

## 2018 Consumer Financial Services Symposium

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

K&L GATES

# Fair Lending Litigation, Enforcement, and Regulation Roundup

Olivia Kelman  
K&L Gates LLP  
[olivia.kelman@klgates.com](mailto:olivia.kelman@klgates.com)  
305-798-8566

# Fair Lending Litigation, Enforcement, & Regulation

## Private lawsuits by municipalities

- Beginning in 2013, cities and counties around the country have filed FHA suits against large lenders.
  - Sacramento, CA filed the most recent suit in February 2018.
- The cities claim that the defendants originated “discriminatory” loans, which led to defaults, which led to foreclosures, which led to increased city spending and less taxes.
  - Cases filed by Cook County challenge loan servicing decisions.
- Lenders have defeated all cases that have reached the merits.
- Cities have tried to establish discrimination under many theories:
  - Pricing
    - Lender credits (i.e., credit for interest rate chosen)
  - Steering
  - Traditional redlining

# Fair Lending Litigation, Enforcement, & Regulation

## Private lawsuits by advocacy groups

- The National Fair Housing Alliance (“NFHA”) has filed FHA suits alleging discrimination in the maintenance and marketing of REO properties following foreclosures, contending properties located in non-minority neighborhoods were better maintained and marketed than those in minority neighborhoods.
  - NFHA v. Fannie Mae, No. 16-06969 (N.D. Cal.)
  - NFHA v. Deutsche Bank, No. 18-0839 (N.D. Ill.)
  - NFHA v. Bank of America, No. 1:18-01919 (D. Md.)
- The claims date back to 2011, when NFHA initially filed administrative complaints with HUD.
  - U.S. Bank defeated NFHA’s claims on the merits when HUD issued a public finding of “no cause.”

# Fair Lending Litigation, Enforcement, & Regulation

## Insurance industry lawsuit challenging HUD's disparate impact rule

- The insurance industry filed two lawsuits challenging HUD's 2013 rule implementing the FHA's disparate impact standard
  - AIA v. HUD, No. 1:13-00966 (D.D.C.)
  - PCIAA v. HUD, No. 1:13-08564
- The suits contend that the rule adopts a standard inconsistent with Supreme Court's decision in *Inclusive Communities*, 125 S. Ct. 2507 (2015)
- After the Trump Administration took office, HUD sought to delay the cases.

## Fair Lending Litigation, Enforcement, & Regulation

### Insurance industry lawsuit challenging HUD's disparate impact rule (Cont.)

- HUD issued an advance notice of proposed rulemaking inviting public comment on possible amendments to the rule, and by the August 20, 2018, deadline, HUD received 1,900 comments
- HUD has stated in court filings that it plans to issue a Notice of Proposed Rulemaking, and has estimated that it will begin the rulemaking process.

# Fair Lending Litigation, Enforcement, & Regulation

DOJ Actions: United States v. KleinBank, No. 17-136 (D. Minn.)

- Filed January 13, 2017 by the Obama Administration
- Resolved May 8, 2018 by the Trump Administration
- Claims: redlining majority-minority areas of Minneapolis
  - Complaint supported by allegations of statistical proportional distribution analyses; of excluding majority-minority census tracts from assessment area; of branching in white areas; and of targeting advertising to white areas
- Settlement Terms:
  - Revise assessment area
  - Branch in majority-minority area
  - \$300,000 in advertising over 3 years
  - \$300,000 in a special purpose credit program targeted to majority-minority areas

# Fair Lending Litigation, Enforcement, & Regulation

## DOJ Actions: Pacific Mercantile Bank (“PMB”)

- DOJ investigation began in 2013 based on Fed referral
- DOJ notified PMB in 2016 of authorization to file a complaint alleging discrimination on the basis of race and national origin in the pricing of retail and wholesale mortgage loans originated between April 2011 and April 2013
- PMB stopped wholesale mortgage lending in April 2011 and stopped mortgage lending all together in December 2013.
  - PMB represented it had no plans to re-enter the mortgage market
- Settlement terms:
  - \$1,000,000 settlement fund, with DOJ to determine the payment amount to each borrower



## Presenter Contact Information



Olivia Kelman  
K&L Gates LLP  
Miami, Florida  
(305) 359-3382  
[olivia.kelman@klgates.com](mailto:olivia.kelman@klgates.com)

## Fair Lending Litigation, Enforcement, and Regulation Roundup

**Arthur P. Baines,**  
Vice President and Co-Practice Leader  
Charles River Associates  
202.662.7838  
abaines@crai.com

## Recap Conclusions from 2017

- Enforcement actions and litigations more focused on ‘bad-actors’ rather than ‘industry’ issues
- Fewer cases, but arguably stronger analytics from government
  - Often accompanied by challenging optics
- Less Disparate Impact, and more:
  - disparate treatment
  - unfair, deceptive or abusive treatment
- More sophisticated econometrics and analytics, requiring larger and more complicated data sourced from multiple systems

# Automotive Enforcement Update

- CFPB's 2013 'Auto' Bulletin repealed by Congress
  - Current CFPB done with dealer markup
  - 2013 'Auto' Bulletin repealed by Congress (May 2018)
    - Bulletin was specific to 'markup' and did not address underwriting or risk-based pricing
  - Toyota granted early exit from its Consent Order
  - BB&T, BMO and other industry participants returning to traditional dealer comp model and caps
  - Examinations still analyze underwriting and buy rates
    - Industry making significant changes to monitoring analytics
  - Pursuing a few, idiosyncratic fair lending enforcements
  - Use of UDAP:
    - Santander consent order: UDAP related to GAP misrepresentation
    - Wells Fargo consent order (with OCC): collateral protection insurance

## Automotive Enforcement Update (Cont.)

- FDIC
  - Attempted to pursue the mark up issue, but appears to be backing off
- NYDFS: Automotive guidance issued on August 23, 2018
  - Considerably more extensive than CFPB's 2012 Bulletin
  - Covers
    - Markup
      - Assess dealer's product marketing and advertising
      - Reduce dealer's discretion (ex. Flat fees)
      - Extensive analysis: portfolio and dealer-level, statistical and regression analysis, *implies use of controls*
    - Underwriting
    - Risked-based pricing
    - Training, Policies, etc.
- Other States?

# Implications

- Industry making significant changes to analytics developed and deployed during Cordray-era CFPB
- Recent research on BISG
  - OCC Economist, Yan Zhang, *Assessing Fair Lending Risk Using Race/Ethnicity Proxies*, 2016, published online in volume 61, issue 1 of Management Science
  - OCC Economist, Ioan Voicu, *Using First Name Information to Improve Race and Ethnicity Classification*, 2018, published online in volume 5, issue 1 of Statistics and Public Policy
- Findings consistent with CRA research
  - Continuous Regression and traditional threshold-based application of BISG result in overstated disparities
  - Overstatement occurs in raw *and* controlled regressions
- Two critical areas in fair lending analytics in which proxies are used
  - How to apply BISG probabilities (See articles above)
  - Use of controls is expanding in the analysis of markup.

## Presenter Contact Information



**Arthur P. Baines,**  
Vice President and Co-Practice Leader  
Charles River Associates  
202.662.7838  
abaines@crai.com

# False Claims Act and Other Enforcement Developments

Steve Topetzes  
K&L Gates LLP  
stephen.topetzes@klgates.com  
202-778-9328



## FALSE CLAIMS ACT – FHA/VA-Insured Loans

- Late 2017 Statements by Secretary Carson:
  - *“We have heard concerns on the part of some in the lender community about participating fully in our programs because of the undue risks they perceive from a lack of clarity in what we expect and exposure to outsized liability from immaterial errors . . . I am very pleased to announce that HUD, in consultation with the Justice Department, is committed to reviewing and addressing these issues.”*

*Remarks by Secretary Ben Carson at MBA Annual Conference, Oct. 23, 2017*

## FALSE CLAIMS ACT – FHA/VA-Insured Loans

### FHA Commissioner Brian Montgomery (July 2018):

- “Bank of America, [JP Morgan] Chase and others barely offer the FHA product anymore.”
- I think the previous administration made some moves in the right place around the defect taxonomy and the loan review system. But lenders still want greater certainty around what’s the bright line, what are the parameters, if you will.”
- A lot of servicers and lenders have paid somewhere north of \$5 or \$6 billion in settlements. In many cases, it drove a lot of depositories away from FHA. I think a lot of them just said ‘we’re done’ . . . And some of the False Claims Act cases, I’m not so sure that the punishment necessarily fits the crime . . . I want to try to bring back some greater certainty.”

(As reported in *HousingWire*, Jul 10, 2018, B. Lane)

## FALSE CLAIMS ACT – DOJ Memoranda

### Memorandum by Michael Granston, Director of Civil Fraud Section (DOJ):

- Internal memorandum, dated January 10, 2018, outlines “Factors for Evaluating Dismissal” of claims asserted by self-styled “whistleblowers,” including:
  - Curbing meritless claims;
  - Preventing parasitic or opportunistic claims;
  - Controlling litigation brought on behalf of U.S.;
  - Safeguarding classified data and national security interests;
  - Preserving government resources; and
  - Addressing egregious procedural errors.
- Focus is *qui tam* actions brought by relators; suggests possible dismissal effort as opposed to mere non-intervention; more active role by DOJ in limiting litigation

## FALSE CLAIMS ACT – DOJ Memoranda (Cont.)

Memoranda to Heads of (DOJ) Civil Litigation and Regulatory Reform Task Force by Rachel L. Brand, Associate Attorney General, dated January 25, 2018:

- Title: “Use of Agency Guidance Documents in Affirmative Civil Enforcement Cases”
- DOJ “may not use its enforcement authority to effectively convert agency guidance documents into binding rules . . . [and] may not use noncompliance with guidance documents as the basis for proving violations of applicable law . . . .”
- Raises questions about future arguments and investigative efforts by DOJ attorneys

## FALSE CLAIMS ACT – YEAR IN REVIEW (LENDING/SERVICING)

- 2018 characterized by absence of new cases
- Remaining (longstanding) investigations resulting in settlement – e.g., *Universal American Mortgage Company LLC* (W. D. Wash., Oct. 19, 2018) (\$13.2 million paid by Defendant; \$1.98 to qui tam relator; alleged conduct occurred between Jan. 1, 2006 and Dec. 31, 2011)

# FALSE CLAIMS ACT – PENDING MATTERS/REMAINING QUESTIONS

- Some evolution or clarification of FCA law:
  - Implied Certification Theory – Validated/Clarified/Limited: *United Health Services, Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 (2016) validated the theory of implied certification, but imposed materiality requirement (i.e., the asserted violation must be “material” to the government decision to pay)
    - Interpreted as requiring plaintiff to plead contents of the claim for payment; decisions are inconsistent with respect to pleading burden for plaintiffs; a number of dismissals upheld (see e.g., *U.S. ex rel. Rose v. Stephens Institute*, 901 F. 3d 1124 (9th Cir. 2018); meaningful chance of further Supreme Court review
    - Question is whether the government **would** have refused payment if it had known of the violation or non-compliance, not whether the government **could** have refused to pay

## FALSE CLAIMS ACT – PENDING MATTERS/REMAINING QUESTIONS

- But, significant aspects of DOJ/HUD theories have not been litigated or tested before the Courts
- The Quicken litigation continues (E.D. Mich.) – Deposition of D. Gilbert; trial scheduled for March 11, 2019
- The Guild Mortgage case continues (S.D. Cal.) – U.S. currently seeks to amend its complaint; proposed narrower lending time period – July 1, 2007 start date as opposed to Jan. 1, 2006; modified allegations purportedly designed to address “materiality” issue
- “Materiality” of asserted defects has not been determined or addressed
- Open issues regarding use of statistical sampling and extrapolation as proof of liability or magnitude of alleged harm
- “Fraudulent Inducement” theories based upon broad programmatic or loan-level certifications of compliance
- Separately, statute of limitations issues persist, particularly re: cases in which the government does not intervene – Sup. Ct. agreed to hear appeal (*Hunt v. Cochise Consultancy* (1<sup>st</sup> Cir.; Cert. Granted Nov. 2018))

## Other Enforcement Issues/Considerations

- HUD OIG/Mortgagee Board – recertification issues; civil money penalties; routine enforcement matters
- State Regulators – e.g., NY Department of Financial Services (anti-money laundering, sanctions, related concerns with respect to compliance and supervisory systems)



## Presenter Contact Information



Steve Topetzes

K&L Gates LLP

Washington, DC

(202) 778-9328

[stephen.topetzes@klgates.com](mailto:stephen.topetzes@klgates.com)

K&L GATES

# OCC SPECIAL PURPOSE CHARTER FOR FINTECHS

John ReVeal  
K&L Gates LLP  
[john.reveal@klgates.com](mailto:john.reveal@klgates.com)  
(202) 778-9055

## OCC SPECIAL PURPOSE CHARTER FOR FINTECHS – BACKGROUND

- August 2015 – OCC begins innovation initiative.
- March 2016 – OCC white paper: Responsible innovation.
- October 2016 – OCC: Office of Innovation.
- December 2016 – Proposal for special purpose charter.
- New technology makes financial products and services more accessible, easier to use, and tailored to individual consumer needs.
- Responding to market forces are thousands of technology-driven nonbank companies – new approach to products and services.
- July 2018 – OCC begins accepting fintech charter applications

# CHARTERING AUTHORITY AND SCOPE

## Required activities.

“Paying checks” or “lending money,” but not receiving deposits.

- Issuing debit cards or facilitating payments electronically are the modern equivalent of paying checks.

**The OCC would consider on a case-by-case basis the permissibility of new activity.**

Other activities mentioned in the white paper:

- Marketplace lending
- Digital currencies and distributed ledger technology
- Financial planning and wealth management products and services

## KEY BENEFITS

### Federal Preemption

- State licensing
- Interest and certain fees
- Loan terms

### Payment processing

- Depends on whether the Federal Reserve will grant a master account.

### Avoiding Bank Holding Company Act

- OCC still might require a financial source of strength.

## BASELINE EXPECTATIONS

- Robust detailed business plan
- Governance structure
- Capital
- Liquidity
- Compliance risk management
- Financial Inclusion
- Recovery and exit strategies; resolution plan and authority

## FINTECH CONCERNS

Requirements too onerous for many (most?) fintechs

- Three-year business plans
- Capitalization and liquidity
- Full banking operations, procedures, and compliance
- Alternate suggestion – “sandboxes”

Major themes underlying OCC Charter

- Payments innovation
- Importance of financial inclusion
- Level playing field

## Presenter Contact Information



John ReVeal  
K&L Gates LLP  
Washington, DC  
(202) 778-9055

[john.reveal@klgates.com](mailto:john.reveal@klgates.com)



# Consumer Bankruptcy Litigation, Enforcement, and Regulation Roundup

Phoebe Winder  
K&L Gates LLP  
[phoebe.winder@klgates.com](mailto:phoebe.winder@klgates.com)  
617-261-3196

## Consumer Bankruptcy Enforcement, & Regulation

Recent U.S. Trustee credit card settlement:

- In re Fazzon, Misc. Proceeding No. 18-201, Bankr. N.D. Georgia Sept. 24, 2018

(Citibank & Department Stores National Bank)

Recent U.S. Trustee credit card agreed resolution:

- In re Cushman, Case No. 16-01017, Bankr. D. Maine, Aug. 24, 2018

(Resurgent/LVNV)

Neither involved third-party monitors

## Consumer Bankruptcy Enforcement, & Regulation

DOJ's Benczkowski Memorandum (October 12, 2018)

- Provides new insight into the selection of monitors and the scope of their work
- Acknowledges that, although a monitor may be a helpful resource, a monitor is likely unnecessary where a corporation's compliance program and controls are demonstrated to be effective and appropriately resourced at the time of corporate criminal resolution.

# Consumer Bankruptcy Litigation,

## Trending Bankruptcy Issues in Litigation

### •Monthly Statements

- Multiple private actions in Nevada involving pre-CFPB statements in bankruptcy.
- Payment application is front and center

### •Itemization of Interest and Fees per Bankruptcy Rule 3001

1. Maddux, 567 B.R. 489 (E.D. Va. Dec. 1, 2016)
2. Jowers, Case No. 16-01667 (D. S.C. May 23, 2017)
3. Thomas, Case No. 16-50612 (W.D. W. Va. Sept. 28, 2018)

### •Bankruptcy Escrow

- Objections by chapter 13 trustees and local U.S. Trustees

# Consumer Bankruptcy Enforcement, & Regulation

## Other Trending Bankruptcy Issues:

- Reconciliation of payments at dismissal;
- Collection of funds where the debtor did not respond to the creditor's Response to Notices of Final Cure;
- Date incurred for purposes of Post-Petition Fee Notices;

**New amendments to Bankruptcy Rules effective December 1.**

## Presenter Contact Information



Phoebe Winder  
K&L Gates LLP  
Boston, Massachusetts  
(617) 261-3196  
phoebe.winder@klgates.com

What to Expect from the CFPB and Broader  
Consequences of Leadership Changes

## Shifting Priorities at the Consumer Financial Protection Bureau

Robert W. Sparkes, III

Partner

Financial Institutions and Services Litigation

K&L Gates LLP

# Introduction: A Year of Changes at the CFPB

**Nov. 24, 2017 to Dec. 3, 2018:** One Year at the Consumer Financial Protection Bureau

- **New Leadership**
  - Cordray → Mulvaney → Kraninger
- **New Agency Name**
  - CFPB → BCFP
- **New Approach and New Priorities**
  - Regulation and Rulemaking
  - Enforcement
  - UDAAP



## Leadership Change at the CFPB

Former Director  
Richard Cordray

Jan. 4, 2012 – Nov. 24, 2017



Acting Director  
Mick Mulvaney

Nov. 24, 2017 - Present



## Future Leadership

### Kathleen Kraninger

- Office of Management & Budget, Mar. 2017–Present
  - Associate Director for General Government
- June 2018: Nominated as Director of the CFPB
- August 2018: Nomination Passed the Senate Banking Committee (13-12)
- November 29: Expected Senate Vote
  - Update on Vote
- Uncertain Agency Future
  - Protégé of Acting Director Mulvaney
  - Expected to Follow a Similar Path



# Bureau Name Change

“What’s in a Name?”

- Consumer Financial Protection Bureau; OR
- Bureau of Consumer Financial Protection

April 2018: The CFPB Officially Becomes the BCFP

- “The CFPB doesn’t exist. The CFPB has never existed[.]” – *M. Mulvaney, April 2018*

What is the Impact of the Name Change?

- Practically: No impact
- Symbolically: Significant
  - Complete break with the Cordray-led CFPB

## Shifting Priorities & Approaches

*“We have committed to fulfill the Bureau’s statutory responsibilities, but go no further.”*

-- Acting Director Mulvaney

*Message from the Acting Director in the Strategic Plan for the Bureau of Consumer Financial Protection for Fiscal Years 2018-2022 (Feb. 12, 2018)*

# Changing Regulatory Focus

## The New CFPB Rulemaking Approach:

- Shift away from the Consumer-Protection-Above-All approach of the Cordray-led CFPB
- Objective to Balance
  - Consumer protection objectives, with
  - Minimizing regulatory burdens on financial services providers
- Characteristics of New Focus:
  - Regulate to provide clarity and certainty to industry,
    - Not to re-make financial markets
  - Industry cooperation and input weighed more heavily
  - Heightened objective to reduce industry compliance burdens
  - Stress on cost-benefit analysis
  - More industry-friendly approach

# Future Areas of New Regulation

## Debt-Collection Practices

- **Why Debt Collection?**
  - Highest volume of consumer complaints
  - Industry seeks guidance on application of the FDCPA to modern collection practices
  - Studying the issues since November 2013
- **Spring 2019: Expect Notice of Proposed Rulemaking**
  - Consumer communication practices
  - Consumer disclosure requirements
  - Prohibit attempts to collect time-barred and obsolete debts
  - Regulating sale and transfer of debts for collection

## Re-Visiting Past Rulemaking

### CFPB's Efforts to Undue or Limit Past Regulations:

- Actively seeking industry input about regulations and rules promulgated by Cordray-led CFPB
  - *E.g.*, Intent to reconsider 2015 HMDA Rule generally
- Calls for evidence regarding CFPB procedures:
  - Unwarranted regulatory burden
  - Rulemaking processes
  - Adopted regulations and new rulemaking authorities
  - Inherited regulations and inherited rulemaking authority
  - Enforcement, supervision, CID, and other Agency processes

# Re-Visiting Past Rulemaking, Cont.

## A Case Study: The CFPB's Payday Lending Rule

- **November 17, 2017:**
  - Final Payday Lending Rule is published in the Federal Register
- **November 24, 2017:**
  - Mulvaney appointed Acting Director
- **January 16, 2018 (Rule Effective Date):**
  - Announces intention to re-open notice and comment period to reconsider the Rule
- **April 2018 – August 2018**
  - Seeks judicial stay of Rule's August 19, 2019 effective date in Trade Group Litigation
    - *See Cmty. Fin. Servs. Ass'n of Am. Ltd. v. Consumer Fin. Prot. Bureau*, No. 1:18-cv-295-LY (W.D. Tex)



## Re-Visiting Past Rulemaking, Cont.

### Status of the Payday Lending Rule:

- August 19, 2019 Compliance Deadlines are Stayed
  - Court granted stay on November 6, 2018
  
- CFPB to Issue Notice of Proposed Rulemaking in January 2019
  - Will revisit ability-to-repay underwriting requirements
  - Will not revisit payment practices provisions
    - See Public Statement Regarding Payday Rule Reconsideration and Delay of Compliance Date (Oct. 26, 2018) (at <https://go.usa.gov/xPPuR>).

## New Enforcement Priorities

### Enforcement Objectives of Mulvaney-Led CFPB

- Eliminate “Regulation by Enforcement”
- Enforce Only Violations of Clear Rules
- Enforcement as a Last Resort

### Methods for Achieving this Goal

- Fewer enforcement actions initiated
- Some pending enforcement actions dismissed
- Issuing rules providing clear lines on prohibited conduct
- Taking action only to curb violations of existing laws and clearly-defined rules

# Unfair, Deceptive, and Abusive Acts and Practices (“UDAAP”)

The CFPB’s Key Statutory Mandate is:

- To protect consumers from Unfair, Deceptive, and Abusive Acts and Practices
- UDAAP authority is broad, providing grounds for regulatory, enforcement, and supervisory action
- Most powerful weapon in the CFPB’s arsenal

UDAAP Under the “New” CFPB:

- Remains in use as an enforcement tool, **BUT**
- Used less aggressively
- Interpreted and applied more strictly

## UDAAP, Cont.

### Defining “Abusive” Acts and Practices

- CFPB is considering rulemaking to define what constitutes an “Abusive” act or practice

### Rationale for “Abusive” Rulemaking

- “Unfair” and “Deceptive” are well-established in law
- “Abusive” has no set or established definition
- “Abusive” is overly-broad and malleable
- Clarity will benefit the financial services industry

## Enforcement Actions Initiated in 2018

November 24, 2017 – April 20, 2018:

- **Zero** enforcement actions or consent orders filed

April 20, 2018 – June 13, 2018:

- **One** consent order entered

June 13, 2018 – November 30, 2018:

- **Nine** enforcement actions initiated / consent orders filed

Total in Civil Money Penalties and Consumer Restitution:

- Civil Money Penalties: **\$1,015,900,001**
- Consumer Restitution: **\$362,012,885**

## Enforcement Actions Initiated in 2018, Cont.

Sample of Activity Targeted by the CFPB in 2018:

- **Unfair, Deceptive, and Abusive Debt Collection Practices:**
  - Visits to consumers' homes and discussing debts with third-parties
  - Threatening consumers with jail and physical harm
  - Visiting consumers' employment;
  - Inflating amounts of debt owed
  - Threatening legal action with no intention or authority
  - Threats to sue on time-barred debts
  - Representations regarding furnishing information to CRAs
- **Violations of TILA and Regulation Z:**
  - Misrepresenting finance charges
  - Failing to disclose APRs
- **Violations of the EFTA and Regulation E:**
  - Deceptive and Abusive marketing of overdraft fee services for ATM and debit-card transactions;
  - Charging overdraft fees without affirmative consent

## Overall Observations

One Year Later – What to Expect from the CFPB:

- **Slower Regulation and Rulemaking**
  - Greater focus on industry cooperation
  - Goal to establish clear rules of the road
- **Fewer Enforcement and Supervisory Actions**
  - Targeting clear violations of existing law
  - Focus on bad-actor scenarios
  - Debt collection practices remain in the crosshairs

A Different Agency Than the Cordray-Led CFPB

- **Can financial services companies feel comfortable with a more industry-friendly CFPB?**

# Filling the Regulatory & Enforcement Gap

## State Oversight of Financial Services Industry

- State Attorneys General likely to fill in the gap
- Increased State AG action in response to Administration actions
- 2018 Mid-Term Election: Democratic candidates captured 4 new AG positions and retained important offices
  - Democrats Control the Majority of State AGs Offices

## Consequences for Financial Services Companies

- Candidates ran on consumer-protection platforms
- Greater coordination across *more* states' lines
- May pick up Cordray-led Bureau initiatives
- Leaders of state coalitions likely to continue to be the historically active AG offices
  - *E.g.*, New York, California, Illinois, and Massachusetts
- **Know the laws in all states in which you operate**



# Filling the Gap: Private Class Action Litigation

## Pre-2018 CFPB:

- Private class action litigation often followed in the wake of CFPB consent orders and enforcement actions

## Post-2018 CFPB:

- Flip the Script: Plaintiffs' class action attorneys will seek to act where the CFPB will not
  - May bring actions mirroring Cordray-era enforcement actions and consent orders
  - May bring actions based on Cordray-era initiatives abandoned by the Mulvaney-led agency
- Private class action attorneys may follow the lead of State Attorneys General

## Conclusion

### Lessons from the Past Year at the CFPB:

- Retreat from the out-in-front, regulation-through-enforcement approach
- Receptiveness to industry input and cooperation in regulation and rulemaking
- Seeding primary enforcement responsibilities to State Attorneys General

### Risk Remains for Financial Services Institutions:

- The CFPB retains broad UDAAP powers
- State AGs may implement more aggressive and coordinated oversight of the industry
- Plaintiffs' class action attorneys are always in search of new claims

## Presenter Contact Information



Robert W. Sparkes, III  
Partner, Financial Institutions and  
Services Litigation

K&L Gates LLP  
Boston, Massachusetts  
(617) 951-9134  
[robert.sparkes@klgates.com](mailto:robert.sparkes@klgates.com)

## Taking Stock After the Midterms: Policy Developments Affecting the Financial Services Sector

Moderated by: Daniel F. Crowley, Partner K&L Gates LLP

Speakers:

Scott Farnin, Legislative Counsel to Rep. Joyce Beatty (D-OH-3)

Kyle Hauptman, Counselor to Senator Tom Cotton (R-AR)

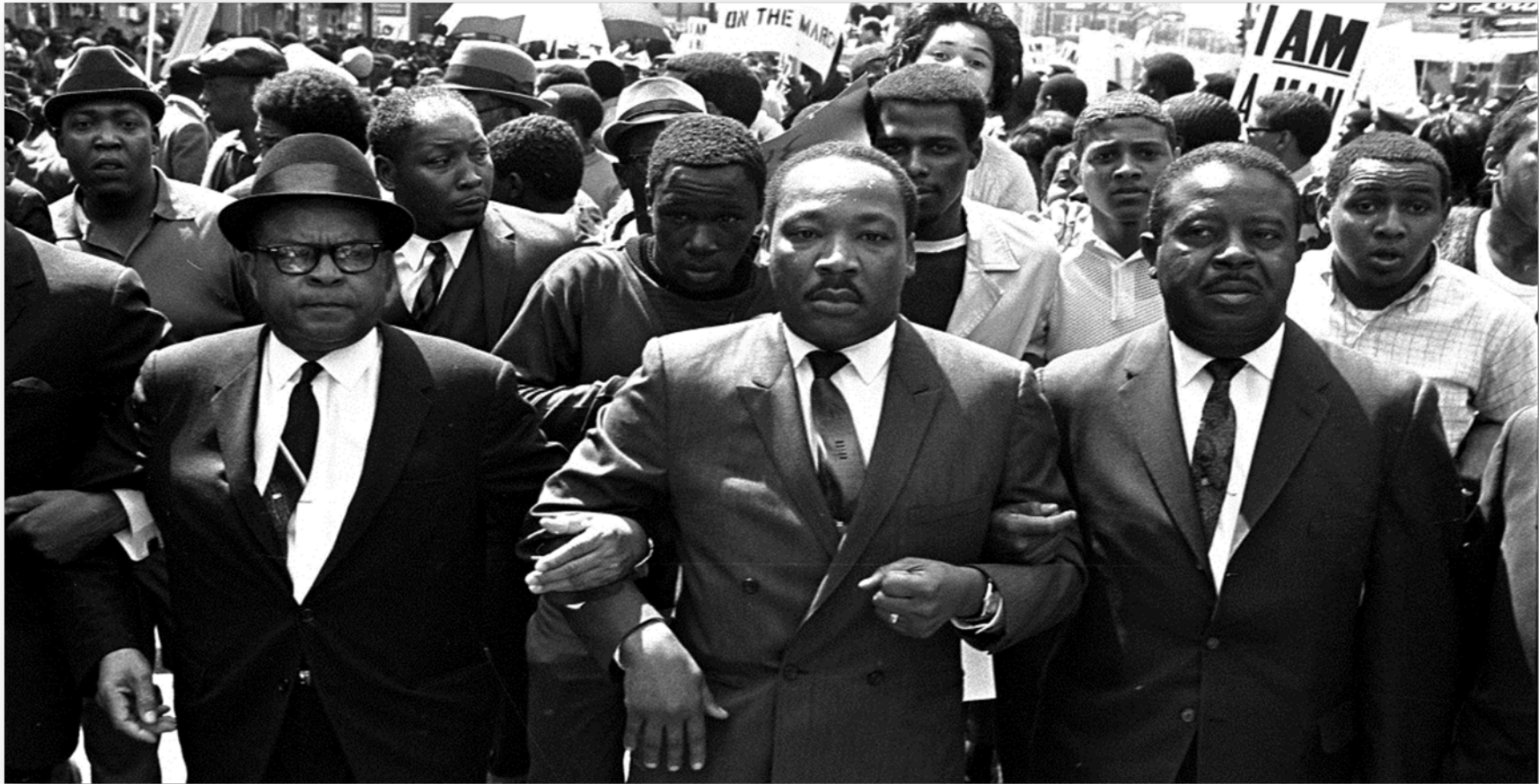
Dennis Kelleher, President & CEO, Better Markets

K&L GATES

## Recognizing the 50th Anniversary of the Fair Housing Act and its Impact on the Mortgage Lending Industry

*Paul F. Hancock*  
*K&L Gates LLP*  
*(305) 539-3378*  
*paul.hancock@klgates.com*







The Weather Index

**The Washington Post**

SATURDAY, APRIL 9, 1944

# 4000 Troops Move Into District After Day of Looting and Arson

### Johnson, Negroes Confer

**John Sweeney, Seattle, Monday Trip Cancelled**

The Council on American-Soviet Friendship, which has been active in the campaign to secure the release of the Soviet prisoners of war, today announced that it had cancelled the trip of John Sweeney, its president, to Seattle, Monday.

Sweeney was scheduled to leave for Seattle today, but the Council announced that it had decided to postpone the trip until after the election in November.

The Council also announced that it had received a letter from the Soviet government, asking that the Council be allowed to send a representative to the Soviet Union to confer with the Soviet government on the release of the prisoners of war.

The Council said that it had agreed to the request, and that it would send a representative to the Soviet Union in the near future.



*Church looters with a telephone wire at 24th Street and Park Road, one of the streets razed during the riot.*



*A small group of persons make its way past the ruins at 24th Street, Irving Street and Park Road.*

### Curfew Imposed As Roving Bands Plunder and Burn

The city today imposed a curfew on all persons in the District after a day of rioting, looting and arson. The curfew is in effect from 10 o'clock tonight to 5 o'clock tomorrow.

The city also announced that it had received a report from the Federal Bureau of Investigation, which said that a group of persons had been seen in the District, looting and burning property.

The city said that it had received a report from the Federal Bureau of Investigation, which said that a group of persons had been seen in the District, looting and burning property.

### Arrest in Slaying 'Close,' Clark Says

The police today announced that they were "close" to making an arrest in the slaying of a man in the District. The police said that they had received a tip from a confidential source, which led them to the suspect.

The police said that they had arrested the suspect, and that they were holding him in custody. They said that they were "close" to making an arrest in the slaying of a man in the District.

### 3 Slain in Chicago, Many Fires Set

Chicago today reported that three persons had been slain and many fires had been set during a riot. The police said that they had received a report from a confidential source, which led them to the suspects.

The police said that they had arrested the suspects, and that they were holding them in custody. They said that they were "close" to making an arrest in the slaying of a man in the District.

### Conditions of Curfew

The city today announced the conditions of the curfew. The curfew is in effect from 10 o'clock tonight to 5 o'clock tomorrow. The city said that it had received a report from the Federal Bureau of Investigation, which said that a group of persons had been seen in the District, looting and burning property.

The city said that it had received a report from the Federal Bureau of Investigation, which said that a group of persons had been seen in the District, looting and burning property.

### Carmichael Warns of 'Retaliation'

The police today warned of "retaliation" against persons who had been seen in the District during the riot. The police said that they had received a report from a confidential source, which led them to the suspects.

The police said that they had arrested the suspects, and that they were holding them in custody. They said that they were "close" to making an arrest in the slaying of a man in the District.



*President and Vice President have Cabinet members for Dr. King.*



*Carmichael, White House (top) declared war.*

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

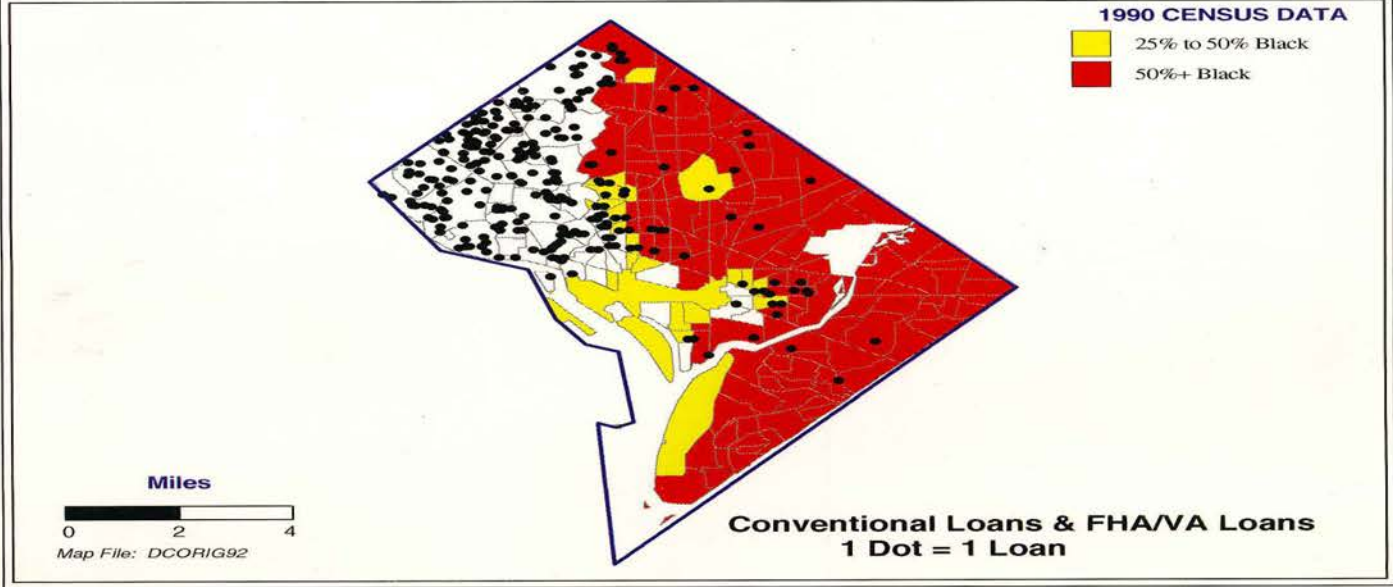


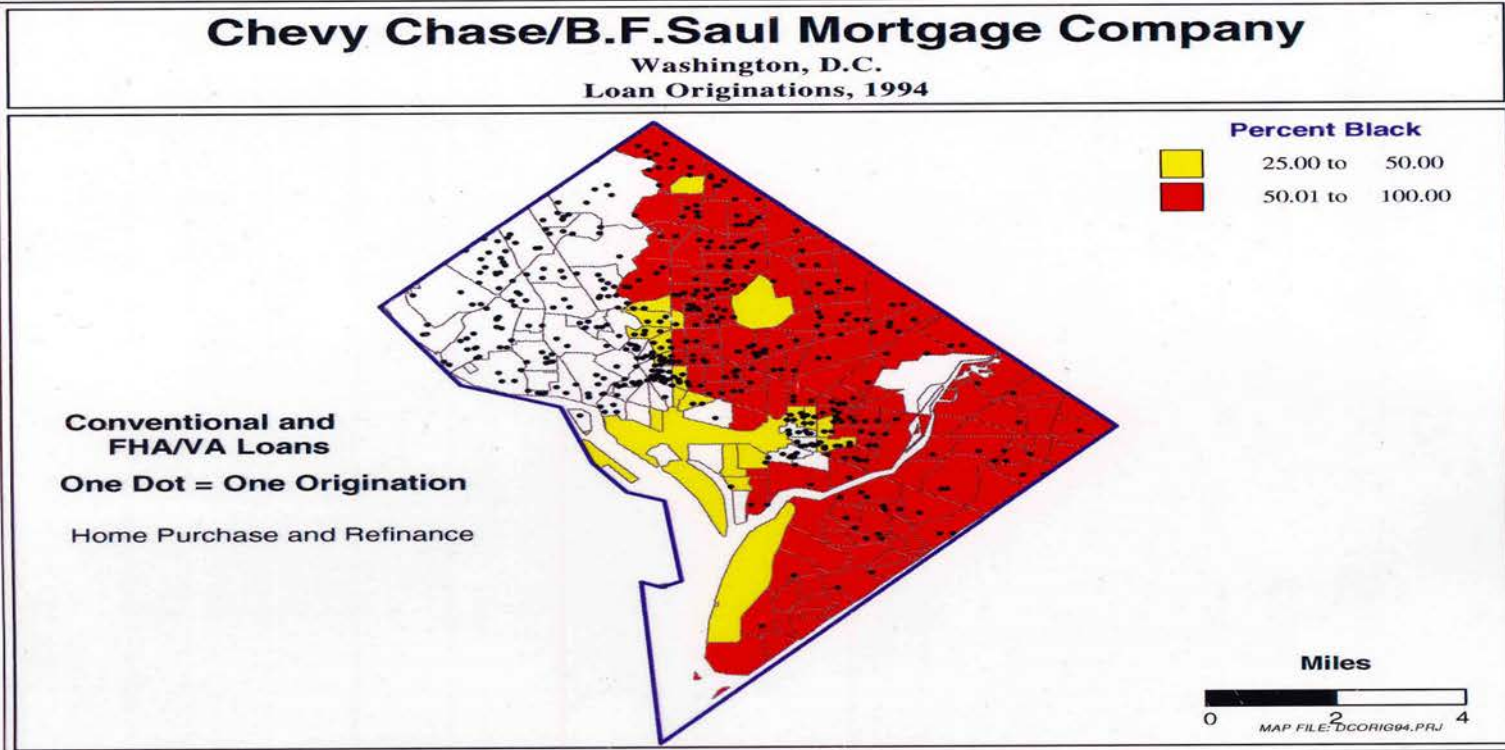




# Chevy Chase/B.F.Saul Mortgage Company

1992 Mortgage Lending (Washington D.C.)







Paul F. Hancock  
Partner, Consumer Financial  
Services

K&L Gates LLP

Miami

(305) 539-3378

[paul.hancock@klgates.com](mailto:paul.hancock@klgates.com)



# The Evolving Regulatory and Litigation Landscape of the FinTech Sector

Moderated by: Dr. Marsha J. Courchane, Vice President, Co-Practice Leader of Financial Economics, Charles River Associates

Speakers:

Melissa Koide, CEO, FinRegLab

Rajini Acharya, Associate, K&L Gates LLP

Andrew C. Glass, Partner, K&L Gates LLP

Jeremy M. McLaughlin, Associate, K&L Gates LLP

Linda C. Odom, Partner, K&L Gates LLP

# Consumer Lending and Alternative Data: Opportunities, Risks, and Challenges

*Presented by*  
*Andrew C. Glass*  
*Partner*  
*K&L Gates LLP*



# Alternative Data

## Meaning and Examples

**Traditional Data:** “data assembled and managed in the core credit files of the nationwide consumer reporting agencies...and credit inquiries, as well as information from public records...It also refers to data customarily provided by consumers as part of applications for credit...” (CFPB)

- Income
- Length of time in residence
- Public records relating to civil judgments, tax liens, and bankruptcies
- Tradeline information
  - Certain loan or credit limit information, debt repayment history, and account status

## Meaning and Examples

**Alternative Data:** “any data that is not ‘traditional’ data” (CFPB)

- Telecommunications, utility, or rent payments
- Educational attainment
- Employment history
- Account transaction history (deposits, withdrawals, and transfers)
- Other data (social media posts and relationships, and online purchasing patterns)

## Alternative Data is a Spectrum

Not all alternative data are equal and many institutions are using more “traditional” types of alternative data rather than more “experimental” types of alternative data

### “Traditional” Alternative Data

- Rent payment history
- Telecommunications and utility payment history
- Insurance payment history
- Change of addresses
- Internal data regarding the applicant’s asset and transaction data
- Educational Attainment

Some “traditional” alternative data is available in consumer credit files

# Alternative Data is a Spectrum

## “Experimental” Alternative Data

- Social media posts
- Social media likes/dislikes
- Members of friend networks and friend-group online history
- Online shopping history
- Historical location information
- Web-browsing patterns
- Lack of online presence

## Traditional and Alternative Modeling

**Traditional Modeling:** “statistical and mathematical techniques, including models, algorithms, and their outputs, that are traditionally used in automated credit processes, especially linear and logistic regression methods.” (CFPB)

**Alternative Modeling:** “all other modeling techniques that are not ‘traditional’” (CFPB)

- Decision trees and random forests
- K-nearest neighbor
- Artificial intelligence and machine learning

# The CFPB's Interest in Alternative Data

## CFPB's Request for Information

CFPB published RFI regarding alternative data in February 2017

CFPB sought feedback on benefits and risks of alternative data, specifically regarding

- Access to credit for more than 25 million “credit invisible” consumers
- The impact on the complexity of the lending process
  - Including credit decision notices
- The impact on the cost and service of lending
- The implications for data privacy and security
- The impact on specific groups, particularly:
  - military members, minorities, and residents of low-income neighborhoods



# CFPB's Initial Thoughts

## Benefits

- Increase access to credit for those with or without credit scores
- Expand access to more timely borrower information
- Decrease lending costs through automation

## Risks

- Difficult to correct inaccuracies or identify the source of adverse data
- Lack of transparency in modeling
- Use of data that does not reflect actions the consumer can change
  - Such as data related to peer group rather than the borrower herself
- Difficult to predict what behaviors will be inappropriately penalized or rewarded

## CFPB's Initial Thoughts

### Risks (cont'd)

- Privacy
- Data quality
- Discrimination
  - Particularly where machine learning is used
- Potential liability under ECOA, FCRA, and UDAAP statues

# Public Comments to the RFI – Industry Response

## Mortgage Bankers Association

- Advocated the creation of a regulatory “sandbox” providing ability to test new ideas with some degree of regulatory protection – No-Action Letter Program insufficient
- Raised concerns about potential for UDAAP liability

## American Bankers Association

- Expressed optimism that alternative data can improve credit access
- Raised concerns of banks’ risks under ECOA and Fair Housing Act
- Recommended increased protections under the No-Action Letter Program

# Public Comments to the RFI – Industry Response

## FICO

- Incorporates alternative data such as utility, telecom, and rent payments in scoring systems, either:
  - where the information is included in a consumer credit file, or
  - where not in a credit file and used in FICO's alternative data scoring model
- Stressed importance of using FCRA-compliant data – for example, data from sources with processes in place to investigate and respond to consumer disputes in a timely with manner
- Stressed importance of using data that is demonstrably and statistically predictive of individuals' creditworthiness
- Pointed out the risk of data integrity

# Public Comments to the RFI – Industry Response

## TransUnion

- Believes use of alternative data can help responsibly expand credit access
- Currently collects some alternative data
  - Actual loan payment amounts vs. amounts due
  - Telecommunication and utility payment information
  - Public records
  - Rent payments and checking account management
- Stressed importance of using FCRA-compliant data

## Public Comments to the RFI – Consumer Advocacy Response

### American Civil Liberties Union

- Concerned that alternative data will be used in targeted marketing to advertise less advantageous credit products to minorities

### National Consumer Law Center

- Concerned that alternative data may be inaccurate and will result in disparate impact on minorities

### Leadership Conference on Civil and Human Rights

- Support the use of alternative data, provided it is predictive, interpretable, and benefits low-income and minority consumers

### Illinois Attorney General

- Encouraged the CFPB to issue guidance stating that failure to consider high-projected default rates from underwriting models is a UDAAP violation

# Benefits and Risks Summary

## Benefits might include:

- More accurate credit pricing
- Expanded consumer pool
- Access to more timely information
- Improve automation of modeling
- Improve fraud prevention efforts

## Risks might include:

- Fair lending issues
- FCRA issues
- UDAAP issues
- Privacy issues

**CFPB Project Catalyst, No-Action Letter  
Program, and Upstart Network, Inc.  
No-Action Letter**



# CFPB Project Catalyst and No-Action Letter Program

## CFPB's Project Catalyst

- Pitch a pilot program
- Trial disclosure of information program
- No-Action Letter program

## CFPB's No-Action Letter Program

- Program to facilitate consumer-friendly innovations
- Letters state the CFPB's present intention not to bring an enforcement action but also includes strict parameters
- Granted on a case-by-case pursuant to an application

# The Upstart Network, Inc. No-Action Letter

## Upstart Network, Inc.

- Online lending platform that connects applicants and Cross River Bank
- Uses traditional and (some) alternative data in automated underwriting model
- Evaluates applicants' credit risk and makes a recommendation to bank
- Requested a no-action letter from the CFPB regarding ECOA and Reg. B

## The CFPB's No-Action Letter

- Issued in Sept. 2017: CFPB's 1<sup>st</sup> no-action letter
- Upstart agreed to provide CFPB with data and to abide by the facts as stated in the letter
- Letter in effect for three years

# Limitations of the No-Action Letter Program

## Narrow Application

- Only applies to Upstart's underwriting model as described
- Only applies to ECOA and Reg. B regulations

## Not Binding

- The CFPB can modify or rescind the letter, can supervise and investigate for compliance, and initiate a retroactive enforcement action if the terms are violated
- The letter is not binding on other federal agencies, state regulators, or private litigants

## Limited Insight

- The CFPB did not elaborate on its decision to grant the no-action letter
- The letter only applies to ECOA and Reg. B so it does not provide insight as to whether the CFPB will grant a no-action letter for other issues such as FCRA

# Regulatory Risks and Challenges

# Fair Lending Risks and Challenges

## Disparate impact considerations under Fair Housing Act and ECOA/Reg. B

- Expensive to investigate whether or not use of alternative data may have caused disparate impact
  - Analysis more complex when a lender relies on a third-party's underwriting model
  - Some data cannot be easily separated, which presents further difficulties
- Whether alternative data will result in disparate impact is difficult to predict and issues will arise several years after such data is used
- Uncertain whether use of alternative data constitutes legitimate business justification
- Risk that traditional modeling or use of different variables will constitute a less discriminatory alternative

Adverse Action Notice under ECOA – Likely needs to explain how alternative data led to adverse decision

# FCRA Risks and Challenges

## Adverse Action

- Must disclose the alternative data that were key factors in adversely affecting the consumer's credit score, but a third-party's model may make this determination difficult or the third party may not share the requisite information
- Must disclose the data used if provided by a non-CRA third party and, upon written request by the consumer, but third parties may not know all of the inputs of their data

## Risk-based Pricing Notice

- If a credit score is used, must disclose alternative data that were key factors in adversely affecting the consumer's credit score, which may be difficult, particularly if working with third parties who provide modeling

Do furnishers of alternative data who are not CRAs have adequate infrastructure to address disputes? Are those furnishers FCRA-compliant?

## UDAAP Risks and Challenges

Certain alternative data may be asserted to abusive or unfair effect

- Data from peer groups could be unfair since the consumer cannot change that behavior, or data that a consumer would not expect to be used, such as shopping history or social media activity
- Liability could arise when using a third-party's model

Could be asserted that it is abusive or unfair if consumers do not understand the source of the error because they have a right to dispute the accuracy of data

- Consumers may claim to have a hard time protecting their interests if they don't understand how certain data affect their creditworthiness
- Complexity and transparency of modeling may be an issue

## UDAAP Risks and Challenges

- Lack of transparency in what data is used and how it is used could be asserted as being deceptive, depending on advertising
- Difficulty in explaining the reason for credit decisions in the Adverse Action may be asserted as constituting an unfair practice because it would prevent a consumer from exercising their dispute rights
- Use of certain alternative data could increase pressure on CFPB to bring data breach cases



# Conclusions

## Concluding Thoughts

CFPB No-Action Letter Program provides limited and restricted benefits

The same questions the industry has about creditors' potential liability under fair lending laws, FCRA, and UDAAP, among others, remain

State laws may also be implicated

### Considerations

- Understand how alternative data impacts credit decisions
- Understand source of alternative data – i.e., from FCRA-complaint entities
- Understand potential risks for fair lending claims and be cognizant of UDAAP

K&L GATES

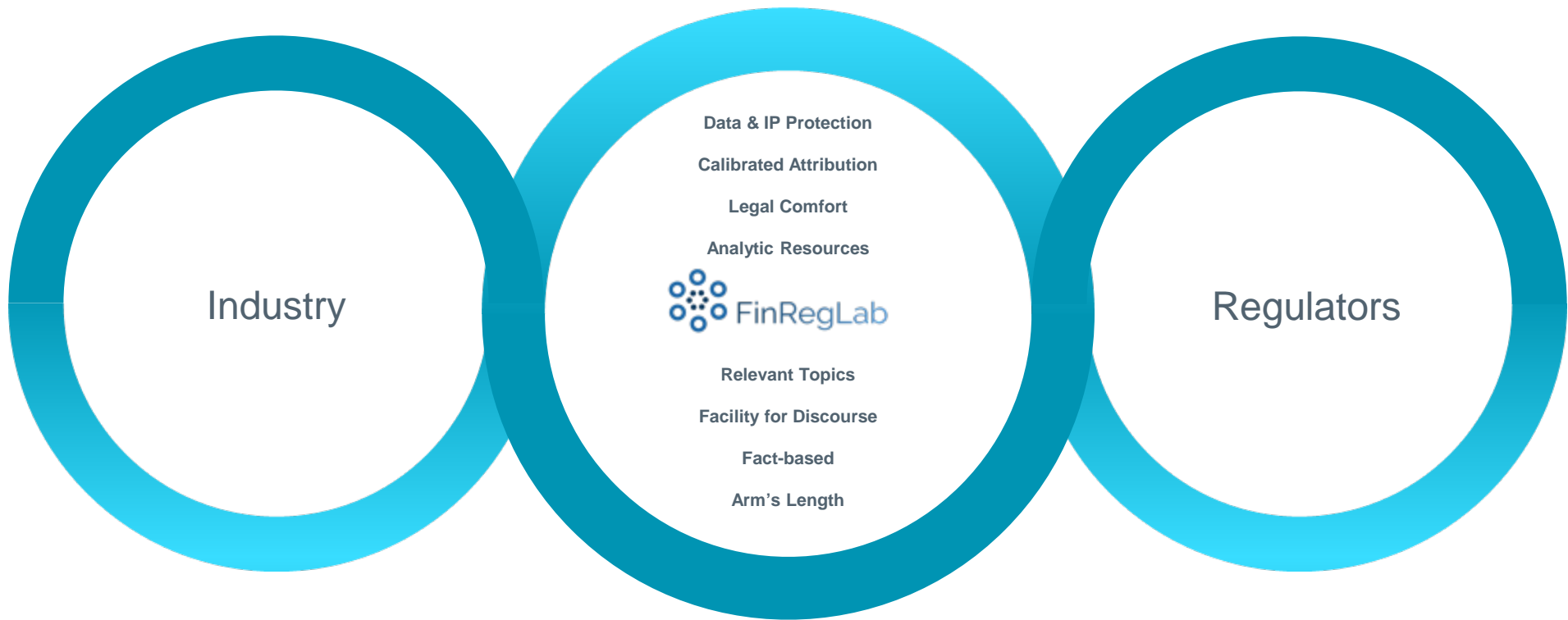
**THANK YOU**

Andrew C. Glass  
Partner  
K&L Gates LLP  
617-261-3107  
[andrew.glass@klgates.com](mailto:andrew.glass@klgates.com)

# Consumer Lending and Alternative Data: Policy

*Presented by:*  
*Melissa Koide*  
*FinRegLab*

# OUR UNIQUE ROLE



## OUR CORE PROCESS



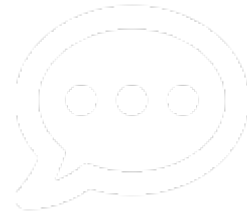
We **identify key topics** in partnership with policymakers and input from other stakeholders.



We collaborate with experts and researchers to design and **field high-priority, policy-relevant experiments.**



We **share the facts and insights** with stakeholders to inform public policy.



# FinRegLab Experiment Update

# CASH FLOW DATA IN UNDERWRITING EXPERIMENT

We have **four lenders participating** in the cash flow data experiment.

Petal, LendUp, Brigit, and Kabbage will contribute loan-level data to assess the lift of including cash flow data in credit underwriting.

## Petal

- An unsecured credit card for thin and no-file consumers. Product rolling out now.

## LendUp

- Short-term loans as a payday alternative. Focuses on the lower end of the credit spectrum.

## Brigit

- An automatic short-term loan that serves as a safety net to bridge cash flow gaps and avoid overdraft fees.

## Kabbage

- Small business lender providing timely working capital loans.

## Additional Consumer Lender

- FinRegLab will announce soon.

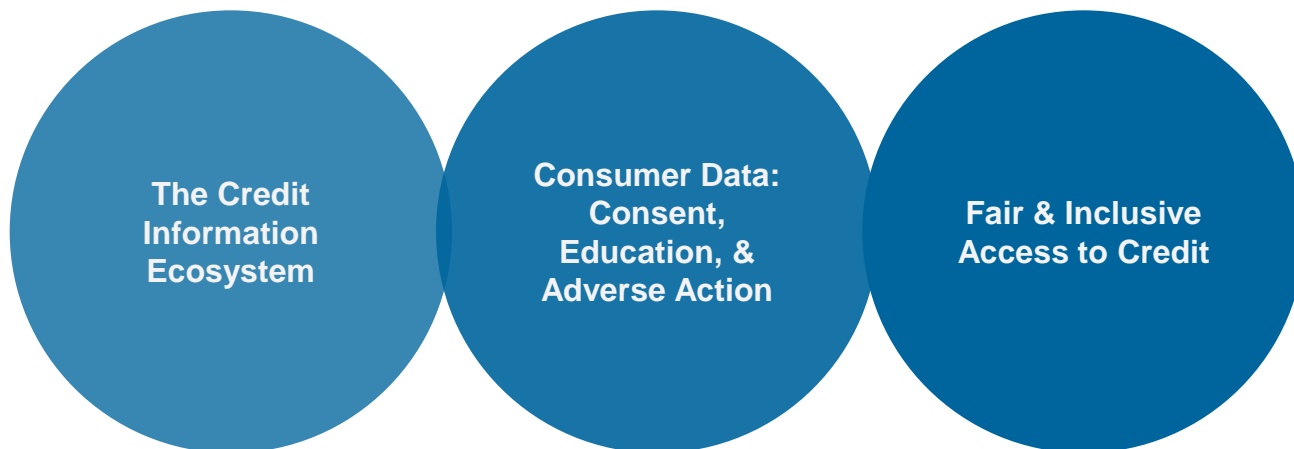




## POLICY WORKING GROUPS

We have established three cross-sector Policy Working Groups, each considering the regulatory and policy implications of cash flow data in credit underwriting for a given topic area.

The Working Groups are running parallel to the experiment.



# THE CREDIT INFORMATION ECOSYSTEM

This group is focusing on the **interplay between the evolving credit information ecosystem and the principles and requirements of the Fair Credit Reporting Act (“FCRA”)**.

Which participants are responsible for ensuring the accuracy of information in the credit ecosystem and does FCRA suffice in allowing for the use of cash flow data in credit underwriting?

Should data sources and intermediaries be subject to the FCRA?

How can the credit information ecosystem be more transparent and understandable to borrowers?

## CONSUMER DATA: CONSENT, EDUCATION, AND ADVERSE ACTION

This group is focusing on **consumer consent, consumer education, and required disclosures, like adverse action notices.**

At what points and in what form does consumer consent need to be obtained to enable use of cash flow data?

What kind of information should consumers be given when cash flow data consent is sought?

What efforts should be made to inform consumers about the changing credit information ecosystem?

## FAIR & INCLUSIVE ACCESS TO CREDIT

This group is focusing on **fair and inclusive access to credit when cash flow data** is used in consumer and small business **credit underwriting**.

What are the major policy and regulatory considerations raised to promote and ensure both fair and inclusive access to credit?

How might policymakers contemplate disparate impact risks when new types of data are used in underwriting that expand credit to thin file and no file consumers (borrowers who would have otherwise been declined or priced higher)?

What policies and strategies (like special purpose credit programs) could help to address credit access needs?

## Key Fintech Regulatory Challenges: Money Transmitter Laws, Cryptocurrency, and Sandboxes

*Presented by*

*Linda Odom, Partner*

*Jeremy McLaughlin, Associate*

*K&L Gates LLP*

## THE BROAD SCOPE OF MTL LAWS

Any service that involves issuing a payment instrument or moving money must take money transmitter licensing laws into account.

Unlicensed money transmission can give rise to substantial fines.

### Examples:

- Mobile wallets that store funds
- Bill or loan payment facilitation service
- Services that facilitate payments from one payment method to another – e.g. P2P payments across platforms
- Cryptocurrency exchange

# STATE MONEY TRANSMITTER LAWS (“MTL”)

49 state laws with consumer protection purpose

Typically regulate nonbank entities that:

- Receive and transfer consumer funds, or
- Issue or sell payments instruments/stored value

General compliance requirements

- Minimum capitalization and bonding
- Fingerprinting, background checks
- AML compliance
- Reporting and examination

## MTL ANALYSIS / STRUCTURING

Step 1 – Decide what role you want to have. A technology company or a financial services company?

Hint: Shoot for technology company

Step 2 – Diagram funds flow including each party and each bank account that will hold funds

Hint: Try not to own or control a bank account in the flow

Step 3 – If it looks like you will need licensing, try to restructure the flow to avoid it.



# Money Transmitter Licensing Requirements

If you are at risk of needing licensing, can you qualify for an exemption?

A state by state inquiry.

Exemptions recognized by a number of states:

- Agent of bank
- Agent of licensee
- Agent of payee
- Payment processor

Each has limits. Interpretations can narrow over time.

# MTL DEVELOPMENTS AND CONSIDERATIONS

New law in South Carolina – only Montana left

CSBS announces compact among states for applications

State law amendments: approximately 6 this year

Notable enforcement actions

# MTL AND CRYPTOCURRENCY

27 states affirmatively do or do not regulate crypto

- Statutory amendments
- Regulatory guidance

Crypto licensing triggers

- Receiving crypto for transmission
- Engaging in transmission or exchange involving crypto & fiat
- Issuing or selling crypto
- Exercising control or custody over crypto

# MTL ALTERNATIVES

## OCC Fintech charter

- Key benefits
  - One regulator/federal preemption
  - Payment processing
  - Avoiding Bank Holding Company
- Key burdens
  - OCC oversight
  - Heightened AML requirements

Status of charter unclear

# MTL ALTERNATIVES CONT.

## State initiatives

- Arizona Regulatory Sandbox
  - Licensing relief for “innovative financial products or services”
  - Applies to wide range of companies
  - Program requirements
- Other state attempts

## BCFP trial disclosure sandbox

# Intellectual Property Strategies for FinTech

*Presented by  
Ranjini Acharya  
Associate  
K&L Gates LLP*

## Key Points

### IP Strategies for FinTech: Best Practices under Current US Law

- Getting to Know Your IP
  - Copyright, Trademarks, Patents – Oh My!
  - Trade Secrets: Evolving Protections
- IP Strategies
  - Patents vs. Trade Secrets
  - Protecting Your Trade Secrets
  - IP Registration

## Key Points

### Intellectual Property Strategies for FinTech

- **Getting to Know Your IP**
  - **Copyright, Trademarks, Patents – Oh My!**
  - **Trade Secrets: Evolving Protections**
- IP Strategies
  - Patents vs. Trade Secrets
  - Protecting Your Trade Secrets
  - IP Registration



# Getting to Know Your IP - Copyright

- Protects the expression of an idea
- “Works”
  - Computer Code
  - Visual Interface Features
  - Audio or Video Guides
- No formal registration required
- Life of author plus 70 years

# Getting to Know Your IP - Trademarks

- Source Identifiers
  - Name of a company
  - Name of a product offering
- No formal registration required
- If registered, renewable every 10 years based on use

# Getting to Know Your IP - Patents

- Novel, non-obvious, useful process, machine, manufacture, composition of matter
- Must be registered
- Run from 20 years of filing date
  - Right to exclude others from making, using, or selling the patented technology for that period

**Laws of nature**

**Natural phenomena**

**Abstract ideas**

- Fundamental economic practices
- Mathematical formulas
- Software that simply implements an otherwise abstract idea

# Getting to Know Your IP - Patents

## Patent Eligibility

- *Alice Corp. v. CLS Bank International*, 134 S. Ct. 2347 (2014)
  - Claims to a computer-implemented, electronic escrow service for facilitating financial transactions invalid as an abstract idea ineligible for patent protection
- Business methods are capable of being patented in the United States (although post-Alice they may face greater hurdles) but in Europe they are per se unpatentable unless they can be shown to solve a 'technical problem'.

## Getting to Know Your IP – Trade Secrets

- Newly created federal statutory cause of action:
  - A formula, practice, process, design, instrument, pattern, commercial method, or compilation of information;
  - Which is not generally known or reasonably ascertainable by others; and
  - By which a business can obtain an economic advantage over competitors or customer
- Protection lasts so long as secrecy is maintained and information derives independent economic value from not being general known or readily ascertainable

## Key Points

### Intellectual Property Strategies for FinTech

- Getting to Know Your IP
  - Copyright, Trademarks, Patents – Oh My!
  - Trade Secrets: Evolving Protections
- **IP Strategies**
  - **Patents vs. Trade Secrets**
  - **Protecting Your Trade Secrets**
  - **IP Registration**

# IP Strategies

## Patents versus Trade Secrets

- Maintain both patent protection and trade secret protection on the same technology
  - Considerations for election of patent protection
    - Material that is easily reverse engineered
    - Material where amending claims over time is helpful
    - Material where Doctrine of Equivalents is valuable
    - Material that is plainly patent eligible subject matter
    - Material where secondary considerations of non-obviousness exist (e.g., mature market with clear nexus)

# IP Strategies

## Patents versus Trade Secrets (2)

- Maintain both patent protection and trade secret protection on the same technology
  - Considerations for election of trade secret protection
    - Material that is difficult to reverse engineer (e.g. source code)
    - Material that is unlikely to change
    - Material that required substantial work in reduction to practice
    - Material where development team is very small
    - Material where secondary considerations of non-obviousness may not yet exist (e.g., young markets or difficult nexus)



# IP Strategies

## Protecting Your Trade Secrets

- Maintain standard practices for documenting breakthroughs:
  - Document breakthroughs and contributors, including those with access.
  - To the extent possible, document in real-time.
  - Explain to researchers that difficult problems, even if minor relative to overall product, can be some of the best kinds of trade secrets (e.g. how to attach wheels can be the key to building a car).

# IP Strategies

## Protecting Your Trade Secrets (2)

- Establish and document measures to protect trade secrets:
  - Develop and publish site security policies.
  - Document confidentiality policies.
  - Deploy NDAs and other contractual mechanisms.
  - Develop and enforce device control policies.
  - Maintain physical and electronic controls on document access.
  - Conduct exit interviews for departing employees and poll team members contemporaneously.

# IP Strategies

## IP Registration

- Patent protection may be available if the innovation generates discernible or tangible results
  - For example: innovation that enhances security, improves resource usage, increases network reliability, or generates inventive display interface features.
- Copyright protection is also available for source code, website, and customer interface look and feel.
- Trademarks function as an indispensable brand differentiator in the marketplace.

## Cybersecurity, Privacy and Data Breach: Understanding and Managing Risk

Moderated by: Dave Christensen, Partner, K&L Gates LLP

Speakers:

Courtney Stout, Chief Privacy Officer, S&P Global

Ross Parker, Global Privacy Strategist, S&P Global

Kevin Kirst, Principal, Charles River Associates

Julia Jacobson, Partner, K&L Gates LLP

Jonathan Cohen, Partner, K&L Gates LLP

## 2018 Notable Developments in Privacy and Cybersecurity – U.S. and International

Courtney Stout, Chief Privacy Officer, S&P Global  
Ross Parker, Global Privacy Strategist, S&P Global  
Julia Jacobson, Partner, K&L Gates LLP

# 2018 Notable Developments in Privacy and Cybersecurity – United States

## 2018 NOTABLE DEVELOPMENTS – UNITED STATES

- Securities and Exchange Commission (SEC)
  - Statement and Guidance on Public Company Cybersecurity Disclosures (Feb. 21, 2018)
    - SEC announced that Yahoo! Inc. “agreed to pay a \$35 million penalty to settle charges that it misled investors by failing to disclose one of the world’s largest data breaches” (April 24, 2018)
  - Identity Theft Red Flags Rule enforced (September 26, 2018)

### Federal Trade Commission (FTC)

- “Mobile Security Updates: Understanding the Issues” (Feb 28, 2018)
- Cybersecurity for Small Businesses – series of guides
- Informational injury (Oct 19, 2018)

# 2018 NOTABLE DEVELOPMENTS – UNITED STATES

## Pending federal developments

- Cybersecurity Disclosure Act – requires a publicly-traded company to disclose whether any board member has expertise in cybersecurity and, if not, what actions the board has implemented to prioritize cybersecurity.
- U.S. Department of Commerce’s National Telecommunications and Information Administration (NTIA)
  - Issued a Request for Comments on consumer privacy framework focused on outcomes vs. prescriptive mandates.
- Federal Privacy Law
  - Senate Hearing (September 26, 2018)
  - Various proposed laws



## 2018 NOTABLE DEVELOPMENTS – U.S. STATES

### New York Department of Financial Services

- March 1, 2018 – One year transitional period ended
- September 4, 2018 – Eighteen month transitional period ended
- March 1, 2019 – Two year transitional period ends.

### California Consumer Privacy Act

- Enacted June 2018 and amended September 2018

### Ohio Cybersecurity Law (October 3, 2018)

- A legal ‘safe harbor’ (affirmative defense to tort claims) to covered entities that voluntarily implement a cybersecurity program based on “industry recognized cybersecurity frameworks,” which include NIST and ISO 270001.

## 2018 NOTABLE DEVELOPMENTS – U.S. STATES

Vermont Data Broker Law

New Information Security Laws , e.g., Colorado, Iowa and Nebraska

Data Breach Laws

- Amended in Arizona, Colorado, Louisiana and Oregon
- Alabama and South Dakota – final states to enact data breach notification laws

Litigation under Illinois Biometric Privacy Act

# 2018 Notable Developments in Privacy and Cybersecurity— outside the United States

# 2018 NOTABLE DEVELOPMENTS – OUTSIDE THE UNITED STATES

## GDPR - key differences for U.S. Organizations

Broad definition of “personal data”

Requires “lawful basis” for processing personal data

- Legitimate business interest analyses

Requires **Data Protection Impact Assessment (DPIA)** when “high risk” processing, e.g., when data is processed by new technology

Requires **Lead Supervisory Authority** or **Representative**

*May* require a **Data Protection Officer** (who has “expert knowledge,” directly reports to “highest management level” and no conflict of interest) and/or **Record of Processing**

# 2018 NOTABLE DEVELOPMENTS – OUTSIDE THE UNITED STATES

## GDPR - key differences for U.S. Organizations

- Data Subjects Rights and Responses
  - **Right to Erasure** (a.k.a. Right to be Forgotten) – Right to request erasure of personal data “without undue delay” if the data is no longer needed, the data subject objects to the processing or the processing was unlawful.
  - **Data Portability** – Right to receive personal data processed through “automated means” in a commonly used and “machine-readable” format
  - **Right of Access** – Right to know what personal data is processed and why

## Data Processing Agreements – GDPR Article 28

# 2018 NOTABLE DEVELOPMENTS – OUTSIDE THE UNITED STATES

## GDPR - key differences for US Organizations

### Personal Data Breach under GDPR

Controller vs. processor obligations

Controller – the standard for notification to *supervisory authorities* is a breach that is likely “to result in a **risk** to the rights and freedoms of natural persons.”

- Notice is required “without undue delay and, where feasible, **not later than 72 hours.**”
- Processor – notify controller “without undue delay.”

Controller – The standard for notification to *data subjects* is a breach that is likely to result in a “**high risk** to the rights and freedoms of natural persons.”

- Notice is required “without undue delay.”

# 2018 NOTABLE DEVELOPMENTS – OUTSIDE THE UNITED STATES

## Countries with Laws like GDPR

### Countries with “adequacy determinations” (EU designation)

- Andorra, Argentina, Canada (commercial organizations only), Faroe Islands, Guernsey, Israel, Isle of Man, Jersey, New Zealand, Switzerland, Uruguay and the United States (limited to the Privacy Shield framework)
- **Japan** – announced during 2018
- **Korea** – in process
- **Brazil** – NEW – applies to the personal data of Brazilians regardless of the location of the entity collecting the data
- **India** – PROPOSED

## 2018 NOTABLE DEVELOPMENTS – OUTSIDE THE UNITED STATES

Canada's New Data Breach Notification Law – effective  
November 1st

If an organization suffers a “breach of security safeguards”  
that gives rise to a “real risk of significant harm”

- Must (i) report the incident to the Office of the Privacy Commissioner of Canada; (ii) notify affected individuals; and (iii) notify any other third party organizations or government institutions that are in a position to mitigate the risk of harm to affected individuals
- Notifications must be made as soon as feasible after the organization determines that the breach has occurred
- “significant harm” is defined to include humiliation, damage to reputation or relationships, loss of employment or other opportunities, financial loss, identity theft, negative effects on the credit record, and damage to or loss of property



K&L GATES

CRA Charles River  
Associates

## Cybersecurity and Incident Response Insights 2018

Kevin Kirst, Principal – Forensic Services, Charles  
River Associates

# Cybersecurity and Incident Response Insights 2018

# Threat Actors and Threats



Criminals



Hacktivists



Criminal Hackers



Competitors



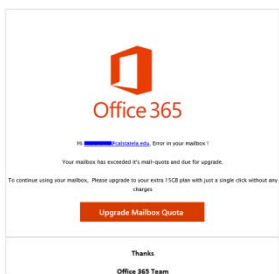
Foreign Nations



Disgruntled Employees

Mass Untargeted

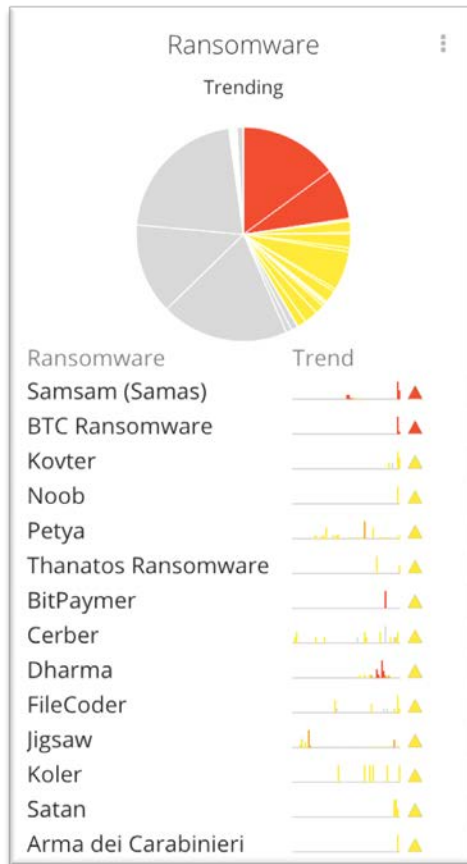
Targets Individuals



# CRA's 2018 Trends and Insights – Ransomware

## Ransomware

- All Year Round
- Smaller Targets: Small Business, Schools, Insurers, etc
- More Actors, More Destructive (DharmaCrysis)
- Actors getting lazy and smarter...“Malware for hire”
- Nation State cash opportunities
- Higher Ransom Demands 600k+
- More demand for remediation



# CRA's 2018 Trends and Insights – Business Email Compromise and Extortion

## BEC

All year

Average 3-5 per week

Target: Office 365

Leaked Credentials

No 2FA or MFA Enabled

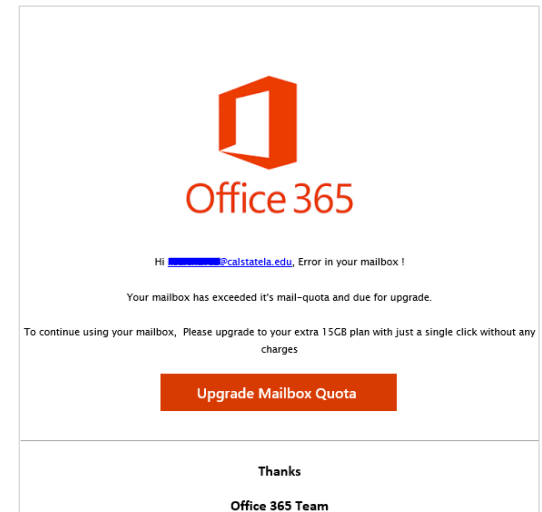
Majority Activity Originating from Nigeria

## Extortion

Beginning of the year

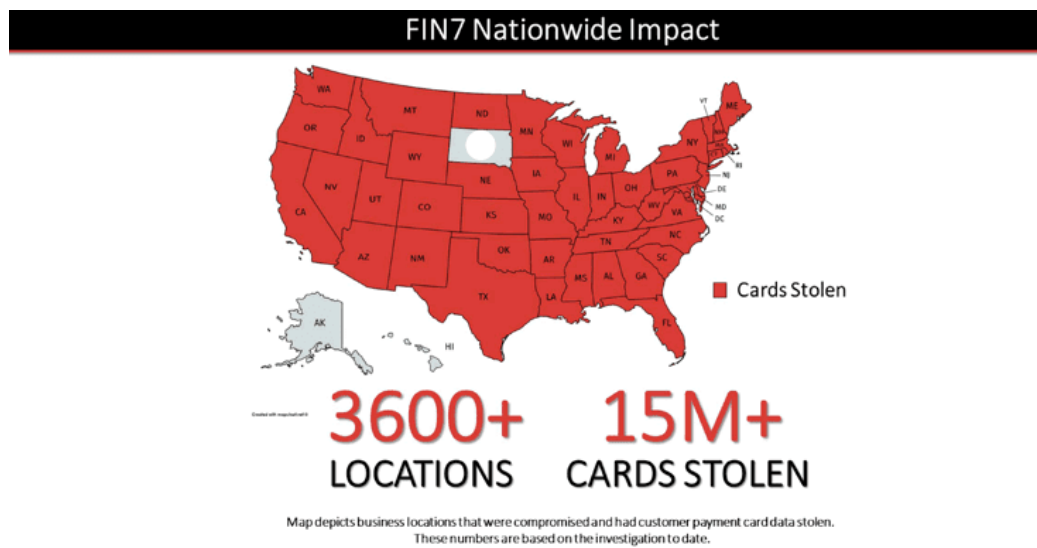
Traditional and Sextortion

Email Notification



# CRA's 2018 Trends and Insights – Advance Persistent Threats

- Lower volume, but greatest impact
- Very difficult to detect, takes more time (months vs weeks)
- Nation State Actors (Part Time)
- Selection of targets changing



## CRA's 2018 Trends and Insights – Financial Industry

- Often more mature due to regulation
- Higher budgets, more resources
- Responding to False Positives
- Support for Strategic Cyber Assessments
  - Compromise Assessments
  - Pen Testing/Red Teaming
  - Cloud Security Assessments
  - Insider Threat Assessments



# CRA's 2018 Trends and Insights – Proactive Trends

Cybersecurity Assessments

Managed Services

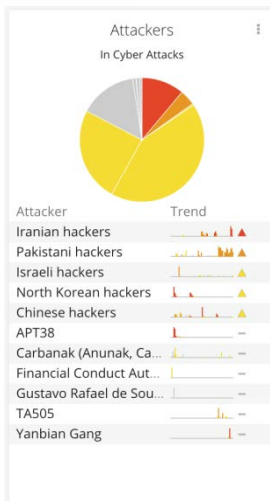
Cloud Security Reviews

Leverage of External Experts

Establishing Incident Response Retainers

Threat Intelligence

## Attacks Stopped



src	src.port	dst	dst.ip	dst.port
176.115.155.99:63915	63915	192.168.0.100:80	192.168.0.100	80
87.117.59.69:2502	2502	192.168.0.100:80	192.168.0.100	80
85.114.17.218:53207	53207	192.168.0.100:80	192.168.0.100	80
193.93.217.30:63116	63116	192.168.0.100:80	192.168.0.100	80
195.91.238.114:59004	59004	192.168.0.100:80	192.168.0.100	80
178.234.75.29:50375	50375	192.168.0.100:80	192.168.0.100	80
95.58.111.228:55961	55961	192.168.0.100:80	192.168.0.100	80
95.81.196.170:57216	57216	192.168.0.100:80	192.168.0.100	80
176.49.112.131:54241	54241	192.168.0.100:80	192.168.0.100	80

End Point – Network – Threat Intelligence



## Some Thoughts on 2019

- Cyber breaches will continue with more SMB impacted
- Law Firm targets to increase
- Cyber Insurance market will increase
- Cyber Insurance claims will continue to rise
- Threat Actors will continue to move down the food chain
- Malware as a service will play a large role in Ransomware
- Community will continue to evolve with proactive assessments, investments in advanced tool sets, and managed services

## TAKING THE BYTE OUT OF CYBER LOSSES: TRENDS IN INSURANCE COVERAGE FOR CYBER-RELATED RISKS

**Jonathan M. Cohen**

Partner

K&L Gates LLP

Washington, D.C.

(202) 778-9103

[jonathan.cohen@klgates.com](mailto:jonathan.cohen@klgates.com)

December 3, 2018

## Goals

Improve the legal side of cyber risk management

Understand what coverage may be available for cyber losses and liabilities

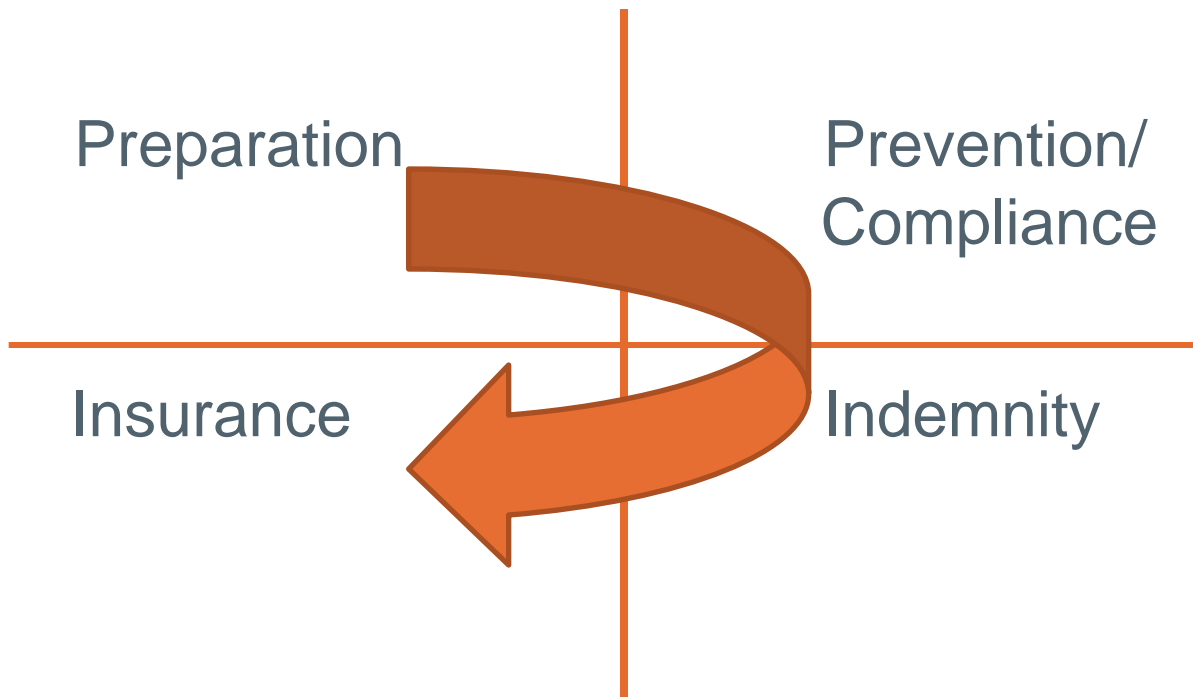
Prepare for insurance claims and disputes

# THE LEGAL SIDE OF CYBER-RISK MANAGEMENT

Breadth of “cyber liability”

- Data breaches (GDPR)
- Malware
- Cyber extortion
- DDOS/DOS attack
- Social engineering/phishing
- New horizons

# THE ROLE OF INSURANCE



## DETAILS, DETAILS, DETAILS

NOT: “I’m worried about cybercrime.”

BUT: “I’m concerned about:

- Third-party phishing attacks
- Rogue employees stealing data
- Data breaches by foreign agents . . . .”

## WHAT TO DO

Risk assessment/insurance audit

Pre-incident consulting coverage

Review indemnities too

## TRENDS IN CYBER COVERAGE

Historic use of standard policies

Possible coverage gaps under standard policies

Rise of specialty cyber policies



## ROLE OF STANDARD POLICIES

Broad Range of Risk = Broad Range of Policies

GL

D&O

Property/BI

E&O

Crime/Fraud

Media Liability

Trends – 2018 was eventful! Some examples:

- Bitcoin/cryptocurrency – covered property (property)
- Phishing – computer fraud (crime/fraud)
- Third-party publication ≠ advertising injury (GL)

**Beware gaps in coverage under standard policies**

# ROLE OF CYBER POLICIES IN 2019 AND BEYOND

What are cyber policies:

- Variation
- Quickly changing
- New Risks

Buyers' market?

# FIRST-PARTY COVERAGES

Cyber extortion

Incident response

Network interruption/security

Digital asset restoration/repair

## **THIRD-PARTY COVERAGES**

Privacy and network security

Regulatory and investigative liability

Media liability

## **SOME KEY QUESTIONS FOR 2019**

Coverage for fines and penalties (GDPR)?

What coverage trends can we expect, particularly if markets continue to expand?

Will insurers emphasize prevention over broadening coverage?

# PRACTICE POINTERS FOR CYBER LOSSES

Early decisions can affect coverage

Documentation and forensic accounting

How/when insurers can support you

How to identify when a coverage dispute arises

Being strategic in dispute resolution

## KEY TAKEAWAYS

Mind the gaps in risk management

Use buying power to negotiate policy terms

Keep an early focus on insurance when a loss or claim arises

# SECURITY INCIDENT SCENARIO



## SECURITY INCIDENT SCENARIO

Launch Mortgage Company offers an online mortgage origination platform through which 'mortgage consultants' assist consumers in obtaining residential home mortgages and home equity lines of credit. Many of the mortgage consultants work out of the office and have remote access to Launch's proprietary platform.

Through the application process, the mortgage consultants collected numerous confidential details, such as social security numbers, income tax returns, occupation, salary, bank accounts and balances and credit card numbers.

You just received a report that an irate customer, Mr. Jones, contacted a Launch customer service representative this morning to accuse Launch of negligently allowing the improper dissemination of his confidential financial data. Among other complaints, Mr. Jones said that Launch failed to notify him when his contact information and document delivery preferences were changed and that he had not made any request for a change. He also reported that his credit card issuer called him about a series of suspicious charges.

# SECURITY INCIDENT SCENARIO

You contact Zach, Launch's CISO, and learn that:

- Adam, the mortgage consultant who started working with the customer, quit Launch to work for a mortgage-company competitor. Apparently, Adam started looking for a new job after receiving a formal written warning for using his Gmail account to communicate with customers and downloading information to an external hard drive. He complained that Launch's antivirus scans and other security controls were slowing him down.
- Zach recently learned that Launch's IT support staff provide mortgage consultants with temporary passwords over the telephone without following Launch's multi-factor authentication requirements. You recall that Zach included funds for enforcing and upgrading Launch's remote access security policies in his 2019 budget request.
- A few days ago, Bob, who took over for Adam, received an email confirming a password change but he had not requested a change.

## SECURITY INCIDENT SCENARIO

- Zach's team is pouring over log files to find out what happened with the false change requests for Mr. Jones' contact information and document delivery preferences and Bob's password.

You just received an email forwarded from Launch's CEO in which Mr. Jones demands action or he will use his Twitter account to "tell the world about Launch's carelessness." You are expected at a meeting at 6:00pm with a "plan."