Chapman and Cutler LLP

To the Point!

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Servicemembers Update

Abusive Practices

The CFPB continues to focus on the treatment by financial institutions of servicemembers now bringing claims of unfair, deceptive, and abusive practices. On June 17, 2015, the CFPB took action against a non-bank auto finance company and a retail furniture company and its related financing entity, all of which were alleged to have committed abusive practices. These practices included, in the case of the auto finance lender, "burying" an authorization to contact the delinquent borrower's commanding officer in an addendum to the loan agreement and exaggerating the effect of a delinquent account on a servicemember's career and, in the case of the retail financing entity, containing in its contracts a consent to a forum state for resolving disputes that was not the state in which the servicemember was stationed. The Dodd-Frank Act defines a practice as abusive when it:

- materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- takes unreasonable advantage of (i) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; (ii) the inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or (iii) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

The CFPB determined these practices were abusive because the companies included unfavorable terms that were not clearly disclosed in a contract with servicemembers that cannot be negotiated.

It is important to note that these practices criticized by the CFPB are not prohibited by the Servicemembers Civil Relief Act ("SCRA") and instead the CFPB has used its broad authority to bring enforcement actions for unfair, deceptive, or abusive acts and practices under the Dodd-Frank Act.

SCRA Compliance and Audit Plan

The OCC recently entered into a consent order with a bank regarding its practices related to servicemembers. The SCRA limits the interest rate that can be charged on credit card debt for active-duty servicemembers and protects them from entry of default judgments. The OCC consent order requires the bank to pay a civil money penalty and implement a remediation plan. The consent order also includes a requirement that a more robust SCRA compliance and audit plan (the "Plan") be instituted and provides those factors that must be included in such a Plan. Specifically, the factors are:

- Uniform standards and processes for determining whether a servicemember who requests SCRA benefits is eligible for *all accounts* that the borrower may have (not just the account subject to the request);
- Policies and procedures for notifying a servicemember of the denial of SCRA benefits or protections;
- Policies and procedures for determining whether real or personal secured property is owned by an SCRA-protected servicemember before referring a loan for foreclosure or repossession and during the foreclosure or repossession process in order to determine whether a court order is required pursuant to the SCRA prior to foreclosure or repossession;
- Processes to ensure that all factual assertions in affidavits of military service are accurate, complete, and reliable;
- Procedures for searching the Department of Defense Manpower Data Center database (or an equivalent database) before filing an affidavit in connection with a default judgment on an account, initiating the foreclosure or repossession process, or making a determination of eligibility for SCRA benefits;
- Procedures for filing an affidavit in connection with obtaining a default judgment on an account;
- Procedures for initiating and pursuing a waiver of rights;
- Procedures regarding applicable state laws, including state laws that may provide more benefits or protections than the SCRA;
- Development of standard guidelines, checklists, or other documentation that conveys complete and accurate information regarding the SCRA that is used by all employees and third-party vendors who are involved in providing customer service to servicemembers in connection with the servicing of their accounts and with collection, repossession, and foreclosure activities;

- A record retention policy to protect records that demonstrate compliance with the SCRA (including documentation of the calculation of benefits; assessment of eligibility for benefits; correspondence with servicemembers; and method, dates, and results of military status verification);
- Policies and procedures to ensure risk management, periodic audits for quality assurance, vendor management, and corporate compliance with the SCRA;
- Policies and procedures for the training of employees;
- Policies and procedures for compliance of third-party vendors;
- Processes for ongoing monitoring, testing, and reporting to Senior Management, Compliance, and the Board of Directors;
- Policies and procedures that require prompt remediation of identified deficiencies; and
- Means by which to ensure that policies, procedures, and processes are updated on an ongoing basis as necessary to incorporate any changes in the SCRA or applicable state laws.

The CFPB has consistently urged financial institutions to respond to the unique consumer financial challenges faced by the military, such as deployment and frequent moves. Financial institutions should review their programs and products and determine whether contract terms and customer service or collection practices may be viewed as abusive given these factors. In particular, collection practices should be reviewed carefully to ensure that all servicemembers are identified and that abusive tactics to coerce payments, such as those outlined above, are not used. Finally, the guidance provided by the OCC in the recent enforcement orders identifies the elements of a strong SCRA compliance and audit plan. The Plan required by the OCC should be reviewed by each financial institution and consideration should be given to making adjustments to its SCRA plans to align with this guidance.

CFPB Consumer Complaint Narratives

Since March 2015 over 7,700 consumers have opted to publicly share the narrative descriptions of their complaints on the CFPB's complaint database. Starting in March 2015, companies were given the option to allow their responses to be included in the database. Companies can select from a set list of structured responses. The database can be searched by product names, features, practices, and state.

Under the CFPB's Consumer Complaint Narrative Policy (the "Policy"), a complaint is listed on the database when the company responds or in fifteen days if no response is provided, whichever is earlier. If the company opts to make its response public, the consumer narrative will be added to the database when the company provides its public response or after the company has had the complaint for 60 days, whichever is earlier. The company has until 180 days following its receipt of the consumer complaint to provide an optional public response.

A financial institution should review the Policy and the structured response options available in the CFPB complaint database and decide whether it wishes to adopt a policy and procedure to permit public response to consumer complaints. It should revise its customer complaint policy and procedures to address the Policy, including issuance of public responses identifying individuals with the required authority if a public response is to be provided.

Private Student Loans and Cosigners

The CFPB recently released its midyear update on student loan complaints. The report highlighted, among other topics, issues related to cosigners. The CFPB identified cosigner issues as particularly significant because over 90 percent of private student loans include cosigners.

In its report, the CFPB commented that many student lenders advertise as a benefit options to release a cosigner if certain eligibility requirements are met. Because the CFPB has received complaints regarding the process to release cosigners, it conducted research and concluded that over 90 percent of the requests for a cosigner release were rejected. The CFPB research also indicated that most lenders and servicers do not proactively notify borrowers when they are eligible to request a cosigner release.

As a result of its research the CFPB also noted that student loan contracts include "auto-default" provisions that apply even if the borrower is current on its student loan payments. Such provisions include, for example, a "universal default" clause that places the borrower in default on the student loan when the borrower is not in good standing on an unrelated loan held by the lender; clauses that permit the lender to find a default if the lender believes the prospect of a borrower repaying its loan is impaired; clauses that permit a lender to find a default if a cosigner dies or files bankruptcy; and clauses that permit a default when a borrower does not quickly notify the lender of a name or address change.

The CFPB commented that these contract terms permit the lender to order the borrower to pay the entire remaining balance in full even if the borrower is current on loan payments. The CFPB indicated that lenders and servicers contacted as part of its research claimed they did not trigger defaults in such cases if the borrower continues to make payments. Yet the CFPB noted that (i) such provisions in private student loan contracts create risks for consumers if, for example, loans are sold or securitized since the lender's business decision not to enforce such provisions no longer applies; and (ii) it had received complaints from borrowers who had experienced such an action.

The CFPB recommends that lenders and servicers notify borrowers of the cosigner release requirements, including by posting the policies and applications on their websites. Borrowers should be warned if an action will disqualify the borrower from the ability to secure a cosigner release, such as in the case of accepting forbearance options to postpone a payment. To help facilitate the process of obtaining a cosigner release, lenders and servicers should proactively notify borrowers when they are eligible. For those applicants who are rejected, the lender or servicer should notify them of the criteria and reasons for the rejection of their application. As to cosigner release eligibility criteria, the CFPB questioned the use of criteria that disqualified consumers who opted to accept certain offers of forbearance options that postponed payments. Finally, the CFPB urged lenders to consider whether "auto-default" provisions such as those identified by the CFPB in its research are appropriate for inclusion in their contracts since lenders indicated that they were not enforced and they create risk for borrowers when a loan is sold or securitized.

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To the Point! is a summary of items of interest and current issues for financial institutions with primary focus on regulatory, consumer, and corporate issues. Chapman maintains a dedicated practice group with the experience to counsel on these issues and other enterprise risk management matters facing financial institutions. If you would like to discuss any of the items contained in these briefings or other legal, regulatory, or compliance issues facing your institution, please contact one of the members of our Bank Regulatory Group:

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