Emerging Enforcement Activity Trends Toward Vicarious Liability for Service Providers

BY VALERIE L. HLETKO AND SARAH E. HAGER

The Consumer Financial Protection Bureau’s (CFPB) latest enforcement action brings the total count relating to ancillary credit products to five. A common theme in the resulting consent orders is service provider management—the quality of diligence, contracts and ongoing oversight. The fourth consent order in late June, however, raises significant questions about the degree to which supervised institutions may “stand in the shoes” of service providers found to have violated the law irrespective of such efforts. Principles of compliance management support robust diligence, oversight and monitoring of service providers, but common law agency principles do not support what appears to be an emerging regulatory concept of vicarious liability.

The Dodd-Frank Act gives the CFPB authority to regulate any “consumer financial product or service” offered by any covered person. Specific activities include a range of transactions—from extending credit and servicing loans to processing payments made through mobile telecommunications networks. A covered person is any person engaged in offering or providing a consumer financial product or service, and any affiliate if such affiliate acts as a service provider. A service provider is defined to include “any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service,” including providers that design, operate or maintain the product or service.

On April 13, 2012, the CFPB released Bulletin 2012-03 (“the Bulletin”), which sets forth the Bureau’s expectations regarding vendor management. The Bulletin requires of the supervised institution: (i) thorough due diligence; (ii) review of policies, procedures, internal controls, and training; (iii) inclusion in the service contract clear compliance expectations and enforceable consequences for noncompliance; and (iv) ongoing monitoring of compliance and prompt corrective action where problems arise.

In general, the findings and injunctive relief in the consent orders relating to ancillary credit products track this guidance. The consent order issued in late June of this year stands out, however, because the core of its findings did not specifically relate to alleged deficiencies in third-party vendor management. The relationship at issue involved a partnership between a bank and Dealers’ Financial Services (“DFS”), which offered an auto loan program called Military Installment Loans and Educational Services (“MILES”). DFS is alleged to have failed to properly disclose fees and to have misrepresented the true cost and coverage of add-on service
contracts. While the bank was the primary lender for MILES, DFS controlled, among other things, the telemarketers, the dealer network and the program website.

The consent order emphasized jurisdiction over DFS as a “service provider” because it “participate[d] in designing, operating, or maintain[ing]” the program at issue. The principal failure on the part of the bank noted in the findings of fact was that, despite a contractual right to review marketing materials, it allegedly failed regularly to validate statements made.

While the latest consent order returns the focus on ancillary products to service provider oversight, questions surrounding the distinction between institutions and their service providers raised in June hang in the air. Compare, for example, paragraph 29 of the June consent order with Paragraphs 5 of the first consent order and Paragraph 9 of the most recent:

- Paragraph 29: “The MILES service contract marketing materials used by DFS and dealers in the MILES program included deceptive statements regarding the cost and coverage of the warranty, which violated the CFPA’s prohibition on deceptive acts or practices, 12 U.S.C. §§ 5531, 5536(a)(1)(B). By virtue of the overall structure and operation of the MILES program as set forth in Paragraphs 2 through 21, [the bank] engaged in these deceptive acts or practices.”

- Paragraph 5: “With respect to the marketing of the Products, [the bank’s] compliance monitoring, service provider management and quality assurance resulted in ineffective oversight which failed to prevent, identify, or correct the improper sales practices [of third-party call centers].”

- Paragraph 9: “[The bank’s] compliance monitoring, service provider management and quality assurance failed to prevent, identify, or correct the billing for services that were not provided.”

Institutions must ensure that they comply with the Bulletin’s guidance; however, there is no basis in law for strictly imputing to them the actions of their service providers, notwithstanding such compliance. Expectations for reasonable diligence and monitoring must not metamorphose into vicarious liability for third-party shortcomings.