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Tuesday, February 23, 2016

The CFPB Giveth, and the CFPB Taketh Away

Last Thursday we got a glimpse of the new normal for creating new technologies in the mortgage space. The CFPB issued a policy statement about providing a “no action letter” to companies seeking to develop and implement new technologies.

What is a “no action letter?”

It is not some kind of Zen-like, written mantra, that hypostatizes reality. It is not an attorney’s opinion letter, offering some prognostication about legal liability. It is not a declaratory statement that seems to offer solutions but is mostly devoid of meaning. In the case of the CFPB’s “no action letter,” it is just a letter that offers some grudging, limited inclination to let companies gauge how their new technologies may or may not conform with existing law and regulations, purportedly providing a semblance of approval possibly in advance of the technology’s implementation.

The idea here is the notion that submitting products to the bureau for a preëmptive, regulatory review will head off future prosecution of regulatory violations. I use the word “notion,” rather than the word “assurance,” since it is debatable whether the CFPB’s determination that the new product which meets existing regulatory standards would fully protect a company from an immediate enforcement action.

The fact is the CFPB’s “no action letter” policy will not really lift the threat of an enforcement action, because the agency retains the right to reverse its decision upon finding the product runs afoul of existing law. Therefore, the limits on the protection that a “no action letter” affords do little to abate the uncertainties that such a policy would nevertheless supply the space or incentive that companies need to come up with new ways to serve customers.

And incentive is the energy that drives creativity and willingness to take risks!

It is one thing to dangle a carrot, but when there are no specific guidelines to follow in order to avoid the stick, that seems a bit of a challenge to negotiate. Innovation comes through incentives and risks, not a placebo letter that *giveth* the appearance of compliance but may just as well *taketh* it away if the hope of some “certainty” evaporates.

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This initiative has been around for a few years. Back in 2012, the Bureau started a program called "Project Catalyst," which allowed firms to work with the CFPB on new products that had the potential to lead to new rules to accommodate financial technology innovations. Actually, the "no action letters" concept was proposed subsequently in late 2014 as part of the foregoing program. The current iteration of these letters is to provide an evaluation of how a new technology works within the existing regulatory structure. As such, excluded from this evaluation process will be products and technologies that did not exist when certain consumer financial protection laws, like TILA and RESPA, were created.

Put yourself in the place of a financial technology company. If you are a start-up with substantial pecuniary resources, you may seek a CFPB "no action letter," but if you are a big company in the technology space, you would now have to put yourself through rather intense scrutiny from the Bureau. Consider this: if you build a product and implement it, yet seek the CFPB's approval for it, and the CFPB says your product does not meet regulatory compliance, you would be admitting to a violation.

This is where risk plays its central role in our economy, for risk is measured in the marketplace in our economic system. How is it possible that the CFPB can second guess the results of market action with respect to risk? Once a product is used, risk is the feedback that improves a product as well as ensures standards of regulatory compliance. Does the Bureau have such a crystal ball?

The process of taking a technology product through a "no action letter" review would have to be exhaustive in terms of the sheer demands on time, professional involvement, and monetary considerations. Virtually every aspect of the product would need to be described and be able to withstand a battering of investigative regulatory oversight. Each request for more documentation and proof of regulatory compliance would be yet another turning of the screw.

Then there is the sharing of information that the Bureau plans to offer the public. In this regards, the Bureau plans to publish the letter, along with a product summary, to the CFPB's website. Even rejected applications will be published. More concerning, however, is the potential leaking of proprietary information belonging to the product's inventors.

But for all this, the Bureau offers its limited assurance that it will not file an enforcement action once the product hits the market – all the while retaining the right to revoke its opinion at any time!

Furthermore, the "no action letter" will not be binding on courts, civil litigants, or other regulatory agencies. So, just how valuable is this letter?

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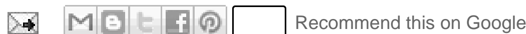
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