchants (debt collectors, aggregators)
  - enhanced scrutiny of card not present
- Deficient underwriting and risk monitoring: “red flags”
  - Underwriting: Criminal background; addresses
  - Risk monitoring: MATCH alerts; lack of contact; chargeback rates & investigations

The Cases: *Intercept*

- Covered person & service provider
- Unfairness against company; substantial assistance against individuals
- "Red flags" – underwriting and processing
  - Concerns from ODFIs about the lawfulness of transactions, complaints from consumers, high return rates, law enforcement actions against clients
  - Perfunctory due diligence when signing up clients: no follow up; no licenses/policies/procedures/loan terms requested
- Multiple ODFIs

Most Important Rule

- No bright line rule.
- CFPB, etc., will evaluate whether you should have known something was amiss based on all the facts and circumstances.
- Very few factors are individually show-stoppers; it's the aggregative effect.

Bottom Line: ***Your underwriters need to be people with sound judgment who can be trusted to make subjective decisions.***

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- In one complaint, the CFPB said that the processors should have known that the company was operating illegally.
  - One lender was allegedly operating without a required license.
  - Another lender was charging fees in excess of state usury limits.
- Things to review:
  - Licensing
  - Product terms
  - Policies and procedures
  - Enforcement actions and litigation

Will Your Underwriters Feel Comfortable Rejecting an Applicant?

- In one case, the CFPB cited an “Underwriting Philosophy” of finding a way to “YES” as evidence that the processor was careless.
- Ensure that underwriters know that they can reject suspicious applications and that they will be supported.
- Ensure that rejections don’t impact compensation/evaluations.

Diligence in an Ongoing Process

- Diligence at onboarding should be thorough.
- Must periodically refresh monitoring.
- The frequency and depth of periodic monitoring should be driven by the riskiness of the client.

Monitor Chargebacks and Complaints

- Chargebacks are an obvious red flag for a processor to monitor.
- Also look at reasons given for disputes to evaluate whether they suggest fraud or illegal practices.
  - Customer complains that she didn't owe anything.
  - Customer says he was promised that the payment wouldn't be processed.
  - Customer says that she was promised documents, etc., and never received them.
  - Customer says that the practices violated the law.
- Have a system to monitor patterns in complaints.
  - One cranky customer isn't necessarily a red flag.
  - Need to be able to spot patterns.

Red Flags Identified by CFPB in Various Actions

- Principal had drug trafficking conviction.
  - Query: How much weight should be put on a conviction for a non-violent crime that doesn't involve fraud?
- Business was conducted out of the home.
  - Many legitimate businesses are home-based. But consider whether the business is one that normally would be based out of a home.
- UPS Store for an address.
- Cell phones given as business numbers instead of landlines.
- CEO shared an address with another (unrelated) principal of the company.
- Poor BBB ratings.
- No company history.
- Routinely experiencing difficulties making contact with representatives of the client—Including that mail was returned and voice mail boxes were full.

What to do if you get a CID

- Time is of the essence
  - 10 day meet-and-confer; 20 day motion to quash
- Dig deep – understand what is or isn't doable
- Use meet and confer to establish credibility & be creative
- Prepare for the long haul