Online Lenders Alliance

Finding your Stride in Vendor Management

July 19, 2022

Online Lenders Alliance

- Third Party Vendors and the Regulatory Landscape
    - CFPB Has Authority to Enforce Consumer Protection Law with regard to Vendors
    - CFPB is Flexing its "Dormant Authority" to examine non-bank Financial Institutions
        - "Given the rapid growth of consumer offerings by nonbanks, the CFPB is now utilizing a dormant authority to hold nonbanks to the same standards that banks are held to," said CFPB Director Rohit Chopra. "This authority gives us critical agility to move as quickly as the market, allowing us to conduct examinations of financial companies posing risks to consumers and stop harm before it spreads."
        - CFPB can examine if it has "reasonable cause to determine [that the activity poses] risk to consumers."

- Third Party Vendors and the Regulatory Landscape
  - CFPB Bulletin 2016-02
    - “[T]he mere fact that a supervised bank or nonbank enters into a business relationship with a service provider does not absolve the supervised bank or nonbank of responsibility for complying with consumer Federal consumer financial service law to avoid consumer harm.”
    - CFPB Expects that lenders will have an effective risk management process.

- Issues in the Secured Space Shed Light on Regulatory Priorities
  - CFPB Commentary on Vendor Management
    - Algorithmic Bias
      - Automated Valuation Model (AVM) SBREFA Outline
        - Bias in Design
        - Bias in Data Used
      - May, 2022 CFPB Circular re. "Black Box" Algorithmic Underwriting Models

- *In re. Green Sky, LLC*
    - July 12, 2021 Consent Order
    - Refund or Cancel up to $9 mm in loans
    - $2.5 mm Civil Penalty
    - Facts
        - Green Sky allowed merchants (usually home improvement companies) to offer financing to consumers.
        - Loans were disbursed directly to the merchants.
        - Green Sky let contractors take out $9mm in loans for thousands of customers without their consent.

Online Lenders Alliance

- *In re. Discover Bank*
  - FDIC / CFPB Joint Enforcement Action and Consent Order, 2012
  - $200 mm in Restitution
  - $14 mm Civil Money Penalty
  - Facts
    - Discover used third-party telemarketers to make outbound sales calls.
    - Outbound call scripts contained misrepresentations
    - Telemarketing vendor engaged in actions – such as speaking more rapidly during disclosures, etc., that the Bureau found to be deceptive.

- Takeaways
  - You are generally responsible for vendor conduct with regard to consumer protection legal regimes
  - Risk increases exponentially when third party partners, including vendors, are consumer-facing
  - Insufficient training often results in disaster
    - Green Sky let merchants submit applications up to two months before completing training on loan applications
    - Only one person from the merchant required to attend training
    - Green Sky failed to act when it determined that there were deficiencies in the training.

Risk / Reward Balance in Vendor Relationships

- **Tolerable**: Is your entire vendor suite consistent with your company's risk tolerance?

- **Manageable**: Do you have processes and procedures in place designed to manage enterprise risk?

- **Reasonable**: Are your vendor management risk controls reasonably consistent with industry expectations?

Aligning your Vendor Suite with your Risk Tolerance

- What functions do your vendors serve?
- More vendors can, but doesn't always, mean more risk.
- The importance of quality vendors
  - Do they know the industry?
  - Do they know the laws and regs?
  - Are they committed to a culture of compliance?
- It's not always about quantity: what functions your vendors cover is just as important as how many vendors you are using.

Aligning your Vendor Suite with your Risk Tolerance

- The importance of individual vendor agreements
  - Nature and scope of vendor arrangement
  - Right to audit
  - Performance measures
  - Indemnification
  - Insurance
  - Confidentiality
  - Privacy and customer data
  - Licensure
  - Dispute resolution
  - Subcontracting

Managing Ongoing Risk

- Vendor audit and monitoring
- More critical the function = increased audit frequency
- Monitoring activity should be sufficiently documented
- Monitoring is not limited to vendor's "owners"
    - Board oversight
    - Management oversight
- Independent audit?
- Age/Length of the relationship.

Are your Processes Reasonably Consistent with Others in the Industry?

- Inventory database with information on all vendors?
- Repository for vendor contracts?
- Monitoring and Reporting systems?
- Training Programs for vendor?
- Documentation?

Are your Processes Reasonably Consistent with Others in the Industry?

- The problem of Algorithmic Underwriting
  - Sophistication = use of third-party vendors
  - Algorithmic Underwriting presents unique fair lending risk
  - Reluctance to allow people to look inside the "black box"
- How can lenders achieve a tolerable level of risk?
  - Contractual Protections
  - Auditing Inputs and Outputs
  - Fair Lending, UDAAP, and the Importance of an *expansive* audit.

OLA
Online Lenders Alliance

What to do when the Unexpected Happens?

- *Hunstein v. Preferred Collection and Management Services*
  - 2021 – Three Judge Panel on the 11th Circuit Court of Appeals held that a debt collector's outsourcing of its mailing processes to a mailing vendor violated the third-party disclosure prohibition in the FDCPA.
  - Case was reheard *en banc* in February

- The original decision created a crisis for debt collectors, virtually all of whom use mailing vendors.

- How do you address an unexpected crisis?

What about Vendor's "Reverse" Due Diligence?

- Why do vendors care who *they* work for (other than getting paid)?

- What is the vendor's objective when performing diligence on their client?

- *FTC v. IT Media Solutions* (2022)
  - Lead generation company paid $1.5mm in civil penalties
  - Allegedly operated hundreds of websites designed to entice consumers into sharing sensitive information.
  - Defendant sold information to marketing companies with no regard to how that information would be used.

What about Vendor Due Diligence? (Cont.)

- *FTC v. Blue Global Media, LLC* (2017)
  - $104mm Judgment
  - Allegation that lead generator enticed consumers to fill out loan applications that were sold as "leads"
  - Seller did not investigate how those "leads" would be used, or whether they would remain secure.

Questions

Jason Romrell, General Counsel and Director of Government Relations, LeadsMarket

Christopher Friedman, Attorney, Bradley

Online Lenders Alliance