STROOCK
SPECIAL BULLETIN

WHAT CFPB'S FIRST NO-ACTION LETTER SIGNALS

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The Consumer Financial Protection Bureau ("CFPB" or "Bureau") yesterday issued its first ever No-Action Letter ("NAL") through its Project Catalyst initiative, and the industry – particularly entities in the realm of emerging financial technologies ("FinTech") – are looking to determine what it may herald for the future. The CFPB issued the NAL to Upstart Network, Inc. ("Upstart"), an online lender aiming to supplement traditional credit history with alternative data, including consumers' education and work record, to support credit decisions. The NAL is less of a harbinger of the agency's intent to provide regulatory relief to the FinTech sector, than a confirmation of its continuing exploration of alternative data as a means to increase the availability of credit to underbanked populations, which could prove highly beneficial to the industry.

The NAL Policy & the Upstart NAL

The CFPB announced its NAL policy in October 2014, to promote responsible innovation in situations of uncertainty concerning compliance with existing statutes and regulations. To be considered, the financial product must show promise of "substantial consumer benefit" as well as apparent legal uncertainties. The Project Catalyst initiative is gaining prominence at the Bureau, and issuance of the Upstart NAL, the first of its kind, marks a major step forward for this initiative and the CFPB's commitment to action – rather than just words – to promote financial technology innovation as a means to increase consumers, access to fair and transparent financial products.

According to Upstart, its credit model benefits customers by providing credit access and better loan terms to traditionally underserved borrowers who have little or no traditional credit history. The NAL, which has a three-year term subject to renewal, states that the CFPB "has no present intention" to initiate supervisory or enforcement action against Upstart under the Equal Credit Opportunity Act and its implementing regulation, Regulation B. As a condition of the NAL, Upstart must regularly report a variety of lending and compliance information to the CFPB, including information on Upstart's loan information, decision-making process, and strategy to mitigate consumer risk and increase access to credit. Besides imposing these reporting requirements, which some companies might find cumbersome, the CFPB drafted the NAL to be narrowly restricted to Upstart's particular credit model.

Portend for FinTech & Alternative Data

Other firms, including those exploring the use of alternative data similar to Upstart, cannot rely on the Upstart NAL, given its case-specific application and reporting requirements. Nor should they perceive it as the harbinger of many more NALs or regulatory relief for FinTech innovation in the near future. Yet the CFPB's commitment to explore the use of alternative data, confirmed by the Upstart NAL, is an encouraging signal for online lenders and their partners.

The CFPB is eager to send the message that it is at the regulatory forefront in encouraging consumer-friendly financial innovation through its Project Catalyst, launched in November 2012 and finalized in February 2016. The Project Catalyst office has announced a range of initiatives, ranging from the NAL experiment, to the disclosure waiver trial program which allows applications for waiver of requirements for consumer disclosures, to the "office hours" program through which the Project Catalyst team makes periodic regional visits at which financial technology innovators may pitch their business models. At the Electronic Transactions Association's FinTech Policy Forum held yesterday, Project Catalyst Senior Advisor Moira Vahey touted the success of the program, including the oversubscription of its upcoming regional "office visits." The FinTech industry has been eager to meet CFPB staff, not only to learn about the agency's regulatory intentions, but more particularly to educate the agency on the variety of business models and to advocate for "right size" regulation in place of outmoded and "one size fits all" regulations that often hinder innovation. Despite its positive interactions with the Project Catalyst staff, however, the FinTech industry should not expect to temper the CFPB's rigorous regulatory scrutiny. As an example, the CFPB's Enforcement team continues to pursue aggressive action in this sector undaunted by court rebukes such as that in the August 2017 ruling of U.S. District Judge Richard Story of the Northern District of Georgia, excoriating the CFPB's resistance to his discovery orders and dismissing claims against third-party payment processors in the Bureau's action against Universal Debt Solutions.

The Project Catalyst initiative to date has not had significant substantive impact on the CFPB's regulatory activities. Yet the Upstart NAL indicates that the agency is opening to take action in discrete areas relevant to financial technology innovation, where it sees a potential for major consumer benefit. The CFPB has been on the fence about the use of alternative data, on the one hand recognizing the potential to increase credit access for the underbanked who have little traditional credit history, and on the other hand fearing the threat that the availability of such alternative data could increase lending discrimination. The CFPB's February 2017 Request for Information on the use of alternative data and modeling techniques in the credit process is a major step forward in confronting these issues. The Upstart NAL is another in increasing the agency's commitment to move that ball forward. In both cases, the CFPB is focused – not only on learning about emerging tools and techniques, market developments and alterations – but also the collection of information about potential benefits and risks, consumer concerns and provider mitigation steps. A strong, substantive industry response to demonstrate that the benefits outweigh the risks will be crucial to the CFPB's acceptance of the use of alternative data. Such a regulatory imprimatur could greatly profit FinTech and other industry players by facilitating efficient underwriting and online lending, as well as increasing the advantages of bill payments and other electronic transactions on the FinTech platform that can provide useful sources of alternative data.

The attorneys of Stroock's Financial Services/Class Action Group are well-positioned to answer any questions you may have about federal and state authorities' FinTech initiatives, as well as other consumer financial regulatory and litigation issues.

For More Information

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