Legal Backgrounder

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CFPB's Systemic Regulation of Four Industries: Enforcing Broader Changes Via Consent Order

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One of the more controversial aspects of the Consumer Financial Protection Bureau (CFPB or Bureau) is what critics term its "regulation by consent order." This phrase refers to CFPB's ongoing practice of using consent orders not simply to resolve individual enforcement actions, but also to bring about systemic change. Critics charge that such use of consent orders deprives companies of fair notice of prohibited conduct and makes an end-run around formal notice-and-comment rulemaking, which the Dodd-Frank Act empowered the Bureau to do.[1]

CFPB has not shied away from the regulatory nature of its consent orders. Instead, the Bureau has made clear that it expects all companies to follow the injunctive prescriptions of every consent decree as if they carried the force of law. Indeed, Director Richard Cordray recently defended CFPB's regulation-by-consent-order approach as necessary to combat fraud and deception in the financial industry. He further asserted that perpetrators of fraud and deception are so creative that it would be impossible to create comprehensive regulations that would avoid the necessity of regulation by consent order.[2]

When a consumer protection agency sees actual instances of fraud and deception, few would argue that it should not act. Many CFPB enforcement actions cannot, however, be justified as necessary to prevent fraud and deception. This Legal Backgrounder explores consent orders in the credit card, debt sales, auto-lending, and data-security industries used to bring about systemic changes that are difficult to justify based on: 1) existing law, or 2) deterring fraud and deception.[3] But first, it will briefly describe the consent-order process.

Overview of CFPB Consent Orders

A CFPB consent order is a settlement agreement between the Bureau and one or more defendants that is then entered as a formal order by a court or CFPB itself (if filed as part of an administrative action). The consent order typically resolves pending litigation between CFPB and a company or an ongoing investigation of a company by the Bureau. Ordinarily, a consent order only binds the parties entering into it, much like a private settlement. Similar to settlement agreements, consent orders are negotiated in private between the CFPB and the parties to the enforcement action or investigation. Also, the parties must agree to a consent order; CFPB cannot impose one unilaterally.

[1] The due-process implications of punishing a defendant for conduct that had not previously been declared unlawful is an important aspect of the regulation-by-consent-order debate, but it is beyond the scope of this Legal Backgrounder.
[2] http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-bankers-association/.
[3] With the exception of *Dwolla*, this article will not discuss specific consent orders. The authors of this paper have represented numerous companies in CFPB consent orders and will therefore refrain from referring to specific orders. Consent orders are available on CFPB's website, www.consumerfinance.gov.

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That both parties must agree to a consent order allays some due-process concerns but, combined with the confidential nature of the negotiations, exposes a significant flaw to the regulation-by-consent-order model. As noted previously, CFPB expects all members of an industry to follow a consent order's requirements, describing it as "compliance malpractice" not to do so. But the industry at large has no role in the consent-order negotiation process, nor any input into the terms of the final consent order; only the parties do. Indeed, the wider industry is often not aware of the negotiations surrounding a consent order, nor that they are even occurring. Instead, the industry often first learns of an investigation when a consent order is executed and publicly filed in connection with CFPB's related complaint.

This closed-door process stands in stark contrast to traditional notice-and-comment rulemaking, which is conducted in public and allows for input from all interested parties. Industry, consumer-advocacy groups, and academic experts all provide input on proposed regulations. These parties may provide research and data to back up their proposals, and independent groups—pro and con—will weigh in as well. The process is admittedly slow, but it forces careful consideration of more widespread views than bilateral consent-order negotiations.

The private nature of consent orders also creates an opportunity for gamesmanship. Neither CFPB nor a defendant will get everything wanted in a consent order; they are negotiated. But defendants tend to only look out for their own interests in the negotiations, not those of the entire industry or the broader economy. Those interests may be specific to a defendant who faces significant cost or risk in litigating a case with a governmental agency, or who plans to exit a business line, giving it little leverage to hold out for better terms and little incentive to preserve industry practices. And interested third parties, including consumer-advocacy groups and academics, do not have an opportunity to provide their expertise or identify any challenges that the consent order's terms may pose to their constituencies.

CFPB's regulation-by-consent-order approach arguably offers some benefits. From a budgetary standpoint, the approach is significantly cheaper and faster than traditional notice-and-comment rulemaking. Regulatory changes introduced through consent orders also might have a net positive effect on the financial industry and economy at large by allowing for faster adjustments to address potential issues. And consent orders can provide much needed guidance on vague statutory terms, such as CFPB's authority to punish "unfair, deceptive, and abusive acts and practices" (UDAAP).[4]

This Legal Backgrounder does not address the normative question of whether regulation by consent order is a net positive or negative. Rather, it identifies key areas in which CFPB has brought about systemic changes that cannot be justified under CFPB's asserted basis for this approach and that may have been more appropriately addressed by CFPB through traditional rulemaking.

Significant Areas of Regulation by Consent Order

This section examines four areas in which CFPB has engaged in regulation by consent order: credit card add-on products, debt sales and collection, auto fair lending, and data privacy. Significant aspects of these consent orders cannot be justified as necessary to prevent fraud. Instead, they seek to impose broader systemic changes through an expedited approach that does not consider the interests of potentially impacted third parties.

Credit Card Add-On Products. One of the first targets of CFPB's enforcement authority, and consequently regulation by consent order, was credit card add-on products. CFPB defines an add-on product as "any consumer financial product or service [that] is offered as an optional add-on product to [b]ank credit cards and/or as an optional add-on product to co-branded consumer products of [a] [b]ank." Examples include identity-theft protection and programs designed to reduce or eliminate payments in the event of unemployment, sickness, disability, and similar life events.

[4] 12 U.S.C. §§ 5531, 5536.

The add-on consent orders have aspects that are designed to prevent fraud and deception, such as bans on misrepresentation in connection with the marketing of add-on products. But the consent orders also include many features that go far beyond. For example, CFPB imposed detailed vendor-management requirements (even mandating the types of provisions that can and cannot be in a contract with the vendor), prohibited oral contracts with vendors, required credit-card issuers to create detailed UDAAP policies specific to add-ons, and required that certain affirmative disclosures be made before and immediately after a consumer purchases an add-on product.

Thus, the add-on consent orders are designed to remake an entire industry segment and have greatly curtailed the availability of these products in the market. That is perhaps by design. CFPB does not see these products as providing any significant value to consumers. For example, CFPB's website warns consumers that "the sales tactics may be high-pressure and confusing [and] the benefits you receive from the product may not match the benefits that you thought you were offered."[5] Wide-ranging, systemic changes to an entire market segment are, however, arguably better suited for notice-and-comment rulemaking than targeted consent orders negotiated privately with select members of the industry.

Debt Sales and Collection. Through multiple consent orders, CFPB has significantly altered the practices of the multi-billion dollar debt-sales industry in just a few short years. And it has accomplished this transformation without adopting a single regulation.[6]

Neither Dodd-Frank nor the Fair Debt Collection Practices Act—nor any other federal law or regulation—requires a debt purchaser or a debt-collection law firm to acquire specific, account-level documentation. Similarly, most state bar and evidence requirements do not require debt-collection law firms to possess account-level documentation prior to filing a lawsuit. Yet CFPB imposed both requirements through a series of consent orders with debt purchasers, debt sellers, and debt-collection law firms.

Requiring original, account-level documentation in debt sales might seem uncontroversial, and even some in the industry would argue the mandate benefits businesses and consumers alike. But, other industry participants fear that CFPB's efforts will curtail the debt-sales industry. Debt sales play an important role in consumer-credit markets. The ability to sell debt allows creditors to recoup at least some of their losses when a consumer defaults, which in turn allows lenders to extend credit to individuals who would otherwise have difficulty obtaining it.[7] Thus, by making it more difficult to sell debt, CFPB potentially made it more difficult for individuals—especially those who are less creditworthy—to obtain credit. This adverse impact will likely be felt primarily by people with lower credit scores, shorter credit histories, or fewer assets.

CFPB's debt-sales consent orders are also an example of what Director Cordray described as "a pattern of actions that conveys an intelligible direction to the marketplace."[8] CFPB did not engage in a "random series of actions [against] the bad actors."[9] It purposefully targeted a large debt seller, two of the largest debt purchasers, and two large debt-collection law firms to bring about systemic changes "across the marketplace."[10] Even if the benefits of CFPB's debt-sales activities ultimately outweigh the costs, CFPB left that outcome to chance by failing to study the costs and benefits publicly and widely *before* it mandated significant changes.

[5] http://www.consumerfinance.gov/askcfpb/1541/what-are-credit-card-add-products.html.

[6] CFPB issued an Advance Notice of Proposed Rulemaking related to debt collection in early November 2013, and the comment period closed in late February 2014. http://files.consumerfinance.gov/f/201311_cfpb_anpr_debtcollection.pdf.

[7] In this regard, debt sales should not be confused with securitization and collateralization from the housing bubble. A debt seller still takes a significant financial hit when the debtor defaults, often only recouping pennies on the dollar from the sale. It does not allow the credit originator to escape the downside of risky credit decisions by transferring the risk-of-loss immediately on origination, as securitization and collateralization permitted.

[8] *Supra* note 2.

[9] *Ibid.*

[10] *Ibid.*

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Auto Fair Lending. CFPB's regulation-by-consent-order approach to fair lending through a series of consent orders with auto-finance companies has been extremely controversial. Fair lending is certainly an appropriate area for regulatory enforcement. But CFPB did not simply seek to address alleged discrimination and prohibit future discrimination. Rather, CFPB sought to advance a specific agenda—and one that has been repeatedly subject to criticism by the auto industry, academics, and even Congress.

Specifically, CFPB used these consent orders to advance its belief that the source of the alleged discrimination in the auto industry resulted from discretion afforded to individual dealerships in setting retail interest rates. It therefore limited the discretion the finance sources afforded to auto dealers to 125 basis points for contracts of 60 months or less and 100 basis points for contracts of more than 60 months. And unless the finance sources eliminate dealer discretion in its entirety, CFPB requires them to provide training to dealers on the finance companies' fair-lending policies and to monitor the dealers' compliance.

CFPB's approach to auto fair lending is remarkable for several reasons. First, the Bureau imposed a very specific remedy—caps on dealer discretion—to a very general alleged problem: discrimination in auto finance. Second, CFPB's consent orders in this area are effectively backdoor regulation of auto dealers, which the Dodd-Frank Act expressly prohibits the Bureau from doing.[11] The main injunctive feature of the auto fair-lending consent orders is targeted at dealer conduct, not at finance sources. Because Dodd-Frank prohibits CFPB from regulating dealers directly, many commentators argue that it has used auto finance sources as a proxy for regulating dealers. This is not only an example of regulation by consent order, it is an example of regulatory overreach targeting non-parties that are exempt from such regulation under Dodd-Frank.

Data Security. CFPB recently extended its domain into the data-security arena through a consent order with Dwolla.[12] The Dwolla consent order marks a departure from CFPB's core area of consumer financial protection and entry into the much more technical area of data security. *Dwolla* could be a one-off matter for CFPB, or it could represent the Bureau's first foray into an emerging area of regulation.

CFPB's main allegation was that Dwolla affirmatively represented that its data-security standards met or exceeded industry standards, when in fact they did not. The consent order attempts to remedy these alleged violations by, in part, requiring Dwolla to adopt industry best practices. The order also requires Dwolla to monitor and audit for compliance with industry best practices.[13]

The Dwolla consent order is markedly different from the other orders this paper has discussed in one key respect. In *Dwolla*, CFPB more or less adopted industry best practices, and required Dwolla to adhere to them. In the other consent orders, by contrast, CFPB sought to change industry practices, not punish companies who failed to live up to them. The different approaches may reflect that CFPB is satisfied with current best practices in the data-privacy industry, or simply that it has not yet developed preferred alternatives.

Conclusion

CFPB is not the first federal agency to impose regulatory changes through enforcement actions and consent decrees. It has, however, made much greater use of this method than previous agencies in order to effect much broader change. In continuing this practice, CFPB should be mindful of what is not being considered in its "regulation." Perhaps CFPB has identified a more efficient means of regulation consistent with the Bureau's ultimate objective of protecting consumers. Or, perhaps CFPB has merely achieved short-term success in short-circuiting the traditional notice-and-comment rulemaking process in a way that will ultimately lead to negative long-term consequences.

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[11] Dodd-Frank § 1029 (the "Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles.").

[12] http://files.consumerfinance.gov/f/201603_cfpb_consent-order-dwolla-inc.pdf.

[13] *Ibid.*