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CARLTON FIELDS

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EXPECTFOCUS® is a quarterly review of developments in the insurance and financial services industry, provided on a complimentary basis to clients and friends of Carlton Fields.

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SEC Sanctions Unregistered EB-5 Investments Broker

BY BILL CHENG

We previously warned that some individuals involved with arranging EB-5 investments may be required to register as broker-dealers (*see* “Immigrant Investor Program Raises SEC Broker Registration Issues” in the Summer 2014 *Expect Focus* and “SEC Charges EB-5 Brokers for Not Registering” in the Summer 2015 *Expect Focus*).

Now, an SEC administrative law judge has ordered Ireeco LLC and its Hong Kong-based parent to disgorge $3.2 million in referral fees received in connection with EB-5 investments. This is the first sanction the SEC has imposed for failing to register as a broker-dealer in such circumstances.

Importantly, the judge declined the SEC Enforcement Division’s request to impose civil penalties in addition to the disgorgement, stating that Ireeco had not deliberately or recklessly disregarded a regulatory requirement. The decision emphasized that, until the SEC charged Ireeco last summer, no firm or individual had been charged with failure to register as a broker-dealer in connection with EB-5 investments.

The decision also noted:

- Ireeco had not engaged in fraud, deceit, or manipulation;
- There was no evidence that the violations caused harm or injury to any investor; and
- Ireeco is insolvent and therefore unlikely to pay either the disgorgement or any additional civil penalty.

This decision is a clear warning that, going forward, parties who engage in broker activities in connection with EB-5 investments without first registering as broker-dealers are likely to face sanctions beyond mere disgorgement, especially if, unlike Ireeco, they are solvent and able to pay. The decision also warns that, although fraud or harm to investors are not prerequisites to severe sanctions, they will probably be considered exacerbating factors.

An SEC administrative law judge has imposed the first sanction for failing to register as a broker-dealer in connection with EB-5 investments.

FINRA to Assess Member Firms' Culture

BY TOM LAUERMAN

Speaking at the Brookings Institution this April, FINRA head Richard Ketchum emphasized the importance of a broker-dealer having a "culture" that favors the firm's customers when their interests conflict with those of the firm or its personnel.

Ketchum's remarks echoed FINRA views expressed in a variety of contexts over many months. For example, FINRA's January 5 "Regulatory and Examination Priorities Letter" for 2016 stated that it would "formalize" its assessment of firm culture, which it defined as:

> "the set of explicit and implicit norms, practices, and expected behaviors that influence how firm executives, supervisors and employees make and implement decisions in the course of conducting a firm's business."

In February, FINRA did formally initiate an assessment via a targeted examination letter that it sent to several firms. The letter advised that FINRA planned to meet with a broad spectrum of the firm's executives to discuss the firm's cultural values and how the firm "communicates and reinforces those values directly, implicitly and through its reward system."

To provide background for these discussions, the letter asked the firm a series of specific questions. FINRA is "particularly interested in how [the] firm measures compliance with its cultural values, what metrics, if any, are used and how you monitor for implementation and consistent application of those values throughout your organization."

FINRA's objective is to "develop potential guidance for the industry and determine other steps that could be taken." Although the January 5 letter says FINRA "does not seek to dictate firm culture," it also states that an understanding of a firm's culture will "inform" FINRA's evaluation and the "regulatory resources" it devotes to the firm. And Ketchum told Brookings: "[W]e will continue to work with firms to ensure the industry fully embraces a culture that puts investors first."

SEC SEEKS FUND RESPONSES TO DISTRIBUTION-IN-GUISE GUIDANCE

BY ED ZAHAREWICZ

Since at least March 2016, SEC examiners have reportedly been checking whether mutual fund firms are complying with the SEC staff's recent guidance on "distribution-in-guise."

The guidance suggests that fund boards, investment advisers, and other relevant service providers consider assuming what some regard as significant new responsibilities. The guidance seeks principally to ensure that so-called "sub-accounting fees," which funds pay to intermediaries for shareholder and recordkeeping services, are not being used directly or indirectly to pay for distribution without complying with the generally-applicable legal requirement that fund distribution payments be covered by a "Rule 12b-1 plan." According to the guidance, regardless of whether a fund has a Rule 12b-1 plan, "the fund should have adequate policies and procedures for reviewing and identifying any payments that may be for distribution-related services that are not paid through the plan."

With the ink barely dry on the guidance, which was published in January, the staff's seeming impatience surprises some. Their reaction results from the significant nature of the guidance, plus the fact that the guidance mostly just identifies procedures that funds and their service providers *could* consider given their own particular circumstances, instead of prescribing specific procedures that funds should generally adopt. This, in turn, also raises a question as to whether the staff is inappropriately treating any aspects of the guidance as a regulation without the benefit of public comment.

Nonetheless, the staff is at least clearly signaling its expectations that registrants and chief compliance officers should be well on their way to completing, if they have not already, the task of assessing their exposure to potential distribution-in-guise issues and implementing reasonably-designed compliance controls in light of the guidance.

Veil Parted on SEC Whistleblower Award

BY TOM LAUERMAN

Early this year, the SEC announced it had paid a whistleblower award of "more than $700,000" to a company "outsider" who "conducted a detailed analysis" that led to a successful enforcement action against the company.

Customarily, such awards, which are granted pursuant to the whistleblower program mandated by the Dodd-Frank Act, leave many potentially interesting facts cloaked in a veil of secrecy. In this case, however, the whistleblower took the unusual step of identifying himself and providing additional information to the press.

Accordingly, it appears:

- The exact award amount was $750,000, which was 15 percent of a related $5,000,000 fine against the New York Stock Exchange and its parent, NYSE Euronext (as compared to the 30 percent maximum the SEC is permitted to award under the program).

- The fine was for the exchange's conduct, over an extended period in 2008, of releasing certain market data to feeds for its proprietary customers slightly sooner than it released the same data to consolidated feeds available to the public.

- This was the first financial penalty the SEC assessed against an exchange.

- The whistleblower was Eric Scott Hunsader, who owns a market data firm and has long asserted prominently that the SEC has done too little to ensure market integrity.

- Although Hunsader discovered the violation, he provided his initial detailed analysis of the violation to the SEC prior to the whistleblower program's establishment. His award, therefore, was based solely on additional analysis that he thereafter provided to the SEC.

This case provides rare (though still imperfect) insight into how the SEC staff may weigh various facts and circumstances in making decisions about whistleblower awards. More generally, however, the case underscores that companies' exposure to whistleblowers with whom they have no affiliation is far from just theoretical.

DOJ's FCPA Pilot Program Keeps Heat on Individuals

BY JOSEPH SWANSON

In April, the Department of Justice (DOJ) announced a one-year pilot program offering certain violators of the Foreign Corrupt Practices Act (FCPA) the possibility of reduced sanctions on top of any credit provided for by the U.S. Sentencing Guidelines. The FCPA generally prohibits payments to foreign government officials that are made to secure business.

Under the pilot program, companies that (i) voluntarily self-disclose misconduct, (ii) fully cooperate, and (iii) remediate in a timely and appropriate manner, qualify for up to a 50-percent reduction from the bottom of the fine range under the Sentencing Guidelines, as well as avoidance of appointment of a monitor. The guidance also indicates that, if all of the program's conditions are met, the DOJ may exercise its discretion not to prosecute at all. A company that does not voluntarily self-disclose – but that fully cooperates and remediates – is eligible for at most a 25-percent fine reduction.

The DOJ's guidance outlines factors bearing on whether a company's self-disclosure of FCPA violations is truly "voluntary." Those factors include timely notification and disclosure of all known "relevant facts" regarding the individuals involved in any violation. The guidance provides additional factors as to what it means to "fully cooperate" and engage in "timely and appropriate remediation."

The program aims to promote transparency and predictability for companies, while continuing DOJ's efforts to focus on individuals, as reflected in the so-called "Yates Memo" on which we previously reported. *See* "Executives in Crosshairs for Corporate Violations" in the Fall 2015 issue of *Expect Focus*. By reserving the greatest credit under the pilot program for companies that, among other things, disclose all relevant facts about the individuals involved, the DOJ seems to have kept the heat on those individuals.

A company that does not voluntarily self-disclose – but that fully cooperates and remediates – is eligible for at most a 25-percent fine reduction.

PENSION INCOME STREAM PRODUCTS WORRY FINRA

BY JOSHUA WIRTH

Some SEC-registered broker-dealers connect individuals wishing to cash in on their future pension payments with potential investors in such income streams. In April, the Financial Industry Regulatory Association (FINRA) published Regulatory Notice 16-12, highlighting certain concerns over its member firms' involvement in such transactions.

Under a typical pension income stream product, the selling pensioner receives a lump-sum amount from the purchasing investor and, in return, is contractually bound to make future payments of pension income to the investor. The FINRA member is typically a pension purchasing company operating as an intermediary and facilitating the investment and subsequent payments. The Notice identifies unique and complex issues facing such FINRA members. These include the possibility of:

- Advertisements incorrectly leading investors to believe the product is a "safe" investment;
- Investors not fully understanding that, because federal law prohibits the assignment of pension assets, their only recourse for non-payment may be a breach of contract claim against the pensioner;
- Insufficient disclosure by pension purchasing companies to investors about commissions payable on the transaction and the illiquidity of the investment;
- Insufficient disclosure by pension purchasing companies to pensioners, including about the difference in value between the lump sum received versus the pension payments the pensioner is giving up; and
- Unavailability to the investor or pensioner of protections under securities or consumer lending laws, if pension purchasing companies incorrectly conclude that the product in question is not a security or a loan.

Member firms that neglect to consider such issues, especially in light of recent case law and administrative proceedings finding similar products to be securities, risk violating federal securities laws and FINRA rules. FINRA suggests firms either prohibit sales of pension income stream products or adopt specific policies and procedures, including training of associated persons, regarding these products.

SEC Committee Recommends Investor-Specific Mutual Fund Cost Disclosures

BY ZACHARY LUDENS

In mid-April, the SEC's Investor Advisory Committee (IAC) issued a recommendation that the SEC "explore ways to improve mutual fund cost disclosures."

As a first step, the IAC urges the SEC to require that periodic account statements delivered to each mutual fund shareholder set forth the actual dollar amount of the direct and indirect costs borne by that shareholder over the period.

The SEC has previously declined to require such customer-specific disclosure, given the substantial costs it would impose on funds. Rather, the SEC has required that mutual funds disclose the costs investors bear as a percentage of net assets and as a dollar amount per $1,000 of investment. However, the IAC believes the current location and nature of such disclosures do not provide optimal investor understanding of the actual costs they bear and the impact of those costs on total accumulations over the life of their investment.

Longer term, the IAC recommends that the SEC consider, among other things, ways to contextualize the cost information for investors. For example, mutual funds could be required to make disclosures that compare the level of their costs to the average benchmark costs for other funds with similar characteristics.

The IAC was established under Dodd-Frank provisions that require the SEC to "promptly" issue a public statement assessing each IAC recommendation and disclosing the responsive action, if any, the Commission intends to take. Moreover, Dodd-Frank requires the SEC's "Investor Advocate" (who is also an ex officio member of the IAC) to annually report directly to Congress about what recommendations the IAC has made, and how the SEC has responded.

Accordingly, the IAC's recommendations are expected to spur substantive consideration at the SEC and, perhaps, in Congress.

Regulatory Musical Chairs for Money

BY ANN FURMAN

The SEC and FINRA continue to play musical chairs with staff resources allocated to examinations of investment advisers and broker-dealers.

According to SEC Chair Mary Jo White's remarks at an April 16 SEC Compliance Outreach Program, the SEC now has approximately 530 dedicated staffers tasked with examining nearly 12,000 registered investment advisers, up from 467 in 2015.

The SEC wants to increase staffing levels in the investment adviser/ investment company examination area by 20 percent. To help accomplish this goal, the SEC decided to transition some staff resources from its broker-dealer examination program to the investment adviser/investment company examination program. In this regard, the SEC intends to rely on FINRA's examination program to take up the slack in broker-dealer examinations. And, as a result, the SEC announced it will enhance its oversight of FINRA to ensure no gaps develop in the examination of broker-dealers.

This development interests both investment advisers and broker-dealers: more investment advisers are likely to be examined by the SEC, and broker-dealers are likely to get more attention from FINRA. It also **raises the questions of whether and how FINRA will get more staff and/or monetary resources to conduct additional broker-dealer examinations**. Typically, FINRA's resources come from the fines it imposes and the fees it assesses against member firms. But this latest switching of regulatory chairs might cause some broker-dealers to wonder if they are, in effect, bearing part of the cost of additional investment adviser examinations.

Supreme Court Declines to Review Constitutionality of SEC In-House Court

BY NATALIE NAPIERALA & GABRIELLA PAGLIERI

The SEC's increased use of its own "home court" for enforcement proceedings has triggered constitutional challenges to SEC administrative proceedings (APs). *See* "Defendants Challenge SEC's Increased Use of Administrative Forum," *Expect Focus*, Winter 2015; "SEC Administrative Law Judge Appointments Held Likely Unconstitutional," *Expect Focus*, Summer 2015. Most of these cases, brought in federal district courts, allege violations of the Appointment, Removal, Due Process and Equal Protection Clauses, the Seventh Amendment right to a jury trial, and the non-delegation doctrine.

While some of these challenges have been decided on jurisdictional grounds, the underlying question of whether APs are constitutional remains unanswered by the U.S. Supreme Court, which has now twice declined to consider constitutional issues raised. In both *Bebo v. SEC* and *Pierce v. SEC*, petitioners argued that, among other things, the SEC's administrative law judges violate Article II because they are "inferior officers" and are hired by SEC staff instead of appointment by the President or the Commission itself. Neither case, however, presented the issue of constitutionality squarely to the Court. For example, in *Bebo*, the question posed was whether district courts can hear challenges before the Commission issues a final decision. And the petitioner in *Pierce* argued that the respondent waived his constitutional challenge, which he failed to raise during the AP and which he brought for the first time after losing an appeal on separate grounds.

Recently, the Eleventh Circuit in *Hill v. SEC* and the Second Circuit in *Tilton v. SEC* joined the Seventh and D.C. Circuits holding that constitutional challenges cannot be brought in federal district court until the Commission issues a final ruling.

Constitutional challenges remain pending in the D.C., Second, Fourth and Eleventh Circuits. For example, the D.C. Court of Appeals recently heard oral argument in *In re Raymond,* where a review is sought of the Commission's holding that the appointment of its ALJs is constitutional. The D.C. Court of Appeals may be the first appellate court to squarely address that issue, and a holding of unconstitutionality could motivate the Supreme Court to at last grant certiorari to review the question.

New York Appellate Court Finds "Electronic Data" Exclusion Applies to Data Breach

BY JOHN PITBLADO

The computer network of a Five Guys Burger franchise, RVST Holdings, LLC (RVST), was hacked. Customers' credit card information was stolen and used to make numerous fraudulent charges. Trustco Bank brought an action against RVST, alleging it was negligent in securing Trustco cardholders' information, causing Trustco to sustain damages related to reimbursing its cardholders for the fraudulent charges.

RVST sought coverage for the Trustco claim from its insurer, Main Street America Assurance Company (Main Street) under a business owner's insurance policy. Main Street declined coverage.

RVST then brought an action against Main Street in a New York state trial court. Main Street moved for summary judgment, citing, among other things, the policy's exclusion for "damages arising out of the loss of … electronic data." The state court judge denied the motion, and Main Street appealed.

In *RVST Holdings, LLC v. Main Street America Assurance Co.,* New York's appellate division reversed, with orders to enter summary judgment in Main Street's favor. Notably, the appellate division's opinion makes evident that the claim was submitted for coverage under the policy's liability coverage for "sums that [the insured] becomes legally obligated to pay as damages because of … 'property damage'."

The court held there was no liability coverage for "property damage" (and thus no duty to defend) for two reasons: (1) the definition of "property damage" included the following explicit caveat: "for the purposes of this insurance, electronic data is not tangible property"; and (2) the policy's "electronic data" exclusion unambiguously applied to the subject data breach, which the court held plainly constituted "damages arising out of the loss of … electronic data." The court also rejected the insured's contention that because the first-party property coverage did not contain the same exclusion, coverage should somehow obtain. The court was dismissive, noting the first-party property coverage was inapplicable to a third-party claim.

This case may mark the beginning of the end of coverage battles for cyber-risks under traditional, non-cyber policies, which now typically include exclusionary language similar to that relied on by the New York Appellate Division. Thus, questions of whether a data breach might constitute a privacy invasion that constitutes a "personal or advertising injury" or if non-functioning hardware or software might constitute "property damage," will now largely become academic (perhaps until some theory of long-tail delayed trigger brings older pre-exclusion occurrence policies back into play). The decision also counsels policyholders to ensure they carefully review their coverage and fill any possible gaps for ever-evolving cyber risk.

Recent Florida Legislation Will Allow for Creation of Specialty Sinkhole Coverage Lines

BY ZACHARY LUDENS

The Florida Legislature passed legislation this session that allows specialty limited sinkhole coverage. According to the Florida Office of Insurance Regulation, Florida has more sinkholes than any other U.S. state. As such, the topic is particularly important in the Sunshine State.

Under the legislation, which was passed as SB 1274, and signed by Governor Rick Scott on April 6, insurance carriers can now offer limited sinkhole damage policies that cover the cost of stabilizing buildings and repairing foundations, rather than the full cost of property replacement. The new legislation seeks to fill a void the legislature created in 2011, when it approved a measure that limited sinkhole damage coverage to homes and businesses with catastrophic ground cover collapse—meaning that a building had to actually fall into the sinkhole to qualify for coverage. However, the 2011 legislation responded to the rising cost and number of claims at the time. As a result, the number of claims shrank from approximately 4,500 in 2011 to 1,200 in 2013, with total losses and allocated loss adjustment expenses falling from $537 million in 2011 to $83 million in 2014.

However, some Florida legislators argue the new legislation "will provide a market for insurance companies that want to insure for things less than the total structural collapses." These legislators also argue that it may result in private insurance carriers offering the limited sinkhole coverage, rather than it falling to the Citizens Property Insurance Corporation (CPIC). However, the CPIC is specifically prohibited from issuing limited sinkhole coverage.

Geologists posit that Florida experiences more sinkholes than any other U.S. state because of the peninsula's geological composition. Specifically, the Florida Geological Survey noted that, "[s]ince the entire state is underlain by carbonate rocks, sinkholes could theoretically form anywhere" in the state. However, the state's west-central area, comprised of Pasco, Hernando, and Hillsborough counties, accounts for more than two-thirds of Florida's sinkholes.

Thus, there is a potential new line of business for insurers in Florida, but only time will tell if any find insuring this risk sufficiently lucrative to be worthwhile. Time will also tell whether the mere existence of coverage for repair, rather than replacement, will play into coverage battles under traditional replacement cost policies, as some legislators apparently fear.

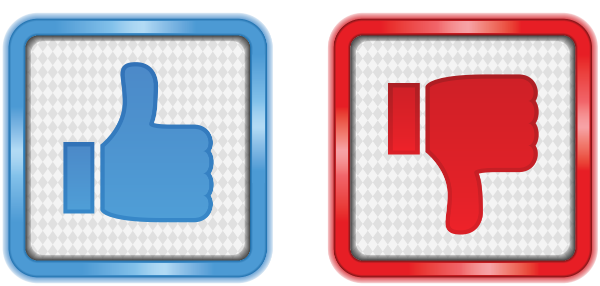
Facebook and HIPAA: Strange Bedfellows

BY ERICA MALLON

As a social media user, you may have experienced Facebook's targeted advertising. Mere moments after searching for a specific item on Google or visiting another website, your Facebook ads reflect your recent browsing history. Facebook uses cookies to track its users' online activities and then develops marketing profiles that companies use for targeted advertising, earning Facebook nearly $11.5 billion in annual advertising revenues.

While the use of cookies is not uncommon in the cyberworld, one attorney has filed suit against Facebook and multiple health care providers, including Adventist Health System, Cleveland Clinic, and University of Texas MD Anderson Cancer Center, alleging the named health care providers are covered entities under the Health Insurance Portability and Accountability Act (HIPAA) and made unauthorized disclosures of protected health information in violation of HIPAA. The personally-identifying information allegedly disclosed included device identifiers, IP addresses, and geographic information, transmitted by the health care providers' websites to Facebook without the individuals' express consent.

The plaintiffs argue that the named health care organizations did not disclose their relationship with Facebook to users, including a Facebook plug-in on their websites, and the users did not consent to transmitting tracking information containing personally-identifying information to Facebook. The lawsuit specifically points to a chart Facebook uses to sell advertisements, which places more than 225 million users into 154 separate medical categories including pregnancy, cancer, diabetes, mental illness, and HIV/AIDs.



If the allegations are proven, the HIPAA covered entities could face a fine of between $100 and $50,000 for each violation with an aggregate cap of $1.5 million "for identical violations during a calendar year." Health care providers must be cognizant of hidden disclosures of protected health information, particularly in the vast depths of cyberspace, and institute appropriate safeguards to either prevent such disclosures or obtain the requisite consents prior to making them.

No More Surprises: Florida Ends Certain Medical Balance Billing

BY PATRICIA CALHOUN

"Surprise medical billing" occurs when a patient receives care at a facility and receives treatment from a provider, such as an anesthesiologist or radiologist, who is not contracted with the patient's health insurance plan. The provider bills the patient as if the patient has no insurance. Surprise! The patient gets billed the entire amount or the "balance" between what the insurer typically pays its contracted providers and what the provider actually billed.

Health maintenance organization (HMO) members, who must typically use network providers in order for their insurance company to pay, were already protected against balance billing when receiving emergency care. But consumers in a preferred provider organization (PPO) insurance lacked that protection.

Effective July 1, 2016, providers will not be allowed to balance bill PPO-covered patients for services provided at a hospital, ambulatory surgery center, or urgent care center for:

1. Emergency services covered by the patient's health insurance plan, and

2. Non-emergent services covered by the patient's health insurance plan provided at a facility under contract with the health plan to provide those services if the patient lacked the opportunity to choose an available participating provider.

Copays, coinsurance, and deductibles can be collected and bills may be rendered for any non-covered service.

Insurers are required to pay the provider, regardless of whether the provider is under contract. If the provider and the insurer cannot agree on a fee, either a voluntary dispute resolution process or litigation will resolve the issue.

The new law also requires Florida hospitals and insurers to provide public notice of their existing provider contracts.

Consumer action groups and health plans welcomed the new law while some physicians objected, fearful it will lead to litigation over physician reimbursement rates. Ambulance services are not covered by this new law.

Two-Midnight Rule Update

BY JON GATTO

As adopted by the Centers for Medicare and Medicaid Services (CMS) on August 19, 2013, the two-midnight rule provided that an inpatient admission generally would only be payable under Medicare Part A if: (1) the admitting practitioner had an expectation, documented in the medical record, that the patient would require an inpatient hospital stay that would span two or more midnights; or (2) the admission was for a surgical procedure designated by CMS as inpatient-only. At the time, CMS anticipated the two-midnight rule would result in increased inpatient admissions, and thus reduce its inpatient prospective payment system (IPPS) payments by 0.2 percent to offset its anticipated, increased costs from the anticipated, increased inpatient admissions.

In 2014, a group of hospitals challenged the 0.2 percent IPPS payment reduction in federal court. On September 21, 2015, a federal judge ordered CMS to reconsider the payment reduction due to procedural deficiencies in CMS's 2013 rulemaking process.

On November 13, 2015, CMS revised the two-midnight rule to specify that an inpatient admission that did not meet the then-existing criteria could still be payable under Medicare Part A if it is supported by the admitting practitioner's clinical judgment and the medical record. CMS did not, however, address the 0.2 percent IPPS payment reduction.

On April 27, CMS proposed to (1) eliminate the 0.2 percent IPPS payment reduction, and (2) implement a 0.6 percent IPPS payment increase for the fiscal year ending 2017. CMS did not, however, propose any new revisions to the two-midnight rule itself.

Hospital/Physician Leases Compliance Checklist

BY LINDA L. FLEMING

LEGAL REQUIREMENTS: A "no" answer to any of the following questions may mean your lease is out of compliance with applicable laws.

- Is the lease in writing?
- Is the lease signed by both parties?
- Does it specifically identify the leased premises?
- Is the term at least one year?
- Is the space reasonable and necessary for the proposed use?
- Is rent set in advance?
- Is rent at fair market value (FMV)?
  - Tenant Improvement Allowance and other landlord concessions impact FMV.
  - Rent does not take into account the volume or value of referrals.
- Is the tenant entitled to exclusive use, except for common areas?
- Is the lease commercially reasonable, even if there were no referrals between landlord and tenant?
- Are holdovers limited to six months?

COMMON PROBLEMS: Once you have confirmed compliance with Legal Requirements, look for these common problems.

- Signature missing or not timely obtained
- Dates of signature omitted
- Escalators not imposed (when contractually required)
- Missed rent payments
- Holdovers permitted past six months

WARNINGS: Both federal and state laws may be implicated. Some of the federal laws are noted below; check for state law counterparts and related legislation.

- The Stark Law
- Anti-Kickback Statute
- False Claims Act

SOLUTIONS: If you identify any failure to meet legal requirements or other problems with your leases to physicians, determine if any other exception or safe harbor applies. If not, develop a strategy to bring the leases into compliance and determine whether other legal action is necessary or recommended.

CFPB Sanctions Law Firm and Debt Buyer For Failing to Review Account Documentation

BY ELLEN K. LYONS

On April 25, the Consumer Financial Protection Bureau (CFPB) entered an enforcement order against New Jersey law firm Pressler and Pressler and its debt-buyer client, New Century Financial Services, for pursuing hundreds of thousands of debt collection lawsuits without reviewing the underlying documentation supporting the existence of a debt. The law firm agreed to pay a $1 million fine, the debt-buyer client agreed to pay a $1.5 million fine, and both agreed to extensive recordkeeping and compliance measures going forward. These recordkeeping and compliance measures include an obligation to file account information in the court file of defaulted debt-collection cases before obtaining a final judgment, and to do no prejudgment discovery of a debtor's assets.

The sanction stemmed from the manner in which the debt-buyer client communicated with its law firm. Rather than sending account files of the purchased debts, the client would electronically send spreadsheets showing debtor information and amounts of debts to the law firm. The law firm, which was staffed by over 300 employees, only 19 of which were attorneys, would then use proprietary software to turn the information in the spreadsheets into civil complaints. Neither the debt-buyer client, nor the non-legal staff, nor the attorneys signing the complaints, would review the original account-level documentation substantiating the debt. As a result of these practices, the CFPB found the law firm filed an untold number of lawsuits based on false or unreliable information.

Using the law firm's own software, CFPB determined that the law firm lawyers typically spent less than a few minutes reviewing a complaint package and comparing it to the summary information on the spreadsheet before signing the complaint and filing it with the court. The lawyers did not review the account level documentation or determine if the information in the spreadsheet was correct or disputed before filing suit. Since most of the debtors defaulted, the information was not disputed, and the false information harmed consumers. Thus, the CFPB found that a law firm's reliance on only summary information provided by a client constituted an unfair or unconscionable means to collect debts.

CFPB CONTINUES SCRUTINY OF PAYDAY LOANS IN RECENT REPORT AND PROPOSED RULE

BY MICHAEL STRAUCH

Online payday loans can result in an array of "steep, hidden costs" for borrowers, according to the latest payday loan report from the Consumer Financial Protection Bureau. The report precedes potential new regulatory scrutiny of payday lenders by the CFPB.

A payday loan is a short-term loan typically due, at least initially, on the borrower's next payday. Using data from an 18-month period in 2011 and 2012 from 330 online payday lenders, the CFPB found that half of online borrowers are charged an average of $185 in bank-related penalties for failed debits when the lender attempts to collect payments from the borrower's account. More than one third of online borrowers who were hit with a bank penalty ended up losing their account, the report noted, with the closures usually occurring within 90 days of the first non-sufficient funds transaction.

Lenders' repeated payment requests—often done electronically through the borrower's depository institution—typically failed to result in collection of payments from the borrower. When lenders made multiple payment requests on the same day, the payment requests typically all succeeded (76 percent) or all failed (21 percent), the report found. Only 3 percent of same-day payment requests resulted in at least one successful payment, suggesting that same-day payment requests rarely result in a successful second debit from the borrower's account and might often end with the borrower paying additional penalties when the account lacked sufficient funds.

The payday lending report is the third from the CFPB since it began supervising payday lenders in January 2012. The report preceded the CFPB's June 2, 2016 announcement of a proposed new rule that would, among other things, make it an abusive and unfair practice to give a payday loan without first reasonably determining that the consumer will be able to repay the loan and still meet other financial obligations like basic living expenses. The proposed rule is sure to face legislatively scrutiny. The House Appropriations Committee recently adopted a bill and amendment designed to stop the CFPB from finalizing or enforcing the rule until the CFPB submits a consumer impact report.

U.S. Department of Education Outlines Loan Relief Pathway for Certain Students

BY DAVID ADAMS

On March 11, the U.S. Department of Education (DOE) released an advanced proposal of rulemaking that would establish a more "borrower-friendly process" for students seeking loan relief triggered by unscrupulous conduct by higher education institutions. Not two weeks later, the DOE issued another press release detailing how students who were defrauded at 91 former Corinthian Colleges, Inc. campuses nationwide "have a clear path to loan forgiveness under evidence uncovered by the Department." Significantly, this DOE rule applies to colleges and not the financial institutions providing student loans to the educational institutions.

In response to the failure of several for-profit higher education institutions like Corinthian, the DOE began a rulemaking process to clarify how direct loan borrowers who believe they have been defrauded by their institutions can seek relief. Importantly, the DOE rule strengthens provisions to hold colleges accountable for alleged wrongdoing outside of arbitration proceedings.

In addition to addressing arbitration, the language of the proposed rule would:

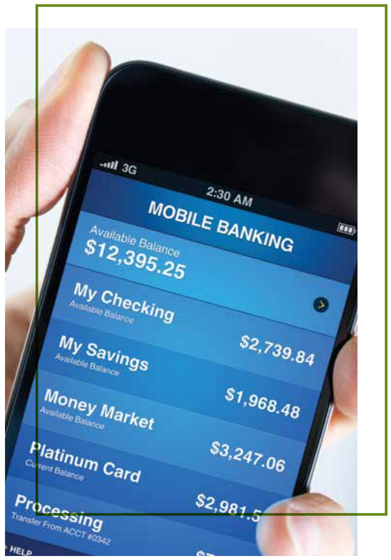
- Allow students to pursue a discharge of their student loan balances without the constraints of a statute of limitation;
- Establish a simpler, more uniform standard for relief that incorporates crucial elements of state consumer protection laws;
- Create borrower-friendly processes for determining whether discharges are merited, including pathways for group relief without individual applications from borrowers;
- Hold schools accountable and ensure they have skin in the game when discharges result from their unlawful actions;
- Ensure schools disclose information to prospective students when various risk indicators are triggered, like too many former students struggling to repay their loans; and
- Provide more information more often to affected borrowers on their closed school discharge rights, and grant discharge without an application in certain circumstances.

The DOE proposal is independent of the Consumer Financial Protection Bureau (CFPB) rule proposed May 5, which prohibits the use of arbitration agreements to block class actions involving consumer financial products and services (including student loans). That rule would cover most consumer loans once finalized. The DOE release clarifies prior DOE regulations for so-called "defense to repayment" or "borrower defense" allowing borrowers to seek discharge of federal loans if their college's acts give rise to a state law cause of action. In the future, post-secondary institutions arranging financing for student loans must comply with both DOE and CFPB rules.

FFIEC Issues New Cybersecurity and Data Privacy Guidelines for Mobile Banking

BY STEVEN BLICKENSDERFER

Mobile banking is a convenient and powerful tool that provides customers with a bevy of cutting-edge services, including mobile check deposits, on-the-go bill pay, and peer-to-peer payments. For financial institutions, this technology has the potential to increase customer satisfaction and decrease costs.



Unfortunately, mobile banking has been involved in many incidents of fraud and security breaches. This is partly because mobile banking requires the coordination of several entities unrelated to the financial institution, such as app developers, device manufacturers, telecommunication companies, and other third-party service providers. Poor risk management and inadequate security measures in the apps and services themselves are also to blame.

To address these growing security concerns, the Federal Financial Institutions Examination Council (FFIEC) recently issued a new appendix to the Retail Payment Systems portion of its Information Technology Handbook, called “Appendix E: Mobile Financial Services.” In it, the FFIEC sets forth numerous guidelines to help examiners evaluate the risk management and mitigation processes of financial institutions and third-party service providers. Among them, the FFIEC recommends financial institutions:

- develop a layered approach to mitigate operational risks and prevent unauthorized access to sensitive data through use of multi-factor and biometric authentication;
- develop apps that do not retain sensitive customer information on the device, such as IDs and passwords, and “rigorously” test them for vulnerabilities annually;
- develop well-constructed third-party contracts with legal counsel to cover the types of data collected and circumstances related to data sharing; and
- reassess mobile service offerings and monitor for any legal and regulatory changes that may apply to mobile banking on an ongoing basis.

The FFIEC is not the only regulatory body calling for tighter security in this space. In November 2015, the New York State Department of Financial Services announced plans to institute new cybersecurity regulations for the firms it oversees, including use of multi-factor authentication. Those regulations are still forthcoming.

SUPREME COURT’S *SPOKEO* DECISION LEAVES QUESTIONS UNRESOLVED

BY AARON S. WEISS

On May 16, the Supreme Court issued its *Spokeo v. Robins* decision. *Spokeo* was a closely-watched case, as it had the potential to substantially limit federal court jurisdiction in cases where plaintiffs sued for violations of federal statutes and only sought statutory damages. But the Court’s 6-2 decision turned out to be fairly narrow.

The plaintiff filed a class action against Spokeo alleging violation of the Fair Credit Reporting Act, 15 U.S.C. § 1681 (FCRA). Specifically, plaintiff alleged Spokeo published inaccurate information about him. In resolving a challenge to standing, the Ninth Circuit held that stating a violation of a statutory right is sufficient injury-in-fact to confer standing.

Justice Alito, writing for the majority, reversed this decision, holding that the Ninth Circuit’s standing analysis was “incomplete” because it focused only on the particularized nature of the injury-in-fact requirement for constitutional standing, but did not address the concreteness requirement. For an injury to be particularized, it must affect the plaintiff in a personal and individual way. Justice Alito held the complaint satisfied this requirement. The injury also must be concrete, meaning it “must actually exist.” Moreover, according to the Court, Congress can identify and elevate intangible harms to the level of concrete injury in certain circumstances.

When it enacted the FCRA, Congress sought to curb the dissemination of false information by adopting procedures designed to decrease that risk. On the other hand, the plaintiff could not satisfy the concreteness requirement by alleging a “bare procedural violation.” Not all inaccuracies in information cause harm. Justice Ginsburg’s dissent, in which she was joined by Justice Sotomayor, posited that the plaintiff had indeed alleged enough about concreteness to cross the threshold on this point.

As evidenced by the favorable reaction from both consumer and industry groups, it is unclear who will ultimately benefit most from the opinion.

CFPB Acts Against Lead Aggregator for Unfair and Abusive Practices

BY KIM GUSTAFSON & ZACHARY LUDENS

The Consumer Financial Protection Bureau (CFPB) recently filed actions against online lead aggregator D and D Marketing, Inc. d/b/a T3Leads and its co-founders alleging unfair and abusive practices in violation of the Consumer Financial Protection Act (CFPA). The CFPB alleges T3Leads resold loan applications containing sensitive personal data without assessing the sources of the leads or the purchasers they sold to. Thus, the CFPB is once again using its power to enforce violations of the CFPA's broad prohibition on unfair and deceptive or abusive practices to pursue companies that are not directly engaged in consumer-facing transactions in the consumer finance industry.

Lead aggregators buy consumer information—leads—from websites that market financial products. This consumer information typically contains a consumer's name, telephone number, home address, email address, references, and employment information. Then, lead aggregators resell this information to lenders and data brokers, who use the information to try to develop relationships with the customers.

The CFPB alleges that T3Leads: (1) bought leads from lead generators with no regard for whether the lead generators' statements to consumers on how their information would be used was false or misleading; and (2) failed to properly vet the buyers of the lead information, who "steered consumers toward bad deals with lenders" and often did not comply with state usury laws. CFPB Director Richard Cordray said these lawsuits are "a reminder to the middlemen who buy and sell consumer loan applications: if you engage in this type of conduct, you risk the consequences for harming people."

The Federal Trade Commission also recently took its first enforcement action against a lead generator (Expand, Inc. d/b/a/ Gigats) and its founder for, among other things, misrepresenting how a consumer's information would be used. Gigats claimed it was "pre-screening" job applicants for employers when it was actually gathering consumer information for lead generation for schools and career training or programs that paid kickbacks to Gigats.

Lead aggregators—and those buying and selling leads from them, or from "data brokers"—should recognize that regulators may hold them responsible for their business partners' conduct.

The CFPB is once again using its power to enforce violations of the CFPA's broad prohibition on unfair and deceptive or abusive practices to pursue companies that are not directly engaged in a consumer-facing direction in the consumer finance industry.

CFPB's Proposed Rule Banning Use of Pre-Dispute Arbitration Agreements to Block Consumer Class Actions Signals New Wave of Class Actions Against Industry

BY ELIZABETH BOHN

On May 5, the Consumer Financial Protection Bureau (CFPB or Bureau) published a proposed rule which would prohibit application of pre-dispute arbitration agreements to class litigation involving a broad range of consumer financial products and services. The proposed rule, the most momentous of the Bureau's rulemaking to date, will apply to pre-dispute arbitration agreements for all "consumer financial products and services" as defined in Dodd-Frank, and contains two restrictions:

Prohibition on class action waivers. First, the rule prohibits inclusion of arbitration clauses that block class action claims in contracts with consumers for consumer financial products and services including credit cards, checking and deposit accounts, auto loans, consumer mortgage and credit servicing, prepaid cards, consumer debt acquisition, credit reporting, and debt collection services. Providers of covered products and services will be prohibited from relying on any pre-dispute arbitration agreement entered into after the rule's effective date. In addition, any arbitration agreement in a contract for covered products or services will be required to expressly state that the provider agrees not to use such arbitration agreement "to stop the consumer from being part of a class action case in court."

Submission of information on all arbitration proceedings. Second, for any pre-dispute arbitration agreements entered into after the effective date, covered entities will be required to provide the CFPB with certain records of all arbitration claims relating to consumer financial products or services filed by or against them, including initial claim filings, the arbitration agreement, and the judgment or award issued by the arbitrator, with personal consumer information redacted. The CFPB "intends to use the information it collects to continue monitoring arbitral proceedings to determine whether there are developments that raise consumer protection concerns that may warrant further Bureau action," and to publish redacted informational materials on its website.

The rule will open the floodgates for costly class actions against consumer financial service providers. In addition, opening individual arbitrations to regulatory scrutiny is also cause for concern. This foretells the possibility of additional future regulation, which will lead to increased compliance costs. Excluded from the rule are brokers regulated by the SEC, the insurance industry, certain state, local, and tribal governmental units that provide consumer financial services, and providers of 25 or fewer consumer products or services annually.

For the second consecutive year, **Carlton Fields** was named to the “BTI Most Recommended Law Firm” list. The list is based solely on in-depth telephone interviews with leading legal decision makers at large and *Fortune* 1000 companies with $1 billion or more in revenue. According to the report, “client-to-client recommendations are the express lane for new client relationships and new business. Clients almost always hire the law firm their peers recommend—without checking out the competition.”

Law360 released its annual series on racial diversity in the U.S. legal industry. The reports include rankings of the top law firms for Hispanic and minority attorneys. **Carlton Fields** ranked third for “Best 10 Firms for Hispanic Attorneys,” 21st for “Top 50 Firms with Minority Equity Partners,” and 32nd for “Top 100 Firms for Minority Attorneys.”

The American Civil Liberties Union of Southern California honored **Carlton Fields** with its 2016 Educational Equity Award at its 22nd Annual Luncheon. Carlton Fields Los Angeles shareholder **Mark Neubauer** and legal administrative assistant **Maria Rodriguez**, and Washington, D.C. shareholder **Dawn Williams** received the award. The annual award ceremony recognizes attorneys and their law firms for the extraordinary work they do to protect civil liberties and civil rights. This legal team represented students from nine elementary, middle, and high schools in the Bay Area and Southern California who had lost learning time because the state did not track or require actual learning time. Students in underperforming schools received less education than students in higher performing schools. In November 2015, California’s State Board of Education approved a settlement protecting students from being assigned to “fake classes.”

Carlton Fields Tampa shareholder and co-chair of the national appellate practice group **Sylvia Walbolt** was chosen by the ABA Death Penalty Representation Project Awards Committee to receive its 2016 John Paul Stevens Guiding Hand of Counsel Award. This award, which was first presented to Justice John Paul Stevens in 2011, has since been given annually to a lawyer who demonstrates exceptional commitment to providing pro bono counsel for individuals facing death sentences.

Carlton Fields Pro Bono Committee Chair **Kathleen S. McLeroy** received The Florida Bar Foundation’s 2016 Medal of Honor Award, the Foundation’s highest honor.

Carlton Fields Washington D.C. Office Managing Shareholder **Roland Goss** was one of only two attorneys to receive The District of Columbia Bar’s prestigious 2016 Laura N. Rinaldi Pro Bono Lawyer of the Year Award. Goss was nominated for this award by The Children’s Law Center, one of the largest legal services non-profit organizations in DC, which focuses on legal, education, and health services and advocacy for children and families. He was recognized for his 25-plus years of work helping abused and neglected children and their families.

Carlton Fields Chief Diversity Officer and shareholder **Nancy J. Faggianelli** received the Multicultural Leadership Award from the Florida Diversity Council at its Diversity & Leadership Conference.

The *Tampa Bay Business Journal* named **Carlton Fields** and the firm’s Chief Operating Officer **Anastasia “Annie” Hiotis**, respectively, as a business leader and “outstanding voice” for its inaugural Business of Pride Awards.

Carlton Fields Miami associate **Daniel G. Enriquez** was selected as a member of the 2016 class of Pathfinders, a new program designed by the Leadership Council on Legal Diversity to train early-career attorneys in critical career development strategies including programming on leadership and network development.

Carlton Fields welcomes the following attorneys to the firm: shareholders **Chris W. Altenbernd** (National Appellate Practice & Trial Support, Tampa) and **James V. Chin** (Property and Casualty Insurance, Atlanta); special counsel **Sarah Johnson Auchterlonie** (Real Estate and Commercial Finance, Washington, D.C.); of counsel **Harvey W. Geller** (National Trial Practice, Los Angeles); and senior counsel **Jeremy Holt** (Real Estate and Commercial Finance, Orlando).

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