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Alert Memo

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The CFPB and Credit Card Marketing: Lessons and Contrasts in the CFPB's First Enforcement Actions

In the last two weeks, the Consumer Financial Protection Bureau ("CFPB") has announced two more actions against credit card issuers taken in coordination with the banking regulators. In the most recent orders, Discover and American Express agreed to pay substantial restitution and civil money penalties. These are the latest in a series of enforcement actions focused on the marketing of credit cards. This alert highlights key takeaways from the most recent orders, and compares and contrasts their approaches to issues such as CFPB jurisdiction, penalties and remedial actions.

Key Take-Aways

- *Significant Financial Penalties*: Following the July orders assessing an estimated $210 million in penalties against Capital One Bank (U.S.A.), N.A ("Capital One"), Discover Bank ("Discover") and American Express Company (and three subsidiaries) have agreed to pay restitution and civil money penalties expected to total $214 million and $112.5 million, respectively. The CFPB has clearly signaled its intention to push for substantial restitution and civil money penalties to pursue its enforcement agenda.

- *Continued Focus on Credit Cards*: Each of the actions involved claims of misleading marketing of credit card products, demonstrating the CFPB's intention to focus on credit card products and how they are sold to consumers. The CFPB has publicly stated that credit card programs will continue to be a focus of its supervisory, enforcement and other efforts.

- *Scrutiny of "Add-on" Products:* The consent orders against Discover and Capital One focused particularly on the marketing of so-called "add-on" products offered to consumers. Director Richard Cordray has said that "more such actions will follow," and the CFPB is actively investigating promotional practices for add-on products at other credit card issuers.

- *No reliance on the "Abusive" Prong*: In each of its consent orders to date, the CFPB has relied in part on its authority under Sections 1031 and 1035 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1], which

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prohibit "unfair, deceptive, or abusive acts or practices" ("UDAAP"). However, so far the CFPB has not invoked the "abusive" prong of the UDAAP statutory standard. The scope of "abusive" in the standards is of considerable interest since it potentially could be used to expand liability beyond the longstanding "unfair or deceptive acts or practices" ("UDAP") standard in Section 5 of the Federal Trade Commission Act ("FTC Act").[2] The CFPB's decision not to rely on the "abusive" prong in the consent orders could have been due to concerns about the retroactive applicability of the UDAAP standards to practices preceding the enactment of the Dodd-Frank Act, but may also suggest that the CFPB may be willing to construe the "abusive" standard as co-extensive with the pre-existing standards under UDAP.[3]

- *Exacting Findings and Granular Prescriptions*: The CFPB consent orders all involve allegations of misrepresentations drawn from exacting readings of telemarketing scripts and other customer communications, and draw broad negative inferences from the absence of specific disclosures. For example, for Discover, the CFPB and the Federal Deposit Insurance Corporation ("FDIC") cited as grounds for the order that consumers were not told that enrollment constituted an agreement to purchase the product. The corrective actions required by these orders are in some instances correspondingly highly-prescriptive and granular. For example, Discover may not impose charges earlier than 15 days from the telephone call on which a product was purchased, and telemarketers may not attempt to resell a product on a cancellation call.

- *Setting Standards Through Orders*: Like banking agency orders in the consumer compliance and anti-money laundering area, the CFPB's prescriptive consent orders raise questions about whether or not the specific requirements of the orders should be viewed as new generally-applicable standards or limited to the facts at issue in the order.

Background

Discover Order

On September 24, 2012, the CFPB and the FDIC announced a consent order with Discover pursuant to which it agreed to pay an estimated $200 million in restitution to nearly 3.5 million customers, in addition to a civil money penalty of $14 million (which will be split evenly between the U.S. Treasury and the Consumer Financial Civil Penalty Fund).[4]

The CFPB and the FDIC alleged that between December 1, 2007 and August 31, 2011, Discover engaged in deceptive acts and practices in its telemarketing and sales of certain add-on products in violation of Section 5 of the FTC Act and Sections 1031 and 1036 of the Dodd-Frank Act. The FDIC also determined that Discover had engaged in unsafe or unsound banking practices.[5]

According to the facts alleged in the order, on inbound and outbound telemarketing calls, Discover's in-house telemarketers and third-party telemarketing vendors used scripts containing misrepresentations and omissions of material terms and conditions. The order alleged that products were misleadingly portrayed to imply that they were free benefits. Customers were frequently not told that enrollment in the products would constitute an agreement to pay additional fees. Mandatory disclosures were glossed over or rushed through, and material terms and conditions such as eligibility requirements were omitted from telemarketing scripts. Material terms and conditions were sent to the customers only after enrollment, even though customers were typically told that they would be charged fees after receipt of such terms and would have a chance to comparison shop.

In addition to the customer restitution damages, the Discover consent order also mandated changes to Discover's existing sales, marketing and operating practices. Compliance, internal control and internal audit systems, which were found to be inadequate, must be reviewed and enhanced. Internal policies and procedures and compliance will be subject to independent review periodically, and Discover's board of directors will be responsible for correcting any deficiencies and implementing any recommendations noted by such audits.

American Express Orders

On October 1, 2012, the CFPB, the FDIC, the Board of Governors of the Federal Reserve System ("FRB"), the Office of Comptroller of the Currency ("OCC") and the Utah Department of Financial Institutions announced consent orders[6] with American Express Company and three of its subsidiaries (collectively, "Amex"), pursuant to which Amex agreed to pay an estimated $85 million in restitution to nearly 250,000 customers. Additionally, the consent orders provide for aggregate civil money penalties of $27.5 million, $14.1 million of which will go to the CFPB, $3.9 million to the FDIC, $9 million to the FRB, and $0.5 million to the OCC.

The CFPB and the FDIC found that between January 1, 2003 and June 30, 2012, Amex had violated Section 5 of the FTC Act and Sections 1031 and 1036 of the Dodd-Frank Act when it engaged in certain debt collection practices and marketed a credit card program. Amex had allegedly misled customers into believing that their debt would be waived or forgiven because it failed to prominently disclose in debt settlement letters that full debt balances would need to be paid before processing future credit or charge card applications, and that settlements in respect of debt that had already been charged off and was no longer being reported to the credit rating agencies would improve customers' credit scores. Customers were also allegedly misled in direct mail solicitations about receiving bonus cash for enrolling. The OCC, in a separate consent order, held these solicitation and collection practices to violate Section 5 of the FTC Act.

The FDIC and CFPB also charged Amex with violating the Truth in Lending Act (as amended by the Credit CARD Act of 2009) and Regulation Z for allegedly charging unlawful late fees on certain hybrid charge cards, and violating the Fair Credit Reporting Act for allegedly failing to report certain consumer disputes to consumer reporting agencies. Additionally, Amex's credit scoring model was found to violate the Equal Credit Opportunity Act and Regulation B by allegedly providing for an improper second look for customers above 35 years of age.

For the first time, the CFPB, like the FDIC, OCC and FRB, determined that "as to matters within [its jurisdiction]", Amex had engaged in "unsafe and unsound banking" practices. The inclusion of such a finding by the CFPB, particularly in a joint consent order with the FDIC, is remarkable since the CFPB is not a prudential regulator, and may represent an oversight by the FDIC.

In the consent orders, Amex agreed to provide restitution including interest to customers who had made payments in excess of settlement amounts in respect of Amex's allegedly misleading debt forgiveness solicitations, $100 to each customer who had settled after receiving such solicitations, restitution with interest to those who allegedly paid late fees on hybrid cards, and full payment of bonus cash to customers to whom bonus cash was allegedly advertised but not paid.

Similar to the Discover and Capital One orders, the Amex consent orders mandate changes to sales, marketing and operating practices, review and enhancement of compliance, internal control and internal audit systems, and independent audits of compliance with the requirements of the orders, with Board responsibility to correct deficiencies and implement recommendations.

Capital One Orders and Guidance on Add-On Products

The Discover and American Express orders followed actions taken on July 18, 2012 by the CFPB and the OCC pursuant to which Capital One agreed to pay an estimated $150 million in restitution and civil penalties totaling $60 million ($25 million to the CFPB and $35 million to the OCC).[7] These orders were based on allegations of deceptive marketing practices related to credit card add-on products. In conjunction with this order, the CFPB issued *CFPB Bulletin 2012-06*, which provides some guidance to issuers on marketing and sales practices, not only of credit card add-on products, but also more generally of other credit and deposit services. The Bulletin identifies certain marketing practices as "CFPB Expectations", emphasizing the following points in broad terms:

- Marketing materials must accurately convey the terms and conditions for the product;
- Employee compensation programs should not create incentives to push products using inaccurate or skewed information;

- Marketing scripts normally should be strictly followed and should accurately state the terms and conditions of the products, require explicit consent to enrollment after disclosure of the terms and conditions, provide clear guidance on responses to consumer requests for more information or decline the product, and explicitly indicate to consumers that purchase of the "add-on" product is not a condition to obtaining credit (unless there is such a requirement);

- Consumers may not be required on a prohibited basis (such as based on their race or age) to purchase the product as a condition for credit;

- Cancellation requests must be handled consistent with the product's actual terms and conditions and in a manner that does not mislead the consumer; and

- Compliance management programs must be robust and include clear written policies and procedures, regular Quality Assurance reviews, independent audits, close oversight over third parties or affiliates, and effective consumer complaints.

Points of Interest and Contrasts among the Orders to Date

Scope of CFPB Jurisdiction

There are questions about the CFPB's jurisdiction over activities before the transfer date of authority to the CFPB on July 21, 2011. However, each of the CFPB orders covers alleged misconduct before the transfer date, and in some cases even covers activities prior to the enactment of the Dodd-Frank Act. Questions about the scope of the CFPB's jurisdiction also likely influenced the different approaches taken by the banking regulators on whether to issue joint, rather than concurrent, orders with the CFPB.

- The Capital One CFPB order includes alleged misconduct going back to August 1 2010, immediately following the enactment of the Dodd-Frank Act. The OCC's concurrent order addressed practices going back to May 2002, but the CFPB order does not cover the longer pre-Dodd-Frank period.

- The Discover joint order with the CFPB and the FDIC is based on alleged activities going back to December 1, 2007, prior to the enactment of the Dodd-Frank Act. Prior to the issuance of the Amex CFPB orders, it appeared that perhaps the CFPB would cover pre-Dodd-Frank activities only if it were issuing the order jointly with a banking regulator.

- The Amex CFPB orders, which were issued jointly with the FDIC with respect to one Amex entity but concurrently with the other banking regulators, involve alleged

activities going back to January 1, 2003, prior to the enactment of the Dodd-Frank Act.

Size of Penalties and Caps on Restitution

The CFPB has clearly signaled that it will seek large penalties against major market participants to pursue its enforcement agenda. There are some notable differences in the approaches to the penalties in the orders.

- *Limits on Restitution Payments*: Capital One was required by the OCC to segregate and pay full customer restitution of $150 million for fees, over-limit charges, financing charges and estimated interest in respect of alleged misconduct in the telemarketing of certain add-on products from May 2002 to January 2012. The OCC consent order explained that the segregated amounts represented the estimate of the maximum potential restitution required by the order. The CFPB order also referenced Capital One's estimate of fees and interest charges. Neither the OCC nor the CFPB limited Capital One's restitution payments if they exceeded such estimates. Similarly, Amex is required to segregate $85 million for estimated restitution payments, but final payments may differ from such estimates in either direction. In contrast, Discover's restitution payments are limited to exactly $200 million. This suggests that the CFPB and the FDIC were concerned that the total Discover restitution would be unreasonably high if it were calculated as it was for Capital One and Amex, and perhaps too high in comparison to Capital One's anticipated payments. Restitution amounts payable by Discover to individual customers do not include all charges and estimated interest, and Discover customers enrolled in a payment protection product for more than a year are limited to only 90 days of fees in the first instance (and receiving additional amounts only if the aggregate restitution payable by Discover falls below $200 million).

- *Civil Money Penalties*: Capital One was assessed civil money penalties of $25 million and $35 million by the CFPB and the OCC, respectively. The CFPB indicated that the larger fine imposed by the OCC was due to the fact that it had found objectionable practices going back to 2002. (As discussed, the Capital One CFPB order only covered activities dating back to August 2010.) Amex was assessed civil money penalties of $14.1 million by the CFPB, and $13.4 million by other banking regulators. The CFPB's $7 million civil money penalty against Discover is smaller than those imposed on Capital One or Amex, both in absolute terms and relative to the size of aggregate penalties and restitution. The differences in the sizes of the civil money penalties are not explained entirely by the duration of the alleged misconduct, nor by the number of affected customers (2 million in the case of Capital One, 0.25 million for Amex, versus nearly 3.5 million for Discover). The CFPB did not explicitly address the rationales for the sizes of the penalties, and it has not yet issued general guidance about penalty calculations. It is possible that

the CFPB limited the size of the Discover penalty in order to maximize the funds available to reimburse customers when restitution might otherwise have been limited.

Remedial Actions

The remedial actions imposed by the consent orders include a mixture of specific changes to marketing, sales and operations processes related to credit cards, new disclosure and recordkeeping requirements, and obligations to review, enhance and revise internal risk management and compliance systems and policies. A few issues are worth highlighting:

- *Scope of Remedial Action*: The CFPB order required that Capital One develop an enterprise-wide program to ensure that all consumer products and services sold by it or through its service providers comply with the UDAAP prohibitions in the Dodd-Frank Act. It also mandated written analysis of UDAAP risk in relation to any new consumer products. Additionally, third-party service relationships in connection with consumer products will become subject to a new service provider management policy approved by the CFPB. Such enterprise-wide requirements reached beyond the actual products and processes involved in the alleged misconduct, and raised questions whether the CFPB may have reached beyond its jurisdiction. In contrast, the Discover consent order requirements cover only the relevant add-on products, and internal systems and policies related to them, suggesting that the CFPB may have consciously narrowed the scope of remedial requirements.

- *Third-Party Providers*: The CFPB and the OCC had focused specifically on alleged misconduct of third-party service providers involved in the telemarketing of Capital One's add-on products, and the CFPB order included detailed requirements with respect to these service providers. Such detailed requirements with respect to service providers in general were also included for Amex, the regulators alleged inadequate oversight of service providers. For Discover, the CFPB and FDIC determined that in-house telemarketers and third-party service providers had been involved in the alleged misconduct, but the Discover consent order only includes more general requirements for the monitoring and training of third-party providers.[8] Specific requirements from the Capital One and Amex CFPB orders, such as a mandatory analysis of the capacity of third-party providers to perform services in compliance with consumer protection laws, and the inclusion of particular terms and conditions in contracts with such providers, were not included in the Discover consent order. The differences may be attributable to the fact that Discover's telemarketing scripts, which were provided to third-party vendors, were themselves found to be misleading, and Discover's alleged misconduct did not stem from lack of supervision of service providers. These differences among the orders in terms of requirements support the view that at least some of the highly-prescriptive provisions should only apply to the particular facts and circumstances of the entity subject to the

enforcement action and do not necessarily represent new, generally applicable requirements.

- *Standard for Disclosures*: Under the CFPB consent orders for each of Capital One, Discover and Amex, disclosures generally are to be made "clearly and prominently". As first described in the Capital One CFPB order, information must be presented, if written, in a type and location "sufficient for an ordinary consumer to read it", in a manner and syntax "recognizable and understandable by an ordinary consumer", and if orally, at a cadence and syntax "sufficient for an ordinary consumer to hear and comprehend."[9] While this standard was not specifically mentioned in *CFPB Bulletin 2012-06*, its repetition in all of the CFPB consent orders suggests that the CFPB may use this standard to evaluate the effectiveness of disclosure on a going forward basis.[10]

- *Enhanced Management and Monitoring with Independent Audits*: Particular emphasis has been placed in each of the consent orders on enhancing compliance management programs with periodic reviews and independent audits, and more effective monitoring of third-party service providers.

- *Recordkeeping Requirements*: Like Capital One, Discover has been required by the CFPB to retain customer records up to two years after a customer ceases to be enrolled in a relevant product. These requirements include obligations to keep audio recordings of telephone calls in which customers purchased products. Product-related records (such as sales scripts, complaints, and refund requests) must be maintained for up to six years (as opposed to two years in the Capital One CFPB order). Under both the Discover consent order and the Capital One CFPB order, records related to compliance with the enforcement action must be retained for six years. The Amex consent orders with the CFPB, however, impose requirements to keep some records for up to seven years.

- *Temporary Prohibitions on Product Offerings*: In contrast to the Capital One order, the Discover and Amex CFPB consent orders do not prohibit continued marketing or solicitation of the relevant products until compliance with all of the CFPB's requirements has been achieved.

Implications for Add-On Products

Although CFPB officials have continued to avoid characterizing credit card add-on products as inherently unfair, insisting that their focus is on the marketing of such products, the release of the Discover order has underscored the risks of marketing such products. Most major credit card issuers are currently in the process of reviewing their add-on products and related marketing practices. In August, Bank of America announced that it was stopping the enrollment of new customers into its credit protection products, and will

discontinue these products for existing customers after providing free coverage for six months. Earlier, in October 2011, J.P. Morgan Chase ceased to offer payment protection products to new customers, though existing customers were not affected. While Discover has stated its intention to continue offering the products that were the subject of the enforcement action, other institutions may be faced with increased pressure to abandon or significantly curtail their involvement with such products due to the perception of increased risk, either in response to the CFPB's recent orders, or based on their own interactions with the CFPB as it scrutinizes their products and practices.

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Notes

[1] 12 U.S.C. §§ 5531 and 5536.

[2] 12 U.S.C. §45(a).

[3] In the *CFPB Examination Handbook 2011,* the CFPB states that the "unfairness" prong will be interpreted the same way as in Section 5 of the Federal Trade Commission Act, and that CFPB examiners will be informed by the FTC's standard for "deceptive". However, the Handbook also notes that separate legal standards shall apply for "abusive" acts and practices, though such acts may also qualify as "unfair" or "deceptive". The Handbook provides no further guidance on what these separate standards might be. There have been indications that the CFPB will likely look to whether conduct is "unfair" or "deceptive" in judging whether it is also "abusive".

[4] *In the Matter of Discover Bank*, Docket Numbers FDIC-11-548b; FDIC-11-55k & 2012-CFPB-0005 (September 24, 2012) (Joint Consent Order, Order for Restitution and Order to Pay Civil Money Penalty).

[5] The OCC had also made a similar determination against Capital One in its consent order in July.

[6] *In the Matter of American Express Centurion Bank*, Docket Numbers FDIC-12-315b; FDIC-12-316k & 2012-CFPB-0002 (October 1, 2012) (Joint Consent Order, Joint Order for Restitution and Joint Order to Pay Civil Money Penalty); *In the Matter of American Express Travel Related Services Company, Inc.*, 2012-CFPB-0004 (October 1, 2012) (Consent Order, Order for Restitution and Order to Pay Civil Money Penalty); *In the Matter of American Express Bank, FSB*, 2012-CFPB-0003 (October 1, 2012) (Consent Order, Order for Restitution and Order to Pay Civil Money Penalty); *In the Matter of American Express Travel Related Services Company, Inc.*, 2012-CFPB-0004 (October 1, 2012) (Consent Order, Order for Restitution and Order to Pay Civil Money

Penalty); *In the Matter of American Express Company and American Express Travel Related Services Company, Inc*, Board of Governors of the Federal Reserve System Docket Nos. 12-066-B-HC & 12-066-CMP-HC (October 1, 2012) (Consent Order and Order of Assessment of a Civil Money Penalty); *In the Matter of American Express Bank, FSB*, Comptroller of the Currency AA-EC-2012-117 (October 1, 2012) (Consent Order for a Civil Money Penalty).

[7] *In the Matter of Capital One Bank, (USA) N.A.* [sic], Administrative Proceeding File No. 2012-CFPB-0001 (July 17, 2012) (Stipulation and Consent Order). The OCC concurrently issued a separate consent order and a consent order for civil money penalty. *In the Matter of Capital One Bank (USA), N.A.*, AA-EC-2012-62 (July 17, 2012) (Consent Order), and *In the Matter of Capital One Bank (USA), N.A.*, AA-EC-2012-63 (July 17, 2012) (Consent Order for Civil Money Penalty).

[8] On April 13, 2012, the CFPB published guidelines on the oversight by supervised banks and non-banks of service providers for compliance with federal consumer laws. *See* CFPB Bulletin 2012-03, *Service Providers* (April 13, 2012). The guidelines were not referenced in the Capital One, Discover and Amex orders.

[9] This description is repeated in the Amex consent orders with the CFPB.

[10] *CFPB Bulletin 2012-06* also states that the CFPB considers the following factors generally in evaluating the effectiveness of disclosures: (1) Whether the statement is prominent enough for the consumer to notice; (2) whether the information is presented in an easy-to-understand format that does not contradict other information in the package and at a time when the consumer's attention is not distracted elsewhere; (3) whether the information is in a location where consumers can be expected to look or hear; and (4) whether the information is in close proximity to the claim it qualifies.

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