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CFPB Supervisory Highlights

Compilation of All Nine Editions from 2012-2015

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EXECUTIVE SUMMARY

The Consumer Financial Protection Bureau (CFPB or Bureau) supervises certain financial institutions and service providers to determine their compliance with applicable Federal consumer financial laws and to help ensure that markets for financial products and services work in a fair and transparent way for consumers. The CFPB communicates findings to the supervised entities and directs corrective action where appropriate, all within the traditional supervisory framework of institutional confidentiality, unless the matter rises to the level of becoming a public enforcement action. More broadly, the CFPB is also committed to a policy of transparency that informs the public of its supervisory goals, work, and accomplishments, while maintaining the confidentiality of the conduct and results of individual examinations.

As part of that commitment, the CFPB will periodically issue *Supervisory Highlights,* through which it will apprise the public and the financial services industry about its examination program, including the concerns that it finds during the course of its completed work, and the remedies that it obtains for consumers who have suffered financial or other harm. This document will not refer to any specific institution but signal to all institutions the kinds of activities that should be carefully scrutinized for compliance with the law. The CFPB believes that *Supervisory Highlights* will help providers of financial products and services better understand the CFPB's supervisory expectations so that they can take action to comply with Federal consumer financial laws and serve their customers in a fair and transparent way.

The issues and problems detected in key product areas are discussed in *Supervisory Highlights: Fall 2012*, as well as the corrective actions and remedies that financial institutions have been directed to undertake. With respect to credit cards, the report discusses both public enforcement actions and non-public supervisory actions that the CFPB has taken to address violations of Federal consumer financial laws. The public actions, taken in conjunction with other federal regulators, have yielded $435 million in restitution for approximately 5.75 million consumers. The violators have been ordered to pay, in aggregate, $101.5 million in civil money penalties.

As *Supervisory Highlights: Fall 2012* explains, the CFPB's non-public supervisory actions against financial institutions participating in the credit card, credit reporting, and mortgage markets have confirmed remedial relief to 1.4 million consumers, and caused the affected financial institutions to correct illegal practices, adopt effective policies and procedures to ensure that violations do not recur, and implement robust compliance management systems (CMS). As *Supervisory Highlights: Fall 2012* describes in more detail, an effective CMS is a critical component of a well-run financial institution.

I. INTRODUCTION:

A. CFPB's Commitment to Transparency: *Supervisory Highlights*

The primary mission of the CFPB is to ensure that markets for financial services and products work in a fair and transparent way for consumers. Consequently, the CFPB expects providers of consumer financial products and services to conduct their businesses responsibly, and in a manner that fully complies with Federal consumer financial law.[1] To facilitate financial institutions' compliance, the CFPB intends to be transparent about the goals of its supervision program and the steps being taken to achieve those goals, while protecting the confidentiality of the underlying financial institution-specific information.[2]

As part of its commitment to transparency, the CFPB expects to regularly inform the financial services industry about its supervisory program and point out some of the significant issues that it is finding and resolving through the supervisory process. In CFPB's view, it is best to help financial institutions avoid compliance problems before they start, or to correct emerging issues at the earliest possible date. Through these supervisory reports, CFPB will provide financial institutions with clear guidance about the standards of conduct expected of them and highlight its commitment to work with financial institutions to facilitate compliance with regulatory requirements.

B. CFPB's Supervisory Program

1. Legal Authority

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act or the Act) transferred to the CFPB the authority to supervise the provision of many consumer financial products and services previously housed in other Federal agencies. Consequently, the CFPB has the authority to examine depository institutions with over $10 billion in assets, and their affiliates, to assess their compliance with Federal consumer financial law, evaluate their compliance management systems, and detect and assess risks to consumers and markets for consumer financial products and services.[3]

The Act also gave the CFPB the authority to examine and require reports from certain non-depository institutions.[4] Generally, this authority includes nonbanks of all sizes that offer or provide residential mortgage loans and certain related services, private education loans, and payday loans, as

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[1] "Federal consumer financial law" is defined in section 1002(14) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

[2] The CFPB considers all supervisory information, including examination reports and ratings, to be confidential. See CFPB's interim final rule on the *Disclosure of Records and Information,* 12 CFR 1070.40 *et seq.*

[3] Banks, saving associations, credit unions, and their affiliates are generally referred to as "depository institutions." Other companies that provide consumer financial products and services, but are not affiliates of large depository institutions, are referred to as "non-depository institutions" or "nonbanks." The term "financial institution" refers to both depository and non-depository institutions collectively.

[4] Dodd-Frank Act, section 1024(b)(1), 12 U.S.C. 5514(b)(1).

well as “larger participants” in markets for other consumer financial products or services, as the Bureau defines by rule. It also includes other nonbanks that the Bureau determines by order pose risks to consumers with respect to consumer financial products and services. So far, the CFPB has adopted final “larger participant” rules which allow it to supervise larger participants in the consumer reporting market[5] and the debt collection market.[6]

Finally, the Dodd Frank Act also provides the CFPB with specific authority to examine and require reports from supervised financial institutions to assess their compliance with Federal consumer financial law and for other purposes.[7] Among other things, the CFPB uses the information it receives in such reports to set the scope of its examinations.

2. Focus on Consumer Protection, Data, and Consistency

The three principles guiding the CFPB supervisory process are:

- Focus on consumers. The CFPB’s reviews of financial institutions will focus on their ability to detect, prevent, and correct practices that present a significant risk of violating law and causing consumer harm.
- Data driven. The CFPB’s supervision function rests firmly on analysis of available data about the activities of entities it supervises, the markets in which they operate, and risks to consumers posed by activities in these markets.
- Consistency. The CFPB will apply consistent standards to its supervision of all financial institutions to the extent possible, and will use the same procedures to examine all supervised entities that offer the same types of consumer financial products or services, or conduct similar activities.

With respect to its consumer focus, CFPB examinations of all financial institutions emphasize areas that pose the greatest risk for consumers to potentially suffer economic loss or other legally-cognizable injury from a violation of Federal consumer financial law. To refine this analysis, the CFPB considers the asset size of a firm, the volume of its transactions involving consumer financial products or services, the risks posed to consumers through the provision of the firm’s products and services, the extent of state oversight, and other factors.[8] The CFPB is continually gathering and analyzing information and data from a variety of sources to better assess consumer risk. In all cases, however, the CFPB expects supervised entities to conduct their businesses in compliance with Federal consumer financial law.

[5] 77 FR 42874 (July 20, 2012).
[6] 77 FR 65775 (October 31, 2012).
[7] Dodd-Frank Act, sections 1024(b)(1) and 1025(b)(1), published at 12 U.S.C. 5514(b)(1) and 5515(b)(1).
[8] The Dodd-Frank Act requires the CFPB to take such risk factors into consideration as part of its larger directive that the CFPB must exercise its nonbank supervisory authority in a manner that is based on risks to consumers. As a matter of policy, the CFPB also considers the risk factors noted above as it supervises all financial institutions.

3. Current Findings

Since the launch of its supervisory program, CFPB examiners have been actively reviewing the operations of financial institutions throughout the country. In the course of this work, the CFPB has identified a number of concerns. The most critical of these are the focus of this issue of *Supervisory Highlights*, which discusses work completed by the CFPB between July 2011 and September 30, 2012. They include deficient compliance management systems, and regulatory violations related to credit cards, credit reporting, and mortgage lending. When the CFPB finds violations of applicable Federal consumer financial law, it directs them to be corrected. Where consumers have experienced harm, it generally directs restitution. As appropriate, the CFPB may also pursue other relief.

II. Compliance Management Systems

A critical component of a well-run financial institution is a robust and effective compliance management system (CMS), designed to ensure that the financial institution's policies and practices are in full compliance with the requirements of Federal consumer financial law.[9] Consequently, one of the most important responsibilities of the CFPB supervisory program is assessing the quality of the compliance management systems employed by the financial institutions under the CFPB's jurisdiction. To do so, CFPB examiners consider whether financial institutions have effectively addressed internal controls and oversight, training, internal monitoring, consumer complaint response, independent testing and audit, third-party service provider oversight, recordkeeping, product development and business acquisition, and marketing practices. As explained in the CFPB's *Supervision and Examination Manual*,[10] each supervised entity should develop and maintain a sound CMS that is integrated into its overall framework, and applied to its entire product and service lifecycle. Without such a system, serious and systemic violations of Federal consumer financial law are likely to occur. Further, a financial institution with a deficient CMS may be unable to detect its own violations. As a result, it will be unaware of resulting harm to consumers, and will be unable to adequately address consumer complaints.

A. Comprehensive CMS Deficiencies Found Through CFPB Supervisory Activities

The CFPB has found one or more situations in which an effective CMS was lacking across the financial institution's entire consumer financial portfolio, or in which the financial institution failed to adopt and follow comprehensive internal policies and procedures, resulting in a significant breakdown in compliance and numerous violations of Federal consumer financial law. In such situations, the financial institution has no ability to address risks presented by its lines of business. To prevent such failures, the CFPB has directed financial institutions to adopt appropriate policies

[9] The CFPB understands that compliance management will be handled differently by large, complex financial organizations at one end of the spectrum, and small entities that offer a narrow range of financial products and services at the other end. While the characteristics and manner of organization will vary from entity to entity, the CFPB expects compliance management activities to be a priority and to be appropriate for the nature, size, and complexity of the financial institution's consumer business.

[10] The *Supervision and Examination Manual* can be found in the Guidance section of the CFPB's website at http://www.consumerfinance.gov/guidance/supervision/manual/examinations.

and procedures, and establish an effective CMS to ensure legal compliance, including enhancement of financial institutional regulatory knowledge and expertise to help ensure proper monitoring of business activities and prompt identification of potential risks to consumers.

It is critically important for financial institutions to ensure that the policies and procedures that they adopt are clearly communicated to employees, fully implemented, and regularly followed. A financial institution's CMS is inadequate where appropriate policies have been adopted, but management fails to take measures to ensure compliance with those policies. In a typical CMS examination, the CFPB evaluates both the understanding and application of the financial institutions' compliance management program by its managers and employees. The CFPB has found one or more situations in which the financial institution had articulated many elements of an appropriate compliance policy, but the policy was not followed. This has occurred, for example, where the necessity of an effective CMS is not fully appreciated by management or employees of the financial institution, or where a compliance department is not given access to the information, resources, and personnel necessary to carry out its compliance duties. In such situations, the CFPB has expected the financial institution to take action to ensure that its CMS is effectively understood and implemented.

B. Deficiencies Related to Failure to Oversee Affiliate and Third-party Service Providers

The CFPB recognizes that the use of affiliate and third-party service providers or vendors (service providers) is often an appropriate business decision for supervised financial institutions. The CFPB considers oversight of service providers to be a key component of an effective CMS, and expects supervised entities that retain or operate through service providers to have an effective process for managing the risks of those relationships to ensure compliance with applicable Federal consumer financial law. The mere fact that a financial institution enters into a business relationship with a service provider does not absolve the financial institution of responsibility for complying with Federal consumer financial law and does not give it license to "turn a blind eye" to violations of Federal consumer financial laws and regulations by the entity that is acting on its behalf. Depending upon the circumstances, responsibility for legal violations by a service provider may lie with the financial institution as well as with the service provider.

The CFPB has noted instances in which a financial institution has failed to establish a comprehensive service provider management program or failed to effectively manage service providers acting on its behalf to ensure compliance with Federal consumer financial law. Such situations have occurred, for example, when a financial institution and a service provider fail to adequately coordinate their correspondence with consumers, causing conflicting interest rate information to be mailed to delinquent credit card holders, accompanied by improper application of a penalty rate to the consumers' outstanding balances, in violation of the Truth in Lending Act (TILA).

Where such situations have occurred, the CFPB has directed financial institutions to develop and implement a comprehensive program that ensures the service providers' compliance with Federal consumer financial law. Such programs typically include consistent, risk-based procedures governing the retention and monitoring of service provider relationships, as well as policies and

procedures to monitor and test for compliance with Federal consumer financial law by service providers acting on behalf of the financial institution.[11]

C. Deficient Fair Lending Compliance Programs

The Equal Credit Opportunity Act (ECOA) makes it unlawful for any creditor to discriminate against an applicant in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, or age. ECOA also provides that the creditor may not discriminate based on the fact that all or part of an applicant's income derives from a public assistance program, or the fact that an applicant has in good faith exercised any right under the Consumer Credit Protection Act. In order to avoid potential fair lending compliance issues, every financial institution should establish fair lending policies, procedures and internal controls to ensure that it is operating in compliance with ECOA, and its implementing Regulation B, in all of the financial institution's relevant lines of business. While the appropriate program will vary from financial institution to financial institution, the CFPB's examiners have found the following common features at financial institutions with well developed fair lending compliance programs:

- An up-to-date fair lending policy statement;
- Regular fair lending training for all employees involved with any aspect of the institution's credit transactions, as well as all officers and Board members;
- Ongoing monitoring for compliance with fair lending policies and procedures;
- Ongoing monitoring for compliance with other policies and procedures that are intended to reduce fair lending risk (such as controls on loan originator discretion);
- Review of lending policies for potential fair lending violations, including potential disparate impact;
- Depending on the size and complexity of the financial institution, regular statistical analysis of loan data for potential disparities on a prohibited class basis in pricing, underwriting, or other aspects of the credit transaction, and including both mortgage and non-mortgage products, such as credit cards, auto lending, and student lending;
- Regular assessment of the marketing of loan products; and
- Meaningful oversight of fair lending compliance by management and where appropriate, the financial institution's board of directors.

The CFPB has found instances in which financial institutions lack any formal fair lending compliance system or in which financial institutions have implemented fair lending compliance systems that are sufficient with respect to some product lines, but exclude compliance oversight for other major lending products. In such situations, the CFPB has directed financial institutions to establish fair lending compliance programs commensurate with the size and complexity of the financial institution and its lines of business. If fair lending violations have occurred, the CFPB has directed remediation that included adoption of comprehensive policies and procedures, allocation of

[11] Further details about service provider relationships and the CFPB's expectations for financial institutions in managing those relationships, as well as CFPB's supervisory authority over service providers, can be found in CFPB Bulletin 2012-03, issued April 13, 2012. *See:* http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf .

sufficient resources to employee training and oversight, and review of adverse action letters to ensure they provide applicants with the required information. In some cases, financial institutions have been directed to expand their internal fair lending regression analysis, monitor compliance through special reports and certifications, or take other steps to address the potential existence of discrimination against applicants on a prohibited basis and to verify full compliance with ECOA.

III. Significant Violations Detected

In the course of its supervisory activities, the CFPB has discovered numerous violations of Federal consumer financial law. In each case, it has directed the financial institution that committed violations to take corrective action. Where warranted, restitution or other relief to consumers has also been provided. As a result of CFPB supervisory activity,[12] financial institutions have been directed to correct violations of a broad spectrum of Federal consumer financial laws and regulations. Examples of the types of violations detected through the CFPB's review of financial institutions' credit card, credit reporting, and mortgage origination activities are discussed below. In connection with these matters, the CFPB has confirmed that financial institutions have provided remedial relief to 1.4 million consumers, stopped illegal practices, adopted effective policies and procedures to ensure that violations do not recur, and implemented robust compliance management programs.

The CFPB, in conjunction with other financial regulators, has also completed three public enforcement actions against three credit card issuers based in part on the findings of CFPB examinations. These actions have terminated misleading and deceptive marketing and collection practices, improper fees, violations of credit reporting requirements, and other practices that have harmed consumers. As a result of these actions, $435 million in relief has been provided to approximately 5.75 million consumers. In addition, the violators will pay civil money penalties of approximately $101.5 million. To help specifically address the use of deceptive practices by credit card issuers to market credit card add-on products, the CFPB has outlined its supervisory expectations with respect to these products in Compliance Bulletin 2012-06.[13]

A. Violations by Credit Card Issuers.

1. Public Enforcement Actions

The CFPB has taken public enforcement actions to correct illegal practices by three credit card issuers. These practices include deceptive marketing of credit card add-on products, misleading consumers about fees or the benefits associated with such products, retaining customers who attempted to cancel such products, enrolling customers in products without their knowledge or consent, unlawful age discrimination against certain credit card applicants, deceptive debt collection practices, and others.[14]

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[12] See footnote 2.

[13] See: http://files.consumerfinance.gov/f/201207_cfpb_marketing_of_credit_card_addon_products.pdf

[14] Financial institutions violate sections 1031 and 1036 of the Dodd-Frank Act when they engage in any unfair, deceptive, or abusive act or practice ("UDAAP") in connection with offering or providing financial products or services to consumers. See 12 U.S.C. 5531 and 5536. Such acts or practices may cause significant financial harm to consumers, erode consumer confidence, and impede competition in the financial marketplace by inserting unfair competitive conditions or decreasing consumer willingness to engage in transactions.

a. Capital One Bank (U.S.A.) N.A.:

Through supervisory work, CFPB's examiners discovered that the call center vendors retained by Capital One Bank (U.S.A.) N.A. (Capital One) to promote its credit card programs engaged in deceptive practices in marketing the company's credit card add-on products.[15] These products include "payment protection" which provides for debt reduction or forgiveness for the consumer under certain circumstances, such as unemployment or disability, and "credit monitoring" which provides identity-theft protection and, in some cases, access to "credit education specialists" and daily monitoring and notification.

The CFPB determined that prospective customers with low credit scores or low credit limits who sought to activate a Capital One credit card were referred to a third-party call center where they were subjected to deceptive tactics to induce them to buy an add-on product. The deceptive marketing practices used to sell these products included the following:

- Misrepresenting the cost of the payment protection product;
- Enrolling customers in a program without their consent;
- Misleading customers about the benefits of the product;
- Telling customers they were required to purchase the product in order to receive full information about it;
- Retaining, through similar practices, customers who attempted to cancel the product;
- Misleading customers about eligibility for payment protection benefits.

As a result of the CFPB's enforcement action, Capital One will take a number of corrective steps. To ensure that all affected customers are repaid and that customers are no longer subjected to these misleading tactics, Capital One has agreed to end deceptive marketing and to undergo an independent audit to ensure compliance with the terms of the Consent Order with the CFPB. Pursuant to orders of the CFPB and the Office of the Comptroller of the Currency (OCC), it will also pay an estimated $150 million to approximately 2 million consumers who were affected by these practices. In addition, the CFPB and the OCC together have required Capital One to pay $60 million in civil money penalties.[16] Out of that total, $25 million has been paid into the CFPB's Civil Penalty Fund.

[15] This matter provides another example of failure to implement a comprehensive and effective vendor risk management program.
[16] Additional information about the Capital One matter, including the full text of the Consent Order, can be found on the CFPB's website at: www.consumerfinance.gov/pressreleases/cfpb-capital-one-probe.

b. Discover Bank

The CFPB and the Federal Deposit Insurance Corporation (FDIC) jointly determined that Discover Bank used deceptive telemarketing practices to sell the following add-on products to customers: (1) Discover Payment Protection, which was marketed as a product that allowed consumers to put their payments on hold for two years in the event of unemployment, hospitalization, or other qualifying life events; (2) Credit Score Tracker, which was marketed as providing a customer unlimited access to his or her credit reports and credit score; (3) Wallet Protection, which was sold as a service that helped a customer cancel credit cards in the event they were lost or stolen; and (4) Identity Theft Protection, which was marketed as providing daily credit monitoring.

The CFPB and the FDIC also determined that Discover, acting through telemarketers, misled consumers about the fact that they would be charged for the products, enrolled consumers in one or more programs without their consent, often falsely suggested that consumers would not be charged for the products until after having a chance to review printed materials from Discover, and withheld material information about eligibility requirements for certain benefits. These practices violated sections 1031 and 1036 of the Dodd-Frank Act, as well as section 5 of the Federal Trade Commission Act (FTCA).[17]

To settle these charges, Discover has agreed to: stop deceptive marketing practices; pay at least $200 million in restitution to the more than 3.5 million customers who purchased one or more credit card add-on products over the telephone between December 1, 2007 and August 31, 2011; and pay a $14 million civil money penalty. The CFPB's Civil Penalty Fund[18] will receive $7 million of this penalty amount.

Discover also agreed to undertake certain corrective actions that include reviewing, revising, or developing, as necessary, a risk-based compliance management system that will ensure that similar violations will not recur in the future. The compliance management system must provide for an effective training and compliance management program for all employees and service providers, including its telemarketers and telemarketing vendors. In addition, Discover must revise advertising and marketing materials so that they disclose clearly and prominently all material conditions, benefits, and restrictions; develop an internal control system to ensure future compliance with applicable laws and regulations; and submit to an independent audit which will report Discover's compliance with certain terms of this settlement to the FDIC and CFPB.[19]

c. American Express Companies

This enforcement action stemmed from examinations by the FDIC and the Utah Department of Financial Institutions, later joined by the CFPB, the Federal Reserve Board, and the OCC, regarding the American Express companies. The action encompassed violations of various Federal consumer financial laws and compliance management deficiencies at American Express Company and three American Express subsidiaries: American Express Centurion Bank, a state-

[17] 15 U.S.C. 45(a)(1).
[18] The civil penalty amount constitutes a penalty for over 3.5 million separate legal violations.
[19] Additional information about the Discover matter, including the full text of the Consent Order, can be found on the CFPB's website at: http://www.consumerfinance.gov/pressreleases/discover-consent-order.

chartered non-member bank; American Express Bank, FSB, a nationally-chartered savings association; and American Express Travel Related Services, a registered bank holding company and parent company of the two American Express banks (collectively, Amex).

The regulatory agencies found violations that occurred at various times from 2003 through the spring of 2012 in virtually every stage of the consumer experience. The enforcement action was based on the following practices:

Deceptive Marketing. American Express Centurion Bank undertook a direct mail credit card solicitation program that promised, but did not deliver, a cash bonus to consumers who met certain conditions. These actions were deceptive.[20]

Unlawful Age Discrimination. American Express Centurion Bank used a credit scoring system that unlawfully discriminated against certain charge card applicants on the basis of age, in violation of ECOA.[21]

Unlawful Fees on Existing Accounts. American Express Centurion Bank and American Express Bank, FSB, charged certain credit card customers an improper late fee, in violation of TILA, as amended by the Credit Card Accountability, Responsibility and Disclosure Act of 2009 (CARD Act).[22]

Consumer Disputes. American Express Centurion Bank and American Express Bank, FSB, created a system that failed to properly report certain consumer disputes of credit information to credit reporting agencies, in violation of the Fair Credit Reporting Act (FCRA).[23]

Deceptive Debt Collection Practices. Amex solicited debt payments from certain customers whose debt was in collection or charged off by misrepresenting to these customers that settlement of their debt would be reflected on their credit report and thus potentially improve their credit score. Additionally, Amex entered into debt settlement agreements with certain customers by misrepresenting that the customers' remaining debt would be "waived" or "forgiven." These practices were deceptive.[24]

To resolve all of these matters, Amex has agreed to refund approximately $85 million to 250,000 consumers, and take all actions necessary to ensure that it does not engage in deceptive practices, charge illegal fees, or unlawfully discriminate based on age in credit decisions. Amex has also agreed to properly report consumer disputes to credit reporting agencies and ensure that customers are told about their rights in the event of a dispute. It will take all necessary action to ensure that all credit scoring models applied to card applicants comply with the requirements of ECOA, and will certify that all qualified customers who suffered unlawful age discrimination were given an opportunity to reapply for credit. Finally, Amex will pay a civil money penalty in the total

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[20] 12 U.S.C. 5531 and 5536. The FDIC also determined that these actions violate section 5 of the FTC Act, 15 U.S.C. 45(a)(1).
[21] 15 U.S.C. 1691(a); 12 C.F.R. 1002.6.
[22] 15 U.S.C. 1601 *et seq.*, and section 1026.52(b)(1) of Regulation Z, 12 C.F.R. 1026.52(b)(1).
[23] 15 U.S.C. 1681 *et seq*.
[24] See 12 U.S.C. 5531and 5536, as well as the FTC Act, 15 U.S.C. 45(a)(1).

amount of $27.5 million to the CFPB, FDIC, OCC, and Federal Reserve Board. The CFPB's portion of the total, $14.1 million, will be paid into the CFPB's Civil Penalty Fund.

Amex will also be required to review, revise, develop, and/or implement a comprehensive compliance risk management program to ensure future compliance with all applicable Federal consumer financial laws. The program must include policies and procedures designed to prevent violations of Federal consumer financial law and associated harm to consumers; an effective training program; an enhanced CMS monitoring process; and an effective consumer complaint monitoring process. Additionally, Amex must develop and implement effective oversight of service provider agreements and services. Compliance with the terms of the consent orders will be verified through the work of an independent auditor.[25]

2. Non-Public Supervisory Actions to Address CARD Act Violations

The CARD Act was signed into law in 2009. It protects consumers from inaccurate and unfair credit card practices, prohibits certain misleading terminology in communications with cardholders, provides protections against certain interest rate increases and excessive late fees, requires financial institutions to fairly credit and allocate payments, and generally requires 45 days' notice of interest rate increases.

CFPB examiners have found one or more situations in which requirements of the CARD Act have not been followed. For example, the "Ability to Pay" provisions of the CARD Act[26] prohibit issuers from opening accounts or increasing credit lines for consumers who lack the financial capacity to repay the credit that would be extended to them. In some situations, credit lines associated with credit card accounts issued to consumers under the age of 21 based on the ability to pay of co-applicants age 21 or older were increased without the financial institution having received written authorization from the co-applicants. To ensure compliance, the CFPB has directed that co-applicants be contacted and that necessary written authorizations be obtained. Where written agreement cannot be obtained, the financial institutions must take corrective action, including reducing the credit line or the co-applicant's liability to the original credit line. Finally, because such violations typically occurred as a result of inadequate internal controls, the CFPB has directed affected financial institutions to reevaluate the process for addressing credit line increase requests on co-applicant accounts where one party is under the age of 21, ensure authorizations are sent and received prior to approving credit line increase requests on co-applicant accounts, and provide additional employee training.

Separately, the CFPB has found one or more situations in which a financial institution has failed to comply with the rate reevaluation requirements of the CARD Act and its implementing regulation, by failing to perform a rate review of an acquired portfolio within 6 months,[27] and failing to establish written policies for rate reevaluation practices.[28] In response to such conduct, the CFPB has directed that policies and procedures ensuring compliance be established. The CFPB also has

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[25] Additional information about the American Express matter, including the full text of the Consent Orders, can be found on the CFPB's website at: http://www.consumerfinance.gov/pressreleases/cfpb-orders-american-express-to-pay-85-million-refund-to-consumers-harmed-by-illegal-credit-card-practices.
[26] As implemented by Regulation Z, 12 CFR 1026.51(b)(2).
[27] As required by 12 CFR 1026.59.
[28] As required by 12 CFR 1026.59(b).

directed performance of rate reevaluation for any acquired portfolio, appropriate rate adjustments, and reimbursements, including interest, to all affected customers.

B. Violations That Relate to Credit Reporting

Credit bureaus assemble, maintain, and communicate reports with information about American consumers' credit activities to financial institutions and other parties. Often these reports include a credit score, which is a numerical risk assessment of the credit information in the credit bureau's file about a consumer. Creditors use this information to identify consumers eligible for credit offers, make eligibility and account review decisions, and pursue collection activities. A good credit report and high credit score can provide a consumer with greater access to credit and eligibility for a lower interest rate, which usually translates into smaller monthly payments. Inaccurate negative information in a consumer's credit report may cause a consumer to pay more for credit than would otherwise be the case or be unjustifiably denied credit altogether. Inaccurate negative credit report information also may unfairly impact an individual's ability to buy a home, obtain a job, or engage in other transactions.

The FCRA regulates the collection, use, and dissemination of consumer report information, and promotes the accuracy, fairness, and privacy of information held by the nation's credit bureaus. As noted above, the CFPB has issued a final rule defining the larger participants in the market for consumer reporting who are now subject to the CFPB's supervisory authority.

The CFPB also examines financial institutions for their compliance with the FCRA's requirements for handling consumers' credit information. Among other things, the FCRA and its implementing regulation, Regulation V, generally require entities that provide consumer information to credit bureaus to establish and implement reasonable written policies and procedures regarding the accuracy and integrity of the consumer information they furnish to these entities.[29] A party's failure to comply with the FCRA may cause significant consumer harm.

CFPB examiners have discovered one or more instances in which a financial institution's employees did not have sufficient training or familiarity with the requirements of the FCRA to implement it properly. Such deficiencies have resulted in failure to communicate appropriate and accurate account information to the credit bureaus, failure to indicate when account information had been disputed by consumers, and inability to determine whether disputes had been fully investigated. Such failures caused the financial institutions to be unaware of and therefore repeatedly fail to respond to communications from consumers about their accounts. In such situations, the relevant financial institutions were directed to take action to correct these FCRA violations. Such actions included implementing procedures for properly reporting consumer credit disputes to all credit bureaus, taking action on all disputes reported directly to the financial institution and correcting errors where appropriate, and deleting information regarding customers, as appropriate, upon completion of their credit dispute investigations.

C. Violations by Mortgage Originators

The Real Estate Settlement Procedures Act (RESPA), TILA, and other statutes are intended to protect consumers engaged in residential real estate mortgage transactions. Among other things,

[29] 12 CFR 1022.42.

RESPA requires residential mortgage lenders to provide consumers with clear and timely disclosures regarding the nature and costs of the real estate settlement process. TILA's implementing Regulation Z also requires certain disclosures by creditors about a loan transaction and prohibits payments to a loan originator that are based on the terms or conditions of the loan, other than the amount of credit extended. It also prohibits steering a consumer to a loan in order to increase the loan originator's compensation, unless the loan is otherwise in the consumer's interest.

During examinations, the CFPB has noted instances of significant non-compliance with these statutes. Violations under RESPA have included failures to make proper and complete disclosures to consumers of costs and other terms of a transaction due to inadequate or improper completion of the Good Faith Estimate and the HUD-1 settlement statement. Violations under TILA have included failures to provide accurate interest rate disclosures, and payment amounts and schedules, as well as disclosures regarding late payments, security interests, and assumption policies. The CFPB expects that all covered institutions under its jurisdiction will maintain the policies and procedures necessary to ensure full compliance with RESPA and TILA, and will require employees to know and follow these laws.

Where financial institutions have violated RESPA and/or TILA, they have been directed to implement appropriate policies, procedures, and monitoring to prevent recurrence of the violations, and to ensure that any third-party vendors, including mortgage brokers, are identified and included in the financial institution's oversight program and in relevant policies and procedures, in order to ensure that proper Good Faith Estimate and HUD-1 disclosures are provided to consumers, and that consumers are not improperly charged. Where appropriate, the CFPB has directed that consumers receive a corrected HUD-1. Where customers are improperly charged, the financial institution has been directed to provide reimbursement.

Another area of concern is mortgage originator compliance with the Home Mortgage Disclosure Act (HMDA). HMDA requires certain lenders to report specific information about their mortgage lending activity to regulators and the public. HMDA plays a key role in the work of the CFPB's examination teams and its Office of Fair Lending and Equal Opportunity, as well as other regulatory agencies. HMDA data helps the CFPB and other agencies ensure that credit is provided fairly and without illegal discrimination. Lenders that do not accurately report data as HMDA requires hinder regulators' and the public's ability to compare mortgage data across the industry in a meaningful way.

The CFPB expects financial institutions to have strong systems in place to ensure HMDA compliance. CFPB examiners have identified several financial institutions with significant error rates in data reported pursuant to HMDA. Failure to capture and accurately report HMDA data is a violation of legal requirements, and can also be an indicator of a weak CMS. Where the CFPB has found deficiencies, it has directed resubmission of HMDA data to correct errors. The CFPB has also directed financial institutions to improve their HMDA data collection and reporting systems, for example, by modifying policies and procedures to provide proper guidance to employees who prepare and submit HMDA data. The CFPB may also seek other corrective action or relief, as appropriate.

IV. Conclusion

Through its supervisory program, the CFPB examines financial institutions to determine their compliance with Federal consumer financial law, and addresses risks to consumers or markets for consumer financial products and services presented by the financial institutions' business practices. The CFPB expects to periodically publish *Supervisory Highlights* to provide general information about its supervision program without identifying specific institutions (except for enforcement actions already made public) and to help communicate the standards of conduct expected of supervised financial institutions. The CFPB's goal is to help ensure a financial services marketplace that operates in accordance with Federal consumer financial law and works well for both consumers and the businesses that serve them.

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Supervisory Highlights

Summer 2013

Consumer Financial
Protection Bureau

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1. Introduction

In the two years since the Bureau began to exercise its supervisory authority, the CFPB has continued to develop, expand, and improve its supervision program as it gained valuable experience through its reviews of both bank and nonbank compliance with Federal consumer financial laws.[1] Since the last issue of *Supervisory Highlights*,[2] CFPB supervisory actions have required changes to compliance management systems to prevent violations and reduce risks to consumers. CFPB's supervisory activities led to a public enforcement action, resulting in approximately $6.5 million in remediation to over 50,000 consumers. In addition, as a result of the CFPB's examination activities, a number of supervised entities self-identified violations and made restitution to approximately 10,000 additional consumers.

In this and future issues of *Supervisory Highlights,* the CFPB will review the development of the Bureau's supervision program and share certain key findings from our supervisory activities in order to help industry limit risks to consumers and comply with Federal consumer financial laws. In Supervisory Observations, we highlight findings in the areas of compliance management systems, mortgage servicing, and fair lending. Under Supervision Program Developments, this issue addresses the CFPB's supervisory priorities, the reorganization of supervision functions in Washington, D.C., and examiner staffing and training.

The CFPB supervises depository institutions (banks, thrifts, and credit unions) with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Act to supervise nonbanks, regardless of size, in certain specific markets: mortgage

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act Section 1002.

[2] The first issue was released on October 31, 2012, and can be found at: http://www.consumerfinance.gov/reports/supervisory-highlights-fall-2012.

companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB can also supervise the “larger participants” in other nonbank markets as the Bureau defines by rule. The Bureau has issued two rules defining larger participants: one rule for the consumer reporting market that went into effect in September 2012, and the other for the debt collection market that went into effect in January 2013. A proposed larger participant rule for the student loan servicing market was issued in March 2013.

This report highlights supervision work completed between November 2012 and June 2013. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

2. Supervisory Observations

2.1 Compliance Management Systems

As noted in the first issue of *Supervisory Highlights*, compliance management is vital to the prevention of violations of Federal consumer financial laws and the resulting harm to consumers. Because of the importance of a robust compliance management system (CMS), this issue of *Supervisory Highlights* addresses CFPB expectations for an effective CMS. The CFPB expects every entity it supervises to have an effective CMS adapted to its business strategy and operations. A CMS is how a supervised entity:

- Establishes its compliance responsibilities;
- Communicates those responsibilities to employees;
- Ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes;
- Reviews operations to ensure responsibilities are carried out and legal requirements are met;
- Takes corrective action, and
- Updates tools, systems, and materials, as necessary.

The CFPB does not require entities to structure their CMS in any particular manner. Large banking organizations with complex compliance profiles and a wide range of consumer financial products and services will likely manage compliance differently than entities that may be owned by a single individual or feature a narrow range of financial products and services. Other entities may outsource functions with consumer compliance-related responsibilities to service providers.

The CFPB also understands that supervised entities will organize their compliance management programs to include compliance not only with consumer-related laws that are within the scope of CFPB's supervision responsibilities, but also those under the jurisdictions of state or other

Federal agencies. However compliance is managed, entities are expected to structure their CMS in a manner sufficient to comply with Federal consumer financial laws and appropriately address associated risks of harm to consumers.

Though the CFPB performs on-site examinations, it expects compliance management systems to be in place in the normal course of business, not just in preparation for an examination. The CFPB is committed to an open dialogue with its supervised entities about their compliance management systems, and has provided CMS-specific procedures within the *Supervision and Examination Manual*,[3] which can be used by an entity to self-assess the effectiveness of its CMS.

2.1.1 CMS Findings

Nearly every examination or targeted review conducted by the CFPB contains an assessment of an entity's CMS, whether it is an assessment of how the entity manages its compliance program enterprise-wide, or how the entity meets its consumer compliance responsibilities within a specific product line.

The CFPB has found, through supervisory work, that nonbanks are more likely to lack a robust CMS, as their consumer compliance-related activities have not been subject to examinations at the federal level for compliance with Federal consumer financial laws prior to the Bureau's existence. The CFPB has identified one or more instances of nonbanks that lack formal policies and procedures, have not developed a consumer compliance program, or do not conduct independent consumer compliance audits. Lack of an effective CMS has, in a number of instances, resulted in violations of Federal consumer financial laws. In these instances, the CFPB expects the institution to implement appropriate corrective action, and in general, both banks and nonbanks have committed to improving their CMS accordingly.

CMS deficiencies noted in nonbanks are generally related to the supervised entity's lacking a CMS structure altogether. CFPB examinations have noted instances where nonbanks do not have a separate compliance function; rather, compliance is embedded in the business line. Policies and procedures and employee training developed within the business line can lead to various problems. For example, employees have not been trained in the legal requirements

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[3] The Manual can be found at: http://www.consumerfinance.gov/guidance/supervision/manual/.

applicable to their jobs, resulting in situations where similar consumer contacts are inconsistently handled within the same entity.

The CFPB has seen consumer complaint response handled in a similar manner, with the business line that received the complaint addressing the issue without any type of centralized method for tracking issues across the entity. Internal quality assurance and monitoring reviews handled only within the individual business line increases the risk that issues identified and addressed within one business line may not be identified or addressed in a similar manner within another. In addition, entities that maintained these decentralized monitoring practices did not conduct any type of roll-up reviews or trend analysis of findings across the entity as a whole, which hindered the entity's ability to identify systemic issues or to determine the root cause of regulatory violations or internal control weaknesses. In this regard, the CFPB has noted violations of Federal consumer financial law that have occurred because a nonbank has failed to address an issue across the entity as a whole.

The majority of banks examined by the CFPB have generally had an adequate CMS structure; however, several institutions lacked one or more of the components of an effective CMS, which creates an increased risk of noncompliance with Federal consumer financial laws.

The most common weakness identified during CFPB CMS reviews in banks is a deficient system of periodic monitoring and independent compliance audits, which will be discussed in further detail below. The CFPB has noted that an effective CMS implements both a system of periodic monitoring reviews and an independent compliance audit. The periodic monitoring reviews are conducted by either the individual business lines or the compliance department on a relatively frequent basis, generally monthly or quarterly, and allow the individual business lines or the compliance department to self-check their processes and ensure day-to-day compliance with Federal consumer financial laws. The independent compliance audit then conducts similar assessments on a less frequent basis, usually annually, to ensure that compliance with Federal consumer financial law is ongoing, that the CMS as a whole is operating properly, and that the board is aware of consumer compliance issues noted as part of these independent reviews.

An entity that lacks periodic monitoring and instead relies on the independent compliance audit to identify regulatory violations and CMS deficiencies increases its risk that violations and weaknesses will go undetected for long periods of time, potentially leading to multiple regulatory violations and increased consumer harm. Additionally, these entities increase the risk that insufficiencies in the periodic monitoring process may not be identified; that the board is not made aware of regulatory violations or program weaknesses; or that practices or conduct by

employees within the business lines or compliance department that are unfair, deceptive, abusive, discriminatory, or otherwise unlawful could go undetected.

2.1.2 CMS Elements

Although the CFPB does not require any specific CMS structure, supervisory experience has found that an effective CMS commonly has four interdependent control components:

1. Board of directors and management oversight;
2. A compliance program;
3. A consumer complaint management program; and
4. An independent compliance audit.

When all of these four control components are strong and well-coordinated, a supervised entity should be successful at managing its compliance responsibilities and risks. A discussion of each of these components follows.

BOARD OF DIRECTORS AND MANAGEMENT OVERSIGHT

All financial service providers have either a board of directors or one or more controlling persons that oversee the operations of the provider. In a bank, the board of directors is ultimately responsible for developing and administering the CMS. In a nonbank offering consumer financial services, the ultimate responsibility may rest with a board of directors in the case of a corporate entity or with a controlling person, senior management, or some other body.

An effective board of directors communicates clear expectations and adopts clear policy statements about consumer compliance, not only within the entity itself, but also to its service providers.[4] The board should establish a compliance function within the entity, allocating sufficient resources to that function, commensurate with the entity's size, organizational complexity, and risk profile. The board should ensure that the compliance function is appropriately staffed with a qualified chief compliance officer, and other additional compliance managers who have the authority and accountability necessary to implement the compliance

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[4] See CFPB Bulletin 2012-03 (April 12, 2012) for the CFPB's expectations on service provider relationships (http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf).

management program, with clear and visible support from senior management, as well. Management should ensure a strong compliance function and provide recurring reports of compliance risks, issues, and resolutions to the board or to a committee of the board.

In a financial services provider that does not have a board of directors, the controlling person or senior management should undertake similar measures to ensure an effective compliance program.

COMPLIANCE PROGRAM

The CFPB expects supervised entities to establish a formal, written compliance program, generally administered by a chief compliance officer. A compliance program includes the following elements:

- Policies and procedures;
- Training;
- Monitoring; and
- Corrective action.

A well-planned, implemented, and maintained compliance program will prevent or reduce regulatory violations, protect consumers from noncompliance and associated harms, decrease the costs and risks of litigation affecting revenues and operational focus, and help align business strategies with outcomes. A discussion of these four elements follows.

Policies and Procedures

Management should develop, and the board should approve, a system of policies and procedures that address every consumer financial product or service offered by the entity. Policies and procedures should be formal, written documents that detail consumer compliance responsibilities and instruct employees on the appropriate methods for executing these responsibilities. Policies and procedures are expected to address compliance with all applicable Federal consumer financial laws in a manner designed to prevent violations and to detect and prevent associated risk of harm to consumers. Management and the board are expected to ensure that the policies and procedures are maintained and modified regularly to remain current and to serve as a reference for employees in their day-to-day activities.

Training

A critical element of a compliance program is providing employees with regular training on their consumer compliance responsibilities. The consumer compliance training program should be current, complete, effective, and commensurate with the entity's size and risk profile. It should include training on not only the regulatory requirements imposed by Federal consumer financial laws, but also those imposed by the entity's own consumer compliance-related policies and procedures. Management and staff should receive regularly-scheduled training that reinforces and helps implement written policies and procedures.

In addition to training employees, a compliance program should ensure that board members receive sufficient information, including training, to enable them to understand the entity's consumer compliance responsibilities and the commensurate resource requirements.

Monitoring

Management and the board should develop a system of risk-based periodic monitoring reviews in order to ensure that transactions and other consumer contacts are handled in accordance with Federal consumer financial laws and with the entity's own policies and procedures. These periodic, risk-based reviews allow the individual business lines to identify procedural or training deficiencies within their operations in an effort to promptly identify and correct weaknesses.

Corrective Action

If monitoring reviews identify areas of weakness within a business line's operations, management should implement corrective actions to address the issues. Further, management should follow up on these corrective actions to ensure that the violation of law or program deficiencies have been resolved. Findings should be escalated to management and the board, where appropriate.

CONSUMER COMPLAINT MANAGEMENT PROGRAM

Financial service providers should be responsive to complaints and inquiries received from consumers. In addition, entities should monitor and analyze complaints to understand and correct weaknesses in their programs that could lead to consumer risks and violations of law.

Key elements of a consumer complaint management program include:

- The establishment of channels through which the entity can receive consumer complaints and inquiries. Such channels may include telephone numbers or email addresses dedicated to receiving consumer complaints or inquiries.
- The proper and timely resolution of all complaints;
- The recordation, categorization, and analysis of complaints and inquiries; and
- Reviews for possible violations of Federal consumer financial laws.

Entities should organize, retain, and analyze complaint data to identify trends, isolate areas of risk, and identify program weaknesses in their lines of business and overall CMS.

INDEPENDENT COMPLIANCE AUDIT

A compliance audit program provides a board of directors or its designated committees with a determination of whether policies and standards are being implemented to provide for the level of compliance and consumer protection established by the board. These audits should be conducted by a body independent of both the compliance program and the business functions. Audits should cover consumer sales as well as customer services. The audit results should be reported directly to the board or a board committee.

The audit schedule and scope is expected to be appropriate for the entity's size, its consumer financial product offerings, and structure for offering these products. The compliance audit program should address compliance with all applicable Federal consumer financial laws, and also identify any significant gaps in policies and standards.

2.2 Mortgage Servicing

Since the CFPB launched its supervision program, it has focused on the risks to consumers in mortgage servicing at both bank and nonbank entities. During the past two years, the CFPB has reviewed servicing practices, including:

- Servicing transfers;
- Payment processing; and
- Loss mitigation.

2.2.1 Servicing Transfers

During its reviews of mortgage servicing, the CFPB detected risks to consumers in transfers of the servicing of loans among institutions. For example, examiners found noncompliance with the requirements of the Real Estate Settlement Procedures Act (RESPA)[5] to provide disclosures to consumers about transfers of the servicing of their loans. In other reviews, examiners noted lack of controls relating to the review and handling of key documents – such as loan modification applications, trial modification agreements, and other loss mitigation agreements – necessary to ensure the proper transfer of servicing responsibilities for a loan. For example, examiners noted that one servicer conducted some due diligence on transferred servicing data but did not review any individual documents that the prior servicer had transferred, such as trial loan modification agreements.

As another example, at one servicer, examiners determined that documentation the servicer received in the transfer was not organized or labeled, and as a result, the servicer did not utilize existing applicable information, in particular, documents delinquent borrowers submitted to the prior servicer in connection with applications for loss mitigation. Because these practices created a risk of engaging in unfair practices, the CFPB expects the servicer to take corrective action, including linking imaged documents received in the transfer to the loan account in the servicer's systems. The CFPB also expects the servicer to ensure that it reviews documents to determine if they may be used in loss mitigation efforts, and that the documents are stored and organized appropriately.

2.2.2 Payment Processing

Servicers are responsible for processing loan payments and handling tax and insurance payments through escrow accounts. In its reviews, CFPB noted several issues related to these responsibilities.

In one instance, a servicer provided inadequate notice to borrowers of a change in the address to which they should send payments. This constituted a potentially unfair practice impacting thousands of borrowers. Examiners alerted the entity to this concern during the course of the

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[5] RESPA, 12 USC 2601 *et seq.*, is implemented through Regulation X, 12 CFR Part 1024.

examination, and the entity acted promptly to ensure that it did not impose late fees or other delinquency fees, or any other negative consequences, as a result of borrower actions attributable to the change.

As an example of concerns related to escrow accounts, one servicer decided – without notice to borrowers – to delay property tax payments from December of one year to January of the next. Instead of paying these taxes in December, which would have been consistent with past practice and the annual escrow statement, it paid the taxes in January of the following year, resulting in the borrowers' inability to claim a tax deduction for the prior year. The servicer failed to provide notice to consumers of the change, which affected thousands of consumers. CFPB cited an unfair practice for failing to provide notice regarding the change in date for property tax payments from escrow accounts. To remedy the situation, it is directing the servicer to identify impacted borrowers and compensate those harmed by this practice.

In another review, the CFPB determined that a servicer paid certain property taxes late, in violation of RESPA. The CFPB directed the servicer to pay any fees associated with the late payment, and to investigate whether consumers experienced any additional harm as a result of the late payments. Further, at the CFPB's direction, the servicer will notify consumers of the late payment and fee payment, and solicit information from borrowers about any additional harm caused by the late payment. If any such harm is identified, the servicer will remediate it.

Examiners have found violations of the Homeowners Protection Act (HPA) [6] at several servicers. In one examination, examiners found excessive delays in processing borrower requests for private mortgage insurance (PMI) cancellation. Additionally, in cases where PMI was canceled, the servicer improperly handled unearned PMI premiums in violation of the HPA. The CFPB required the servicer to amend its policies and procedures relating to PMI cancellation. The servicer also must conduct a review to determine whether borrowers were subject to additional harm caused by delays in processing PMI cancellations.

Additionally, examiners have found certain issues regarding default-related fees. Examiners identified a servicer that charged consumers default-related fees without adequately documenting the reasons for and amounts of the fees. Examiners also identified situations

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[6] 12 USC 4901 *et seq*.

where servicers mistakenly charged borrowers default-related fees that investors were supposed to pay under investor agreements. Servicers have refunded these fees to borrowers, often during the CFPB's examination.

2.2.3 Loss Mitigation

Another key area in mortgage servicing that presents risks to consumers is the loss mitigation process.[7] CFPB examiners have found several issues related to various aspects of loss mitigation, including:

- Inconsistent borrower solicitation and communication;
- Inconsistent loss mitigation underwriting;
- Inconsistent waivers of certain fees or interest charges;
- Long application review periods;
- Missing denial notices;
- Incomplete and disorganized servicing files;
- Incomplete written policies and procedures; and
- Lack of quality assurance on underwriting decisions.

When examiners identify these issues, CFPB expects corrective action, and in the case of violations, directs the servicer to improve its policies and procedures governing the handling of loans in loss mitigation and the documentation of servicer actions, as well as training appropriate personnel on the new policies and procedures. Additionally, CFPB has directed servicers to engage in specific corrective actions appropriate to the circumstances, such as: reviewing loss mitigation decisions and related fees or charges to borrowers to determine whether any reimbursement is appropriate, conducting periodic testing to monitor areas of concern, and providing reports to CFPB on progress completing these corrective actions.

In addition to general compliance risks, weak compliance management surrounding loss mitigation processes creates fair lending risk. CFPB expects that entities servicing mortgage loans will implement fair lending policies, procedures, and controls to ensure that they are

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[7] "Loss mitigation" refers to an alternative to foreclosure offered by the owner or assignee of a mortgage loan that is made available through the servicer to the borrower.

complying with the Equal Credit Opportunity Act.[8] While the appropriate program will vary from financial institution to financial institution, CFPB expects that at a minimum, entities servicing mortgage loans will conduct fair lending training for loss mitigation staff, and will engage in effective and timely fair lending risk assessments, compliance monitoring, and testing of fair lending risks.

Examiners have reviewed communications with borrowers in the course of the loss mitigation process. In one examination, examiners found that the servicer's procedures for requesting missing or incomplete information were cumbersome and made it difficult for consumers to provide the correct documentation. CFPB expects the servicer to improve the instructions it provides to borrowers in its communications. In another examination, examiners found that the servicer's communications to borrowers about the status of loan modification applications and documents submitted were deceptive. CFPB directed the servicer to change the language it used in these communications and to train employees responsible for developing communications to borrowers to prevent future violations.

Discussions have also occurred with major mortgage servicers about the upcoming mortgage servicing rules recently adopted by the CFPB, which take effect on January 10, 2014. The importance of compliance with these rules has been emphasized, and the examination materials that will be used to assess compliance with these new provisions have been published, well in advance of the compliance deadline.

2.3 Fair Lending – Provision of Adverse Action Notices

An additional focus of the CFPB continues to be reviewing compliance by banks and nonbanks with fair lending laws and regulations: the Home Mortgage Disclosure Act (HMDA)[9] and the Equal Credit Opportunity Act (ECOA). As a result of its reviews in this area to date, the CFPB

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[8] ECOA, 15 USC 1591 *et seq.*, is implemented by Regulation B, 12 CFR Part 1002.

[9] HMDA, 12 USC 2801 *et seq.*, is implemented by Regulation C, 12 CFR Part 1003.

reminds entities under its jurisdiction of their responsibilities regarding the provision of adverse action notices.

The CFPB has noted that some lenders are not complying with various aspects of the adverse action notification requirements under ECOA and Regulation B. ECOA requires creditors to provide notification of any adverse action taken on an application, unless the applicant is currently delinquent or in default.[10] Furthermore, ECOA requires that the creditor provide or make available a specific statement of reasons for such action.[11] Finally, a creditor must send an adverse action notice to an applicant within 30 days of receipt of a completed application.[12] The CFPB has found instances where supervised entities violated ECOA and Regulation B by failing to comply with either the provision, content, or timing requirements for adverse action notices.

In such instances, the CFPB has directed the entities to develop and implement plans to ensure that the appropriate monitoring and internal controls are in place to detect and prevent future violations. Supervised entities should maintain compliance management systems that ensure notifications are sent to consumers with the appropriate content and within the timeframes required under Regulation B. For example, loan servicers should have systems in place to determine whether borrowers who apply for a change in the terms of credit are entitled to adverse action notices. Some institutions may find it helpful to arrange for independent, internal reviews of loan files to ensure that the documentation supports the action taken and that all timing requirements are met. In addition, institutions should provide comprehensive periodic training to management and staff regarding compliance with ECOA and Regulation B, including compliance with provisions on adverse action notices.

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[10] 15 USC 1691(d)(1); 12 CFR 1002.9(a)(1), Official Staff Commentary, 12 CFR 1002.2(c)(2)(ii)-2.

[11] 15 USC 1691(d)(2)-(3); 12 CFR 1002.9(a)(2).

[12] 12 CFR 1002.9(a)(1). Additionally, the failure to provide adverse action notices may also constitute violations of the Fair Credit Reporting Act (FCRA), 15 USC 1681 *et seq*.

2.4 Significant Violations Detected

2.4.1 Public Enforcement Action

Since the last issue of *Supervisory Highlights*, supervisory activities have resulted in the following public enforcement action, which emphasizes the importance of monitoring the activities of service providers.

On June 27, 2013, CFPB announced that it had ordered U.S. Bank and one of its nonbank partner companies, Dealers' Financial Services (DFS), to end deceptive marketing and lending practices targeting active-duty military. The two companies must return about $6.5 million to servicemembers for failing to properly disclose all the fees charged to participants in the companies' Military Installment Loans and Educational Services (MILES) auto loans program, and for misrepresenting the true cost and coverage of add-on products financed along with the auto loans. In particular, through its supervisory work, the CFPB found that U.S. Bank required servicemembers to repay their auto loans using the military allotment system – which deducts payments directly from a military member's paycheck before that salary is deposited in his or her bank account – but did not properly disclose the processing fee charged for using the allotment system or how often payments would be taken by allotment. Under the CFPB orders, the companies have agreed to stop deceptive practices, pay restitution to servicemembers, provide refunds or credits without any further action by consumers, stop requiring the use of military allotments, improve disclosures, and submit required reports to demonstrate their compliance with the orders.

2.4.2 Non-Public Supervisory Actions

In addition to the public enforcement action above, supervisory activities have resulted in remediation to approximately 10,000 additional consumers. In some instances, this remediation was initiated by the supervised entity and reported to the CFPB, further emphasizing the importance of robust compliance management systems in the early detection and resolution of violations of Federal consumer financial laws. These examples of remediation span many of the markets under the CFPB's supervisory authority, such as banks, mortgage servicers, and short-term, small dollar lenders.

3. Supervision Program Developments

3.1 Recent Supervisory Guidance

The CFPB is committed to providing guidance to both industry and the public as its supervisory program priorities develop over time.[13] As the CFPB continues to develop and refine its supervisory program, we have intentionally employed a strong quality control function to ensure consistency in our supervisory activities. Some of our recent guidance includes fair lending examination modules, as well as bulletins concerning auto finance and mortgage servicing transfers.

3.1.1 Equal Credit Opportunity Act (ECOA) Baseline Review Modules

In July 2013, the CFPB added new fair lending examination procedures to the *Supervision and Examination Manual* to help streamline fair lending reviews. These procedures, known as the Equal Credit Opportunity Act (ECOA) Baseline Review Modules (the Modules), will be used by examiners during ECOA baseline reviews[14] to identify and analyze fair lending risks, facilitate

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[13] Guidance bulletins and other relevant information can be found at: http://consumerfinance.gov/guidance/.

[14] ECOA baseline reviews are one type of fair lending review conducted by the CFPB, in addition to ECOA targeted reviews and Home Mortgage Disclosure Act (HMDA) reviews. An ECOA targeted review includes an in-depth look at a specific area of fair lending risk, and is conducted using the ECOA Examination Procedures within the Manual. A HMDA review includes transactional testing for HMDA data accuracy, and is conducted using the HMDA Examination Procedures within the Manual.

the identification of certain types of ECOA and Regulation B violations, and inform fair lending prioritization decisions for future CFPB reviews.

The CFPB is publishing the Modules in order to provide supervised entities a better understanding of how the CFPB identifies potential fair lending risks. In addition, supervised entities can use the Modules to develop fair lending compliance programs that are appropriate to the size and nature of their business.

When a baseline review is scheduled, examiners and the Office of Fair Lending will determine which modules should be completed. Once the appropriate modules have been selected, and in advance of the review, examiners will send the supervised entity information requests that correspond with the selected modules. In addition to information request responses, examiners may review other sources of information to complete the Modules, including publicly available information about the entity and information obtained at interviews or other supervisory meetings with the entity.

Findings identified in the Modules are not determinative of whether a supervised entity has violated the law; rather, the Modules are designed to identify risks of such violations. Any fair lending risks found in a particular review will be assessed to determine what, if any, further actions should be taken given the known information about the particular entity.

As always, the CFPB welcomes feedback and comments regarding this compliance tool and others to address fair lending concerns. Feedback may be addressed to: FairLending@cfpb.gov.

3.1.2 Auto Finance[15]

In March 2013, the CFPB released a compliance bulletin reminding certain lenders offering auto loans through dealerships that they could be held responsible for unlawful, discriminatory pricing. Discriminatory markups[16] in auto lending may result in tens of millions of dollars in

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[15] This Bulletin can be found at: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[16] Markups occur when an indirect auto lender has a policy that allows the dealer to "mark up" the interest rate above the indirect auto lender's buy rate. In the event that the dealer charges the consumer an interest rate that is higher than the lender's buy rate, the lender may pay the dealer what is typically referred to as "reserve" (or "participation"),

consumer harm each year. In particular, the bulletin provides guidance for indirect auto lenders within the CFPB's jurisdiction on ways to limit the fair lending risk of dealer markup and compensation policies in accordance with ECOA.[17]

The CFPB recommends that indirect auto lenders take steps to ensure that they are operating in compliance with fair lending laws as applied to dealer markup and compensation policies. These steps may include, but are not limited to:

- Imposing controls on dealer markup, or otherwise revising dealer markup policies, and monitoring and addressing the effects of markup policies as part of a robust fair lending compliance program;

or

- Eliminating dealer discretion to markup buy rates and fairly compensating dealers using a different mechanism that does not result in discrimination.

3.1.3 Mortgage Servicing[18]

In February 2013, the CFPB released guidance to residential mortgage servicers and subservicers about risks to consumers relating to transfers of servicing. This Bulletin noted the CFPB's commitment to carefully review servicers' compliance with applicable Federal consumer financial laws related to servicing, such as the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act,[19] and prohibitions on unfair, deceptive, or abusive acts or practices (UDAAPs). The Bulletin emphasizes that even if conduct

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compensation based upon the difference in interest revenues between the buy rate and the actual note rate charged to the consumer in the retail installment contract executed with the dealer.

[17] The ECOA makes it illegal for a creditor to discriminate in any aspect of a credit transaction on prohibited bases including race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise, in good faith, of a right under the Consumer Credit Protection Act. 15 USC 1691 *et seq*.

[18] This Bulletin can be found at: http://files.consumerfinance.gov/f/201302_cfpb_bulletin-on-servicing-transfers.pdf.

[19] 15 USC 1692 *et seq*.

does not violate any specific prohibitions in other statutes, the conduct may nonetheless constitute a UDAAP under the Dodd-Frank Act.[20]

In addition, the Bulletin advises servicers that CFPB examiners will direct particular attention to the following areas:

- How a transferor servicer has prepared for the transfer of servicing rights and/or responsibilities;
- How a transferee servicer handles the files transferred to it; and
- For loans with loss mitigation in process, what policies the transferor and transferee have implemented, including what procedures they adopted, to facilitate the transfer of information, documents, and payments and to communicate with the borrowers accurately about the status of loss mitigation applications.[21]

Section 2.2, above, discusses supervisory observations related to servicing transfers, as well as other mortgage servicing practices.

3.2 Program Implementation

3.2.1 Headquarters Reorganization

When the CFPB began its supervisory operation, it established two offices in Washington, D.C. to oversee its supervisory program. The Office of Large Bank Supervision took responsibility for the supervisory authority transferred from other federal agencies – examining institutions with assets over $10 billion, and their affiliates. The Office of Nonbank Supervision was tasked with building a program to supervise the consumer compliance activities at nonbank entities – a role

[20] The CFPB Supervision and Examination Manual provides further guidance on how the UDAAP prohibition applies to supervised entities.

[21] The Bulletin also provides an overview of the servicing transfer-related provisions of the new mortgage servicing rules, which take effect on January 10, 2014. These rules will require servicers to maintain policies and procedures that are reasonably designed to achieve the objectives of facilitating the transfer of information during mortgage servicing transfers.

that had not existed previously at other Federal agencies. In order to improve program efficiency across the combined bank and nonbank markets, in December 2012, the CFPB realigned its Headquarters supervision staff into two new offices: the Office of Supervision Examinations and the Office of Supervision Policy. Our regional examination workforce was organized from the outset without regard to entity type.

The Examinations office focuses on many of the processes and the work vital to support CFPB examiners throughout the country. This office oversees our efforts to:

- Plan and appropriately execute examinations to evaluate compliance with Federal consumer financial laws in light of our resources and priorities;
- Recruit, train, and commission examiners; and
- Ensure policies and procedures are followed.

The Policy office, organized by product or service market such as mortgage lending, oversees efforts to:

- Develop supervision strategy and policy across both bank and nonbank markets;
- Ensure policy decisions for supervision across markets, charters, and regions are consistent with the law and the CFPB mission; and
- Provide ongoing expert support to examiners in each product market.

3.2.2 Examiner Training and Staffing

Since the outset of the CFPB's supervision program, examiner recruiting has been a central priority. As the CFPB works to reach a steady state, the focus remains on recruiting staff who can bring a broad range of skills and experiences to the examination program, including in-depth knowledge of Federal consumer financial laws. In particular, as of July 1, 2013:

- CFPB Supervision staff includes over 300 examiners. A significant majority of them have experience in examinations at federal or state regulators, or from private industry.
- Nearly 100 of our examiners are commissioned, either coming to the CFPB with commissioning credentials from other agencies, or earning commissions through the CFPB's interim commissioning process. The CFPB is currently developing its own

commissioning program similar to those utilized by the prudential regulators, but focused on the CFPB's unique mission.

- Examiners are supervised by our regional teams, who have significant experience in the consumer financial protection arena, and supported by headquarters staff.

The CFPB continues to develop and provide training opportunities to further strengthen the expertise of our examination staff, especially with regard to the CFPB's recently introduced mortgage rules, and to ensure the broad knowledge necessary to examine both banks and nonbanks.

3.2.3 Risk-Based Approach to Examinations

Our singular focus on consumer protection, combined with the wide range of both entities and products that fall under the CFPB's supervisory authority, requires use of an examination prioritization process that focuses on the greatest risks to consumers.

Our focus on consumer protection influences another aspect of our approach to supervision. In particular, our risk assessments are made not just on an entity or organization-wide basis, but also at the consumer business unit level, what we call "Institution Product Lines" or IPLs. This approach allows for comparisons of products across entities and aligns with the CFPB's objective of ensuring that Federal consumer financial laws are enforced consistently across the marketplace, without regard to business structure, type of charter, or location.

Several factors influence the CFPB's examination priorities, including a risk-based prioritization of the entities, products, and markets under the CFPB's jurisdiction. This risk-based analysis assesses a number of factors,[22] including:

[22] The factors incorporate the risk factors that the CFPB is required to take into account with respect to its nonbank supervision program under Dodd-Frank Act Section 1024(b)(2).

Product Markets:

- **Market Size**: the relative product market size in the overall consumer finance marketplace; and
- **Market Risk**: the potential risk to a consumer from new or existing products offered in the market.

Institution Product Lines:

- **Institution Product Size**: an entity's market share or level of activity within a product market; and
- **Field and Market Intelligence**: other relevant information about a supervised entity (which may include a variety of factors including complaints, strength of compliance systems, and management commitment to compliance).

4. Conclusion

Through its supervisory program, the CFPB examines financial institutions to determine their compliance with Federal consumer financial law, to obtain information about their activities and compliance systems and procedures, and to detect and assess risks to consumers or markets for consumer financial products and services. The CFPB plans to periodically publish *Supervisory Highlights* to provide general information about its supervision program without identifying specific institutions (except for enforcement actions already made public) and to help communicate the standards of conduct expected of supervised entities. The CFPB's goal is to help ensure a financial services marketplace that operates in accordance with Federal consumer financial law and works well for both consumers and the businesses that serve them.

Supervisory Highlights

Winter 2013

cfpb Consumer Financial Protection Bureau

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1. Introduction

The CFPB remains committed to transparency in its supervisory program by sharing key findings in order to help industry limit risks to consumers and comply with Federal consumer financial law. To that end, the Bureau is releasing its third edition of *Supervisory Highlights* in order to share its latest observations.

Since the last issue of *Supervisory Highlights*, CFPB supervisory activities have uncovered unfair and deceptive practices in violation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in markets supervised by the Bureau, such as the mortgage servicing industry. CFPB examination teams have continued to encounter weaknesses in compliance management systems (CMS) and where necessary, have directed institutions to implement changes to prevent violations and reduce risks to consumers in various markets.

CFPB's supervisory activities either led to or supported six recent public enforcement actions.[1] As a result of a recent enforcement action against JP Morgan Chase and Chase Bank, 2.1 million consumers will receive over $309 million in refunds related to credit card add-on products. Chase will also pay $20 million in civil money penalties. Also related to credit card add-on products, more than 335,000 customers of American Express have received, or will shortly, approximately $59.5 million in refunds as a result of supervision and enforcement action. American Express will pay $9.6 million in civil money penalties to the CFPB. In the Bureau's first enforcement action against a payday lender, Cash America will pay $14 million in refunds related to illegal collections activities. It will also pay $5 million in civil money penalties as a result of these violations and for violating the Military Lending Act and for destroying records in advance of the CFPB examination. Enforcement actions against Mortgage Master, Inc. and

[1] The CFPB Office of Enforcement also brought other actions unrelated to supervisory activities.

Washington Federal, N.A. resulted in over $450,000 in civil money penalties related to the accuracy of data reported pursuant to the Home Mortgage Disclosure Act (HMDA): $425,000 against Mortgage Master and $34,000 against Washington Federal. Finally, an enforcement action against Ally Financial Inc. and Ally Bank resulted in the federal government's largest auto loan discrimination settlement in history, with expected compensation totaling $80 million to more than 235,000 African-American, Hispanic, and Asian and Pacific Islander borrowers; and payment of $18 million in civil money penalties.

In addition to these public enforcement actions, recent nonpublic supervisory actions and self-reported violations have resulted in at least $2.6 million in remediation to consumers.

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Act to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.[2]

The CFPB may also supervise nonbank "larger participants" in other markets as the Bureau defines by rule. To date, the Bureau has issued three rules defining larger participants in the following markets: consumer reporting (effective September 2012), debt collection (effective January 2013), and student loan servicing (effective March 2014).

This report highlights supervision work completed between July and October 2013, and related enforcement actions announced before publication. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

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[2] Banks, saving associations and credit unions with assets over $10 billion and their affiliates are generally referred to as "depository institutions" or "banks." Other companies that provide consumer financial products and services, but are not affiliates of large depository institutions, are referred to as "non-depository institutions" or "nonbanks." The term "financial institution" refers to both depository and non-depository institutions collectively.

2. Supervisory Observations

2.1 Mortgage Servicing

As the CFPB reported in the last edition of *Supervisory Highlights*, CFPB examiners have uncovered practices at mortgage servicers that can harm consumers. The CFPB has continued to focus on a wide spectrum of supervisory concerns at bank and nonbank mortgage servicers. In particular, CFPB examiners identified law violations relating to:

- Servicing transfers;
- Waivers of rights in loss mitigation agreements;
- Payment processing;
- Furnishing information to consumer reporting agencies; and
- Other issues arising in servicing of defaulted loans.

New mortgage servicing rules took effect on January 10, 2014. The issues discussed in this edition of Supervisory Highlights relate to practices under pre-existing law, before the effective date of the new rules. In particular, the prohibition on engaging in unfair, deceptive, or abusive acts or practices (UDAAPs) provided -- and continues to provide -- important protections for consumers.

2.1.1 Servicing Transfers

The new mortgage servicing rules that took effect on January 10, 2014, have specific provisions addressing servicing transfers. However, pre-existing law prohibits servicers from engaging in acts or practices that are unfair, deceptive, or abusive, including in the course of servicing transfers.

CFPB examiners found that two servicers had engaged in unfair practices in connection with servicing transfers. Specifically, these servicers failed to honor existing permanent or trial loan

modifications after a servicing transfer. In many instances, they failed to honor the trial modifications unless they were able to independently confirm that the prior servicer properly offered a trial modification, even if the investor had previously approved the trial modification. In other instances, the servicer did not identify a permanent or trial loan modification in the records that the prior servicer transferred. Often the servicers required borrowers to submit additional paperwork or subjected the borrowers to significant delay while re-underwriting the loan modifications. These servicers also engaged in deception in connection with this practice by communicating to borrowers that they should have made the payments required by the original note, instead of acknowledging that the borrowers were to make reduced payments set by their trial modification agreements with the prior servicer.

For example, one servicer conducted collection activities, sent default letters to borrowers performing under loss mitigation agreements, attempted to collect the contractual monthly payment amount (rather than the lower trial modification amount), and called borrowers repeatedly to represent that they should have paid amounts exceeding those required by their modification agreements. To remedy these violations, Supervision directed the servicers to cease the practices and implement revised policies and procedures regarding transferred trial modifications to identify all transferred trial modifications and secure all documentation related to a transferred trial modification at the time of transfer. Supervision also directed the servicers to take remedial measures to address consumer harm.

Additionally, CFPB examiners detected other risks and law violations as a result of servicing transfers. In one examination, a servicer failed to provide notices of transfer to consumers with newly transferred loans within 15 days of the transfer as required by RESPA. Supervision directed the servicer to develop policies and procedures to ensure the timely issuance of notices of transfer.

2.1.2 Waivers of Rights in Loss Mitigation Agreements

At two servicers, Supervision cited the unfair practice of requiring all borrowers, regardless of individual circumstance, to enter into across-the-board waivers of existing claims in order to obtain a forbearance or loan modification agreement. As these servicers presented these clauses in a “take it or leave it” fashion in the ordinary course of offering loss mitigation agreements, rather than in the context of resolution of a contested claim or another individualized analysis of the servicer’s risks and the consumer’s potential claims, Supervision determined that these servicers had engaged in unfair practices. As a result, Supervision directed these servicers to cease using broad waiver clauses like those identified in these examinations in loss mitigation

agreements in the ordinary course of business, without regard to individual circumstances. Supervision also directed them to cease enforcing the existing unfair waiver clauses and to provide notice to the borrowers that it would not enforce these waivers in the future.

2.1.3 Payment Processing

Some servicers market bi-weekly payment programs to borrowers, and one servicing examination identified deceptive marketing of such a program. Examiners found that the solicitations for the program misrepresented to borrowers when the payment program would apply the payments and the source of the savings resulting from the program. The overall net impression of the solicitation was that, if a consumer signed up for the program, the servicer would be crediting payments biweekly, when in fact the program submitted payments monthly as usual and retained the extra money to make a 13th annual payment. Consumers would expect to save mortgage interest as a result of the biweekly crediting, and the communications failed to disclose adequately that the 13th extra payment was the sole source of savings under the program.

As part of the escrow function, servicers send annual notices to borrowers regarding the escrow account balances, and to correct any shortage or surplus. Examiners identified a deceptive practice at one servicer, where the escrow statements to delinquent borrowers stated that the consumer would receive a refund of escrow surplus, when in fact the account was delinquent and the consumer would not be receiving a refund. Supervision directed the servicer to cease the practice of stating that the consumer would receive a refund of a surplus, and to implement monitoring procedures to ensure that this practice did not reoccur.

Additionally, examiners identified violations of the Homeowners Protection Act (HPA) at servicers, including failure to automatically terminate private mortgage insurance (PMI) on the date that the principal balance reaches 78 percent of the original value of the property. For example, a servicer imposed an additional requirement that the loan had been originated at least two years ago, when the HPA does not permit such a requirement. Examiners also identified HPA violations where the servicer failed to return premium amounts to the borrower within the 45 days that HPA requires for return of funds after the borrower appropriately requested PMI cancellation.

2.1.4 Furnishing of Information to Consumer Reporting Agencies

Mortgage servicers generally furnish data to consumer reporting agencies. In one examination, Supervision cited Fair Credit Reporting Act violations as a result of the servicer's failure to comply with the Furnisher Rule,[3] which imposes specific obligations on entities that provide information to consumer reporting agencies. In one matter, the servicer engaged in a significant number of short sales, and then it reported the short sales using the credit reporting "code" for foreclosure. Incorrectly identified short sales on a person's credit report can impede the person's ability to obtain conventional home financing because common underwriting standards treat short sales and foreclosures much differently. This servicer self-identified the issue through internal audits and reported it to the CFPB; it also began working to remedy the inaccurate reporting.

At another examination, examiners found that the servicer had identified through internal audits that it had misreported certain information to consumer reporting agencies. Specifically, the servicer misreported borrowers who had trial loan modifications as being in the foreclosure process and inaccurately reported whether certain loan modifications were made under governmental or proprietary programs. These audit findings raised concerns about the servicer's compliance with the Furnisher Rule. The examiners subsequently found that the servicer implemented new procedures to correct the mistakes identified in its internal audits in a timely manner and the servicer otherwise maintained acceptable procedures. To address the consumer risks, Supervision directed the servicer to strengthen credit reporting practices to ensure that it reports accurate information to consumer reporting agencies, including monitoring and tracking exceptions to identify and correct the root causes of any inaccurate reporting, and improve training and other processes.

2.1.5 Other Default Servicing Issues

At another servicer, examiners identified loss mitigation costs that the servicer charged to certain borrowers in error. The servicer promptly worked to correct the underlying software coding mistake and will reverse the fees. Supervision directed the servicer to complete its

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[3] 12 CFR 1022.42 and Appendix E.

analysis to identify any erroneously charged fees, reverse the fees, and report to the CFPB on the status of affected loans.

The CFPB has a particular interest in protecting consumers serving in the military, and military consumers have certain supplemental protections relating to consumer financial products. Examiners noted that two servicers were at risk of committing legal violations and creating consumer harm for failing to conduct applicable checks and document the results regarding a borrower's military status prior to referring the borrower to foreclosure.

Additionally, examiners identified an unfair act relating to the treatment of a military borrower who received a deferred payment plan under state law while on active military duty. Despite written confirmation of the deferred payment plan, the servicer failed to properly code the account to reflect the deferral. The borrower began receiving collection calls and letters indicating the account was past due, and that the loan would be referred to foreclosure if it was not brought current. The servicer did not correct the mistake promptly when the borrower complained, and it charged improper late fees to the borrower and reported the loan to the credit bureaus as delinquent during the deferral period. In this instance, the servicer ultimately removed the late fees and corrected the credit reporting on the account, and Supervision directed the servicer to revise policies and procedures to ensure that any such payment plans are honored, and to train employees to prevent future violations.

In one examination, Supervision cited a deceptive practice in connection with short sale conditional approval letters. As a general matter, servicers send these letters when they are willing to approve a short sale for less than the amount owed on the mortgage if certain conditions are met. In this instance, Supervision determined that short sale conditional approval letters that state the borrower must "close" by a specific sale date, when in fact the servicer also required that it (1) receive the funds by that date and (2) conduct a review of the file to ensure the loan is paid off according to investor guidelines by that date, were deceptive. A consumer could reasonably interpret "closing" to mean when the buyer, seller and settlement agent execute the closing documents, exchange funds, and transfer title to the property if the document does not say otherwise. The misrepresentation would be material, for example, because a consumer would likely select an earlier date for closing if he or she knew the servicer required receipt of the funds before the prescribed date. To remedy these violations, Supervision directed the servicers to clearly and prominently disclose all material terms of the conditional approval and conduct a review to address past consumer harm resulting from this practice.

Mortgage servicers sometimes undertake collection activities, including attempts to contact the borrower and collect on an outstanding amount due. Examiners noted an issue at one servicer, where collection agents failed to honor existing requests from consumers directing the servicer to contact their attorneys for all communications. The servicer continued to contact the consumers in violation of the Fair Debt Collection Practices Act (which was applicable to the particular activities of the servicer at issue). Supervision directed the servicer to implement training and monitoring to prevent future violations.

2.2 Remedial Actions

2.2.1 Public Enforcement Actions

CFPB's supervisory activities resulted in or supported the following public enforcement actions.

CHASE AND JP MORGAN CHASE

On September 19, 2013, CFPB ordered Chase Bank USA, N.A. and JPMorgan Chase Bank, N.A. to refund an estimated $309 million to more than 2.1 million customers for illegal credit card practices. This enforcement action was the result of work started by the Office of the Comptroller of the Currency (OCC), which the CFPB joined last year. The agencies found that Chase engaged in unfair billing practices for certain credit card "add-on products" by charging consumers for credit monitoring services that they did not receive. Consumers unfairly incurred charges for interest and fees, and failed to receive the benefits of the products. In addition to providing refunds, Chase has agreed to end the unfair billing practices, submit to an independent audit, improve its oversight of third-party service providers, and pay $20 million to the CFPB's Civil Penalty Fund.

MORTGAGE MASTER AND WASHINGTON FEDERAL

The Home Mortgage Disclosure Act (HMDA) is intended to provide the public with loan data that can be used: (i) to help determine whether financial institutions are serving the housing needs of their communities, (ii) to assist public officials in distributing public-sector investment to help attract private investment to areas where it is needed, and (iii) to assist in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes, such as the Equal Credit Opportunity Act (ECOA).

The CFPB considers accurate HMDA data and effective HMDA compliance management systems to be of great importance. The CFPB routinely reviews HMDA data and assesses compliance programs as part of its supervision of both banks and nonbanks. To date, the CFPB has conducted HMDA reviews at dozens of financial institutions, both bank and nonbank, and has found that many lenders have adequate HMDA data compliance management systems, resulting in HMDA data with no errors or errors falling under the resubmission thresholds.[4]

However, several HMDA reviews at financial institutions found error rates over the resubmission thresholds and Supervision directed the financial institutions to resubmit their HMDA data and improve their HMDA compliance systems. In October, the CFPB entered into Consent Orders with two lenders to address violations of HMDA. One entity, Mortgage Master, Inc., is a nonbank headquartered in Walpole, Massachusetts. The other entity, Washington Federal, is a bank headquartered in Seattle, Washington. During examinations at these institutions, Supervision found patterns of HMDA non-compliance and severely compromised mortgage lending data. The entities were required to improve their HMDA compliance management systems, resubmit their HMDA data, and pay civil money penalties. Mortgage Master paid $425,000 in penalties and Washington Federal paid $34,000 in penalties, which reflects the relative gravity of the violations in each instance.

CASH AMERICA

On November 20, 2013, the CFPB announced an enforcement action against Cash America International, Inc., a payday lender, for robo- signing court documents in debt collection lawsuits. The CFPB also found that Cash America – one of the largest short-term, small-dollar lenders in the country – violated the Military Lending Act by illegally overcharging servicemembers and their families. Cash America will pay up to $14 million in refunds to consumers who were victimized by these practices. This enforcement action arose from a CFPB examination, and the consent order includes a $5 million fine for these violations and for destroying records in advance of the Bureau's examination. This was the Bureau's first public enforcement action against a payday lender, its first public action under the Military Lending

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[4] A resubmission threshold is the data accuracy standard that the Bureau uses in its examinations. If an institution's data errors exceed the resubmission threshold, Supervision may direct the institution to correct and resubmit its HMDA Loan Application Register (LAR). For more guidance on these thresholds, see http://files.consumerfinance.gov/f/201310_cfpb_hmda_compliance-bulletin_fair-lending.pdf.

Act, and its first public action involving a company's failure to comply fully with a CFPB examination.

ALLY FINANCIAL INC. AND ALLY BANK

On December 19, 2013, the CFPB, in partnership with the Department of Justice (DOJ), ordered Ally Financial Inc. and Ally Bank to pay $80 million to more than 235,000 minority customers who paid higher interest rates on their auto loans because of Ally's discriminatory pricing system. The CFPB and DOJ's actions marked the federal government's largest auto loan discrimination settlement in history. The CFPB, acting jointly with the DOJ, found that Ally through its indirect auto financing program sets a minimum interest rate that a dealer charges a borrower. Ally's policy then allows the dealer to increase – or mark up – the interest rate and shares the profit made from the markup with the dealer. As a result of this policy, the CFPB and DOJ found that African-American, Hispanic, and Asian and Pacific Islander borrowers paid more for auto loans than did similarly-situated non-Hispanic white borrowers. In addition to providing consumer remuneration, Ally has agreed to establish an enhanced compliance framework. Ally will monitor dealer markup in order to prevent or redress future discrimination or can decide to eliminate dealer markups altogether. Within this framework, Ally will be able to exercise its business judgment about how to achieve compliance with fair lending law. Finally, Ally agreed to pay $18 million in penalties to the CFPB's Civil Penalty Fund.

AMERICAN EXPRESS

On December 23, 2013, in coordination with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC), the CFPB ordered American Express Centurion Bank, American Express Bank, FSB, and American Express Travel Related Services (American Express) to pay $59.5 million to more than 335,000 consumers for unfair billing practices and deceptive marketing of credit card add-on products. In addition to consumer restitution, American Express agreed to eliminate all deceptive or unfair practices and violations of other laws relating to the sale, marketing, and administration of these products; hire an independent third party to review other credit card add-on products for compliance with federal consumer financial laws, and address any compliance issues, including remediation if necessary to correct any legal violations; and improve its oversight of third-party vendors. Finally, American Express will pay an additional $9.6 million in civil money penalties to the CFPB; American Express Centurion Bank will pay $3.6 million to the FDIC; and American Express

Bank, FSB will pay $3 million to the OCC. This is the fourth action with respect to credit card add-on products taken in coordination with other regulators.

2.2.2 Non-Public Supervisory Actions

In addition to the public enforcement actions above, recent supervisory activities have resulted in at least $2.6 million in remediation to consumers. These non-public supervisory actions generally have been the product of CFPB examinations, either through examiner findings or self-reported violations of Federal consumer financial law during an exam. Recent non-public supervisory actions have occurred in areas such as mortgage origination and mortgage servicing.

3. Supervision Program Developments

As its supervision program enters its third year, the Bureau continues to refine its operations and strive for greater efficiency in its supervision activities. The CFPB continues to recruit highly qualified examination staff in order to reach a steady state. As of January 2, 2014, Bureau examination staff numbered approximately 320 examiners, and 108 of the CFPB's examiners are commissioned through the Bureau's internal process, or came to the CFPB with commissions from other regulators. Developing and implementing training opportunities, especially for the CFPB mortgage rules effective in January 2014, remains a top Bureau priority.

3.1 Changes to Examination Reports and Supervisory Letters

Beginning in January 2014 we are changing the format of the Examination Reports and Supervisory Letters (collectively referred to as reports) that we send supervised entities after our reviews of their compliance with Federal consumer financial laws. The changes to our report templates aim to:

- facilitate drafting by examiners;
- simplify reports and reduce repetition; and
- facilitate follow-up reporting by supervised entities about actions they take to address compliance management weaknesses or legal violations found at CFPB reviews.

We anticipate that these changes will reduce the amount of time necessary to finalize reports, thus enabling us to more efficiently provide the reports to supervised entities.

The main changes to the templates are:

- Elimination of Recommendations. Any recommendations for improving currently satisfactory processes will be provided orally when examiners are on-site.
- Elimination of the list of CFPB team members participating in a review. Reports will continue to be signed by the Examiner in Charge and provide regional management contact information.
- Creation of a single section in the report that includes all of the items that we expect the entity to address when the review identifies violations of law or weaknesses in compliance management. This entire section will be referred to as "Matters Requiring Attention," regardless of whether the CFPB is requiring specific attention by an entity's Board of Directors. We will no longer include additional "Required Corrective Actions." The entity receiving the report will be expected to furnish periodic progress reports to the CFPB about all Matters Requiring Attention. The frequency of reporting will be tailored to the specific Matters in a report.

Examiners will begin using the new report format for reviews with an on-site review start dates of January 2, 2014 or later. Examiners also may use the new format for reviews that started before January 2, 2014, but for which report drafting started after that date. The new templates will be available on Consumerfinance.gov on the same page as the Supervision and Examination Manual.

3.2 Examination Procedures

The CFPB is committed to publishing, in their entirety, the procedures its examiners use to assess compliance with all Federal consumer financial laws relevant to a particular product or market. All of the Bureau's examination procedures can be found at: http://www.consumerfinance.gov/guidance/supervision/manual/, and are updated as regulatory changes warrant.

3.2.1 Mortgage Rules Examination Procedures

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB issued new mortgage rules in January 2013. The majority of the rules went into effect in January 2014 (some provisions were previously in effect), and the CFPB released examination procedures well in advance of the effective date to help industry better understand their compliance responsibilities.[5]

On June 4, 2013, the CFPB published interim examination procedures for the Truth in Lending Act (TILA) and the Equal Credit Opportunity Act (ECOA), and on August 15, 2013, the Bureau released interim procedures for the Real Estate Settlement Procedures Act (RESPA). On November 27, 2013, the CFPB finalized all three sets of procedures to reflect technical changes to the Bureau's rules.

In addition to publishing these examination procedures, the CFPB maintains a webpage dedicated to helping industry come into compliance with the rules at http://www.consumerfinance.gov/regulatory-implementation/.

3.2.2 Remittances Examination Procedures

On October 22, 2013, the CFPB published examination procedures that will be used to supervise financial institutions that provide remittances in the normal course of their business.[6] The CFPB's remittance transfer rule is an amendment to Regulation E, which implements the Electronic Fund Transfer Act (EFTA). The rule is principally contained in three *Federal Register* notices published in February 2012, August 2012, and May 2013.[7] It became effective on October 28, 2013. The examination procedures will guide CFPB examiners as they determine

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[5] The CFPB's examination procedures are based on the Federal Financial Institutions Examination Council examination procedures, which were approved on an interagency basis.

[6] A "remittance transfer" is an electronic transfer of money from a consumer in the U.S. to a person or business in a foreign country that is sent by a remittance transfer provider. It can include transfers from retail non-depository "money transmitters" as well as banks and credit unions that transfer funds through wire transfers, automated clearing house transactions, or other methods.

[7] Additionally, a technical correction and clarifying amendment were published on August 14, 2013, and a technical correction was published on July 10, 2012.

the applicability of the rule to CFPB-supervised entities and evaluate compliance with its requirements.

3.2.3 Short-Term, Small-Dollar Loan Examination Procedures Updates

On September 17, 2013, the CFPB released an important update to its Short-Term, Small-Dollar Loan examination procedures to include guidance on how to identify Military Lending Act (MLA) violations. In 2006, Congress passed the MLA to address lending practices directed toward military personnel and their families by granting broad protections, such as a military annual percentage rate cap of 36 percent and bans on the "roll over" of payday loans and the requirement to repay by military allotment.

In 2013, amendments to the MLA gave the CFPB authority to enforce the MLA. Through our supervisory and enforcement work, we will be ensuring that lenders are adhering to MLA requirements when they make short-term, small-dollar loans to servicemembers and their dependents. The updates to the examination procedures also include guidance for CFPB examiners to consider expanding the scope of examinations to cover any other consumer financial product or service offered by the lender that may pose risks to consumers, such as title loans and check cashing.

3.3 CFPB Guidance

The CFPB is committed to providing guidance on its supervisory priorities to industry and members of the public. These guidance documents are published at http://www.consumerfinance.gov/guidance/, and highlights from some of those published from July through October are below.

3.3.1 Representations Regarding Effect of Debt Payments on Credit Reports and Scores

On July 10, 2013, the CFPB released a bulletin providing guidance to creditors, debt buyers, and third-party collectors about compliance with the Fair Debt Collection Practices Act (FDCPA) and sections 1031 and 1036 of the Dodd-Frank Act when making representations about the impact that payments on debts in collection may have on credit reports and credit scores. Based on its

supervisory, enforcement, and other work, CFPB became aware that some of these entities are making representations that paying debts in collection may yield improvements in a consumer's credit report, credit score, creditworthiness, or likelihood of receiving credit or favorable credit terms. The Bureau is concerned that some of these representations may be deceptive under the FDCPA and/or the Dodd-Frank Act, as applicable.

Though not exhaustive, the bulletin gives specific examples of statements that may be deceptive under the FDCPA and/or the Dodd-Frank Act, and encourages debt-owners and third-party debt collectors to take appropriate steps in managing their collection activities. CFPB plans to use its supervision and enforcement tools to review relevant documentation to assess whether owners of debts and third-party debt collectors are making these types of claims and the factual bases for them, and to take any corrective action deemed necessary.

3.3.2 Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts

Also on July 10, 2013, CFPB released a bulletin explaining that certain acts or practices related to the collection of consumer debt could constitute unfair, deceptive, or abusive acts or practices (UDAAPs) prohibited by the Dodd-Frank Act. While a UDAAP determination is dependent on the facts and circumstances, and case-by-case analysis, the bulletin gives ten examples of practices that could constitute UDAAPs. The list is not exhaustive, but the CFPB will monitor the specific practices listed particularly closely in its supervision and enforcement activities. Finally, the bulletin reiterates that the obligation to avoid UDAAPs under the Dodd-Frank Act is in addition to any obligations that may arise under the FDCPA, and applies even with respect to first-party creditors and others who may not be subject to the FDCPA.

3.3.3 Fair Credit Reporting Act (FCRA) and Furnisher Obligations

On September 4, 2013, the CFPB published a bulletin outlining its expectations for furnishers under the Fair Credit Reporting Act (FCRA). When a consumer disputes the accuracy or completeness of information supplied by a furnisher to a consumer reporting agency (CRA), the FCRA generally requires the CRA to provide the furnisher with all relevant information timely submitted by the consumer.

The furnisher, in turn, must "conduct an investigation with respect to the disputed information," "review all relevant information" provided by the CRA, and respond appropriately based on the

result of the investigation.[8] The CFPB expects CRAs and furnishers to comply fully with these FCRA requirements, thereby promoting the accuracy and completeness of information in the consumer reporting system. Specifically, the CFPB expects furnishers to have reasonable systems and technology in place to receive and process notices of disputes and information regarding disputes, including relevant documentation, forwarded to them by CRAs. Finally, the bulletin reminds supervised entities that the CFPB monitors consumer complaints received and prioritizes examinations and other activities on the basis of risks posed to consumers.

3.3.4 Payroll Card Bulletin

On September 12, 2013, the CFPB issued a bulletin to reiterate the application of the Electronic Fund Transfer Act (EFTA) and Regulation E, which implements the EFTA, to payroll card accounts.[9] Employees who receive their wages via payroll cards are entitled to certain Regulation E protections, including clear and readily understandable initial disclosures, access to account history, limited liability for unauthorized transfers, and error resolution rights.

Additionally, the bulletin reminds employers and others that Regulation E prohibits employers from mandating that employees receive wages only on a payroll card of the employer's choosing. An employer may, however, offer employees the choice of receiving their wages on a payroll card or receiving it by some other means. Permissible alternative wage payment methods are governed by state law, but may include direct deposit to an account of the employee's choosing, a paper check, cash, or other evidence of indebtedness.

The CFPB has the authority to examine supervised entities' use of third-party service providers, to assess both the supervised entity's and the service provider's compliance with federal consumer financial laws, including the EFTA and Regulation E. Finally, the bulletin notes that

[8] 15 USC 1681s-2(b)(1).

[9] Payroll card accounts are accounts that are established directly or indirectly through an employer, and to which transfers of the consumer's salary, wages, or other employee compensation are made on a recurring basis. *See* 12 CFR 1005.02(b)(2).

the Bureau is also authorized, subject to certain exceptions, to enforce the EFTA and Regulation E against any person subject to the Regulation, including financial institutions and employers.[10]

3.3.5 Elder Financial Abuse Bulletin

In conjunction with various Federal regulators,[11] the CFPB released guidance on September 24, 2013, pertaining to the reporting by financial institutions of suspected elder financial abuse and the requirements of the Gramm-Leach-Bliley Act (GLBA). In response to concerns about whether this reporting could violate the GLBA, the guidance clarifies that reporting suspected financial abuse of older adults to appropriate local, state, or federal agencies does not, in general, violate the privacy provisions of the GLBA or its implementing regulations. The guidance points to various sections of the GLBA that could permit the sharing of nonpublic personal information about consumers with the proper agencies for the purpose of reporting suspected financial abuse of older adults without the consumer's authorization and without violating the GLBA.

The guidance shares common signs of elder financial exploitation, and encourages interested financial institutions to refer to *Money Smart for Older Adults*, a joint publication of the CFPB and FDIC, for training and further information.

3.3.6 Home Mortgage Disclosure Act (HMDA) and Regulation C Bulletin

On October 9, 2013, the CFPB published a bulletin reiterating the importance of accurate HMDA data and effective HMDA compliance management systems. This bulletin, released simultaneously with the CFPB's HMDA enforcement actions described above, provides further clarity to the Bureau's approach to enforcing HMDA.

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[10] EFTA 918(a)(5), 15 USC 1693o(a)(5).

[11] Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Federal Trade Commission, National Credit Union Administration, Office of the Comptroller of the Currency, and Securities and Exchange Commission.

Specifically, the bulletin discusses components of an effective HMDA compliance management system. The bulletin suggests that common elements of an effective compliance system include employee training, internal audits to test and evaluate information accuracy, and assigning responsibility for timely and accurate reporting of the data. The bulletin also details factors the CFPB may consider when evaluating whether to pursue a public enforcement action for HMDA violations. Additionally, the bulletin announces the release of the CFPB's HMDA Resubmission Schedule and Guidelines, which lists the error thresholds that CFPB examination teams will use to determine when institutions should correct and resubmit their HMDA data, and are effective for examinations that begin on or after January 18, 2014.

3.4 Other Developments

3.4.1 Larger Participant Rulemaking

The Bureau issued a rule on December 3, 2013, that allows the CFPB to supervise for the first time nonbanks that are larger participants in the student loan servicing market. The Bureau already had authority to supervise student loan servicing at the largest banks and their affiliates before the rule was issued, and this rule expands that supervision authority to any nonbank student loan servicer that handles more than one million borrower accounts, regardless of whether they service federal or private loans. Under the rule, those servicers will be considered "larger participants," and the Bureau may examine their activity to assess their compliance with Federal consumer financial laws. To coincide with this new authority, the Bureau also updated its Supervision and Examination Manual to provide guidance on how the Bureau will monitor bank and nonbank servicers of private and federal student loans.

3.4.2 Qualified Mortgage and Fair Lending

The CFPB's Ability-to-Repay Rule implements provisions of the Dodd-Frank Act that require creditors to make a reasonable, good faith determination that a consumer has the ability to repay a mortgage loan before extending credit to the consumer. Lenders are presumed to have complied with the Ability-to-Repay Rule if they issue Qualified Mortgages, which must satisfy requirements that prohibit or limit risky features that harmed consumers in the recent financial crisis. In response to industry questions about fair lending risk, including possible disparate impact, the CFPB, the Board of Governors of the Federal Reserve System, the Federal Deposit

Insurance Corporation, the National Credit Union Administration, and the Office of Comptroller of the Currency issued guidance addressing the choice to offer only Qualified Mortgages.

The CFPB and these other federal regulators do not anticipate that a creditor's decision to offer only Qualified Mortgages would, absent other factors, elevate a supervised institution's fair lending risk. Creditors should continue to evaluate fair lending risk as they would for other types of product selection decisions, including by carefully monitoring policies and practices and implementing effective compliance management systems.

4. Conclusion

The Dodd-Frank Act gave the CFPB various tools to promote a financial services marketplace that operates in accordance with Federal consumer financial law and works well for both consumers and the businesses that serve them. Through one of these tools – its supervisory program – the CFPB examines financial institutions to assess their compliance with Federal consumer financial law and directs institutions to improve their practices and remediate harm to consumers where appropriate. The CFPB plans to periodically publish *Supervisory Highlights* to provide general information about its supervision program without identifying specific institutions (except for enforcement actions already made public) and to help communicate the standards of conduct expected of supervised entities.

Supervisory Highlights

Consumer Financial
Protection Bureau

Spring 2014

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1. Introduction

The CFPB is committed to a consumer financial marketplace that is fair, transparent, and competitive, and that works for all consumers. The supervision of companies offering financial products and services – both banks and nonbanks – is one of the tools available to the Bureau to help meet this goal. In *Supervisory Highlights*, the CFPB reports examination findings, such as regulatory violations or unfair, deceptive or abusive acts or practices (UDAAPs), in selected program areas so that industry participants can use the information to ensure their operations remain in compliance with Federal consumer financial law. In some cases, certain violations reported have been found at a small number of institutions; however, because similar practices may be occurring at other institutions, this report includes them so that entities may proactively make any necessary changes to prevent violations of law and consumer harm.

In this fourth edition of *Supervisory Highlights*, the CFPB reiterates the importance of robust compliance management systems and shares recent supervisory observations, which include short-term, small-dollar lending, consumer reporting, debt collection, and fair lending.

CFPB supervisory work contributed to a recent enforcement action against Bank of America and FIA Card Services, resulting in relief of approximately $727 million to consumers for illegal practices related to credit card add-on products. In addition to this public enforcement action, recent nonpublic supervisory actions and self-reported violations in a number of program areas have resulted in more than $70 million in remediation for approximately 775,000 consumers.

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB may also supervise the "larger participants" in other nonbank markets as the Bureau defines by rule. To date, the Bureau has issued three rules defining larger participants in the following markets: consumer reporting (effective September 2012), consumer debt collection (effective January 2013), and student loan servicing (effective March 2014). In January 2014, the CFPB proposed a rule to define the larger participants in the international money transfer, or remittances, market.[1]

This report highlights supervision work completed between November 2013 and February 2014. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

[1] Defining Larger Participants of the International Money Transfer Market, *available at:* https://www.federalregister.gov/articles/2014/01/31/2014-01606/defining-larger-participants-of-the-international-money-transfer-market.

2. Supervisory observations

The Bureau began its bank supervision operations on July 21, 2011, and on January 5, 2012, announced the launch of its nonbank supervision program. Since then, CFPB's supervisory program has grown steadily, and currently spans both bank and nonbank entities offering a variety of consumer financial products and services. In 2013, the CFPB conducted over one hundred supervisory activities – such as full scope reviews and subsequent follow-up examinations – and plans to conduct approximately 150 of these activities in 2014. As always, Supervision continues to prioritize examination resources according to the greatest risks of consumer harm.

A well-developed compliance management system, or CMS, lessens risks to consumers and reduces the potential for violations of Federal consumer financial law. Because of the importance of a robust CMS, every CFPB examination contains some level of CMS review. As CFPB has described in its *Supervision and Examination Manual*,[2] CMS is how an entity:

- Establishes its compliance responsibilities, by determining the regulatory requirements applicable to its business operations;
- Communicates those responsibilities to employees;
- Ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes;
- Reviews operations to ensure responsibilities are carried out and legal requirements are met;

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[2] *See* Supervision and Examination Manual, Part II.A, for further discussion of the elements commonly observed in an effective CMS, *available at:* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

- Takes corrective action; and
- Updates tools, systems, training, and materials, as necessary.

As discussed in a previous issue of *Supervisory Highlights*, the CFPB does not require a particular CMS structure.[3] However, supervisory experience has found that an effective CMS commonly has four interdependent control components:

1. Board of directors and management oversight;
2. A compliance program;
3. A consumer complaint management program; and
4. An independent compliance audit.

When all of these control components are strong and well-coordinated, a supervised entity is likely to be more successful at managing its compliance responsibilities and risks.

The leadership of a supervised entity, up to and including the board of directors, is expected to establish clear lines of accountability and provide oversight of its CMS, including the establishment of a comprehensive program commensurate with its size, consumer risk profile, and product offerings.

A strong compliance program consists of adequate policies and procedures, training, and monitoring and corrective action. Policies and procedures should include guidance to the company's personnel regarding how to carry out their responsibilities in compliance with applicable Federal consumer financial laws. These policies and procedures should be consistent with one another, and they should be written, followed, and board- or leadership-approved. Additionally, institutions need to implement training programs robust enough to provide effective and comprehensive instruction to personnel. With appropriate breadth and depth, training is expected to address all applicable Federal consumer financial laws, and a company's leadership is expected to ensure that its staff is trained regarding how to perform their jobs in a

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[3] *See* Supervisory Highlights: Summer 2013, *available at:* http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf.

compliant manner. Appropriate training programs typically include formal training schedules, attendance records, and written reference materials. Additionally, training programs should be responsive to new or changing regulatory requirements, new products and services, and product changes. Monitoring should, in an organized and risk-focused way, identify procedural or training weaknesses in an effort to provide for a high level of compliance by promptly identifying and correcting weaknesses.

Supervision expects entities to respond to their customers' complaints, not only to address potential consumer harm in a single instance, but to identify major issues and trends that may evidence broader concerns, including risk to consumers, gaps in compliance management, and potential violations of Federal consumer financial law.

Compliance audit programs should include an audit plan that takes consumer compliance risks into consideration. Moreover, compliance audits should include a process by which the institution reports its findings to appropriate leadership and managers, responds to exceptions, implements corrective action, and monitors the results of corrective action. Importantly, these audit programs should be independent of both the compliance program, including the monitoring function, and those business functions that include customer sales or service.

Finally, CFPB recognizes the importance of third-party service providers to the operations of many supervised entities. However, as the CFPB explained in Bulletin 2012-03,[4] it expects entities to select these service providers carefully, include compliance expectations in contracts, and monitor service providers' work and complaints about their work. If a third-party service provider fails to perform properly, a supervised entity is expected to require remediation and to take measures that may include, in appropriate circumstances, termination of the service provider's contract. The fact that a supervised entity enters into a business relationship with a service provider does not absolve the supervised entity of responsibility for complying with Federal consumer financial law and, depending on the circumstances, it may be held legally responsible for violations by the third party.

In the course of recent examinations, Supervision has identified CMS strengths as well as deficiencies in the various nonbank entities reviewed, including in the areas of consumer

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[4] CFPB Bulletin 2012-03 (April 12, 2013), *available at:* http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf.

reporting, debt collection, and payday lending. These and other findings – including findings of violations of law, such as unfair, deceptive, or abusive acts or practices (UDAAPs) in violation of the Dodd-Frank Act – are discussed in the sections that follow.

2.1 Consumer reporting

The Bureau's rule establishing its supervision program for larger participants of the consumer reporting market went into effect on September 30, 2012.[5] Shortly thereafter, the Bureau established a nationwide team of examiners to focus on consumer reporting agencies (CRAs). The reviews were initially limited to evaluations of the entities' CMS, although they were later expanded to encompass dispute-handling practices.

During reviews, examiners observed certain compliance management weaknesses with the potential to harm consumers. As an initial matter, CFPB examinations found that some CRAs had either no formal CMS or inadequate CMS. In these cases, Supervision directed the relevant entities to take a number of measures to establish and implement a documented, formalized, and effective CMS.

CFPB Supervision found that the board of directors and senior management at some CRAs exercised insufficient oversight of the entity's CMS. At least one of the CRAs lacked a chief compliance officer (CCO) or an official with comparable responsibility for company-wide compliance oversight. At one of the CRAs that did employ a CCO, examiners found little evidence that the CCO reported on compliance risks, issues, and resolutions to the board of directors or any of its committees. At least one CRA failed to obtain board approval of its compliance policies. As a result, Supervision directed the relevant entities to ensure a more active role for the board and senior management in compliance matters.

Supervision found that some CRAs had problems with the development and documentation of compliance policies and procedures addressing Federal consumer financial laws, and the Fair

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[5] 12 CFR Part 1090.104.

Credit Reporting Act (FCRA)[6] in particular. Among the concerns identified was a failure to document policies and procedures, or if these procedures existed, there was no mechanism for reviewing them regularly, updating them as needed, and communicating changes to appropriate staff. In particular, one or more of the CRAs lacked policies and procedures that adequately addressed the entity's dispute-handling obligations under Section 611 of the FCRA,[7] or the prohibition on UDAAPs set forth in the Dodd-Frank Act.[8] Supervision directed the relevant entities to document their policies and procedures, draft new policies and procedures addressing the FCRA's dispute-handling requirements and the Dodd-Frank Act's prohibition on UDAAPs, and develop processes to review and update those policies and procedures as necessary.

In addition, CFPB examinations found that some CRAs failed to exercise adequate oversight of their business relationships with third-party service providers. Such third parties may operate call centers, handle consumer disputes, sell products to businesses and consumers, or perform other functions. Several CRAs lacked policies and procedures to verify that service providers understood their responsibilities under Federal consumer financial law, that the employees of service providers were appropriately trained, and that service providers and their employees in fact complied with Federal consumer financial law. Supervision directed the relevant entities to institute effective processes for managing the risks of service provider relationships, along the lines described in *Bulletin 2012-03*.

Supervision also found that one or more of the CRAs did not monitor and track consumer complaints.[9] Supervision directed the relevant entities to establish a comprehensive complaint-management process to monitor and track consumer complaints and litigation claims, and to use that information to identify and address areas of potential consumer risk.

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[6] 15 USC 1681-1681x.

[7] 15 USC 1681i.

[8] 12 USC 5531, 5536(a).

[9] Here, we mean that these CRAs were not tracking complaints about matters other than the completeness or accuracy of any item of information in a consumer report. The FCRA establishes specific obligations regarding disputes on those topics. 15 USC 1681i.

As noted previously, Section 611 of the FCRA provides that a consumer may dispute the completeness or accuracy of any information contained in the consumer's file at a CRA. Section 611 also imposes on CRAs certain obligations relating to the dispute-handling process, including the obligation to provide to the furnisher of the disputed information "all relevant information regarding the dispute that the [CRA] receives from the consumer."[10] During reviews, examiners found that many consumers supplied CRAs with relevant documents supporting their disputes – including, for example, cancelled checks, invoices, and correspondence – but that one or more CRAs failed to forward such documents to furnishers. Supervision directed the relevant entities to begin forwarding to furnishers all relevant documents submitted by consumers.

During its reviews, Supervision also found that one or more CRAs refused to accept disputes filed online or by telephone if the consumer had not recently received a consumer report or file disclosure from the CRA. The CRAs in question enforced this policy by assigning an identification number to each report they provided to a consumer, and requiring the consumer to supply the identification number before initiating a dispute via the CRA's online portal or by telephone. Although the CRAs did not require an identification number to file a dispute by U.S. mail, the CRAs did not inform consumers about this option. Taken together, these practices suggest to consumers that they must obtain a current report (often for a fee) to file a dispute with the CRAs in question. However, Section 611 of the FCRA – which requires a CRA, "free of charge," to investigate a dispute regarding "any item of information contained in a consumer's file" once a consumer "notifies the agency" of the dispute – contains no current-report precondition.[11] Supervision directed the relevant entities to eliminate any policy or practice that requires a consumer to obtain a current report or identification number before disputing the completeness or accuracy of information in his or her file.

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[10] 15 USC 1681i(a)(2).

[11] 15 USC 1681i(a)(1)(A).

2.2 Debt collection

In October 2012, the Bureau issued its rule defining larger participants in the debt collection market.[12] The Bureau began conducting supervisory examinations of those larger participants after the rule became effective in January 2013. Supervision has also examined financial institutions regarding their sales of debts to debt collectors. In each exam, CFPB teams review the adequacy of the entity's compliance management system (CMS), and in some of these examinations, Supervision identified significant CMS weaknesses.

In addition to assessing CMS, the examinations evaluate entities' compliance with Federal consumer financial laws that apply to debt collection. Examiners have identified a number of practices that violate the law, such as:

- Failure of debt collectors (and others) who furnish information to CRAs to investigate disputes regarding that information;
- Failure to obtain appropriate authorization prior to initiating a recurring electronic transfer of funds from a consumer's account; and
- Failure of debt collectors to comply with the Fair Debt Collection Practices Act's limitations on the use of phone calls and its prohibition on false and misleading statements.

2.2.1 Compliance management issues

Supervision observed significant weaknesses in the CMS of several debt collectors. In one debt collector examination, Supervision determined that the entity had inadequate written CMS policies and procedures, and lacked sufficient board and management oversight of CMS. The report also noted the entity's inadequate consumer complaint and dispute resolution processes, including the lack of processes for logging and tracking complaints and their resolutions. The entity also operated without any complaint analysis or compliance auditing. In another examination, Supervision determined that the entity had weak CMS policies and procedures, and failed to review and update those policies and procedures on a regular basis. At another

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[12] 12 CFR Part 1090.105.

entity, the examination team observed that, although the entity had some elements of a CMS, it lacked certain critical components. In particular, it lacked adequate board and management oversight, sufficient policies and procedures, and an effective compliance audit function. During another examination, examiners learned that the entity had no CMS in place until nearly the end of the review period, and that the CMS it adopted was inadequate in several respects. In each instance, Supervision directed the entity to correct promptly the flaws in its CMS.

As noted, adequate CMS must encompass not only an entity's internal operations, but also its business relationships with other providers of financial services. For instance, in one examination, examiners observed that a creditor that relied on a network of debt buyers to collect its debts failed to adequately assess the debt buyers' compliance with Federal consumer financial law. Although the creditor ostensibly reviewed the debt buyers on a regular basis for compliance, the creditor lacked specific policies and procedures to guide the assessment process. The creditor documented its review in a cursory manner, and often failed to retain the review results. As a result, in many instances, examiners were unable to determine how the creditor had decided which debt buyers had complied with Federal consumer financial law. In response, Supervision directed this creditor to take steps to ensure that its business arrangements with the debt buyers would not expose consumers to unwarranted risks.

Similarly, the CFPB expects creditors and other debt sellers to employ adequate policies and procedures to ensure the accuracy of the data associated with any debts they sell. Examiners identified one instance in which a creditor had sold an account to a debt buyer after that creditor had issued the consumer an IRS Form 1099-C ("Cancellation of Debt" form), indicating that the debt had been cancelled and the consumer was no longer liable for it. After reviewing its own files, the creditor identified dozens of other instances where, because of a flaw in its record retention policy, it had sold cancelled debts. The creditor agreed to modify its procedures to prevent such accounts from being sold in the future. Supervision directed the creditor to provide a comprehensive report assessing the effectiveness of these procedural modifications. Supervision further directed the creditor to identify the consumers harmed from the sale of cancelled debts, and to remediate any harm that had been done to consumers.

2.2.2 Investigating disputes

The Fair Credit Reporting Act (FCRA)[13] and its implementing regulation, Regulation V,[14] impose certain requirements on those entities that furnish information regarding consumers to consumer reporting agencies.[15] When consumers dispute that information, those furnishers generally must conduct investigations of those disputes. In one review, CFPB examiners determined that a debt collector that furnished information to consumer reporting agencies failed to investigate disputes regarding the information, and instead only directed the consumer reporting agencies to delete the disputed accounts. Investigations of disputes provide a critical check on the accuracy of furnished items and can identify systematic problems with furnishers' data. Accordingly, Supervision directed that, going forward, the debt collector investigate disputes it receives regarding information that it has furnished.

2.2.3 Recurring electronic fund transfers

The Electronic Fund Transfer Act,[16] implemented by Regulation E,[17] requires written authorization before commencing recurring electronic fund transfers (EFTs) from a consumer's account. The written authorization must be "signed or similarly authenticated by the consumer." In several examinations, Supervision determined that supervised entities violated Regulation E by failing to secure a written authorization, either signed or similarly authenticated by the consumer, before initiating recurring electronic fund transfers from consumers' accounts. The CFPB expects supervised entities to comply fully with Regulation E when setting up payment plans and other arrangements with consumers.

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[13] 15 USC 1681-1681x.

[14] 12 CFR Part 1022.

[15] *See* Section 3.2.1, *infra*, for more information on CFPB's expectations regarding these requirements.

[16] 15 USC 1693 *et seq.*

[17] 12 CFR Part 1005.

2.2.4 Compliance with the Fair Debt Collection Practices Act

Telephone calls

The Fair Debt Collection Practices Act (FDCPA)[18] prohibits a number of abusive debt collection practices. In one examination, Supervision determined that a supervised entity had engaged in repeated violations of the FDCPA. During the review period, the entity had made approximately 17,000 calls to consumers outside of the appropriate calling hours set forth in the FDCPA. In addition, the entity also violated the FDCPA when it repeatedly contacted more than one thousand consumers, contacting some consumers as often as 20 times within two days.

Misleading representations in debt collection litigation

The FDCPA also prohibits entities from making false or misleading representations in connection with the collection of a debt. As part of a debt collector examination, Supervision reviewed collection lawsuits initiated by the entity. Examiners found that in 70% of the cases, when the consumer filed an answer, the entity would dismiss the suit because it was unable to locate documentation to support its claims. Despite the entity's express or implied representations to consumers that it intended to establish that consumers owed a debt in the amount claimed in court filings, in numerous instances, the entity misled consumers because it demonstrably had no such intention.

2.3 Short-term, small-dollar lending

The Dodd-Frank Act gave the CFPB supervisory and enforcement authority over payday lenders, which generally provide short-term, small-dollar loans directly to consumers. The CFPB officially launched its payday lending supervisory program in January 2012, marking the first time these lenders have been subject to Federal compliance examinations.

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[18] 15 USC 1692-1692p.

The payday examination findings described below cover CMS shortcomings and illegal debt collection practices, as well as unfair, deceptive or abusive acts or practices in violation of the Dodd-Frank Act.

2.3.1 Compliance management issues

Though some lenders have demonstrated a commitment to building a strong compliance management system by dedicating increased staff and resources to compliance, CFPB examinations have found that a number of payday lenders have not implemented effective compliance management systems. Some payday lenders have been unable to fully respond to CFPB information requests or examiner inquiries on-site.[19] Generally, however, CMS concerns covered a range of issues, including lack of oversight of compliance management programs, ineffective oversight of third-party service providers, inadequate complaint management, failure to adopt appropriate written policies and procedures, failure to adequately train staff, and lack of effective compliance audit programs.

In a number of the institutions reviewed, the leadership did not hold personnel accountable for compliance or oversee the compliance program. Additionally, certain lenders failed to properly oversee third-party service providers, which contributed to violations of the Fair Debt Collections Practices Act and the Dodd-Frank Act prohibition of unfair, deceptive, or abusive acts or practices. Many contracts examined by CFPB examiners between payday lenders and third-party service providers contained no specific compliance-related expectations, and some did not include any reference at all to compliance responsibilities. Further, a number of lenders lacked adequate processes for analyzing the root causes of complaints and for monitoring the resolution of complaints.

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[19] In one instance, a lender, Cash America, impeded an examination by failing to properly retain documents requested by the CFPB, destroying documents after being ordered to cease, removing materials from call centers regarding sales and collections metrics, and coaching call center employees to de-emphasize the sales aspect of their duties. These actions contributed to the CFPB's order in November 2013 that Cash America pay $5 million to the CFPB's Civil Penalty Fund, in addition to $14 million refunded to consumers harmed by Cash America's violations of Federal consumer financial law. The Cash America consent order can be found here: http://files.consumerfinance.gov/f/201311_cfpb_cashamerica_consent-order.pdf. *See also* Supervisory Highlights: Winter 2013, Section 2.2.1: Public Enforcement Actions, *available at:* http://files.consumerfinance.gov/f/201401_cfpb_supervision-highlights.pdf.

Examiners also identified weaknesses in policies and procedures, training programs, and compliance audit programs. While examinations have found lenders that regularly review and revise their policies and procedures, many examinations found multiple weaknesses in this area. For instance, one branch manager indicated that the branch received no policies regarding electronic payments, and therefore, branch employees created their own policies with no corporate oversight. More than one lender provided examiners with undated policies, or policies dated at or after the start of the CFPB examination, making it impossible to determine when they were drafted and/or updated, and leading examiners to believe that no such policies existed prior to the examination. At multiple lenders, policies and procedures for record retention either did not exist or were not followed, leading to incomplete record destruction logs and improperly destroyed records.[20]

As noted above, all entities should implement training programs that are robust enough to provide effective and comprehensive instruction to personnel. At multiple lenders, training programs were nonexistent or missing vital components, such as applicable Federal consumer financial laws and instruction on how to avoid unfair, deceptive, or abusive acts or practices.

Supervision did find some adequate compliance audit programs, including one that self-identified a violation and remediated the harm by providing customer refunds. However, many programs reviewed by the CFPB focused heavily on asset and site security and personnel safety and did not address, or only nominally addressed, compliance with Federal consumer financial law. For instance, despite documented compliance weaknesses in its collections activities, one lender did not add this area to the audit function until just prior to the CFPB's examination. Another lender did not have a policy in place to test loan files, and examiners discovered forged signatures in a loan file.

2.3.2 Debt collection issues

An important focus of the CFPB's short-term, small-dollar loan examination program is how lenders collect consumer debt. The CFPB's supervisory activities in this area cover both lenders' own collection practices and those of third-party debt collectors. Supervision pays close

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[20] *See, e.g.*, Equal Credit Opportunity Act, as implemented by Regulation B, 12 CFR Part 1002.12; Truth in Lending Act, as implemented by Regulation Z, 12 CFR Part 1026.25.

attention to the way in which lenders oversee those debt collectors acting as their service providers.[21] When reviewing lender collection activities, Supervision primarily assesses whether these activities have been conducted free from unfair, deceptive, or abusive acts or practices. The CFPB also reviews lenders' compliance management systems with respect to collection activities to ensure that they can effectively prevent violations of Federal consumer financial law. When reviewing third party collection activities, examiners assess compliance with the Fair Debt Collection Practices (FDCPA) and the Dodd-Frank Act prohibition of UDAAPs.

At several short-term, small-dollar lenders, CFPB examiners found inadequate compliance management systems for collection activity. Lenders did not adequately monitor collections calls, attempt to understand the root causes of complaints arising from collections practices, provide training for collectors, and properly oversee third-party service providers.

Improper collections calls

Supervision has cited multiple lenders for unfair, deceptive, or abusive acts or practices, or risks of these acts or practices, for their policies of: repeatedly making unnecessary calls to third parties; improperly disclosing personal debt information; calling borrowers in violation of do-not-call requests; and making false claims during collections calls.

Every payday lender examined by the CFPB has policies in place to obtain additional contacts or references from borrowers. The loan applications typically suggest that this information will only be used for character or credit references; however, these contacts are sometimes called to ascertain a borrower's location upon default. Examiners found that employees of at least one lender called third parties even after the employees had already made contact with consumers. Moreover, an examiner's review of consumer complaints also showed that the lender continued to call customers and references after consumers had made verbal and written requests that they stop doing so. Multiple lenders contacted references and improperly disclosed personal debt information to these third parties, and others lacked sufficient procedures to verify that these in-house collection calls first confirmed the identity of the borrower before sharing personal debt information.

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[21] *See* CFPB Bulletin 2012-03, *supra* note 4.

Multiple lenders examined by the CFPB place a strong emphasis on collections activity. CFPB examination reports have noted the common practice of calling a borrower multiple times per day. At least one lender failed to properly log calls, leading borrowers to receive more calls than documented, and examiners observed practices and weaknesses in the monitoring and corrective action functions at other lenders that could lead to excessive daily calls. These deficiencies also resulted in collection calls being made after borrowers filed do-not-call requests. CFPB examinations reports have noted that these practices and CMS weaknesses pose a risk that lenders may engage in unfair acts or practices in violation of the Dodd-Frank Act.

Finally, Supervision cited deceptive acts or practices at multiple lenders for their false or misleading communications with borrowers. Examiners identified the following deceptive claims during collections activities:

- False threats to add additional fees;
- False threats to report to consumer reporting agencies (CRAs);
- False threats of legal action or referral to a non-existent in-house "legal department";
- False claims that the lender will debit the borrower's account at any time; and
- Deceptive messages regarding non-existent special promotions to induce borrowers to return calls.

Workplace collection visits

During some CFPB reviews, examiners identified complaints concerning visits by employees of payday lenders to consumer workplaces in attempts to collect debt. In some of these situations, consumers had asked the lender to cease the practice. Supervision has cited this practice as unfair in violation of the Dodd-Frank Act, and has directed at least one lender to cease these workplace collections visits.

Third-party collection calls

In several situations, examiners identified violations carried out by third-party debt collectors acting as service providers to creditors. The FDCPA prohibits debt collectors from using any false, deceptive, or misleading representation or means in connection with the collection of any debt, and the Dodd-Frank Act prohibition on UDAAPs also applies to these activities. Examiners

found a number of violations by third-party debt collection service providers in this area including:

- Claiming the account would be reported to a credit bureau when there was no such reporting;
- Making false threats of litigation and referral for criminal prosecution;
- Misrepresenting identity as an impartial mediator or attorney;
- Failing to disclose the identity of the caller or the purpose of the communication;
- Threatening to add unauthorized fees; and
- Making false claims that a borrower's bank account would be closed.

In addition to these specific violations, CFPB examinations found third-party collectors engaging in conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt in violation of the FDCPA.

Additionally, the FDCPA prohibits debt collectors from communicating with a consumer in connection with the collection of a debt at any unusual time or with any person other than a consumer, unless otherwise permitted by law. Examiners found that third-party debt collection service providers violated this prohibition by initiating phone calls prior to 8:00 a.m., by not verifying the identity of the person who answered the call, and by providing sensitive account information to a third party to whom the debt collector was not authorized to provide this information.

Finally, the FDCPA requires debt collectors to provide consumers who properly request it a validation of debt before continuing collection efforts. Examiners found situations in which a third-party debt collector tried to collect debts despite failing to provide this validation.

As indicated in *CFPB Bulletin 2012-03*, the CFPB expects supervised persons to oversee their business relationships with service providers in a manner that ensures compliance with Federal consumer financial law. In the payday lending market, third-party debt collection is an area where this guidance is particularly relevant, and it will remain a focus for CFPB examiners.

2.3.3 Concerns regarding ACH practices

CFPB examinations have found deceptive practices at one or more payday lenders. Upon a borrower's default, payday lenders frequently will initiate one or more preauthorized ACH[22] transactions pursuant to the loan agreement for repayment from the borrower's checking account. Lenders should ensure that communications with borrowers regarding these ACH practices are accurate. At one or more lenders, Supervision cited a deceptive practice when communications with borrowers threatened ACH transactions that were contrary to the agreement, and that the lender did not intend to initiate.

Examiners will continue to review payment practices at payday lenders for compliance with all applicable requirements, including the Dodd-Frank Act prohibition on UDAAPs.

2.4 Fair Lending: Documenting exceptions to credit standards to mitigate fair lending risk

CFPB examination teams have observed instances in which financial institutions lack adequate policies and procedures for managing the fair lending risk that may arise when a lender makes exceptions to its established credit standards. For example, a lender may decide not to apply certain credit standards to a borrower when there is a competing offer from another institution. Such decisions are appropriate where they are based on a legitimate justification, but it is important to maintain adequate documentation and oversight to avoid increasing fair lending

[22] ACH stands for Automated Clearing House, which is an electronic network for processing credit and debit transactions, such as direct deposits and consumer payments, such as those pre-authorized when a consumer applies for a payday loan.

risk under the Equal Credit Opportunity Act (ECOA)[23] and its implementing regulation, Regulation B.[24]

At the same time, the Bureau recognizes the purpose of Regulation B in promoting the availability of credit without regard to prohibited basis characteristics.[25] A lender may promote the availability of credit by providing credit to an applicant based on a lawful exception to the lender's credit standards when exceptions practices are complemented by an appropriate system of fair lending compliance management. A strong compliance management system can also mitigate fair lending risk related to credit exceptions by adequately documenting the basis for the credit exception, monitoring and tracking exceptions activity, and controlling any resulting fair lending risk.

A strong compliance management system often includes the following fair lending-related elements:

Policies and procedures

- Granting exceptions: policies and procedures that specifically define the circumstances when the institution allows exceptions to be made to its credit standards. For example, a lender may have policies that permit pricing exceptions so that the lender can meet the rate in a competing offer, in appropriate circumstances.
- Documenting exceptions: policies and procedures that require, for each applicant offered an underwriting, pricing or other exception, documentation appropriate to that specific exception that is, at a minimum, sufficient to effectively monitor compliance with the exceptions policies. Such documentation should be sufficient to explain and provide details regarding the basis for granting any underwriting or any other exception. As such, the lender's policy for documenting exceptions should require more than a records

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[23] 15 USC 1691-1691f.

[24] 12 CFR Part 1002.

[25] 12 CFR Part 1002.1(b).

notation that identifies or lists only the policy basis for the exception. Records should provide details and/or documentation of the particular circumstances of the exception.

- Record retention: document retention requirements should, at a minimum, correspond with the record retention obligations of Regulation B, which generally requires retention, for twenty-five months, of certain records related to a non-business credit application.[26]

Monitoring, audit, and corrective action

- Monitoring: ensure regular monitoring of compliance with all exceptions policies, including exceptions documentation.
- Audit: conduct periodic audits for compliance with all policies and procedures relevant to granting exceptions, and to test for and identify fair lending risk.
- Corrective action: take appropriate corrective action for noncompliance with exceptions policies or procedures, or if internal monitoring and audits identify areas of fair lending risk.

Training

- Provide training for all relevant individuals related to these policies and procedures.

Management participation

- Provide for management and/or board oversight, as appropriate, of relevant policies and procedures.

The Bureau recognizes that each lender is different and that an effective compliance management system may take different forms depending on many factors, including the size and complexity of the lender's business. However, the successful implementation of the recommendations identified above will assist lenders in mitigating fair lending risk when making exceptions to credit standards while also furthering the purposes of Regulation B in promoting the availability of credit.

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[26] *Id.* at 1002.12(b).

2.5 Remedial actions

2.5.1 Public enforcement action

On April 9, 2014, the CFPB announced that it had ordered Bank of America, N.A. and FIA Card Services, N.A. to refund an estimated $727 million to consumers for illegal practices related to credit card add-on products and to pay a $20 million civil penalty. This marks the Bureau's fifth public enforcement action to address illegal practices with respect to credit card add-on products.[27]

From 2010 to 2012, Bank of America deceptively marketed two credit card payment protection products, misleading consumers about their costs and benefits, as well as the enrollment process. Over 1.4 million consumers were affected by this deceptive marketing.

Bank of America also enrolled consumers in identity protection credit card add-on products and billed consumers for these products without or before having the authorization necessary to perform the credit monitoring and credit report retrieval services. Bank of America illegally charged 1.9 million consumer accounts for services not fully received, leading consumers to believe that their credit was being monitored for fraud or identity theft when it may not have been.

Bank of America was ordered to provide relief to affected consumers, end the unfair billing practices, and pay a $20 million fine to the CFPB's Civil Penalty Fund. Additionally, the Bank will be barred from marketing any credit protection or credit monitoring add-on products until it submits a compliance plan to the CFPB.

2.5.2 Non-public supervisory actions

In addition to the public enforcement action and supervisory observations above, recent supervisory activities have resulted in more than $70 million in remediation to over 775,000

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[27] These enforcement actions have been in conjunction with other Federal regulators. In this case, the Office of the Comptroller of the Currency (OCC) also ordered Bank of America to pay $25 million in civil penalties for its unfair billing practices. The full CFPB Consent Order can be found here: http://files.consumerfinance.gov/f/201404_cfpb_bankofamerica_consent-order.pdf.

consumers. These non-public supervisory actions generally have been the product of CFPB examinations, either through examiner findings or self-reported violations of Federal consumer financial law during an exam. Recent non-public supervisory actions have occurred in areas such as deposits, consumer reporting, credit cards, mortgage origination, and mortgage servicing.

3. Supervision program developments

The Bureau continues to recruit talented and highly motivated staff, both in the field and at headquarters. As of May 1, 2014, Bureau examination staff numbers approximately 320 examiners supported by both regional management and headquarters staff. More than 100 of these examiners have been commissioned through the Bureau's internal process, or came to the CFPB with commissions from other regulators. At headquarters, recent staff and management hires will allow Supervision to further develop its policy and oversight functions, and complete the Bureau's internal training curriculum.

3.1 Examination procedures

The CFPB is committed to publishing, in their entirety, the procedures its examiners use to assess compliance with all Federal consumer financial laws relevant to a particular product or market. All of the Bureau's examination procedures can be found at: http://www.consumerfinance.gov/guidance/supervision/manual/, and are updated as regulatory changes warrant.

The CFPB examination manual is generally organized both by statute and implementing regulation, as well as by product line. On January 10, 2014, the CFPB released updated modules for both mortgage origination and mortgage servicing.[28] These modules provide a single

[28] CFPB Examination Procedures: Mortgage Origination, *available at:* http://files.consumerfinance.gov/f/201401_cfpb_mortgage-origination-exam-procedures.pdf; *see also* CFPB

resource outlining the specific topics that may be the focus of a CFPB examination, such as underwriting, closing, servicing transfers, and loss mitigation.

Additionally, on December 3, 2013, the CFPB released examination procedures pertaining to education loans.[29] The procedures are sorted into modules, and provide guidance for the examination of all aspects of private education loans and examination of servicing practices in connection with all types of student loans.

3.2 Recent CFPB guidance

3.2.1 Fair Credit Reporting Act and Regulation V

On February 27, 2014, the CFPB issued a Bulletin to address certain provisions of the FCRA and Regulation V that apply to debt buyers, debt collectors, and others who furnish information to consumer reporting agencies (CRAs) for inclusion in credit reports.[30] When a consumer disputes the completeness or accuracy of information a furnisher has provided to a CRA, the furnisher is generally required to conduct a reasonable investigation with respect to the disputed information.[31] If the investigation reveals that an item of information is inaccurate or incomplete or cannot be verified, the furnisher must modify, delete, or permanently block the reporting of the item of information.

As noted above in *Supervisory Observations*, the CFPB is concerned that, instead of investigating disputed information, furnishers may simply direct the CRAs to delete the disputed information. Furnishers may do this because they believe that it satisfies the

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Examination Procedures: Mortgage Servicing, *available at:* http://files.consumerfinance.gov/f/201401_cfpb_mortgage-servicing-exam-procedures.pdf.

[29] CFPB Examination Procedures: Education Loans, *available at:* http://files.consumerfinance.gov/f/201312_cfpb_exam-procedures_education-loans.pdf.

[30] CFPB Bulletin 2014-01 (Feb. 27, 2014), *available at:* http://files.consumerfinance.gov/f/201402_cfpb_bulletin_fair-credit-reporting-act.pdf.

[31] Pursuant to Section 623 of the FCRA, when a consumer submits a dispute to the CRA, the CRA will ordinarily—except in certain circumstances—forward the dispute to the furnisher for reinvestigation. 15 USC 1681i; 15 USC 1681s02(a)(8)(E), (b)(1). Pursuant to Regulation V, when a consumer submits a dispute directly to a furnisher, the furnisher must—with certain exceptions—conduct its own investigation. 12 CFR Part 1022.43(e).

requirement to conduct a reasonable investigation or because they assume that once the furnished information is deleted, they are no longer furnishers with respect to the disputed information.

However, as the Bulletin explains, the investigation of disputes provides a critical check on the accuracy of furnished items and can identify systematic problems with furnishers' data. Whether an investigation is reasonable depends upon the circumstances. The Bureau will continue to monitor furnishers' compliance with their obligations under FCRA.

3.2.2 Social Media: Consumer Compliance Risk Management Guidance

On December 11, 2013, the Federal Financial Institutions Examination Council, on behalf of its members, including the CFPB, issued a guidance document pertaining to social media.[32] This guidance is designed to help financial institutions navigate the applicability of federal consumer protection and compliance laws, regulations, and policies to activities conducted via social media. The guidance does not impose any new requirements, but offers considerations that financial institutions may find useful in conducting risk assessments and crafting and evaluating policies and procedures regarding social media.

3.3 Other developments

3.3.1 Larger participant rulemaking

On January 31, 2014, the CFPB issued a proposed rule to define the larger participants in the international money transfer market.[33] Under its existing authority, the CFPB may supervise large depository institutions and credit unions that provide these transfers, generally known as remittances. The proposed rule would extend the Bureau's supervisory authority to nonbank

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[32] Social Media: Consumer Compliance Risk Management Guidance, *available at:* http://files.consumerfinance.gov/f/201309_cfpb_social_media_guidance.pdf.

[33] *See supra* note 1.

providers that meet the threshold of a larger participant in the market. As proposed, providers that have at least one million aggregate international money transfers annually would be larger participants under the rule. Comments on the proposed rule were due on April 1, 2014. The CFPB is reviewing the comments and intends to issue a final rule.

The CFPB also anticipates moving forward with a proposal to expand its supervisory authority beyond the larger banks to include the larger indirect nonbank auto lenders. In so doing, the Bureau will be providing more complete oversight over the lender side of this marketplace.

4. Conclusion

Supervision is one of the CFPB's core functions, and allows the Bureau to assess compliance with the Federal consumer financial laws under its authority. The CFPB is committed to periodically publishing *Supervisory Highlights* to provide general information about its supervisory findings without identifying specific institutions (except for enforcement actions already made public), to share updates about operational changes to the Bureau's supervisory program, and to help communicate the standards of conduct expected of supervised entities.

Supervisory Highlights

Consumer Financial
Protection Bureau

Summer 2014

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1. Introduction

This special edition of *Supervisory Highlights* describes the Bureau's fair lending supervisory activity in the indirect automobile lending market. Promoting a fair, equitable, and nondiscriminatory auto lending market is a priority for the Bureau. In March 2013, the Bureau issued the *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act* Bulletin (*Indirect Auto Lending Bulletin*),[1] which reminded indirect auto lenders[2] of their existing responsibilities under the Equal Credit Opportunity Act (ECOA).[3] It also noted the heightened fair lending risks associated with lenders' pricing and compensation policies that allow auto dealers the discretion to increase (or "mark up") the consumer's interest rate and benefit from the increased interest revenue.

Since issuing the *Indirect Auto Lending Bulletin*, the Bureau's examination teams[4] have continued to review indirect auto lenders for ECOA compliance. These targeted ECOA reviews generally have included an examination of three areas: credit approvals and denials, interest rates quoted by the lender to the dealer (the "buy rates"), and any discretionary markup or adjustments to the buy rate.

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[1] CFPB Bulletin 2013-02 (March 21, 2013), *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[2] In contrast to direct financing, which occurs when a consumer finances a vehicle directly through a financial institution, indirect auto lending occurs when a consumer secures vehicle financing through the dealer, which typically originates the loan to the consumer and arranges financing through a third-party financial institution (the indirect lender).

[3] 15 USC 1691-1691f.

[4] As used in this edition of *Supervisory Highlights*, an "examination team" generally includes personnel from multiple Bureau offices, including the Offices of Supervision Examinations, Supervision Policy, Fair Lending, and Research.

Whenever there is reason to believe that a lender's discretionary pricing policies have resulted in a pattern or practice of discrimination in violation of the ECOA, the Bureau is required to refer the matter to the U.S. Department of Justice (DOJ).[5] Where appropriate, the Bureau and the DOJ coordinate investigations and resolutions of fair lending matters. However, a referral to the DOJ does not affect the Bureau's authority to take independent corrective action.

During the last two years, multiple supervisory reviews have identified indirect auto lenders with discretionary pricing policies that resulted in discrimination against African-American, Hispanic, and/or Asian and Pacific Islander borrowers in violation of the ECOA.[6] These institutions maintained discretionary pricing policies while not adequately monitoring and controlling the fair lending risk associated with their policies. Examination and enforcement teams have already reached resolutions with several supervised institutions that will collectively pay about $136 million to provide redress for up to 425,000 consumers, an average of more than $300 per consumer. For example, together with the DOJ, the Bureau took public enforcement action against Ally Financial Inc. and Ally Bank (collectively, Ally) in December 2013, requiring Ally to pay $80 million to address harm to about 235,000 borrowers. Supervisory resolutions with several other auto lenders will account for the remaining approximately $56 million to provide redress for up to 190,000 consumers. In addition to the matters discussed above, there are additional supervisory reviews that have cited ECOA violations at other auto lending institutions, and examination and enforcement teams are actively working toward resolutions for the harmed consumers in each of these matters.

When examination teams have determined that discrimination has occurred and corrective action is necessary, the indirect auto lender was directed to pay remediation sufficient to address direct and indirect consumer harm from the examination period through the date of the resolution addressing the discrimination. To the extent that a lender has chosen to maintain discretionary pricing policies, examination teams have directed the lender to establish and

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[5] *See* Memorandum of Understanding between the Consumer Financial Protection Bureau and the United States Department of Justice Regarding Fair Lending Coordination 7 (Dec. 6, 2012), *available at* http://files.consumerfinance.gov/f/201212_cfpb_doj-fair-lending-mou.pdf [MOU Regarding Fair Lending]; *see also* 15 USC 1691e(g).

[6] As used in this document, "African American" includes "Black or African American," "Hispanic" includes "Hispanic or Latino," and "Asian and Pacific Islander" includes both "Asian" and "Native Hawaiian or Other Pacific Islander," as defined by the Office of Management and Budget. *See* Revisions to the Standards for the Classification of Federal Data on Race and Ethnicity (Oct. 30, 1997), *available at* http://www.whitehouse.gov/omb/fedreg_1997standards.

maintain strong compliance management to prevent, detect, and remediate future disparities in pricing on prohibited bases. Supervisory and enforcement resolutions have also directed indirect auto lenders to limit maximum allowable discretionary markup.

Already, as a result of these supervisory actions, some lenders are more stringently monitoring dealers and, when monitoring reveals evidence suggesting discrimination, implementing additional limits to discretionary pricing adjustments or taking other appropriate action to manage or reduce the lender's fair lending risk. Further, supervisory resolutions will result in prompt remuneration of affected consumers when pricing analysis reveals unexplained disparities on a prohibited basis. Although approaches vary, some lenders are instituting remuneration of affected consumers as frequently as monthly by adjusting interest rates to address emerging disparities, in addition to regular compliance management that includes annual analysis of portfolio pricing.

Supervisory experience suggests that significantly limiting discretionary pricing adjustments—for example, imposing limits of 100 basis points, rather than the more common limits of 200 or 250 basis points—may reduce or even effectively eliminate pricing disparities.[7] An institution that implements significant limits on discretionary pricing may find that it can significantly reduce certain compliance management activities, such as dealer-specific monitoring and discipline, to which the institution would otherwise need to devote significant attention and resources.

Alternatively, the indirect auto lender could choose to adopt non-discretionary dealer compensation policies. Since publication of the *Indirect Auto Lending Bulletin*, several indirect auto lenders have chosen to fully implement or pilot policies that do not rely on discretionary markup to compensate dealers.

As with all lending products, fair lending examination teams expect indirect auto lenders to use underwriting and risk-based pricing practices that appropriately take into account objective factors, including borrower creditworthiness, the characteristics of the collateral, and the terms of the transaction. The supervisory focus on indirect auto lending, however, has been primarily concerned with the fair lending risk created by lenders' policies that compensate dealers by

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[7] 250 basis points equal 2.5 percentage points. Basis points often denote interest rate variations.

allowing them the discretion to mark up each consumer's interest rate *after* the lender has already underwritten the consumer's loan application and generated a risk-based price.

Given the fair lending risk associated with discretionary pricing policies affecting dealer compensation, indirect auto lending remains a significant focus of supervisory reviews, especially for indirect auto lenders that maintain discretionary markup policies and have not yet been subject to a fair lending review. Examination teams will continue to review lenders for compliance with Federal consumer financial law, and take supervisory action as appropriate to reduce fair lending risk and to promote a fair and competitive auto lending market for consumers.

Questions or comments can be directed to CFPB_Supervision@cfpb.gov.

2. Supervising indirect auto lenders – authority, methods, and procedures

In the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act),[8] Congress gave the Bureau the authority to supervise larger depository institutions with more than $10 billion in assets, and their affiliates.[9] These institutions include a number of indirect auto lenders. The Bureau is also authorized to supervise nonbanks that are larger participants in other markets, as defined by a Bureau rule.[10] To provide more complete oversight of the auto financing market, the Bureau has proposed a rule to define larger participants in this market.[11] In addition to its supervisory authority, and subject to certain exceptions, the Dodd-Frank Act also gives the Bureau enforcement authority over both banks and nonbanks in the auto lending market, including "captive" auto lenders.[12]

Consistent with the jurisdiction granted by the Dodd-Frank Act, the Bureau uses both supervisory and enforcement tools to ensure compliance with Federal consumer financial laws,

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[8] Pub L No 111-203, 124 Stat 1376 (2010) (codified at 12 USC 5301 *et seq*.).

[9] *See* 12 USC 5515.

[10] *See* 12 USC 5514(a)(1)(B), (b).

[11] Defining Larger Participants of the Automobile Financing Market (proposed Sept. 2014) (to be codified at 12 CFR Parts 1001 and 1090), *available at* http://files.consumerfinance.gov/f/201409_cfpb_proposed-rule_lp-v_auto-financing.pdf.

[12] *See* 12 USC 5563, 5564. Captive auto lenders are indirect auto lenders that are directly affiliated with a particular automobile manufacturer.

including the ECOA. The ECOA and its implementing regulation, Regulation B, make it illegal for a "creditor" to discriminate against any applicant in any aspect of a credit transaction because of race, color, religion, national origin, sex, marital status, age, receipt of income from any public assistance program, or the exercise, in good faith, of a right under the Consumer Credit Protection Act.[13] Consistent with statements by the Interagency Task Force on Fair Lending,[14] the Bureau has indicated that it will consider evidence of disparate treatment and disparate impact in identifying lending discrimination under the ECOA.[15]

As noted in the *Indirect Auto Lending Bulletin*, the ECOA applies to indirect auto lenders that, in the ordinary course of business, regularly participate in the credit decision.[16] Supervisory reviews have revealed that indirect auto lenders' standard policies and practices related to underwriting and pricing often constitute participation in a credit decision.[17] The following section addresses what indirect auto lenders can expect of a targeted ECOA review and the methodologies that examination teams employ in evaluating ECOA compliance in this context.

2.1 The targeted ECOA review

Bureau examination teams rely on the *Interagency Fair Lending Examination Procedures*[18] and the Bureau's *ECOA Examination Procedures*[19] in conducting a targeted ECOA review.

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[13] *See* 15 USC 1691(a); 12 CFR 1002.2(z), 1002.4.

[14] *See* Policy Statement on Discrimination in Lending, 59 Fed Reg 18,266 (Apr. 15, 1994), *available at* http://www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf.

[15] *See* CFPB Bulletin 2012-04 at 2 (Apr. 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf [Lending Discrimination Bulletin].

[16] *See* Indirect Auto Lending Bulletin, *supra* note 1, at 2-3 (citing 15 USC 1691a(e); 12 CFR 1002.2(*l*)).

[17] *See also* Indirect Auto Lending Bulletin, *supra* note 1, at 2-3.

[18] Interagency Fair Lending Examination Procedures (Aug. 2009), *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

[19] ECOA Examination Procedures (Oct. 2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

Examination teams evaluate ECOA compliance in light of a particular lender's business model, the product type, and other unique facts and circumstances. The typical targeted ECOA review of an indirect auto lender includes a review of the lender's relevant policies, procedures, and fair lending compliance management. As mentioned above, examination teams also typically consider statistical analyses of three areas: credit approvals and denials, buy rates, and any discretionary markup or adjustment to the buy rate.

The first step in a targeted ECOA review is to identify areas of fair lending risk. One indicator of fair lending risk is policies and procedures that allow for broad discretion in underwriting, pricing, and compensation decisions.[20] When a review identifies lender policies that allow broad discretion without appropriate monitoring and controls, examination teams may evaluate whether such policies result in violations of the ECOA and Regulation B.

Regarding the indirect auto lender's compliance management, previous editions of *Supervisory Highlights* have indicated the importance of strong compliance management in adhering to consumer financial laws, including, for lenders, strong fair lending compliance management.[21] Key components of such systems are preventative measures—such as limits on discretionary markups—and self-monitoring, which often includes statistical analyses to identify disparities on a prohibited basis. In the context of a lender's discretionary pricing policies, self-monitoring—and appropriate corrective action if potential discrimination is detected—is important to managing the fair lending risk inherent in such systems. Accordingly, targeted ECOA reviews of indirect auto lenders will generally review mechanisms for prevention, monitoring, corrective action, and other aspects of the lender's compliance management.

Examination teams may also conduct statistical analyses of lending data to identify evidence of discrimination. Such analyses may include the use of regression models to test whether a specific policy results in unlawful differences based on race, national origin, or other prohibited basis characteristics. In analyzing lending data for statistical disparities, examination teams typically construct regression models based on the particular institution's specific policies and practices, which vary from institution to institution and may also vary by product and product

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[20] *See* Interagency Fair Lending Examination Procedures, *supra* note 18, at 15.

[21] *See* Supervisory Highlights: Fall 2012 at 6, *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervisory-highlights-fall-2012.pdf.

characteristic. For this reason, for each institution subject to review, examination teams may construct multiple regression models and tailor different models by including controls that reflect the institution's various policies, practices, and products, as well as any additional factors identified by the examination team or the institution.

A regression model to detect disparities on a prohibited basis in the buy rate that the lender quotes the dealer, for example, typically must control for characteristics appropriate to setting the buy rate. In general, such a model will consider creditworthiness factors, such as credit scores and debt-to-income ratios; characteristics of the collateral; and terms of the deal, such as the amount financed, down payments, the existence of a manufacturer discounted rate, and the term of the loan, as these factors are typically taken into account by lenders in arriving at the appropriate buy rate.

Controls that may be appropriate to a statistical analysis of buy rates may not be appropriate in an analysis of dealer markup, however. Such controls may not be appropriate to a dealer markup analysis because, when the dealer considers applying a discretionary markup, the indirect auto lender's underwriting and pricing systems have often already considered risk-based factors related to creditworthiness, the characteristics of the collateral, and the terms of the transaction. Absent a showing of a legitimate business need, it is generally not appropriate to consider such factors for a second time in conducting an analysis of dealer markup to identify disparities on a prohibited basis.

2.2 The use of proxy methodology in supervision

Regulation B generally prohibits a creditor from inquiring "about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction,"[22] with a few exceptions, including for home mortgages covered under the Home

[22] 12 CFR 1002.5(b).

Mortgage Disclosure Act.[23] For this reason, information on race, ethnicity, and sex is typically not collected as part of an auto lending transaction or a transaction involving other non-mortgage consumer lending products. In the context of discussing comparative file reviews, the *Interagency Fair Lending Examination Procedures* provide that when direct evidence of a particular prohibited basis characteristic is not otherwise available, "[a] surrogate for a prohibited basis group characteristic may be used to set up a comparative analysis with control group applicants or borrowers."[24] Similarly, when analyzing lending data for prohibited disparities, Bureau examination teams, other federal supervisory and enforcement agencies, and many lenders use a proxy methodology to differentiate among consumers based upon race, national origin, and sex. The concept of using proxies for unavailable data is a mathematical and statistical approach used across disciplines.[25]

When utilizing a proxy, examination teams are using a borrower's name and geographic information to match data that are publicly available from the Social Security Administration and the United States Census Bureau. In general, the proxy methodology used depends on the characteristic being proxied. For example, to proxy for sex, examination teams are relying on a first-name database from the Social Security Administration that reports counts of individuals by sex and birth year for first names occurring at least five times for a particular sex in a birth year.[26] In such a case, the proxy method assigns a probability that a particular applicant is female based on the distribution of the population across sex categories (male or female) for the applicant's first name.

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[23] *See* 12 CFR 1002.5(a)(2), 1002.13. For the Home Mortgage Disclosure Act and its implementing regulation, Regulation C, see 12 USC 2801-2810 and 12 CFR Part 1003. For the Regulation B provisions concerning requests for information generally, see 12 CFR 1002.5.

[24] Interagency Fair Lending Examination Procedures, *supra* note 18, at 19.

[25] *See* Marc N. Elliott et al., *Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities*, Health Services & Outcomes Research Methodology 69-83 (June 2009); Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment (Sept. 2014), *available at* http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf [Proxy Methodology and Assessment].

[26] Social Security Administration, Beyond the Top 1000 Names (Sept. 12, 2014, 3:01 pm), http://ssa.gov/oact/babynames/limits.html.

There are several methods that can be used to proxy for race and national origin. One common method for proxying the probability that an applicant is Hispanic or Asian is to use the surname database published by the Census Bureau.[27] Another method to proxy for race and national origin—typically referred to as "geocoding"—uses the demographics of the census geography (e.g., census tract, block group, or block) in which an individual's residence is located, and assigns probabilities about the individual's race or national origin based on the demographics of that area. This method may be used, for example, to proxy the probability that an applicant is African-American, Hispanic, or Asian or Pacific Islander.

To proxy for race and national origin in the non-mortgage context, examination teams are using a proxy method that integrates both the surname and geographical approaches described above, called Bayesian Improved Surname Geocoding (BISG).[28] The BISG method combines the respective probabilities generated by the surname and geographical proxies. Published academic research has found that the integrated approach produces proxies that correlate highly with self-reported race and ethnicity data and are more accurate than using surname or geography alone.[29] The Bureau's own analysis demonstrates that the BISG proxy probability, which assigns an individual probability of inclusion in a prohibited-basis group, is more accurate than a geography-only or surname-only proxy in its ability to predict individual applicants' reported race and ethnicity and generally more accurate than a geography-only or surname-only proxy at approximating the overall reported distribution of race and ethnicity.[30] The BISG methodology has evolved over time and will continue to evolve as enhancements are identified that improve accuracy and performance.

There are proxy methods for race and national origin that use nonpublic information, such as proprietary databases developed in the private sector matching first or middle names to certain racial or ethnic groups. However, for the purpose of conducting supervisory work, examination teams use proxy methods that rely solely on public data so that lenders can, if they choose,

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[27] United States Census Bureau, Genealogy Data: Frequently Occurring Surnames from Census 2000 (Sept. 12, 2014, 3:02 pm), http://census.gov/genealogy/www/data/2000surnames/index.html.

[28] *See* Proxy Methodology and Assessment, *supra* note 25.

[29] *See* Elliott, *supra* note 25.

[30] *See* Proxy Methodology and Assessment, *supra* note 25.

replicate these proxy methods without the need to recreate or purchase proprietary databases as part of their own fair lending compliance management. There may be other proxy methodologies that would also be appropriate in particular circumstances, and examination teams consider analyses based on such methodologies when provided by lenders.

2.3 What to expect if the examination reveals potential violations

If the examination team finds statistically significant disparities on a prohibited basis or other evidence of possible discrimination, the Office of Fair Lending will send a letter stating its preliminary findings and inviting the institution to provide additional information for consideration in determining whether the institution has violated the ECOA. In appropriate circumstances, the Office of Fair Lending's notification may now include the unique, custom computer code or scripts used to prepare analytical data and perform statistical analyses, including regression modeling. Additionally, the Office of Fair Lending notifies the institution that if the potential legal violations constitute a pattern or practice of lending discrimination, the Bureau is required to refer the findings to the DOJ.[31] Resolutions arising from supervisory findings are based on a case-by-case assessment to determine the appropriate corrective action, including supervisory or enforcement resolutions.[32]

In addition, if the Bureau is required to refer the lender to the DOJ based on a pattern or practice of discrimination, the DOJ may elect to open an investigation, initiate a civil action, or defer resolution to the Bureau.[33] Findings of disparities in discretionary markup in an indirect auto lender's portfolio typically constitute a pattern or practice of discrimination if the disparities cannot be justified by "a legitimate business need that cannot reasonably be achieved

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[31] *See* MOU Regarding Fair Lending, *supra* note 5, at 7; *see also* 15 USC 1691e(g).

[32] For information on the factors that the Bureau considers related to responsible business conduct, see CFPB Bulletin 2013-06 (June 25, 2013), *available at* http://files.consumerfinance.gov/f/201306_cfpb_bulletin_responsible-conduct.pdf.

[33] *See* MOU Regarding Fair Lending, *supra* note 5, 7-9.

as well by means that are less disparate in their impact."[34] Where both the Bureau and the DOJ determine that they will take actions related to the potential violation, they seek to coordinate that action in a consistent and complementary manner.[35] However, a referral to the DOJ does not affect the Bureau's authority to take independent supervisory or enforcement action.

[34] 12 CFR 1002, Supp I, 1002.6, 6(a)-2. *See also* Lending Discrimination Bulletin, *supra* note 15, at 2-3.

[35] *See* MOU Regarding Fair Lending, *supra* note 5, at 8.

3. Supervisory observations

To date, examination teams have conducted targeted ECOA reviews at institutions that represent over 30 percent of the indirect auto lending market. Many, but not all, of these indirect auto lending examinations have revealed illegal discrimination and a need for corrective action. Examination teams found that indirect auto lending policies that allow discretionary markups affecting dealer compensation often resulted in disparities in dealer markup based on race and/or national origin. Examination teams generally determined that these disparities could not be explained by a legitimate business need that was not reasonably achievable as well by means less disparate in their impact. In many instances, these disparities persisted across the institution's entire indirect auto lending portfolio. In other cases, disparities were limited to certain products or programs and did not exist in other areas of the institution's auto lending business.

Examination teams also observed that indirect auto lenders often limit discretionary dealer markup to between 200 and 250 basis points. Yet examination teams found that indirect auto lenders often do not otherwise engage in significant monitoring and internal control of the fair lending risk related to their discretionary pricing policies and practices. In contrast, supervisory activity identified some auto lending products that significantly limit, by policy, discretionary dealer pricing adjustments. Supervisory experience suggests that where these significant limits on discretionary pricing have been in effect, they may result in considerable reductions or effective elimination of markup disparities for the particular product or business line subject to the limit. Thus, supervisory experience suggests that significant limits on markup, such as a limit of 100 basis points, may reduce fair lending risk and significantly reduce the need for certain compliance management activities. When institutions did not implement significant controls on discretionary pricing adjustments and did not engage in strong compliance management, fair lending examination teams have generally identified statistically significant disparities in dealer markup.

3.1 Remedial action involving indirect auto lenders

Examinations of indirect auto lenders have found disparities in dealer markup and have resulted in supervisory resolutions with some institutions and an enforcement resolution against Ally Financial Inc. and Ally Bank. Thus, examination and enforcement teams have already reached resolutions with several institutions that will collectively pay about $136 million to provide redress to up to 425,000 consumers. Redress directed by such resolutions has included damages for direct and indirect harm to affected consumers. As a result of these supervisory actions, some lenders are more stringently monitoring dealers and, when monitoring reveals evidence suggesting discrimination, are implementing additional limits to discretionary pricing adjustments or taking other appropriate action to manage or reduce their fair lending risk. As noted in the April 2014 *Fair Lending Report of the Consumer Financial Protection Bureau*[36] and *The Attorney General's 2013 Annual Report to Congress Pursuant to the ECOA Amendments of 1976*,[37] discrimination in auto lending continues to be an area of focus for the Bureau and the DOJ.

3.1.1 Non-public supervisory actions

When appropriate, the Office of Fair Lending and the Office of Supervision have reached non-public supervisory resolutions with institutions to address identified discrimination on a prohibited basis across indirect auto lending portfolios. As a result, supervisory resolutions have directed indirect auto lenders to pay about $56 million to provide redress for up to 190,000 consumers. Corrective action in the supervisory context in many ways mirrors corrective action in the public enforcement context. Supervisory resolutions have, to date, directed remediation sufficient to address consumer harm for past disparities in dealer markup, based on a methodology that is appropriately designed to distribute funds to harmed consumers. In addition, examination teams directed the supervised institutions to address the aspects of their businesses that gave rise to the fair lending risk. Consistent with the enforcement resolution with Ally, supervisory resolutions have not required institutions to adopt a single compliance

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[36] Available at http://files.consumerfinance.gov/f/201404_cfpb_report_fair-lending.pdf.

[37] Available at http://www.justice.gov/crt/about/hce/documents/ecoareport2013.pdf.

alternative. Instead, institutions have the choice to adopt compliance mechanisms that suit their particular business structure, provided that the institution addresses the policies and practices that resulted in the disparities in dealer markup. A discussion of some compliance options follows in Section 3.2.

The institutions also were directed to remunerate harmed consumers on a prospective basis if compliance mechanisms do not eliminate disparities in dealer markup in the future. Supervisory actions will result in prompt remuneration of affected consumers when pricing analysis reveals unexplained disparities on a prohibited basis. Although approaches vary, some lenders are instituting remuneration of affected consumers as frequently as monthly by adjusting interest rates to address emerging disparities, in addition to regular compliance management that includes an annual analysis of portfolio pricing. Unlike enforcement resolutions, supervisory resolutions do not include the possibility of civil money penalties.

3.1.2 Public enforcement activity

On December 20, 2013, the Bureau and the DOJ announced an enforcement action and concurrent consent orders that required Ally to pay $80 million to establish a settlement fund to provide redress to consumers who were harmed by Ally's discretionary pricing policy between April 2011 and December 2013.[38] The policy resulted in illegal discrimination against approximately 235,000 African-American, Hispanic, and Asian and Pacific Islander borrowers. In addition, the consent orders required Ally to hire a settlement administrator to distribute funds to harmed borrowers identified by the Bureau and the DOJ. The administrator must be accessible to victims on a cost-free basis and ensure that impacted borrowers receive compensation. In addition, Ally was directed to pay an $18 million civil money penalty.

Pursuant to the consent orders, Ally will monitor discretionary dealer markups to prevent future discrimination or may choose to eliminate discretionary dealer markup policies altogether. Ally is required to implement a compliance program to prevent future discrimination, including: dealer education, dealer monitoring and prompt corrective action against dealers when there are dealer-level disparities in loan pricing, and portfolio-wide analysis of pricing data for disparities

[38] *See* CFPB and DOJ Order Ally to Pay $80 Million to Consumers Harmed by Discriminatory Auto Loan Pricing (Dec. 20, 2013), *available at* http://www.consumerfinance.gov/newsroom/cfpb-and-doj-order-ally-to-pay-80-million-to-consumers-harmed-by-discriminatory-auto-loan-pricing/.

and consumer remuneration if Ally detects disparities. In the alternative, Ally can decide to move away from discretionary pricing affecting dealer compensation to a non-discretionary dealer compensation structure, which would eliminate Ally's obligation to monitor the fair lending risk of its policy permitting discretionary dealer markups and reduce Ally's overall fair lending compliance responsibilities. The Bureau is currently engaged in additional enforcement investigations involving other indirect auto lenders.

3.2 Mitigating fair lending risk

When addressing discrimination in indirect auto lending, a key component of supervisory resolutions has been to direct the lender to adopt policies and practices that effectively mitigate fair lending risk. Supervisory and enforcement experience has identified three possible methods of mitigating the fair lending risk associated with auto lending policies that allow discretionary pricing adjustments; however, there may be other methods, and examination teams recognize that the appropriate program will vary among financial institutions. One alternative is to monitor and, if necessary, correct disparities through a strong compliance management system. Another alternative is to implement policies that limit the maximum discretionary pricing adjustment to an amount that significantly reduces or eliminates disparities and fair lending risk. This option may significantly reduce but will not eliminate compliance activities related to discretionary pricing. A third alternative is to eliminate discretionary dealer adjustments to risk-based buy rates altogether and fairly compensate dealers using a non-discretionary mechanism that does not result in discrimination. By eliminating dealer pricing discretion, the lender eliminates the need for monitoring of discretionary dealer pricing adjustments. Each of these three options is discussed in detail below.

Innovation and experience may provide other effective alternatives to mitigating fair lending risk in indirect auto lending. Further, no one alternative is necessarily exclusive of the others and hybrid approaches may effectively mitigate fair lending risk. For example, a combination of tighter limits on discretionary pricing and compliance management may significantly reduce fair lending risk. Alternatively, adopting a non-discretionary dealer compensation program or imposing strict limits on discretionary pricing may significantly reduce an institution's fair lending risk, thereby requiring fewer resources for compliance management.

3.2.1 Fair lending compliance management systems

In prior issues of *Supervisory Highlights*, the Bureau has identified the following common features found at financial institutions with well-developed fair lending compliance systems:

- An up-to-date fair lending policy statement;
- Regular fair lending training for all employees involved with any aspect of the institution's credit transactions, as well as all officers and board members;
- Ongoing monitoring for compliance with fair lending policies and procedures;
- Ongoing monitoring for compliance with other policies and procedures that are intended to reduce fair lending risk (such as controls on loan originator discretion);
- Review of lending policies for potential fair lending violations, including potential disparate impact;
- Depending on the size and complexity of the financial institution, regular statistical analysis of loan data for potential disparities on a prohibited class basis in pricing, underwriting, or other aspects of the credit transaction;
- Regular assessment of the marketing of loan products; and
- Meaningful oversight of fair lending compliance by management and, where appropriate, the financial institution's board of directors.[39]

Elaborating on these elements, the *Indirect Auto Lending Bulletin* identified a number of features of a strong fair lending compliance program that may be effective in mitigating fair lending risk for indirect auto lenders.[40] Supervisory and enforcement experience provides further guidance. Institutions that choose to permit discretionary pricing affecting dealer compensation after an examination revealing discrimination on a basis prohibited by the ECOA have been directed to take the following corrective actions to ensure strong fair lending compliance management:

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[39] Supervisory Highlights: Fall 2012, *supra* note 21, at 6.

[40] *See* Indirect Auto Lending Bulletin, *supra* note 1, at 4-5.

- Maintaining appropriate limits on maximum rate spread between the institution's buy rate and the contract rate of the auto loan;
- Sending regular communications to all participating dealers explaining the ECOA, stating the lender's expectations with respect to ECOA compliance, and articulating the dealer's obligation to mark up interest rates in a non-discriminatory manner in instances where such markups are permitted;
- Conducting regular analyses of both dealer-specific and portfolio-wide loan pricing data for potential disparities on a prohibited basis resulting from discretionary pricing policies, including:
  - using only controls that reflect legitimate, nondiscriminatory, demonstrated factors when analyzing the discretionary pricing adjustments (as discussed above, controls appropriate in analyzing the lender buy rate may not be appropriate in analyzing subsequent discretionary pricing adjustments); and
  - applying a reasonable proxy when analyzing loans for disparities based on race or ethnicity (see Section 2.2 for a discussion of proxy methodologies);
- Commencing prompt corrective action against dealers, when analysis identifies unexplained, statistically significant disparities on a prohibited basis, including:
  - providing dealer education and training, as well as assisting the dealer in developing a strong fair lending compliance management system;
  - restricting or eliminating the dealer's discretion to adjust the buy rate; or
  - excluding dealers from future transactions when the disparities cannot be corrected or explained by a legitimate, nondiscriminatory, and demonstrated factor;
- Promptly remunerating affected consumers—including issuing checks, providing account credits, or adjusting interest rates—sufficient to address consumer harm, when unexplained disparities on a prohibited basis are identified by an institution across its portfolio using a regression model and proxy method that are appropriately designed to identify harmed consumers.

Supervisory experience has identified an array of possible approaches to dealer monitoring and corrective action. Effective dealer monitoring programs generally set a reasonable minimum volume requirement to identify dealers with sufficient transactions with the indirect lender to

permit effective statistical analysis for prohibited basis disparities. At the same time, any approach to dealer monitoring should ensure broad coverage of dealers conducting business with the indirect lender to maximize risk mitigation. Supervisory experience suggests multiple approaches to setting this minimum volume requirement, but the approach chosen should consider sufficient information for a large enough pool of applicants to permit sound statistical analysis of the prohibited basis groups identified for testing. Supervisory experience suggests such an analysis may be difficult or may result in statistical anomalies when a dealer has limited transactions with the indirect lender. A strong dealer monitoring program will appropriately weigh this consideration while also ensuring broad coverage of participating dealers. Such minimum volume requirements would only apply to dealer-specific monitoring, rather than the portfolio-level analyses.

Robust processes to monitor and correct for potential discrimination resulting from discretionary pricing policies can be critical to ensuring compliance with the ECOA. Supervisory experience is that the scope of the monitoring regime may appropriately vary based on the nature, size, and complexity of the institution's auto lending operations. However, examination teams have observed that implementing a compliance management system that includes most of the above elements can reduce disparities or quickly address them, thereby significantly mitigating fair lending risk.

In general, if a lender involved in an examination is not sure whether its compliance management system or corrective actions adequately address potential fair lending risk, the lender can contact the Office of Fair Lending or the Office of Supervision for input on specific questions by emailing CFPB_Supervision@cfpb.gov.

3.2.2 Limits on maximum allowable discretionary pricing adjustments

Based on supervisory experience, indirect auto lenders may also substantially mitigate fair lending risk by significantly limiting the maximum allowable discretionary pricing adjustment that a dealer can make for a loan financed by the lender. For example, fair lending reviews to date have found no actionable disparities associated with certain auto lending products or business lines that limit, by policy, discretionary pricing adjustments to significantly less than 200 or 250 basis points (for example, limits of 100 basis points). Imposing such limits on discretionary pricing adjustments does not completely eliminate all fair lending risk, though it can effectively mitigate such risk. Strict limits on discretionary pricing adjustments may result in significant reductions in portfolio-level disparities in dealer markup and ease reliance on

compliance management alone to address disparities. For example, an institution that implements significant limits on discretionary pricing may find that it can significantly reduce certain compliance activities, such as dealer-specific monitoring and corrective action, to which the institution would otherwise need to devote significant attention and resources. As with any policy that limits but does not eliminate discretion, limits on discretionary pricing adjustments require ongoing monitoring of fair lending risk at each stage of the transaction across the lender's portfolio. Yet, if successful in reducing or eliminating disparities, limits on discretionary pricing reduce or eliminate the need for portfolio-level remediation.

3.2.3 Dealer compensation not based on discretionary markup

The Bureau remains concerned about indirect lending programs built around discretion and financial incentives that create fair lending risks. As described above, when a lender allows for discretionary pricing affecting dealer compensation, the lender should employ strong controls or engage in robust compliance management to address the potential for discrimination. The *Indirect Auto Lending Bulletin* also noted that lenders may choose to adopt alternative pricing policies as a method of addressing fair lending risks.[41]

During the last year, supervisory experience has revealed that some entities have chosen to develop dealer compensation policies not based on discretionary markup. In addition, industry participants have identified several possible models of non-discretionary dealer compensation. One model compensates dealers using the same fixed amount for each loan (sometimes called a "flat fee"). Under another model, dealers are paid a fixed percentage of the amount financed. Alternatively, a lender could develop a multiple-criteria system in which compensation is tied to both the amount financed and the duration of the contract. Both of these latter approaches are non-discretionary compensation systems that allow for differences in compensation based on loan amount and potentially term and hence differ from a flat fee approach. These are a few examples of potential non-discretionary compensation systems, which could vary in design and sophistication, depending on the needs of an individual lender's business. There could be many other possibilities, and the Office of Fair Lending welcomes their creation and development, so long as they appropriately mitigate fair lending risk and do not adversely impact consumers.

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[41] *See* Indirect Auto Lending Bulletin, *supra* note 1, at 4.

For example, BMO Harris Bank publicly announced in April that it has eliminated dealer compensation for discretionary markups.[42] BMO Harris publicly stated that it will instead pay dealers three percent of the amount financed, up to a fixed dollar figure.[43] As CFPB Director Richard Cordray stated at the time, BMO Harris's new policy represents "a proactive step to protect consumers from discrimination."[44] This institution's approach is an example of but one option to limit fair lending risk in indirect auto lending.

As a general matter, the Office of Fair Lending expects that lenders consider a variety of factors in designing a dealer compensation system, including the extent to which the system mitigates fair lending risk, whether the system would create new risks of discrimination or other consumer harm, and the system's economic sustainability.

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[42] *See Bank Eliminates Dealer Markup, Cites CFPB Guidance*, F&I and Showroom (Apr. 24, 2014), *available at* http://www.fi-magazine.com/channel/f-i-products/news/story/2014/04/bank-eliminates-dealer-markup-cites-cfpb-guidance.aspx.

[43] *See Bank Eliminates Dealer Markup*, *supra* note 42.

[44] Statement of CFPB Director Richard Cordray on BMO Harris Auto Lending Policy (Apr. 30, 2014), *available at* http://www.consumerfinance.gov/newsroom/statement-of-cfpb-director-richard-cordray-on-bmo-harris-auto-lending-policy/.

4. Conclusion

Supervisory and enforcement experience reveals that significant discrimination often results from indirect auto lending policies that compensate dealers based on discretionary markup. Supervisory and enforcement resolutions have directed institutions to pay remediation sufficient to address consumer harm, engage in ongoing robust compliance management, and consider the option of adopting compensation and pricing policies not based on discretionary markup. Through the supervisory process, the Bureau will continue to conduct regular examinations to ensure that indirect auto lenders comply with the ECOA and Regulation B, and to promote fair and equal access to credit in the auto lending market.

To avoid risking liability for violations of the ECOA, indirect auto lenders should take proactive steps to mitigate fair lending risk. Supervisory and enforcement experience suggests that maintaining strong compliance management, imposing strict caps on discretionary pricing adjustments, and/or adopting non-discretionary dealer compensation models may limit fair lending risk. Innovation and experience may reveal other compliance options.

Supervisory Highlights

Consumer Financial
Protection Bureau

Fall 2014

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1. Introduction

As the Bureau's supervision program enters its fourth year, Supervision continues to conduct examinations of bank and nonbank providers of consumer financial products and services under the Bureau's jurisdiction. In this sixth edition of *Supervisory Highlights*, the CFPB shares recent supervisory observations, such as regulatory violations or unfair, deceptive, or abusive acts or practices (UDAAPs) in the areas of consumer reporting, debt collection, deposits, mortgage servicing, and student loan servicing. This edition also includes updated supervisory guidance about Home Mortgage Disclosure Act (HMDA) reporting. The findings reported here reflect information obtained by Supervision at the time of issuance of an examination report or supervisory letter.

CFPB supervisory work contributed to recent enforcement actions against GE Capital Retail Bank, ACE Cash Express, U.S. Bank, Flagstar Bank, and M&T Bank resulting in relief of approximately $308 million to more than 1.2 million consumers for illegal practices related to credit cards, payday loans, mortgage servicing, and checking accounts. In addition to these public enforcement actions, Supervision continues to resolve violations using non-public supervisory actions, sometimes including those initiated by entities self-reporting violations to Supervision staff. When Supervision examinations determine violations occurred, supervised entities are directed to implement appropriate corrective measures, including remediation to consumers as appropriate.

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB may also supervise the "larger participants" in other nonbank markets as the Bureau defines by rule. To date, the Bureau has issued four rules defining larger participants in the following markets: consumer reporting (effective September 2012), consumer debt collection (effective January 2013), student loan servicing (effective March 2014), and most recently, international money transfers (effective December 2014).

This report highlights supervision work generally completed between March 2014 and June 2014. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

2. Supervisory observations

As noted in previous issues of *Supervisory Highlights*, compliance management system (CMS) reviews remain a priority in CFPB's examination program. Recent examinations have seen, especially in the nonbank sector, increased efforts by supervised entities to develop more robust compliance management systems. At both bank and nonbank entities, examiners have observed increases in resources dedicated to compliance, changes in reporting structures to ensure compliance issues are heard and addressed by the board of directors (or other controlling person(s)), and instances of self-identified issues resulting in remediation to consumers.

Below are some of Supervision's recent observations from examinations in consumer reporting, debt collection, deposits, mortgage servicing, student loan servicing; updated guidance on HMDA reporting; and recent enforcement actions resulting at least in part from supervisory work.

2.1 Consumer reporting

As discussed in a past issue of *Supervisory Highlights*,[1] an important focus of the CFPB's consumer reporting examination program is how consumer reporting agencies (CRAs) carry out their dispute-handling obligations under Section 611 of the Fair Credit Reporting Act (FCRA).[2] Under Section 611, a consumer may dispute the completeness or accuracy of any information contained in his or her file at a CRA. Section 611 also requires CRAs to conduct reasonable

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[1] *See* Supervisory Highlights: Spring 2014 at 9, *available at:* http://www.consumerfinance.gov/reports/supervisory-highlights-spring-2014/.

[2] 15 USC 1681 *et seq*.

reinvestigations of such disputes and to provide consumers with written notice of the results of those reinvestigations. During their reviews, CFPB examiners found that one or more CRAs failed to comply with Section 611(a)(6), which specifies the information that must be included in the written notice following the completion of a reinvestigation. For example, examiners found that, for a period of several months, one or more CRAs failed to provide disputing consumers with (i) a statement that the reinvestigation was complete; (ii) a notice that, if requested by the consumer, it would describe the procedure it used to conduct the investigation; (iii) a notice that the consumer could add a statement of dispute to his or her file; and (iv) a notice that the consumer could request the CRA to notify certain third parties of any deletions it made (or, if applicable, the statement of dispute). Examiners attributed these violations to weaknesses in the monitoring and corrective action programs in place at the relevant entities, and Supervision directed those entities to enhance their programs to ensure compliance with Section 611.

In the course of examining dispute handling at one or more nationwide specialty consumer reporting agencies (specialty CRAs), CFPB examiners found that the processes of at least one specialty CRA were inconsistent with regard to handling disputes received by telephone. Specifically, examiners found that specialty CRA agents provided inconsistent information regarding the ability of consumers to lodge disputes by telephone. Supervision concluded that such inconsistencies created compliance risks and potentially discouraged consumers from completing the dispute process. CFPB examiners also found that at least one specialty CRA maintained a weak general consumer complaint program. Specifically, examiners found program(s) that lacked a formal definition for direct consumer complaints, did not provide training on how to handle such complaints, and inconsistently tracked such complaints. One or more nationwide CRA's procedures also failed to cover complaints received directly from consumers, creating a risk that the entities would fail to identify compliance issues presented by those complaints.

2.2 Debt collection

The Bureau began its supervision of larger participant debt collectors in January 2013. In recent examinations, the Bureau's examiners identified an unfair practice and several violations of the Fair Debt Collection Practices Act (FDCPA).[3]

2.2.1 Unlawful imposition of convenience fees

The FDCPA limits the situations where a debt collector may impose convenience fees. One limit is when state law is silent regarding the legality of imposing convenience fees and the contract creating the debt does not authorize the imposition of such fees. In one or more examinations of debt collectors, examiners observed that convenience fees, which ranged from $5 to $14, were imposed if a consumer made payment using either a credit or a debit card. Due to a systems failure, fees were imposed on consumers who lived in states where state law prohibited the collection of such convenience fees. One or more collectors also imposed convenience fees on consumers who lived in states where the law was silent regarding the collection of fees without reviewing the agreements creating the consumer debts to find out if those agreements expressly authorized the collection of such fees. Supervision directed these collectors to identify consumers who were improperly charged convenience fees, and to develop a plan for reimbursing those consumers.

2.2.2 False threats of litigation

The FDCPA prohibits a debt collector from threatening a consumer with any action it does not intend to undertake.[4] Accordingly, a debt collector violates the FDCPA when it threatens a consumer with litigation it does not intend to pursue. In at least one examination, Supervision staff determined that a collector routinely threatened consumers with litigation even though it generally did not intend to file suit. Litigation was initiated on only a small fraction of the

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[3] 15 USC 1692-1692p.

[4] 15 USC 1692e(5); *see also* 12 USC 1692e(10) (prohibiting "[t]he use of any false representation or deceptive means to collect or attempt to collect any debt").

accounts collected. Supervision directed one or more collectors to cease threatening consumers with litigation it did not intend to pursue.

2.2.3 Faulty training materials causing prohibited disclosures to third parties

The FDCPA prohibits a debt collector's representatives from identifying their employer when communicating with a third party for the purpose of acquiring location information, unless expressly requested to do so.[5] During one or more examinations, Supervision determined that representatives regularly identified their employer to third parties without being expressly requested to do so. This collector provided faulty training materials that directed its representatives to disclose their name and the name of the collector before identifying the party with whom they were speaking. Supervision directed the collector to conduct remedial training and update its training program, and monitor its collection agents to ensure effectiveness of the training program.

2.2.4 Unfair practices with respect to debt sales

In examining one or more financial institutions that sold charged-off credit card debt to debt buyers, Supervision's examination team identified unfair practices connected to those sales. First, with respect to a substantial number of accounts that were sold to debt buyers, at least one financial institution overstated the annual percentage rates (APRs) in the account documents provided to each debt buyer. Specifically, one or more financial institutions reported APRs that exceeded the rate for which the consumer was liable pursuant to the credit agreement. Second, in some instances, when at least one financial institution received payments from consumers on accounts post-sale, forwarding the payments to the appropriate debt buyer was significantly delayed, with delays ranging from two months to over two years. The relevant financial institutions have undertaken remedial and corrective actions regarding these violations, which are under review by the Bureau.

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[5] 15 USC 1692b(1).

2.3 Deposits

The Electronic Fund Transfer Act (EFTA) establishes the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer and remittance transfer services and of financial institutions or other persons that offer these services. The primary objective of the EFTA and its implementing regulation, Regulation E,[6] is the protection of individual consumers engaging in electronic fund transfers and remittance transfers.

Regulation E contains specific procedures for financial institutions to use to resolve errors reported by consumers related to electronic fund transfers, including requirements governing the prompt investigation of errors, providing timely provisional credit, and providing consumers with notice of the findings of the financial institution's investigation and the right to obtain the documentation the financial institution relied upon.[7] Outlined below are some significant Supervision findings in this area. When violations of Regulation E are identified, Supervision directs entities to determine the cause of the violations and implement appropriate corrective actions.

2.3.1 Violations of error resolution requirements

Regulation E prescribes the timeframe for resolving errors and generally requires a financial institution to investigate and determine whether an error occurred within 10 business days of receiving a notice.[8] Consumers may report an error either orally or in writing. Examiners cited violations of Regulation E at one or more institutions that, in the case of an oral notice of error, would wait until the customer had returned a dispute confirmation form before initiating an investigation. Examiners further found that at least one institution waited to request additional information until the written confirmation was received, and would require the consumer to respond to the request for additional information within 10 days of the original notice. Unless the consumer submitted the additional information requested within 10 days of the original notice, consumers would be denied their claim due to lack of information. At one or more

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[6] 12 CFR 1005.

[7] 12 CFR 1005.11.

[8] 12 CFR 1005.11(c)

financial institutions, examiners found that customers who complained about unauthorized transactions were told they must first contact the merchant, where applicable, before an investigation would begin.

Consistent with Regulation E, a financial institution may request written confirmation of an oral notice within 10 days of the notice.[9] However, a financial institution must begin its investigation promptly upon receipt of an oral notice.[10] The Official Interpretations further state that a financial institution cannot delay an investigation until the financial institution has received a written confirmation.[11]

Regulation E also sets forth the timing and content requirement to assert an error, specifically, sufficient information to identify the consumer's name and account number and why the consumer believes an error exists, including, to the extent possible, the type, date, and amount of the error.[12] A financial institution cannot deny an error claim on the basis of a consumer failing to provide additional information, or require the consumer to contact the merchant involved first.

2.3.2 Violations regarding liability for unauthorized transfers

Under Regulation E, if a consumer notifies a financial institution within two business days after learning of the loss or theft of an access device, the consumer's liability shall not exceed the lesser of $50 or the amount of unauthorized transfers that occurred before notice was provided to the financial institution.[13] Negligence by the consumer cannot be used as the basis for imposing greater liability than is permissible under Regulation E.[14] During one or more

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[9] 12 CFR 1005.11(b)(2).

[10] *See* Official Interpretations to 12 CFR 1005.11(b)(1)-2.

[11] *Id.*

[12] 12 CFR 1005.11(b)(1).

[13] 12 CFR 1005.6(b)(1).

[14] *See* Official Interpretations to 12 CFR 1005.6(b)-2.

examinations, Supervision found a violation of Regulation E when, despite a consumer's provision of details of the theft of a debit card and subsequent unauthorized PIN-based transfers, the consumer's claim was denied based on the fact that the customer was unable to explain how his PIN was compromised.

In these cases, Supervision directed institutions to revise policies and procedures and implement training to appropriately address these particular provisions of Regulation E.

2.3.3 Notice deficiencies

Regulation E requires institutions to advise consumers both of the results of the error notice investigation and the consumers' right to obtain the documentation the institution relied upon in its error resolution investigation(s).[15]

The standard form error resolution notices used by one or more of the financial institutions examined by Supervision failed to include a statement regarding a consumer's right to obtain the documentation that the institution relied on in its error resolution investigations as required by Regulation E.[16] At least one institution used notice templates referencing the issuance of provisional credit regardless of whether provisional credit was issued. These omissions and inconsistencies raise significant consumer protection concerns, and Supervision directed the institutions to correct these notice forms.

2.4 Mortgage servicing

The CFPB's new mortgage servicing rules took effect on January 10, 2014. These rules affect many aspects of mortgage servicing, including payment processing, periodic statements, and force-placed insurance. The rules also impose early intervention requirements and continuity of contact obligations on servicers for certain borrowers, as well as procedural requirements for loss mitigation applications. CFPB mortgage servicing examinations now include reviews for

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[15] 12 CFR 1005.11(d)(1).

[16] *Id.*

compliance with these new regulations. Moreover, conduct that does not violate one of the specific requirements or prohibitions may constitute an unfair, deceptive, or abusive act or practice (UDAAP). This section will discuss Supervision's initial new rules work and certain UDAAPs identified in the loss mitigation area.

2.4.1 New mortgage servicing rules

In the first half of this year, Supervision conducted targeted reviews examining for compliance with the new rules. For example, the new rules obligate servicers to maintain policies and procedures that are reasonably designed to achieve specific objectives, including objectives related to loss mitigation, servicing transfers, and service provider oversight.[17]

In reviewing this area, examiners found that the policies and procedures at several servicers appeared to be reasonably designed to meet the specific objectives laid out in the rule. For example, some servicers' policies and procedures clearly outlined the ways in which they access and provide timely and accurate information. These policies and procedures included specific written guidance as to who accesses the information, when they access it, and which software systems they use to obtain the information.

In contrast, Supervision cited violations based on policies and procedures reviewed at other servicers. Specifically, the rules require servicers to have policies and procedures reasonably designed to ensure servicers can provide servicer personnel with access to information reflecting actions performed by service providers, facilitate periodic reviews of service providers, and facilitate sharing of information regarding a borrower's loss mitigation application between the servicer and service provider. Examiners found that one or more servicers lacked any policies and procedures relating to oversight of service providers. Moreover, some policies and procedures reviewed by examiners did not reflect all of service provider relationships as defined by Regulation X; additionally, one or more servicers failed to maintain policies and procedures to facilitate periodic reviews of service providers. Finally, one or more servicers failed to maintain policies and procedures reasonably designed to facilitate the sharing of loss mitigation information when necessary: the policies and procedures failed to identify what information

[17] 12 CFR 1024.38(a), (b).

should be shared with service providers, who would provide it, and timeframes for sharing the information.

When examiners detected weaknesses in servicer policies and procedures, Supervision directed the servicers to improve their policies and procedures.

2.4.2 Loss mitigation

Loan modifications

In offering loan modifications to certain borrowers to avoid foreclosure, a servicer may require a borrower to complete a trial modification for a short period before it finalizes a permanent modification. In at least one examination, examiners found servicer failures to timely convert a substantial number of trial modifications to permanent modifications after the successful completion of a trial modification. The delays harmed borrowers who then owed higher amounts of accrued interest under the finalized permanent modifications than they would have owed under a timely conversion. During the delay for each borrower, the interest accrued at the original contractual rate, rather than at the lower rate provided under the permanent modification's terms. The servicers then capitalized the additional interest into the principal balance owed under the permanent modification. The servicers also continued to report borrowers that had been delinquent at the beginning of their trial modifications as delinquent to the consumer reporting agencies during the length of the delays. Supervision determined that the substantial delays, combined with the negative consequences attributable to the delays, constituted an unfair practice.

Moreover, at least one servicer sent permanent modification agreements to some borrowers that did not match the terms approved by its underwriting software. Many borrowers signed and returned the agreements, but then the agreements were not executed by the servicer(s). Instead, after substantial delays, borrowers were sent updated modification agreements with materially different terms. These misrepresentations about the available terms affected the ultimate payment the borrowers would make, influencing both whether they would accept the modification and how they could subsequently budget based on their expected payment. Supervision determined that one or more servicers engaged in a deceptive practice in connection with these modifications.

During examinations at one or more servicers, examiners detected a deceptive act relating to loss mitigation. For example, a servicer would notify a borrower regarding eligibility for two

different modifications – one a Home Affordable Modification Program (HAMP) modification and one a proprietary modification. One or more servicers, through a series of communications, touted the benefits of the proprietary option while downplaying its drawbacks and also misrepresenting aspects of the HAMP modification. The Bureau directed one or more servicers to compensate borrower(s) for the financial difference between the two modifications, in light of these misrepresentations.

Short sales

At one or more servicers, examiners identified a deceptive practice relating to the servicer's communications regarding deficiency balances resulting from short sales. Servicer representatives told consumers that a deficiency judgment relating to a short sale would not be sought. However, the resulting short sale approval agreements did not specifically waive a loan owner's right to pursue a deficiency judgment. Because a reasonable consumer would understand the statement to mean that if a borrower agreed on a short sale, there would be no deficiency judgment from any entity, Supervision cited this practice as deceptive.

2.5 Student loan servicing

The authority to supervise the federal and private student loan servicing activities affiliated with large banks for compliance with Federal consumer financial laws was transferred to the CFPB in July 2011. In December 2013, the CFPB issued its rule defining nonbank larger participants in the student loan servicing market.[18] The CFPB began conducting supervisory examinations of those larger participants after the rule became effective in March 2014. When reviewing student loan servicing activities, Supervision primarily assesses whether these activities have been conducted free from unfair, deceptive, or abusive acts or practices prohibited by the Dodd-Frank Act.[19] CFPB examiners have identified a number of unfair or deceptive acts or practices, described below.

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[18] 12 CFR 1090.106.

[19] 12 USC 5536(a)(1)(B).

2.5.1 Allocating partial payments in a way that maximizes late fees

CFPB examiners identified an unfair practice where one or more supervised entities proportionally allocated partial payments among loans in a student loan account in a manner that maximized late fees and was not adequately communicated to consumers.

Typically, servicers handle multiple student loans for each borrower in one combined student loan account. Servicers typically bill borrowers for the sum of the minimum monthly payment for each loan. The servicer allocates a borrower's single payment among the borrower's loans to satisfy the monthly payment for each loan.

CFPB examiners have reviewed how servicers allocate payments when a borrower pays less than the total amount due on all of the loans in the borrower's account. Examiners found that partial payments were being allocated proportionally, or pro rata, among all the loans, resulting in all of the loans in a borrower's account becoming delinquent. In instances that examiners observed, each loan in the account was then charged a minimum late fee.[20] Taken together, these practices maximized the late fees for the consumer. Further, examiners did not observe plausible options for borrowers to avoid the additional late fees. Supervision cited these fee-maximizing practices as unfair under the Dodd-Frank Act.

2.5.2 Misrepresentations about required minimum payments on billing statements

CFPB examiners identified a deceptive practice where a student loan servicer represented to consumers that an inflated minimum payment was due on periodic statements and online account statements. The minimum payment amount included accrued interest on loans that were still in deferment, which was therefore not actually due.

[20] For example, a minimum late fee may take the form of a number of assessment methodologies, including but not limited to: (1) a simple flat fee assessed for late payment of an individual loan, or (2) a fee based on the percent of the unpaid balance, rounded up to a minimum amount for each loan.

2.5.3 Charging improper late fees

CFPB examiners found one or more supervised entities that were charging late fees when payments were received during the grace period. Like many other types of loans, many student loan contracts have grace periods after the due date. If a payment is received after the due date but during the grace period, the promissory note stated that late fees would not be charged. Examiners have found instances where late fees were being charged during the grace period; Supervision identified these instances as unfair and deceptive practices and directed that entities cease charging late fees on full payments provided within the contractual grace period.

2.5.4 Failure to provide accurate tax information

Supervision found that one or more student loan servicers failed to provide consumers with information essential for deducting student loan interest payments on their tax filings. The IRS allows a consumer to deduct up to $2,500 of interest paid on student loans if the student loan is used for qualified higher education expenses and the borrower meets other eligibility requirements. Treasury guidelines require student loan lenders or servicers to receive certification from consumers that the student loan was used for qualified higher education expenses, which is usually part of the loan application itself. Student loan servicers typically provide consumers with the amount of annual qualified student loan interest paid on a 1098-E tax form if the consumer paid more than $600 in annual qualified student loan interest.

In at least one examination, Supervision concluded that a student loan servicer, without adequate disclosures, required consumers to provide an additional certification that a student loan was used for qualified higher education expenses, even though such borrowers had already supplied this information in their loan applications. If consumers did not provide the additional certification, they were not furnished with 1098-E forms, impeding their access to a valuable tax benefit. Examiners found this practice was unfair. Furthermore, misrepresentations were made to these consumers that they had paid no deductible student loan interest on their online account statements if the additional certification was not completed. Examiners found this practice was deceptive when borrowers had in fact paid deductible student loan interest.

2.5.5 Misrepresentations about discharging student loans in bankruptcy

CFPB examiners found one or more supervised entities that were misrepresenting to consumers that student loans are never dischargeable in bankruptcy.

Student loans are more difficult to discharge in bankruptcy than most other types of loans. To discharge a student loan in bankruptcy, a borrower must affirmatively assert and prove “undue hardship” in a court. Examiners reviewed communications to student loan borrowers about filing bankruptcy and found statements misrepresenting borrowers’ ability to discharge loans in bankruptcy. These statements asserted or implied that student loans were never dischargeable. Examiners identified communications of this nature as deceptive. When this occurred, Supervision directed entities to implement policies and procedures and appropriate oversight to clarify that no verbal or written communications should categorize student loans as never dischargeable in bankruptcy.

2.5.6 Improper telephone communications

In at least one examination, Supervision cited a student loan servicer for an unfair practice because its automated dialer routinely placed telephone calls to delinquent consumers in the early morning or late at night, which examiners determined was a form of harassment and an unfair practice. During the review, examiners identified more than 5,000 calls made at inconvenient times during a 45-day period, which included 48 inconvenient calls made to one consumer. The examiners concluded that the inconvenient calls resulted from an automated dialer with deficient controls. Specifically, the automated dialer was not programmed to account for information related to the consumers’ locations. Supervision directed the entity to improve internal controls to ensure that it would not place such violative phone calls in the future.

2.6 Fair Lending: CFPB's HMDA resubmission schedule & guidelines

The Bureau's examiners have conducted Home Mortgage Disclosure Act (HMDA)[21] Data Integrity Reviews (HMDA Reviews) at dozens of mortgage lenders, both bank and nonbank, and have found that many lenders have adequate HMDA compliance systems, resulting in HMDA data with no errors or very few errors. At some institutions, however, examiners have found inadequate compliance management systems and severely compromised mortgage lending data. On October 9, 2013, the Bureau published its HMDA Resubmission Schedule and Guidelines (HMDA Resubmission Standards)[22] and a HMDA Compliance Bulletin.[23] The Bureau did this to highlight the importance of accurate HMDA data and effective HMDA compliance management systems, and to provide transparency into how the Bureau enforces HMDA. Based on our examination experience, the Bureau has determined that it is appropriate to provide additional guidance with respect to the new standards.

Prior to implementation of the CFPB's HMDA Resubmission Standards in January 2014, CFPB examiners used the Federal Reserve Board's HMDA Resubmission Standards when conducting HMDA Reviews of CFPB-supervised financial institutions that are required to collect and report data pursuant to HMDA[24] and Regulation C[25] (CFPB HMDA Reporters). For the majority of CFPB HMDA Reporters, the CFPB's HMDA Resubmission Standards are generally similar to the Federal Reserve Board's HMDA Resubmission Standards. The Bureau announced a different resubmission standard for the largest CFPB HMDA Reporters – defined as any institution reporting 100,000 (or more) loans on its HMDA Loan Application Register (HMDA LAR) – given the significance of these institutions' impact on access to mortgage credit.

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[21] 12 USC 2801-2810.

[22] HMDA Examination Procedures (Oct. 2013), *available at:* http://files.consumerfinance.gov/f/201310_cfpb_hmda_resubmission-guidelines_fair-lending.pdf.

[23] CFPB Bulletin 2013-11 (Oct. 9, 2013), *available at:* http://files.consumerfinance.gov/f/201310_cfpb_hmda_compliance-bulletin_fair-lending.pdf.

[24] 12 USC 2803.

[25] 12 CFR 1003.4.

In its supervisory work, Bureau staff will follow the CFPB's HMDA Resubmission Standards in reviews of 2014 and subsequent HMDA data, but will continue to follow the previous standards for reviews of 2013 and earlier HMDA data. This will provide CFPB HMDA Reporters with an appropriate opportunity to calibrate their HMDA data collection, reporting, and compliance programs to the Bureau's HMDA Resubmission Standards. Bureau examination teams will continue conducting HMDA Reviews using the resubmission thresholds and guidelines that are appropriate to the year of the data being reviewed.

2.7 Remedial actions

The following public enforcement actions resulted, at least in part, from recent supervisory work. As described above, Supervision also continues to resolve matters, where appropriate, using non-public supervisory tools.

2.7.1 Public enforcement actions

M&T Bank

On October 9, 2014, the Bureau announced an action against Manufacturers and Traders Trust Company (M&T Bank) for deceptively advertising free checking accounts. During an examination, CFPB found that M&T Bank advertised checking accounts to consumers with promises of "no strings attached" free checking, without disclosing key eligibility requirements, in violation of both the Dodd-Frank Act's prohibition on deceptive practices and the Truth in Savings Act as implemented by Regulation DD. In this advertising, M&T Bank did not disclose that free checking account customers had to maintain a minimum level of account activity with deposits and withdrawals to maintain the free account. If there was no account activity for 90 days, the bank automatically converted the "Free Checking" accounts to "M&T First" checking accounts. Consumers with "M&T First" accounts who failed to maintain an average or combined monthly balance of $1,500 were charged fees of $5 to $14 per month. M&T Bank will provide $2.9 million in refunds to the approximately 59,000 consumers deceived into paying fees, and pay a $200,000 civil money penalty for the violations.

Flagstar Bank

On September 29, 2014, CFPB announced its first enforcement action related to the Bureau's mortgage servicing rules that went into effect in January 2014. Supervision examinations and subsequent investigations revealed that Flagstar Bank, F.S.B., took excessive time to process borrowers' applications for foreclosure relief, failed to tell borrowers when their applications were incomplete, denied loan modifications to qualified borrowers, and illegally delayed finalizing permanent loan modifications – in violation of the Bureau's mortgage servicing rules pertaining to loss mitigation, or the Dodd-Frank Act's prohibition on unfair and/or deceptive acts. As a result of this enforcement action, Flagstar will halt its illegal mortgage servicing activities, pay $27.5 million to victims, and pay $10 million in civil penalties. Flagstar will also engage in efforts to help affected borrowers preserve their homes, and will be prohibited from acquiring servicing rights for default loan portfolios until it demonstrates it has the ability to comply with laws that protect consumers during the loss mitigation process.

U.S. Bank

On September 25, 2014, CFPB ordered U.S. Bank, N.A., to provide an estimated $48 million in relief to more than 420,000 consumers harmed by illegal billing practices related to "add-on products" for credit cards and other bank products such as mortgage loans and checking accounts. Examination work by the CFPB and the Office of the Comptroller of the Currency (OCC) led to a determination that Bank customers were unfairly charged for certain identity protection and credit monitoring services that they did not receive. Some consumers also unfairly incurred charges for interest and fees as a result of these services. In addition to conveniently repaying customers and strengthening its service provider oversight program, U.S. Bank will pay a $5 million civil money penalty to the CFPB and a $4 million penalty to the OCC.

GE Capital Retail Bank

On June 19, 2014, CFPB announced that it was ordering GE Capital Retail Bank (GE Capital), now known as Synchrony Bank, to provide an estimated $225 million in relief to consumers harmed by illegal and discriminatory credit card practices. First, GE Capital was ordered to refund $56 million to approximately 638,000 consumers who were subjected to deceptive marketing practices when being sold credit card add-on products. These practices – related to five different debt cancellation add-on products – were uncovered during a CFPB examination conducted between December 2012 and February 2013. Examiners found that GE Capital's telemarketers misrepresented these products in a number of ways, such as:

- Marketing the product as free of charge;
- Failing to disclose consumers' ineligibility;
- Failing to disclose that consumers were making a purchase; and
- Marketing products as a limited time offer when they were not.

Second, in addition to these deceptive marketing practices, the CFPB and the Department of Justice announced a joint enforcement action requiring GE Capital to also provide an additional $169 million to about 108,000 borrowers excluded from debt relief offers because of their national origin. GE Capital had two different promotions that allowed credit card customers with delinquent accounts to settle their balances by paying off a specific portion of their debt, but it did not extend these offers to any customers who indicated that they preferred to communicate in Spanish or had a mailing address in Puerto Rico, even if the customer met the promotion's qualifications. This resulted in Hispanic populations being unfairly denied the opportunity to benefit from these promotions, in direct violation of the Equal Credit Opportunity Act (ECOA). This order represents the federal government's largest credit card discrimination settlement in history.

ACE Cash Express

On July 10, 2014, CFPB announced an enforcement action against ACE Cash Express, Inc., one of the largest payday lenders in the United States. The Bureau determined that ACE used illegal debt collection tactics to pressure overdue borrowers into taking out additional loans they could not afford. The Bureau conducted the examination of ACE in coordination with the Texas Office of Consumer Credit Commissioner. ACE was ordered to provide $5 million in refunds and to pay a $5 million penalty for these violations.

The CFPB found that ACE used unfair, deceptive, and abusive practices to collect consumer debts, both when collecting its own debt and when using third-party debt collectors to collect its debts. The Bureau found that ACE collectors engaged in a number of aggressive and unlawful collections practices, including:

- Threatening to sue or criminally prosecute;
- Threatening to charge extra fees and report consumers to credit reporting agencies; and
- Harassing consumers with collection calls.

The Bureau alleged that ACE used these illegal debt collection tactics to create a false sense of urgency to lure overdue borrowers into payday debt traps, even when consumers explained to

ACE that they could not afford to repay the loan. The Bureau alleged this creation of a false sense of urgency to get delinquent borrowers to take out more payday loans – while charging new fees each time – is abusive.

3. Supervision program developments

Recruiting and training continue to be priority areas for Supervision, as the Bureau makes progress toward its steady state hiring levels. As of October 23, 2014, Bureau examination staff numbers approximately 400 examiners supported by both regional management and headquarters staff. More than 165 of these examiners have been commissioned through the Bureau's internal process, or came to the CFPB with commissions from other regulators.

The Bureau remains committed to publishing guidance documents to aid industry in complying with the Bureau's expectations of supervised entities. Below are summaries of the Bureau's recent guidance documents.

3.1 Recent CFPB guidance

3.1.1 Bulletin on marketing of credit card promotional APR offers

On September 3, 2014, CFPB released a bulletin to inform credit card issuers of the risk of engaging in deceptive and/or abusive acts and practices in connection with solicitations that offer a promotional annual percentage rate (APR) on a particular transaction over a defined period of time.[26] The Bureau has observed that certain solicitations for such offers do not clearly

[26] CFPB Bulletin 2014-02 (Sept. 3, 2014), *available at:* http://files.consumerfinance.gov/f/201409_cfpb_bulletin_marketing-credit-card-promotional-apr-offers.pdf.

and prominently convey that a consumer who accepts the offer and continues to use the credit card to make purchases will lose the grace period on the new purchases if the consumer does not pay the entire statement balance, including the amount subject to the promotional APR, by the payment due date.

3.1.2 FFIEC credit practices guidance

On August 22, 2014, the Bureau joined the Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), and OCC in issuing interagency guidance regarding certain consumer credit practices.[27] The guidance explains that while the Federal Trade Commission's (FTC) Credit Practices Rule[28] remains in effect, the parallel rules for banks, savings associations, and Federal credit unions would be repealed as a consequence of the Dodd-Frank Act. In this guidance, the agencies noted that regardless of the repeal of these rules, they maintain their supervisory and enforcement authority regarding unfair or deceptive acts or practices, which could include the practices previously addressed in the former credit practices rules.

3.1.3 Mortgage servicing transfers bulletin

On August 19, 2014, CFPB released Bulletin 2014-01, a Compliance Bulletin and Policy Guidance titled "Mortgage Servicing Transfers."[29] This document lays out supervisory expectations for servicers engaged in the transfer of mortgage servicing rights; it updates and supersedes CFPB Bulletin 2013-01, "Mortgage Servicing Transfers." It provides examples of policies and procedures that CFPB examiners may consider as helping a servicer to comply with the 12 CFR Part 1024.38 requirements that servicers adopt policies and procedures reasonably designed to achieve the objectives of facilitating the transfer of information during servicing

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[27] *See* Interagency Guidance Regarding Unfair or Deceptive Credit Practices, *available at:* http://files.consumerfinance.gov/f/201408_cfpb_guidance_ffiec_credit-card-practices.pdf.

[28] 16 CFR 444.1-.5. The FTC's Credit Practices Rule generally prohibits (1) the use of certain provisions in consumer credit contracts, (2) the misrepresentation of the nature or extent of cosigner liability, and (3) the pyramiding of late fees.

[29] CFPB Bulletin 2014-01 (Aug. 19, 2014), *available at:* http://files.consumerfinance.gov/f/201408_cfpb_bulletin_mortgage-servicing-transfer.pdf.

transfers and properly evaluating loss mitigation applications. It also provides examples of policies and procedures, as well as operational failures, that examiners may consider as detrimental to complying with the 12 CFR Part 1024.38 requirements. The compliance bulletin and policy guidance also describes the application of certain other sections of Regulation X to the servicing transfer context and explains certain areas where CFPB examiners will focus when examining for compliance with these section of Regulation X in the servicing transfer context.

3.1.4 Mortgage origination "mini-correspondent" guidance

The Bureau became aware that some mortgage brokers may be shifting their business models in the possible belief that doing so will alter the applicability of important consumer protections that apply to transactions involving mortgage brokers. On July 11, 2014, the Bureau issued guidance explaining how the Bureau evaluates mortgage transactions involving mini-correspondent lenders.[30] The guidance sets out some of the questions the CFPB may consider in evaluating mortgage transactions involving mini-correspondent lenders in order to understand their true nature. This evaluation involves examining how the mini-correspondent lender is structured and operating, for example: whether it is continuing to broker loans; its sources of funding; whether it funds its loans through a bona fide warehouse line of credit; its relationship with its investors; and its involvement in mortgage origination activities such as loan processing, underwriting, and making the final credit approval decision.

The guidance makes clear that no single question necessarily determines how the CFPB may exercise its supervisory and enforcement authorities, and that the facts and circumstances of the particular mortgage transaction being reviewed would be relevant to how the Bureau exercises these authorities.

Finally, the guidance confirms that whether parties must comply with the broker compensation rules does not depend on how they may describe their business structure.

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[30] Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders (July 11, 2014), *available at:* http://files.consumerfinance.gov/f/201407_cfpb_guidance_mini-correspondent-lenders.pdf.

3.2 Other developments

3.2.1 Larger participant rulemakings

On September 23, 2014, the CFPB published a final rule in the *Federal Register* defining the larger participants in the international money transfer market.[31] Under its existing authority, the CFPB was able to supervise large depository institutions and credit unions, which often provide international transfers; this final rule extends the Bureau's supervisory authority to nonbank providers that meet the threshold of a larger participant in the market. Nonbanks that provide at least one million aggregate annual international money transfers will be larger participants under the rule, which will go into effect on December 1, 2014.

On October 8, 2014, the Bureau published a proposed rule in the *Federal Register* that, if finalized, would expand its supervisory authority over the larger nonbank participants in the automobile financing market.[32] Currently, the Bureau's supervision authority reaches large banks and credit unions that originate automobile loans and leases, but the nonbank members of this market have never been supervised at the federal level. As proposed, the rule would generally allow the Bureau to supervise nonbank automobile financing companies (excluding dealers) that originate 10,000 or more loans and/or leases in a year. The Bureau estimates that about 38 automobile financing companies would be subject to this new oversight, and that collectively, these companies originate around 90 percent of nonbank automobile loans and leases. The proposed rule is open for comment until December 8, 2014. The Bureau intends to issue a final rule after it has reviewed and considered submitted comments.

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[31] Final Rule: Defining Larger Participants of the International Money Transfer Market, 79 FR 56631 (Sept. 23, 2014), codified at 12 CFR 1090.107.

[32] Proposed Rule: Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 79 FR 60762 (Oct. 8, 2014).

4. Conclusion

As its Supervision program continues to mature operationally, as well as expand through larger participant rulemakings, the Bureau continues to recognize the value in communicating program findings to CFPB-supervised entities to aid them in efforts to comply with Federal consumer financial law.

To that end, the CFPB remains committed to periodically publishing *Supervisory Highlights* to share general information about examination findings without identifying specific institutions (except for public enforcement actions), to communicate operational changes to the program, and to provide a convenient resource for information on the Bureau's recent guidance documents.

Supervisory Highlights

cfpb Consumer Financial Protection Bureau

Winter 2015

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1. Introduction

The supervision of consumer financial services providers is a core function of the Consumer Financial Protection Bureau (CFPB or Bureau), and Supervision[1] continues to prioritize entities for examination based on assessments of consumer risk across the products and services under the Bureau's authority, as well as within particular markets.[2] Supervision remains committed to sharing findings from these examinations – while maintaining the confidentiality of supervised entities – to assist industry in its efforts to remain in compliance with Federal consumer financial law.

As noted in previous issues of *Supervisory Highlights*, Supervision continues to resolve violations using non-public supervisory actions. Recent supervisory resolutions have resulted in remediation of approximately $19.4 million to more than 92,000 consumers.[3] The findings reported in this seventh issue of *Supervisory Highlights* reflect information obtained by Supervision at the time of issuance of an examination report or supervisory letter. When Supervision examinations determine violations occurred, supervised entities are directed to implement appropriate corrective measures, including remediation to consumers as appropriate.

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[1] Supervision includes CFPB's examiners and regional and headquarters members of the Office of Supervision Examinations, and the Office of Supervision Policy. Members of the Office of Fair Lending and Equal Opportunity also participate in the supervision process.

[2] *See* Supervisory Highlights: Summer 2013, Section 3.2.3 (Risk-Based Approach to Examinations), *available at* http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf.

[3] Remediation numbers represent remedial actions that have been completed since the publication of the last issue of Supervisory Highlights and during the period under review.

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB may also supervise the "larger participants" in other nonbank markets as the Bureau defines by rule. To date, the Bureau has issued four rules defining larger participants in the following markets: consumer reporting (effective September 2012), consumer debt collection (effective January 2013), student loan servicing (effective March 2014), and most recently, international money transfers (effective December 2014). In September 2014, the Bureau proposed a rule defining the larger participants in the nonbank automobile finance market. The comment period for the proposed rule ended on December 8, 2014, and the CFPB expects to issue a final rule after reviewing the comments received.

This report highlights supervision work generally completed between July 2014 and December 2014.

2. Supervisory observations

Below are some of Supervision's recent observations from examinations in consumer reporting, debt collection, deposits, mortgage origination, and fair lending.

2.1 Consumer reporting

In prior issues of *Supervisory Highlights*, Supervision discussed its consumer reporting examination program and its focus on how consumer reporting agencies (CRAs) meet their dispute-handling obligations under Section 611 of the Fair Credit Reporting Act (FCRA), including the requirement that a CRA generally notify a furnisher when a consumer disputes the accuracy or completeness of an item of information provided by the furnisher to the CRA and promptly provide the furnisher "all relevant information" regarding the dispute. CFPB examiners previously found that some CRAs failed to forward relevant documents submitted by consumers, including cancelled checks, invoices, and correspondence, to furnishers.

In follow-up reviews, examiners found that one or more CRAs significantly enhanced their dispute handling systems in response to CFPB directives. Examiners found that one or more CRAs now allow consumers to use online portals to submit disputes directly to furnishers, and have implemented systems to forward to furnishers relevant dispute documents submitted by consumers via the mail. Examiners also found that one or more CRAs made improvements to call center scripts and training regarding solicitation of relevant information from consumers with disputes.

While CFPB examiners have seen progress in compliance with dispute handling obligations under the FCRA, recent reviews identified several practices that failed to meet dispute handling obligations. For example, examiners continued to find that one or more CRAs failed to consistently forward all relevant information found in letters and supporting documents supplied by consumers with their disputes.

In recent reviews, examiners found deficiencies in the updating of public record information, leading to errors in the updating of files after a reinvestigation and in the reporting of dispute results to consumers. In light of these findings, examiners directed one or more CRAs to take corrective action, including the development of appropriate training with respect to the notice of dispute and forwarding of relevant information to furnishers in accordance with FCRA requirements. One or more CRAs must also establish necessary policies and procedures to ensure that when, as a result of a reinvestigation, a provider of public record information notifies the CRA that information in the CRA's system is incorrect or incomplete, the CRA promptly modifies or updates the public record information in its system.

2.2 Debt collection

The Supervision program covers certain bank and nonbank creditors who originate and collect their own debt. The Bureau also began its supervision of the larger participants among third-party debt collectors in January 2013. The Bureau's recent examinations have identified a risk of a deceptive practice, violations of the FCRA[4] and Regulation V,[5] and violations of the Fair Debt Collection Practices Act (FDCPA).[6]

2.2.1 False and misleading representations in debt collection communications

The FDCPA prohibits the use of any false, deceptive, or misleading representation or means in connection with the collection of any debt.[7] In one or more examinations of debt collectors performing collection services of defaulted student loans for the Department of Education, examiners identified collections calls, scripts and letters containing various misrepresentations to consumers. Examiners found that collection agents overstated the benefits of federal student

[4] 15 USC 1681s.

[5] 12 CFR 1022.42-1022.43.

[6] 15 USC 1692.

[7] 15 USC 1692e.

loan rehabilitation. Specifically, these agents overstated the rehabilitation program's impact on consumers' credit report and credit score and the extent to which collection fees would be waived upon completion of the program.[8] In addition, examiners identified instances in which collection agents misrepresented to consumers that they could not participate in a federal student loan rehabilitation program unless consumers made payments by credit card, debit card, or Automatic Clearing House (ACH) payment, when in fact no such program requirement existed.[9] Examiners also found that collectors threatened to take action against certain consumers, which created the impression that if they did not make a payment they would be sued. In fact, none of the collection agents knew whether legal action would be taken and did not intend to take legal action.[10] The relevant financial institutions have undertaken remedial and corrective actions regarding these violations, which are under review by the Bureau.

2.2.2 Risk of a deceptive practice regarding required minimum notice for cancellation or modification of recurring ACH payments

The Dodd-Frank Act makes it unlawful for any covered institution to engage in any unfair, deceptive, or abusive act or practice.[11] In one or more examinations, examiners identified a practice that created a risk of deception. When attempting to collect on delinquent accounts, collectors offered consumers a recurring ACH payment option. When informing consumers about this payment option, collectors promoted the consumers' ability to adjust or cancel a recurring ACH payment with only 24 hours' notice. This representation, however, contradicted both an express representation in monthly periodic statements provided to consumers and internal policies and procedures, which stated that a minimum of 72 hours' notice was required. The contradiction in oral and written disclosures of the timeframe required to cancel or adjust a recurring ACH created a risk of deception.

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[8] 15 USC 1692e(10).

[9] 15 USC 1692e(10).

[10] 15 USC 1692e(5).

[11] 12 USC 5531, 5536.

2.3 Deposits

The Bureau has reviewed overdraft protection services at multiple financial institutions. Bureau examiners observed that one or more financial institutions switched from a ledger-balance method to an available-balance method for purposes of deciding whether to authorize signature-based debit transactions and other electronic transactions (collectively "electronic transactions") and whether to post or return checks and ACH transactions. In addition, one or more institutions switched to an available-balance method for purposes of calculating whether a transaction results in an overdraft and/or whether an overdraft fee is assessed when a transaction is settled.

A ledger-balance method factors in only settled transactions in calculating an account's balance; an available-balance method calculates an account's balance based on electronic transactions that the institutions have authorized (and therefore are obligated to pay) but not yet settled, along with settled transactions. An available balance also reflects holds on deposits that have not yet cleared. Examiners observed that in some instances, transactions that would not have resulted in an overdraft (or an overdraft fee) under a ledger-balance method did result in an overdraft (and an overdraft fee) under an available-balance method.

At one or more financial institutions, examiners noted that these changes to the balance-calculation method used were not disclosed at all, or were not sufficiently disclosed, resulting in customers being misled as to the circumstances under which overdraft fees would be assessed. Because these misleading practices could be material to a reasonable consumer's decision-making and actions, they were found to be deceptive.

Examiners also observed at one or more institutions the following sequence of events after the institutions switched balance-calculation methods: a financial institution authorized an electronic transaction, which reduced a customer's available balance but did not result in an overdraft at the time of authorization; settlement of a subsequent unrelated transaction that further lowered the customer's available balance and pushed the account into overdraft status; and when the original electronic transaction was later presented for settlement, because of the intervening transaction and overdraft fee, the electronic transaction also posted as an overdraft and an additional overdraft fee was charged. Because such fees caused harm to consumers, one or more supervised entities were found to have acted unfairly when they charged fees in the manner described above. Consumers likely had no reason to anticipate this practice, which was not appropriately disclosed. They therefore could not reasonably avoid incurring the overdraft fees charged. Consistent with the deception findings summarized above, examiners found that

the failure to properly disclose the practice of charging overdraft fees in these circumstances was deceptive.

At one or more institutions, examiners found deceptive practices relating to the disclosure of overdraft processing logic for electronic transactions. Examiners noted that these disclosures created a misimpression that the institutions would not charge an overdraft fee with respect to an electronic transaction if the authorization of the transaction did not push the customer's available balance into overdraft status. But the institutions assessed overdraft fees for electronic transactions in a manner inconsistent with the overall net impression created by the disclosures. Examiners therefore concluded that the disclosures were misleading or likely to mislead, and because such misimpressions could be material to a reasonable consumer's decision-making and actions, examiners found the practice to be deceptive. Furthermore, because consumers were substantially injured or likely to be so injured by overdraft fees assessed contrary to the overall net impression created by the disclosures (in a manner not outweighed by countervailing benefits to consumers or competition), and because consumers could not reasonably avoid the fees (given the misimpressions created by the disclosures), the practice of assessing the fees under these circumstances was found to be unfair.

2.4 Mortgage origination

In January 2013, the CFPB issued rules pursuant to Title XIV of the Dodd-Frank Act (Title XIV rules) related to mortgage origination activities. The Title XIV rules cover the ability-to-repay and qualified mortgage standards, escrow requirements, high-cost mortgage and homeownership counseling requirements, appraisal requirements for higher-priced mortgage loans, and loan originator compensation. Most of the Title XIV rules took effect in January 2014 and the CFPB commenced supervisory examinations for compliance four months after the effective date. Supervision's examination findings for compliance with Title XIV rules will be discussed, for the most part, in a future issue of *Supervisory Highlights*. The discussion below largely focuses on Supervision's examination findings and observations from July 2014 to December 2014.

2.4.1 Loan originators cannot receive compensation based on a term of a transaction

Regulation Z prohibits a loan originator from receiving compensation based, directly or indirectly, on the terms of a consumer credit transaction secured by a dwelling.[12] A loan originator includes administrative staff and branch managers who, for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arrange, negotiate, or otherwise obtain an extension of consumer credit for another person.[13] This rule has been in effect since April 2011; it was originally promulgated by the Federal Reserve Board of Governors in September 2010. The Bureau has since revised the rule.

In one or more examinations, examiners found that branch managers were loan originators and owners of related marketing services entities. Supervision found instances of improperly allocated expenses on branch income statements which resulted in marketing services entities receiving income based on the profitability of retail loans originated by branch managers. Consequently, branch managers, as owners of the marketing services entities, received compensation based on the terms of transactions originated by the branch managers themselves. Supervision directed that compensation to loan originators based on a term of a transaction, including branch managers, cease.

2.4.2 Improper use of lender credit absent changed circumstances

Regulation X requires that a loan originator be bound, within the applicable tolerances, to the settlement charges and terms listed on the Good Faith Estimate (GFE) provided to the borrower, unless a revised GFE is provided prior to settlement.[14] A loan originator that provides a revised GFE is required to document the reason for the revised GFE and retain those records for no less than three years after settlement.[15]

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[12] 12 CFR 1026.36(d)(1).

[13] 12 CFR 1026.36(a)(1).

[14] 12 CFR 1024.7(f).

[15] 12 CFR 1024.7(f).

At one or more institutions, examiners identified practices that caused the amounts disclosed on the HUD-1 to exceed those disclosed on the GFE. Due to inadequate training and compliance policies and procedures, a lender credit in one or more examinations was reduced on the HUD-1 to prevent the borrower, on a no-cost refinance, from receiving excess cash-back at closing. This reduction, however, in the absence of changed circumstances, impermissibly increased the final adjusted origination charge, a violation of Regulation X.[16] The difference in the amounts disclosed was refunded to consumers.

2.4.3 Failing to provide the Good Faith Estimate in a timely manner

Regulation X requires that a lender provide a GFE not later than three business days after it receives an application, or information sufficient to complete an application.[17] Regulation Z also requires creditors, in certain mortgage transactions secured by a consumer's dwelling, to provide a good faith estimate of the Truth in Lending disclosure not later than the third business day after the creditor receives the consumer's written application.[18]

During one or more examinations, examiners identified policies and procedures that did not define sufficiently when an application was received. As a result, the lender did not measure the three-business-day period accurately, and this caused the good faith estimates to be delayed beyond the three-business-day requirement, a violation of Regulations X and Z.[19] Examiners directed appropriate corrective action.

2.4.4 Improperly using advertisements with triggering terms without the required additional disclosures

Regulation Z requires advertisements to include disclosures when certain triggering terms are advertised. Examiners found in one or more institutions that social media advertising was not

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[16] 12 CFR 1024.7(e)(1).

[17] 12 CFR 1024.7(a)(1).

[18] 12 CFR 1026.19(a)(1)(i).

[19] 12 CFR 1024.7(a)(1); 12 CFR 1026.19(a)(1)(i).

subject to monitoring or compliance audit, which are components of an effective compliance management system. Loan originators created their own advertisements and content. Loan originators advertised the length of payment, amount of payments, numbers of payments, and finance charges, without providing the required disclosures, a violation of Regulation Z.[20] These institutions agreed to appropriate corrective actions.

2.4.5 Adverse action notice deficiencies and failure to provide the notice in a timely manner

Regulation B requires a lender to notify an applicant of action taken within 30 days after receiving a completed application regarding the creditor's adverse action on the application.[21] The notice must be in writing and contain a statement of the action taken; the name and address of the creditor; a statement describing the provisions of section 701(a) of the Equal Credit Opportunity Act (ECOA); the name and address of the Federal agency that administers compliance with respect to the creditor; and either a statement of the specific reasons for the action taken, or a disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification.[22]

CFPB examiners found one or more supervised entities failed to provide the requisite information in denial notices as set forth in Regulation B and failed to notify an applicant of action taken within 30 days after receiving the completed application. These errors were attributed to weaknesses in the compliance audit programs and the monitoring and corrective action component of the compliance programs.[23] Supervision directed the supervised entities to conduct a review of all mortgage loan applications denied within the relevant time period and take appropriate corrective action, including providing corrected notices to applicants.

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[20] 12 CFR 1026.24(d).

[21] 12 CFR 1002.9(a)(1)(i).

[22] 12 CFR 1002.9(a)(2); *see* 15 USC 1691–1691f.

[23] *See* Supervisory Highlights: Summer 2014, *available at* http://files.consumerfinance.gov/f/201409_cfpb_supervisory-highlights_auto-lending_summer-2014.pdf.

2.4.6 Deficiencies in compliance management systems

A sound and robust compliance management system is essential to ensuring compliance with Federal consumer financial law and preventing associated risks of harm to consumers. As noted in previous issues of *Supervisory Highlights*, an effective compliance management system includes board and management oversight, a compliance program, a consumer complaint management program, and a compliance audit program. The board of directors and senior management should, among other things, adopt clear policy statements concerning consumer compliance, establish a compliance function to set policies and procedures, and assign resources to the compliance function commensurate with the size and complexity of the supervised entity's practices and operations. A compliance program should include policies and procedures, training, and monitoring and corrective action processes. A compliance audit program should assist the board of directors or board committees in determining whether policies and standards adopted by the board are being implemented, and should also identify any significant gaps in board policies and standards.

At one or more institutions, examiners concluded that a weak compliance management system allowed numerous violations of Regulations B, X, and Z to occur. For example, in one or more instances, a supervised entity first adopted a compliance policy manual and hired a compliance officer shortly before the start of a Bureau examination, and as a result, lacked procedures to implement the manual and was unable to effectively communicate compliance responsibilities to employees. In one or more instances, an institution's board members did not receive any training, the training provided to employees was not comprehensive or accurate, and training content was neither kept current nor directed towards the appropriate employees. At one or more institutions, Supervision found that compliance audits performed by third parties were limited in scope and failed to identify numerous regulatory violations found by examiners, and audit results were not reported to directors. Examiners directed the institutions to take appropriate action to address the weaknesses in order to implement effective compliance management systems.

2.5 Fair Lending: Consideration of protected forms of income

Since the start of the Bureau's supervision program, examiners have conducted ECOA targeted mortgage origination reviews at institutions, both bank and nonbank, that receive about 40% of

the applications and make about 40% of the originations reported pursuant to the Home Mortgage Disclosure Act (HMDA),[24] and have found that many lenders operate in compliance with the ECOA and its implementing regulation, Regulation B.[25] At some institutions, however, examiners have identified violations of the ECOA and Regulation B, including violations related to the failure to consider public assistance income or other sources of income protected by Regulation B.

The ECOA forbids a creditor from discriminating against any applicant "because all or part of the applicant's income derives from any public assistance program."[26] Furthermore, Regulation B states that a creditor "shall not . . . exclude from consideration the income of an applicant . . . because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension, or other retirement benefit . . . ."[27] In addition, Regulation B also states that a "creditor shall not make any . . . written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application."[28]

During recent examinations, the Bureau's examination staff found one or more violations of the ECOA and Regulation B related to the treatment of protected forms of income. Applicants were automatically declined if they relied on income from a non-employment source, such as social security income or retirement benefits, in order to repay the loan. Marketing materials contained written statements regarding the prohibition and may have discouraged applicants who received public assistance or other protected sources of income from applying for credit.

While the general rules governing the prohibition against consideration of protected forms of income include narrow exceptions (*e.g.,* while a creditor may not consider the fact that an

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[24] *See* 12 USC 2801–2810.

[25] *See* 12 CFR 1002.

[26] 15 USC 1691(a)(2); *see* 12 CFR 1002.4(a).

[27] 12 CFR 1002.6(b)(5). Regulation B also states that "[w]hen an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, the creditor shall consider such payments as income to the extent that they are likely to be consistently made."

[28] 12 CFR 1002.4(b).

applicant receives public assistance income, the creditor can consider "[t]he length of time an applicant will likely remain eligible to receive such income"[29]), for these exceptions to apply, an institution must analyze each applicant's particular situation.[30] A blanket practice of denying any applicant who relies on public assistance income, or a specific form of public assistance income, without an assessment of an applicant's particular situation, violates the ECOA and Regulation B.

The relevant supervised entities were directed by examination staff to identify applicants who were wrongly denied on the basis of their protected income source, as well as potential applicants who were discouraged by the marketing materials. Supervision also directed that remediation be made to harmed applicants and prospective applicants, including reimbursement of fees and interest; the opportunity to reapply; and additional remuneration for any consumers who were improperly denied and subsequently lost their homes.

2.6 Remedial actions

Recent supervisory resolutions reached in the areas of payday lending, mortgage servicing, and mortgage origination have resulted in remediation of approximately $19.4 million to more than 92,000 consumers.

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[29] *See* Official Staff Commentary, 12 CFR 1002, ¶ 6(b)(2)-6 (Supp. I).

[30] *See* Official Staff Commentary, 12 CFR 1002, ¶ 6(b)(2)-6 (Supp. I) ("When considering income derived from a public assistance program, a creditor may take into account, for example: i. The length of time an applicant will likely remain eligible to receive such income. ii. Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (as in the case of Temporary Aid to Needy Families, or social security payments to a minor).").

3. Supervision program developments

Supervision continues to strive for increased efficiency in its operations, and continues to focus on recruiting highly-qualified examination staff and providing regular and thorough training to all Bureau examiners. As of February 6, 2015, Bureau examination staff numbers approximately 400 examiners supported by both regional management and headquarters staff. More than 165 of these examiners have been commissioned through the Bureau's internal process, or came to the CFPB with commissions from other regulators.

The Bureau remains committed to publishing guidance documents to aid industry in complying with the Bureau's expectations of supervised entities. Below are summaries of the Bureau's recent guidance documents and updates to examination procedures, as well as operational updates related to examiner training.

3.1 Examination procedures

3.1.1 Credit card account management examination procedures

In February 2015, the CFPB added new Credit Card Account Management examination procedures to the Supervision and Examination Manual.[31] These procedures are expected to

[31] *See* Credit Card Account Management Examination Procedures, *available at* http://files.consumerfinance.gov/f/201502_cfpb_credit-card-account-management-examination-procedures.pdf.

help examiners carry out credit card product level examinations more efficiently. They are a compilation of existing FFIEC[32]-approved Truth in Lending Act/Regulation Z open-end credit exam procedures related to credit cards, organized into Modules that follow the lifecycle of a credit card account. Depending on scope, each examination will cover one or more of the Modules:

- Advertising and Marketing
- Account Origination
- Account Servicing
- Payments and Periodic Statements
- Dispute Resolution
- Marketing, Sale, and Servicing of Credit Card Add-on Products

3.2 Recent guidance from the CFPB

3.2.1 Confidential Supervisory Information guidance

On January 27, 2015, the CFPB issued a bulletin entitled "Treatment of Confidential Supervisory Information."[33] This bulletin reminded supervised financial institutions, including nonbank companies that may be unfamiliar with federal supervision, of existing regulatory requirements regarding confidential supervisory information (CSI). The bulletin sets forth the definition of CSI, provides examples of CSI, and highlights certain existing legal restrictions on the disclosure of CSI. It also explains that provisions in non-disclosure agreements entered into by supervised

[32] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the CFPB.

[33] Compliance Bulletin 2015-01, *available at* http://files.consumerfinance.gov/f/201501_cfpb_compliance-bulletin_treatment-of-confidential-supervisory-information.pdf.

financial institutions do not alter or limit the CFPB's existing supervisory authority or the institution's obligations related to CSI.

3.2.2 Bulletin on Social Security disability income verification and compliance with the Equal Credit Opportunity Act and Regulation B

On November 18, 2014, the Bureau issued a bulletin providing guidance to help lenders avoid prohibited discrimination against consumers receiving Social Security disability income.[34] The bulletin reminds lenders that requiring unnecessary documentation from consumers who receive Social Security disability income may raise fair lending risk, and calls attention to standards and guidelines that may help lenders comply with the law.

The Social Security Administration provides certain benefits for individuals with serious disabilities, but generally will not provide documentation regarding how long benefits will last. Some applicants have reported being asked for information about their disabilities or even for doctors' notes about the likely duration of their disabilities. The ECOA and Regulation B prohibit creditors from discriminating against an applicant because some or all of the applicant's income comes from any public assistance program, which includes Social Security disability income. Though lenders can consider the source of an applicant's income for determining pertinent elements of creditworthiness, the bulletin notes that lenders may face fair lending risk if they require documentation beyond that required by lawful applicable agency or secondary market standards and guidelines in order to demonstrate that Social Security disability income is likely to continue.

The bulletin discusses current standards and guidelines on verification of Social Security disability income, including under the CFPB's Ability-to-Repay rule, the Department of Housing and Urban Development's standards for Federal Housing Administration-insured loans, the Department of Veterans Affairs (VA) standards for VA-guaranteed loans, and guidelines from Fannie Mae and Freddie Mac. The bulletin reminds lenders that following the applicable

[34] Social Security Disability Income Verification Bulletin 2014-03, *available at* http://files.consumerfinance.gov/f/201411_cfpb_bulletin_disability-income.pdf.

standards and guidelines may help them avoid policies and practices that violate the ECOA and Regulation B.

3.3 Other developments

3.3.1 Examiner Commissioning Program (ECP)

The CFPB Division of Supervision, Enforcement, and Fair Lending (SEFL) recently released the new Examiner Commissioning Program (ECP) with support from the National Treasury Employees Union. The ECP sets standards and processes for the CFPB's certification of examiners who perform the Bureau's critical supervision mission, and replaces the interim guidance from 2012. Successful completion of the ECP is a milestone of professional achievement signifying an examiner's attainment of the broad-based technical expertise, knowledge, skills, and tools necessary to perform the duties of a commissioned examiner. It also sets a clear future path for Bureau examiners.

Principal elements of the ECP include:

- Required course work (operations and deposits, lending principles, fair lending, advanced communications, and a capstone course);
- Two assignments acting as examiner-in-charge (EIC) for a CFPB review (under supervision of a commissioned examiner);
- Successful completion of a comprehensive multiple-choice test of knowledge of Federal consumer financial law; and
- Successful performance during EIC Case Study assessment.

4. Conclusion

The Bureau intends and expects that regular publication of *Supervisory Highlights,* now in its seventh edition, will continue to aid supervised entities across the spectrum of consumer financial services achieve the goal of remaining in compliance with Federal consumer financial law. Any questions or comments about this or previous editions of *Supervisory Highlights* can be directed to CFPB_Supervision@cfpb.gov.

Supervisory Highlights

Consumer Financial
Protection Bureau

Summer 2015

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1. Introduction

The Consumer Financial Protection Bureau (CFPB or Bureau) remains committed to transparency in its supervisory program by sharing key findings in order to help industry limit risks to consumers and comply with Federal consumer financial law. In this eighth edition of *Supervisory Highlights*, the Bureau shares recent supervisory observations in the areas of consumer reporting, debt collection, student loan servicing, mortgage origination, mortgage servicing, and fair lending. The findings reported here reflect information obtained by Supervision[1] at the time of issuance of an examination report or supervisory letter.

Supervision continues to resolve violations using non-public supervisory actions, sometimes including those initiated by entities self-reporting violations to Supervision staff. Recent supervisory resolutions have resulted in remediation of approximately $11.6 million to more than 80,000 consumers.[2] When examinations determine violations occurred, supervised entities are directed to implement appropriate corrective measures, including remediation to consumers as appropriate.

The CFPB supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and

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[1] Supervision includes CFPB's examiners and regional and headquarters members of the Office of Supervision Examinations and the Office of Supervision Policy. Members of the Office of Fair Lending and Equal Opportunity participate in the supervision process.

[2] Remediation numbers generally represent remedial actions that have been completed since the publication of the last issue of *Supervisory Highlights* and during the period under review.

providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB may also supervise the "larger participants" in other nonbank markets as the Bureau defines by rule. To date, the Bureau has issued five rules defining larger participants in the following markets: consumer reporting (effective September 2012), consumer debt collection (effective January 2013), student loan servicing (effective March 2014), international money transfers (effective December 2014), and most recently, the nonbank automobile market. In September 2014, the Bureau proposed a rule defining larger participants in the nonbank automobile market. The comment period for the proposed rule ended on December 8, 2014, and the CFPB issued a final rule in June this year.

This report highlights supervision work generally completed between January 2015 and April 2015. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

2. Supervisory observations

Below are some recent examination observations in consumer reporting, debt collection, student loan servicing, mortgage origination, mortgage serving and fair lending.

2.1 Consumer reporting

The Fair Credit Reporting Act (FCRA) requires consumer reporting agencies (CRAs) that create a consumer report[3] to "follow reasonable procedures to assure maximum possible accuracy of information" in the report. CFPB examiners conducted reviews of the reasonableness of methods and processes used by certain CRAs to assure maximum possible accuracy of consumer reports they produce.

The reviews evaluated the CRAs' procedures and related compliance management systems for assuring accuracy of the information the CRAs collect, maintain, and use to prepare consumer reports. Examiners reviewed management processes for information collection, oversight of furnishers, monitoring of data, oversight of public records providers, and consumer report compilation, including quality control of the accuracy of consumer reports produced.

Some CRAs retain highly knowledgeable staff and management that oversee complex processes for maintaining consumer credit data. However, the reviews found weaknesses with the methods and processes for assuring maximum possible accuracy in consumer reports.

[3] Consumer reports used for credit eligibility are also commonly referred to as credit reports.

2.1.1 Information collection

Oversight of furnishers

Examiners reviewed the policies and procedures at one or more CRAs for vetting and overseeing new furnishers and found several weaknesses. One or more CRAs' policies and procedures were not updated to describe actual practices. In some instances, the policies and procedures included outdated information. Examiners further found that one or more CRAs did not conduct regular monitoring to ensure that furnishers adhere to the CRAs' vetting requirements. Supervision directed one or more CRAs to correct these weaknesses by revising their policies related to their oversight of furnishers and compliance with membership requirements.

Monitoring of data

The reviews included assessments of data management and oversight programs at one or more CRAs. Examiners found in reviews that one or more CRAs lacked formal programs to oversee and manage data supplied by furnishers. Examiners also found that one or more CRAs lacked systematic or consistent policies and procedures to provide feedback to furnishers regarding the quality of the data furnished. Even when one or more CRAs generated reports identifying specific quality issues with the furnisher data, there were CRAs that relied on requests from furnishers or, in some cases, imposed a fee before the reports were provided to the furnishers. Supervision directed the CRAs to improve the monitoring and feedback they provide to furnishers.

Oversight of public records providers

Examiners found that the oversight of public records providers by one or more CRAs was weak and required corrective action. For example, one or more CRAs had never conducted a formal audit of their public records providers. In addition, one or more CRAs did not have defined processes to verify the accuracy of public record information provided by their public records providers. In light of such weaknesses, Supervision directed one or more CRAs to establish and implement suitable and effective oversight of public records providers.

2.1.2 Quality control

Examiners reviewed quality control processes with respect to the accuracy of consumer reports produced by one or more CRAs and found that, with certain exceptions, there were no quality

control policies and procedures to test compiled consumer reports for accuracy. While processes existed to analyze and improve the quality of incoming data, there was no post-compilation report review or sampling to test the accuracy of consumer reports. In light of these weaknesses, Supervision directed one or more CRAs to develop a plan with implementation timelines to establish quality controls that regularly assess the accuracy and integrity of the consumer reports and consumer file disclosures produced.

2.2 Debt collection

2.2.1 Weaknesses in compliance management systems

As discussed in previous issues of *Supervisory Highlights*, the CFPB expects a financial institution under its supervision to maintain an adequate compliance management system (CMS) tailored to its operations. A robust and well-administered CMS is vital to preventing violations of Federal consumer financial law and the resulting harm to consumers. Examinations of one or more institutions engaging in consumer debt collection identified various CMS weaknesses that created a risk of consumer harm. One or more institutions' boards of directors did not hold regularly scheduled meetings or receive information sufficient to adequately oversee compliance practices. Examiners found that the institutions lacked formal follow-up or escalation procedures for third-party debt collection personnel who were delinquent in completing their required training. These providers were allowed to continue collecting on debt and interacting with consumers, even when their training was overdue. And the institutions lacked comprehensive compliance audit programs. Supervision directed the institutions to remedy these compliance management weaknesses.

During an examination of one or more institutions, examiners also found weaknesses in inquiry and complaint management for collections operations. The institutions did not log or record consumer complaints that were resolved by agents or their managers – depriving compliance personnel of an important tool for detecting violations of Federal consumer financial law during collection activities. Examiners identified instances where complaints and inquiries forwarded from third-party debt collectors were not recorded, categorized, or processed by the financial institution receiving them. Instead, they remained unreviewed in an electronic queue. Supervision directed the institutions to enhance their procedures and monitoring program to ensure that inquiries and complaints were timely identified, categorized, and resolved, and to

conduct an audit to identify and analyze the items in the queue, and the root cause for why the items stayed in the queue.

2.2.2 Failure to conduct investigations of dispute notices from consumers and consumer reporting agencies

The FCRA and its implementing regulation, Regulation V, requires furnishers to conduct a reasonable investigation with respect to disputed information after receiving a dispute notice from a consumer or consumer reporting agency. Furnishers are also required to review all relevant information provided by the consumer, to complete their investigation and report the results to the consumer within the timeframes specified in the FCRA, and to notify the consumer reporting agency and correct any inaccurate information.[4] At one or more debt collectors, examiners found that the entities were simply deleting the trade lines of accounts after they received direct and indirect disputes on those accounts, without fulfilling the requirements of Regulation V.[5] No investigation results or corrections were ever sent to the CRA. Supervision directed the entities to begin tracking, investigating, and resolving direct and indirect consumer disputes.[6]

Relatedly, one or more online statements made by the entities expressed that companies rarely deleted trade lines and regularly investigated disputes. In practice, the entities summarily deleted trade lines and failed to conduct investigations of disputes. Examiners found that these statements were deceptive in violation of the Fair Debt Collection Practices Act.[7] Supervision directed the collectors to remove the deceptive statements.

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[4] 12 CFR 1022.43(e) and 15 USC 1681s-2(b).

[5] Failures to comply with these furnisher obligations can be harmful to consumers and the accuracy of the consumer reporting system as explained in the CFPB's February 2014 Compliance Bulletin: http://files.consumerfinance.gov/f/201402_cfpb_bulletin_fair-credit-reporting-act.pdf.

[6] 12 CFR 1022.43(e).

[7] 15 USC 1692e.

2.2.3 Failure to have reasonable written policies and procedures regarding information furnished to consumer reporting agencies

Regulation V requires furnishers to establish and implement reasonable written policies and procedures regarding the accuracy and integrity of consumer information that it furnishes to a CRA[8]. These policies and procedures must be appropriate to the nature, size, complexity, and scope of the furnisher's activities. During the examination of one or more debt collectors, examiners found that the entity lacked the appropriate written policies and procedures required to fulfill Regulation V. Supervision directed the collectors to develop reasonable written policies and procedures regarding consumer information that is furnished to CRAs.

2.3 Student loan servicing

The Supervision program covers certain Federal and private student loan servicers. The Bureau's recent examinations identified deceptive practices and a FCRA violation.[9]

2.3.1 Deceptive statements about the deductibility of student loan interest

During one or more examinations, examiners determined that student loan servicers included language on periodic statements suggesting that borrowers could not deduct on tax filings interest paid on qualified student loans unless they paid more than $600 in interest. Examiners found this practice to be deceptive because there is no minimum amount of qualified student loan interest that borrowers must pay before taking a deduction.[10]

At the time of the examination, one or more student loan servicers had already removed the language suggesting a $600 threshold for deducting student loan interest. In addition, the

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[8] 12 CFR 1022.42(a).

[9] 15 USC 1681m.

[10] See generally IRS Publication 970 (2013), Tax Benefits for Education.

relevant servicers offered free tax advice and re-filing assistance for borrowers negatively affected by the misleading language.

2.3.2 Deficient FCRA adverse action notices

The FCRA requires that every adverse action notice contain the name, address, and telephone number of the CRA that furnished the report, and a statement that the CRA did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse action was taken.[11] The FCRA further provides that if any person takes an adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report, the person must, if they use a credit score, provide to the consumer the credit score, the range of possible credit scores, a maximum of four key factors that adversely affected the credit score, the date on which the credit score was created, and the name of the entity that provided the credit score.[12]

Lenders sometimes require borrowers to have a cosigner in order to take out a private student loan. In many instances, a borrower may later request the release of a cosigner from the loan obligation provided that some conditions are met. These conditions often include satisfying certain credit criteria. If a student loan servicer uses a consumer report to deny a cosigner release request, the servicer must provide a FCRA adverse action notice.[13] During one or more examinations, Supervision determined that a student loan servicer did not include all required information in FCRA adverse action notices when denying cosigner release requests.

In response to a citation, one or more student loan servicers conducted a root cause analysis to determine why the adverse action notices were deficient, and have undertaken remedial and corrective actions regarding this violation, which is under review by Supervision.

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[11] 15 USC 1681m(a)(3)(A) & (B).

[12] 15 USC 1681m(a)(2)(A) & (B).

[13] 15 USC 1681m(a).

2.4 Mortgage origination

Supervision has completed the first round of targeted reviews for mortgage origination examinations for compliance with the Title XIV rules. The Title XIV rules include requirements related to the ability-to-repay, loan originator compensation, high-cost mortgages, homeownership counseling and escrows. Supervision found instances of non-compliance with certain Title XIV rules and violations of disclosure requirements associated with the Good Faith Estimate (GFE) and the Settlement Statement (HUD-1) as discussed in detail below.

2.4.1 Failing to establish and maintain written policies and procedures pursuant to the Loan Originator Rule

The Loan Originator Rule,[14] as set out in the Truth in Lending Act (TILA)[15] and its implementing regulation, Regulation Z, require, among other things, that a depository institution establish and maintain written policies and procedures designed to ensure and monitor compliance with its provisions.[16] The policies and procedures must be commensurate to the nature, size, and scope of the mortgage lending activities of the depository institution and its subsidiaries.

During the examination process Supervision determined that one or more supervised entities violated Regulation Z by failing to establish written policies and procedures as required by the rule. Specifically, Supervision found written policies on loan originator compensation and qualification and identification requirements without written procedures instructing employees on how to comply with the written policies. Supervision directed one or more supervised entities to develop, implement and maintain written procedures that provide comprehensive guidance to ensure and monitor compliance with the Loan Originator Rule as required by Regulation Z.

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[14] 12 CFR 1026.36(a), (b), (d)-(j).

[15] 15 USC 1601 *et seq.*

[16] 12 CFR 1026.36(j).

2.4.2 Failing to comply with disclosure requirements concerning the RESPA list of homeownership counseling organizations

The Real Estate Settlement Procedures Act (RESPA)[17] and its implementing regulation, Regulation X, require a lender to provide mortgage applicants with a clear and conspicuous written list of homeownership counseling organizations (housing counseling agencies) within three business days of receiving the application.[18] A lender may comply with the requirements by generating the list of housing counseling agencies in the applicant's location up to 30 days in advance by: (1) utilizing a tool developed and maintained by the Bureau (using HUD data on HUD-approved counseling agencies);[19] or (2) using the lender's own systems utilizing the same HUD data that the Bureau uses on HUD-approved counseling agencies, in accordance with the Bureau's list of requirements in the Bureau's Homeownership Counseling Organizations Lists and High-Cost Mortgage Counseling Interpretive Rule.[20] Lenders comply with these requirements by providing the following data fields for each housing counseling agency on the list to the extent available through the HUD automatic programming interface (API): agency name, phone number, street address, city, state, zip code, website URL, email address, counseling services provided, and languages spoken.

During one or more examinations, examiners found that supervised entities did not fully comply with the disclosure requirements of Regulation X by failing to provide the list of housing counseling agencies to consumers. In particular, the housing counseling agencies lists did not contain the website address for each listed housing counseling agency because the vendors accidentally omitted the website data field. The supervised entities took appropriate actions to correct these violations.

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[17] 12 USC 2601 *et seq.*

[18] 12 CFR 1024.20(a)(1).

[19] See CFPB, "Find a Housing Counselor," *available at* http://www.consumerfinance.gov/find-a-housing-counselor/.

[20] See CFPB, "Homeownership Counseling Organizations Lists Interpretive Rule," 78 Fed. Reg. 68,343 (Nov. 14, 2013) and CFPB "Homeownership Counseling Organizations Lists and High-Cost Mortgage Counseling Interpretive Rule," 80 Fed. Reg. 22,091 (April 21, 2015).

2.4.3 Failing to fully comply with Regulation X requirements for the GFE

Regulation X provides requirements to lenders for accurate completion of the GFE.[21] Generally, the lender must provide a GFE to a mortgage loan applicant within three business days of receipt of a complete application.[22] The applicant may not be charged any fees, other than the cost of a consumer report, until after the applicant has received the GFE and indicated an intention to proceed with the loan covered by that GFE.[23] Subject to certain exceptions and tolerances, the loan originator is bound to the actual charges and terms listed on the GFE.[24] However, a revised GFE may be provided under certain circumstances enumerated in Regulation X, including, but not limited to, changed circumstances affecting settlement costs or the borrower's eligibility for the specific loan terms identified in the GFE, borrower-requested changes, expiration of the GFE, and changes related to interest-rate dependent charges and terms.[25]

In one or more recent examinations, Supervision found the following violations of Regulation X:

- Failing to provide the consumer a GFE within three business days of receipt of a complete application;
- Failing to provide the consumer a timely revised GFE within three business days of receiving information to establish a changed circumstance;
- Failing to include all fees on a GFE;

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[21] 12 CFR 1024.7.

[22] 12 CFR 1024.7(a)(1).

[23] 12 CFR 1024.7(a)(4).

[24] 12 CFR 1024.7(f).

[25] 12 CFR 1024.7(f)(1)-(5).

Generally, these were systemic violations that were caused by weaknesses in training, monitoring and corrective action,[26] or compliance audit. Supervision informed one or more supervised entities of the need to enhance compliance training to ensure comprehensive coverage of applicable Regulation X requirements. Additionally, entities were informed that these violations indicate a need for accurate and timely corrective action as well as the need to enhance the compliance audit schedule and coverage of audit activities to address these requirements.

2.4.4 Failing to fully comply with Regulation X requirements for completion of the HUD-1

Regulation X requires that the settlement agent complete the HUD-1 or HUD-1A in accordance with the instructions set forth in Appendix A of the regulation.[27] The loan originator must transmit to the settlement agent all information necessary to fully and accurately complete the HUD-1 or HUD-1A.[28] In examining financial institutions, Supervision cited one or more instances of failure to ensure that the HUD-1 settlement statement accurately reflects the actual settlement charges paid by the borrower.

Generally, this violation was indicative of weaknesses in training, monitoring and corrective action, and compliance audit. Supervision directed one or more supervised entities to review their loan files and refund the appropriate amounts to affected customers.

2.4.5 Deceptive practice from overly broad release in home equity installment loan agreements

Under Regulation Z, a contract or agreement relating to a consumer credit transaction secured by a dwelling, including a home equity line of credit secured by the consumer's principal

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[26] The CFPB's Supervision and Examination manual defines 'monitoring' as "a compliance program element that seeks, in an organized and risk-focused way, to identify procedural or training weaknesses in an effort to provide for a high level of compliance by promptly identifying and correcting weaknesses."

[27] 12 CFR 1024.8(b).

[28] *Id.*

dwelling, may not be applied or interpreted to bar a consumer from bringing a claim in court pursuant to any provision of law for damages or other relief in connection with any alleged violation of Federal law.[29] Despite this requirement, at one or more supervised entities, language in the "General Waiver Provisions" of agreements provided that consumers who signed the agreements waived all other notices or demands in connection with the delivery, acceptance, performance, default or enforcement of the agreement.

Examiners concluded that such a general waiver provision is a deceptive practice because it implies that the borrower is agreeing to a waiver that is unenforceable as to any claims based upon a Federal statute.[30] A reasonable consumer might be misled into believing that by signing the note they had waived all notices or demands in connection with the delivery, acceptance, performance, default or enforcement of the note and would therefore be less likely to assert his or her Federal statutory rights. Supervision directed the supervised entities to cease requiring consumers to sign note agreements with waivers that appear to waive rights that may include Federal statutory claims or defenses and provide borrowers who received the broad waiver language with a more limited waiver.

2.5 Mortgage servicing

A high priority for Supervision has been to ensure compliance with the CFPB mortgage servicing rules that took effect on January 10, 2014. While the rules encompass many aspects of mortgage servicing, this section focuses on findings in the areas of loss mitigation, foreclosure, periodic statement disclosures, and Homeowners Protection Act compliance.

2.5.1 Loss mitigation

Regulation X sets forth requirements for soliciting, completing, and evaluating loss mitigation applications. As part of these requirements, servicers must notify borrowers in writing within

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[29] 12 CFR 1026.36(h)(2).

[30] 12 USC 5536.

five days after receiving a loss mitigation application acknowledging that it received the application, and stating whether it is complete or incomplete. If the application is incomplete, the servicer must list in its notice the additional documents and information the borrower must submit to complete the application, often called "acknowledgement notices."[31]

Examiners found that at least one servicer sent borrowers loss mitigation acknowledgment notices requesting documents, sometimes dozens in number, inapplicable to their circumstances and which it did not need to evaluate the borrower for loss mitigation. Examiners also found that at least one servicer sent loss mitigation acknowledgement notices requesting documents that borrowers had previously submitted. Supervision cited the servicers for violating Regulation X and directed them to state in acknowledgment notices the specific additional documents actually required to complete a loss mitigation application.[32]

Examiners also found that one or more servicers failed to send any loss mitigation acknowledgment notices. At least one servicer did not send notices after a loss mitigation processing platform malfunctioned repeatedly over a significant period of time. Supervision cited one or more servicers for violating Regulation X. Supervision also cited this practice as unfair because the breakdown caused delays in converting trial modifications to permanent modifications, resulting in harm to borrowers, and may have caused other harm. The injury caused by the platform failure is not reasonably avoidable by consumers and is not outweighed by countervailing benefits to consumers or competition. At Supervision's direction, one or more servicers have begun to remediate consumers, including for interest and fees incurred and for any additional harm. Supervision also directed one or more servicers to fix the servicing platform and to monitor for system weaknesses.

At least one other servicer did not send loss mitigation acknowledgment notices to borrowers who had requested payment relief on their mortgage payments. One or more servicers treated certain requests as requests for short-term payment relief instead of requests for loss mitigation under Regulation X. However, short-term payment relief, including deferments, provide loss

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[31] 12 CFR 1024.41(b)(2)(i)(B).

[32] *See* 12 CFR 1024.41(b)(2)(i)(B).

mitigation options in that they provide borrowers an alternative to foreclosure, and Regulation X requires that servicers send loss mitigation acknowledgment notices in response to requests for a loss mitigation option.[33] Supervision determined that at least one servicer violated Regulation X by failing to send these notices.[34]

Additionally, examiners found a deceptive practice related to how one or more servicers disclosed the terms of a payment plan that deferred mortgage payments for daily simple interest mortgage loans.[35] The servicer's communications included misleading representations about how the deferments worked, incorrectly suggesting that deferred interest would be repayable at the end of the loan term when, in fact, it would be collected from the consumer immediately after the deferment ended. Supervision directed one or more servicers to clearly disclose how interest accrues while on the plan and its impact on monthly payments after the deferment period concludes.

The Bureau continues to examine for the risks inherent in transferring loans in loss mitigation, including the risk that information is not accurately transferred between servicers.[36] Examiners found one or more servicers failed to honor the terms of some trial modifications after transfer. Some borrowers who completed trial payments with the new servicer nonetheless encountered substantial delays before receiving a permanent loan modification. Supervision concluded that the delay caused substantial injury as trial payments were less than the amounts required by the promissory note, and consumers continuing to make trial payments while waiting for the permanent modification accrued interest on the unpaid principal balance. Because Supervision also concluded that such injury is not reasonably avoidable by consumers and is not outweighed by countervailing benefits to consumers or competition, Supervision cited this practice as

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[33] 12 CFR 1024.31.; 12 CFR 1024.41(c)(2)(iii).

[34] 12 CFR 1024.41(b)(2)(i)(B).

[35] 12 USC 5536(a)(1)(B).

[36] In August 2014, CFPB released a compliance bulletin and policy guidance discussing mortgage servicing transfers: http://files.consumerfinance.gov/f/201408_cfpb_bulletin_mortgage-servicing-transfer.pdf.

unfair.[37] Supervision directed one or more servicers to develop and implement policies, procedures, training, and audits to promptly identify and honor loss mitigation agreements, whether completed or in progress, between the borrower and prior servicer at time of transfer.

2.5.2 Foreclosure process

In reviewing the loss mitigation and foreclosure process, examiners also found certain unfair and deceptive practices. At least one servicer sent notices of intent to foreclose to borrowers already approved for a trial modification and before the trial modification's first payment was due without verifying whether borrowers had a pending loss mitigation plan before sending its notice. As the notice could deter borrowers from carrying out trial modifications, it likely causes substantial injury not reasonably avoidable by consumers and not outweighed by countervailing benefits to consumers or competition. Supervision cited this practice as unfair. Moreover, a reasonable borrower receiving one of these notices would be misled to think the servicer had abandoned the trial modification. Misinformation would substantially change the borrower's understanding of what actions were available to protect himself, from making the trial payments to bringing the loan current. Supervision also cited this practice as deceptive. One or more servicers were directed to modify and track notices of intent to foreclose, and to clearly and conspicuously state whether such notices affect any pending loss mitigation offer.

CFPB examiners found at least one servicer sent notices warning borrowers who were current on their loans that foreclosure would be imminent. The practice stemmed from a system error whereby default letters were generated to borrowers with low-balance home equity lines of credit (HELOCs) and no monthly payment due. Supervision cited this practice as deceptive and directed one or more servicers to cease sending foreclosure letters to borrowers that the servicer has no intention to pursue.

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[37] 12 USC 5536(a)(1)(B).

2.5.3 Regulation Z disclosures

Regulation Z requires servicers to send periodic statements each billing cycle that display clearly and conspicuously in writing, content that includes the account's transaction history encompassing any activity that causes a credit or debit to the amount currently due.[38] In reviewing for Regulation Z compliance, examiners observed that one or more servicers:

- Failed to send periodic statements to some borrowers because of a sustained system error;
- Failed to send periodic statements on a portfolio of loans because the servicer incorrectly believed the loans were exempt from Regulation Z requirements;
- Included an incomplete number of past transactions on periodic statements because of a software limitation; and
- Listed the same fee twice in the transaction history section of the periodic statement

In these cases, Supervision cited the servicer for violating Regulation Z and directed the servicer to send periodic statements when required, and to promptly enhance its systems so that it could show transaction histories that include any activity that causes a credit or debit to the amount currently due as required.[39]

2.5.4 Homeowners Protection Act

The Homeowners Protection Act requires automatic termination of borrower-paid private mortgage insurance (PMI) when the mortgage balance is first scheduled to reach 78 percent of the original value of the property securing the loan, if the borrower is current on the termination date, or, if the borrower is not current, on the first day of the first month beginning after the

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[38] 12 CFR 1026.41.

[39] 12 CFR 1026.41(d)(4).

date that the mortgagor becomes current.[40] For fixed rate mortgages, the timing is based on the initial amortization schedule for the mortgage.[41]

For borrowers who were delinquent when their mortgage balance reached 78 percent of the original value of the property based on the original amortization schedule, examiners found one or more servicers failed to automatically cancel the borrower's PMI when the borrower became current. As a result, the servicer collected unearned premiums from some borrowers in violation of the Homeowners Protection Act. Supervision directed one or more servicers to remediate affected borrowers and to implement controls to prevent the issue from recurring.

2.6 Fair lending

2.6.1 Consideration of Public Assistance Income – Section 8 Homeownership Program Vouchers

The Section 8 Housing Choice Voucher (HCV) Homeownership Program was created to assist low-income, first-time homebuyers in purchasing homes. The program is a component of the Department of Housing and Urban Development's (HUD's) Section 8 HCV Program, which also includes a rental assistance program.[42] These programs are funded by HUD and administered by participating local Public Housing Authorities (PHAs).

Through the Section 8 HCV Homeownership Program, the participating PHA may provide an eligible consumer with a monthly housing assistance payment to help pay for homeownership

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[40] 12 USC 4901(18); 12 USC 4902(b).

[41] 12 USC 4901(18)(A).

[42] "Section 8 Housing Choice Voucher Homeownership Program" refers to the homeownership assistance program authorized by the Quality Housing & Work Responsibility Act of 1998 (Pub. L. No. 105-276, approved October 21, 1998; 112 Stat. 2461), and the applicable implementing regulations, 24 CFR 982.625-982.643. The program is also referred to as the Voucher Homeownership Program, the Housing Choice Voucher Homeownership Option, or the Section 8 Homeownership Program.

expenses associated with a housing unit purchased in accordance with HUD's regulations.[43] In addition to HUD's regulations, the PHAs may also adopt additional requirements, including lender qualifications or terms of financing.[44]

The Equal Credit Opportunity Act (ECOA)[45] and its implementing regulation, Regulation B,[46] prohibit creditors from discriminating in any aspect of a credit transaction against an applicant "because all or part of the applicant's income derives from any public assistance program."[47] "Any Federal, state, or local governmental assistance program that provides a continuing, periodic income supplement, whether premised on entitlement or need, is 'public assistance' for purposes of the regulation. The term includes (but is not limited to) . . . mortgage supplement or assistance programs . . . ."[48] As such, mortgage assistance provided under the Section 8 HCV Homeownership Program is income derived from a public assistance program under ECOA and Regulation B.

Regulation B further provides that "[i]n a judgmental system of evaluating creditworthiness, a creditor may consider . . . whether an applicant's income derives from any public assistance program only for the purpose of determining a pertinent element of creditworthiness."[49] However, "[i]n considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any protected income. Any discounting or exclusion must be based on the applicant's actual circumstances."[50] Accordingly, a blanket practice of excluding or refusing to consider Section 8 HCV Homeownership Program vouchers as a source of income or accepting the vouchers only for certain mortgage loan

[43] 24 CFR 982.625(c).

[44] 24 CFR 982.632(a).

[45] 15 USC 1691 *et seq.*

[46] 12 CFR pt. 1002 *et seq.*

[47] 15 USC 1691(a)(2); 12 CFR 1002.2(z), 1002.4(a).

[48] Official Staff Commentary, 12 C.F.R. pt. 1002, Supp. I, 2(z)-3.

[49] 12 CFR 1002.6(b)(2)(iii).

[50] Official Staff Commentary, 12 CFR. pt. 1002, Supp. I, 6(b)(5)-3(ii).

products or delivery channels, without an assessment of an applicant's particular situation, may violate the ECOA and Regulation B.

Through the supervisory process, Supervision has become aware of one or more institutions excluding or refusing to consider income derived from the Section 8 HCV Homeownership Program during the mortgage loan application and underwriting process. Some institutions have restricted the use of Section 8 HCV Homeownership Program vouchers to only certain home mortgage loan products or delivery channels. Supervision has required one or more institutions to update their policies and procedures to ensure that their practices concerning Section 8 HCV Homeownership Program vouchers comply with ECOA and its implementing regulation, Regulation B. In addition, Supervision has required one or more institutions to identify borrowers who, due to their reliance on Section 8 HCV Homeownership Program vouchers, were either denied loans, or discouraged from applying; and to provide those borrowers with financial remuneration and an opportunity to reapply.

An institution's clear articulation of underwriting policies regarding income derived from public assistance programs; training of underwriters, mortgage loan originators, and others involved in mortgage loan origination; and careful monitoring for compliance with such underwriting policies can all help the institution manage fair lending risk in this area and comply with the requirements of ECOA and Regulation B.

2.7 Remedial actions

2.7.1 Public enforcement action

The following public enforcement actions resulted, at least in part, from examination work.

Guarantee Mortgage Corporation

On June 5, 2015, the CFPB announced an enforcement action against a California mortgage bank, Guarantee Mortgage Corporation. Guarantee, which is in the process of dissolving, will pay a civil penalty of $228,000 for paying its branch managers based, in part, on the interest rates of the loans they closed. The Loan Originator Compensation Rule, which the Bureau has enforced since July 21, 2011, protects consumers from being steered into costlier loans by prohibiting loan originators from receiving compensation based on the interest rates of the loans they close.

Regions Bank

On April 28, 2015, the Bureau announced a public enforcement action against Regions Bank (Regions) for its unlawful actions related to the entity's overdraft coverage. In 2010, federal rules took effect that prohibited banks and credit unions from charging overdraft fees on ATM and one-time debit card transactions unless consumers affirmatively opted in. Regions failed to obtain the required opt-ins for certain consumers and delayed fixing the violation for almost a year after it was discovered. Additionally, Regions misrepresented overdraft and non-sufficient funds fees related to its deposit advance product, Regions Ready Advance.[51]

Regions has already refunded hundreds of thousands of consumers approximately $49 million in fees, and the consent order requires the bank to fully refund all remaining consumers, and correct all instances of negative information reported to CRAs as a result of these unlawful fees. The Bureau also fined the company $7.5 million for its illegal actions.

2.7.2 Non-public supervisory actions

Recent non-public supervisory resolutions reached in the areas of mortgage origination, fair lending, mortgage servicing, deposits, payday lending, and debt collection have resulted in remediation of approximately $11.6 million to more than 80,000 consumers.

[51] Regions Ready Advance is a short-term, small-dollar line of credit available to some checking account customers. With deposit advance products, the borrower authorizes the bank to claim repayment as soon as the next qualifying electronic deposit is received.

3. Supervision program developments

3.1.1 Mortgage origination examination procedures

On April 1, 2015, the CFPB published examination procedures[52] developed and approved by the Federal Financial Institutions Examination Council (FFIEC)[53] reflecting the upcoming implementation of the Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (RESPA), and its implementing regulation, Regulation X, and the Truth In Lending Act (TILA), and its implementing regulation, Regulation Z (TILA-RESPA Integrated Disclosure Rule). The CFPB drafted the TILA-RESPA Integrated Disclosure Rule pursuant to its mandate under the Dodd-Frank Act to integrate the TILA and RESPA mortgage origination disclosures. As a result of the TILA-RESPA Integrated Disclosure Rule, which is effective August 1, 2015, creditors originating most closed-end residential mortgage credit transactions secured by a dwelling must provide consumers with a Loan Estimate (which replaces the Good Faith Estimate and the initial Truth in Lending disclosure) and a Closing Disclosure (which replaces the HUD-1 and final Truth in Lending disclosure). The TILA-RESPA Integrated Disclosure Rule

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[52] *See* TILA examination procedures, *available at* http://www.consumerfinance.gov/f/201503_cfpb_truth-in-lending-act.pdf and the RESPA examination procedures, *available at* http://www.consumerfinance.gov/f/201503_cfpb_regulation-x-real-estate-settlement-procedures-act.pdf.

[53] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the CFPB.

provides specific guidance on how to complete and provide both forms for most closed-end consumer mortgages.

In May 2015, the CFPB published CFPB-specific Mortgage Origination examination procedures[54] to incorporate the updated TILA and RESPA examination procedures. The FFIEC's TILA-RESPA examination procedures and the CFPB's Mortgage Origination examination procedures will guide examiners' review for TILA-RESPA Integrated Disclosure Rule compliance and promote efficient examinations of mortgage origination activity. The Mortgage Origination examination procedures are organized into Modules by subject area. Depending on scope, each examination will cover one or more of the following Modules:

- Company Business Model
- Advertising and Marketing
- Loan Originators
- Loan Disclosures and Terms – Closed-End Residential Mortgage Loans
- Loan Disclosures and Terms – Other Residential Mortgage Loans
- Appraisals
- Underwriting
- Examiner Conclusions and Wrap-up

3.1.2 Risk-based prioritization

As explained in a previous issue of *Supervisory Highlights,* the CFPB prioritizes its supervisory responsibilities by focusing on risks to consumers.[55] The Bureau looks at each distinct product line at an institution, referred to as an "institutional product line." Once broken down into

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[54] *See* Mortgage Origination Examination Procedures, *available at* http://files.consumerfinance.gov/f/201505_cfpb_mortgage-origination-exam-procedures.pdf.

[55] *See* Supervisory Highlights: Summer 2013, Section 3.2.3, available at http://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf.

institutional product line, comparisons are made across institutions, charters, or licenses. The Bureau evaluates each product line based on the potential for consumer harm related to a particular market; the size of the product market; the supervised entity's market share; and risks inherent to the supervised entity's operations and offering of financial consumer products within that market.

The Bureau's prioritization approach assesses risks to the consumer at two levels: the market level and then the institution level. At the market-wide level, risk to the consumer is assessed from the products and practices being followed in a particular market. Some markets have stronger incentives to serve consumers than others. While there are potential risks to consumers in numerous financial markets, some markets are viewed as higher risk. In addition to the risks posed to the consumer from the products and practices in the marketplace, the Bureau also considers the relative product market size in the overall consumer finance marketplace.

The other part of the prioritization framework focuses on the institution. It recognizes that some institutions' business models within a market raise greater risk of consumer harm than others. Accordingly, prioritization efforts assess the relative risks to the consumer from each institution's activity within any given market. This process accounts for a broad range of factors that predict the likelihood of specific consumer harm, starting with institution's market share within an individual product line, which corresponds to the number of consumers affected. Relatively large players are typically prioritized as they have a more dominant presence given their ability to impact more consumers than relatively small players.

This prioritization approach augments the size consideration significantly with field and market intelligence. Field and market intelligence includes both qualitative and quantitative factors for each institutional product line, such as the strength of compliance management systems, the existence of other regulatory actions, findings from prior exams, metrics gathered from public reports, and the number and severity of consumer complaints received.

In addition, given the Bureau's mandate to ensure fair, equitable, and nondiscriminatory access to credit for all consumers, general field and market intelligence is supplemented with fair-lending-focused information to ensure that fair lending risks are appropriately identified and prioritized as well. Taken together, the information that gathered about each institutional product line at the market-level and at the institution-level allows the Bureau to focus its resources where consumers have the greatest potential to be harmed. The Bureau's highest priorities are relatively higher risk institutional product lines within relatively higher risk markets.

3.1.3 Potential Action and Request for Response letter

As part of the examination process, the Bureau may send a Potential Action and Request for Response (PARR) letter to a supervised entity. The PARR letter provides the entity notice of preliminary findings of violation(s) of Federal consumer financial law, including fair lending laws, and the Military Lending Act (MLA).[56] If there is a potential ECOA violation that could be referred to Department of Justice, the PARR letter provides the entity notice of the potential for a referral.

The PARR letter also notifies the entity that the Bureau is considering taking supervisory action, such as a non-public memorandum of understanding, or a public enforcement action, based on the potential violations identified and described in the letter. Supervision invites the entity to respond to a PARR letter within 14 days, and to set forth in the response any reasons of fact, law or policy as to why the Bureau should not take action against the entity. The entity is asked to provide documentation with its response. In certain instances, the Bureau requests additional documentation after reviewing the entity's response to the PARR letter. The information provided by the entity helps in determining whether it is appropriate to take supervisory or enforcement action against the entity.

3.1.4 Action Review Committee process

In certain instances, where examiners have found evidence of significant violations of Federal consumer financial law, matters are referred to the Bureau's Action Review Committee (ARC). Where the Bureau sent a PARR letter to a supervised entity, the ARC process comes after the entity's response, so that the committee can consider the response to the examiners' preliminary conclusions.

The ARC determines through a deliberative and rigorous process whether matters that originate from examinations will be resolved through confidential supervisory action, such as a board resolution or memorandum of understanding, or through a public enforcement action. Based

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[56] The Military Lending Act (MLA), codified at 10 USC 987 and implemented by Department of Defense regulation at 32 CFR Part 232, is not included in the definition of "Federal consumer financial laws" set forth in Section 1002 of the Dodd Frank Act. The 2013 Amendments to the Military Lending Act in sections 661-663 of the National Defense Authorization Act for Fiscal Year 2013 authorize enforcement of the MLA by the agencies specified in section 108 of the Truth in Lending Act, which include the CFPB and other regulators.

upon the severity of examination findings, the Bureau's field team will make a recommendation to senior leaders within the Division of Supervision, Enforcement, and Fair Lending whether supervisory or enforcement action is appropriate.

4. Conclusion

The Bureau recognizes the value of communicating program findings to CFPB-supervised entities to aid them in their efforts to comply with Federal consumer financial law, and to other stakeholders to foster better understanding of the CFPB's supervisory work.

To ensure this, the Bureau remains committed to publishing periodically its *Supervisory Highlights* report to share information regarding general examination findings (without identifying specific institutions, except in the case of public enforcement actions), to communicate operational changes to the supervision program and to provide a convenient and easily accessible resource for information on the Bureau's guidance documents.

Supervisory Highlights

Issue 9, Fall 2015

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Consumer Financial
Protection Bureau

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1. Introduction

The CFPB is committed to a consumer financial marketplace that is fair, transparent, and competitive, and that works for all consumers. The supervision of institutions that offer financial products and services – both banks and nonbanks – is one of the tools available to the Bureau to help meet this goal. In this ninth edition of *Supervisory Highlights*, the Bureau shares recent supervisory observations in the areas of consumer reporting, debt collection, mortgage origination, mortgage servicing, student loan servicing, and fair lending. One of the Bureau's goals is to provide information that enables industry participants to ensure their operations remain in compliance with Federal consumer financial law. The findings reported here reflect information obtained from supervisory activities completed during the period under review as captured in examination reports or supervisory letters. In some instances, not all corrective actions, including through enforcement, have been completed at the time of releasing this report.

The Bureau's supervisory activities have either led to or supported six recent public enforcement actions, resulting in $764.9 million being returned to consumers and $50.7 million in civil money penalties.[1] The Bureau also imposed other corrective actions at these institutions, including requiring improved compliance management systems (CMS), processes, and controls. In addition to these public enforcement actions, Supervision continues to resolve violations using non-public supervisory actions. When Supervision examinations determine that a supervised entity has violated a statute or regulation, the CFPB directs the entity to implement appropriate corrective measures, including remediation of consumer harm when appropriate.

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[1] The CFPB's Office of Enforcement also brought other actions unrelated to supervisory activities.

Recent supervisory resolutions have resulted in restitution[2] of approximately $107 million to more than 238,000 consumers. Other corrective actions have included, among other things, correction of information submitted to consumer reporting agencies (CRAs), creation and implementation of new policies and procedures, and cessation of particular deceptive practices.

The CFPB supervises insured depository institutions and insured credit unions with total assets of more than $10 billion, and their affiliates. In addition, the Bureau has authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to supervise nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB may also supervise "larger participants" in other nonbank markets as the Bureau defines by rule. To date, the Bureau has issued five rules defining larger participants in the following markets: consumer reporting (effective September 2012), consumer debt collection (effective January 2013), student loan servicing (effective March 2014), international money transfers (effective December 2014) and, most recently, automobile financing (effective August 2015).

This report highlights supervision work generally completed between May 2015 and August 2015. Any questions or comments from supervised entities can be directed to CFPB_Supervision@cfpb.gov.

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[2] The term "restitution" as used in this report refers specifically to monetary relief (or redress) to consumers, whereas remediation includes both monetary and non-monetary forms of relief.

2. Supervisory observations

Summarized below are some recent supervisory examination observations in consumer reporting, debt collection, mortgage origination, mortgage servicing, student loan servicing, and fair lending.

Companies that furnish information to consumer reporting agencies must comply with the Fair Credit Reporting Act (FCRA) and its implementing regulation, Regulation V.[3] These furnishers have a considerable impact on consumers and their ability to obtain credit. This issue of *Supervisory Highlights* reports on observations regarding such furnishing activities across a number of product areas. (*See* sections 2.1, 2.2.3, 2.5 and 2.5.6).

2.1 Consumer reporting

CFPB examiners (examiners) conducted one or more reviews of compliance with furnisher obligations under the FCRA and Regulation V at depository institutions. The reviews focused on furnishing activities to consumer reporting agencies (CRAs) that specialize in reporting on consumers' deposit account information.

Examiners found that one or more entities failed to establish and implement reasonable written policies and procedures regarding the accuracy and integrity of information furnished to CRAs, as required by Regulation V.[4] Examiners found that while one or more entities had policies and procedures addressing accuracy and integrity with respect to their furnishing of information to

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[3] 15 USC 1681 *et seq.*; 12 CFR Part 1022.

[4] 12 CFR 1022.42.

CRAs on credit accounts, they failed to have policies and procedures addressing accuracy and integrity with respect to their furnishing information on deposit accounts. Regulation V requires that such policies and procedures be appropriate to the nature, size, complexity, and scope of each furnisher's activities, and requires that furnishers consider Appendix E of Regulation V, the "Interagency Guidelines Concerning the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies," and incorporate those guidelines as appropriate.[5] In addition, examiners found that one or more entities failed to periodically review and update their policies and procedures, as required by Regulation V.[6]

Regulation V also requires furnishers to provide consumers with notice of the results of investigations of direct disputes of information furnished to CRAs.[7] Examiners identified one or more entities that failed to provide such notice to consumers and thus violated Regulation V.

Furnishers are also users of consumer reports and, when acting in their capacity as users, are required by the FCRA to provide consumers with adverse action notices when they take any adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report.[8] Examiners found that one or more entities, in violation of the FCRA,[9] sent adverse action notices to consumers that failed to include the name, address, and telephone number of the CRA that provided the information relied upon when the adverse action was taken.

Examiners further identified weaknesses at one or more entities with respect to processes, policies, and procedures for ensuring proper handling of disputes in compliance with their obligations under the FCRA[10] and Regulation V.[11] Specifically, they failed to distinguish FCRA

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[5] *Id.*

[6] *Id.*

[7] 12 CFR 1022.43(e)(3).

[8] 15 USC 1681m(a)(1).

[9] 15 USC 1681m(a)(3).

[10] 15 USC 1681s-2(b).

[11] 12 CFR 1022.43(e).

disputes from other communications (*e.g.*, complaints) they received, and failed to monitor and track direct FCRA disputes they received from consumers and indirect FCRA disputes they received from CRAs. These systemic deficiencies compromised the ability of these entities to assess their compliance with their dispute obligations, including their obligations to conduct a reasonable investigation, review all relevant information, and respond within certain time frames. Supervision directed one or more entities to update and implement dispute handling policies and procedures and to create a coordinated monitoring system in order to ensure all direct and indirect disputes of deposit information are tracked, investigated, and resolved completely and within the timeframes required.[12]

The CFPB expects financial institutions under its supervision to maintain an adequate CMS tailored to their operations. This includes oversight and training with respect to the policies and procedures used to furnish information to CRAs. For example, one or more entities furnishing negative information about consumers' use of deposit accounts (in particular, fraud and account abuse) to specialty CRAs failed to establish policies, procedures or processes governing this furnishing. They also failed to train employees and oversee such furnishing. Supervision directed one or more entities to establish and implement policies and procedures and conduct training on such furnishing.

2.2 Debt collection

2.2.1 Failure to state that a call is from a debt collector

The Fair Debt Collection Practices Act (FDCPA) requires debt collectors to make certain disclosures in their first communication with a consumer. In subsequent communications, among other things, they must state that the communication is from a debt collector.[13] During the examination of one or more debt collectors, examiners determined that the collectors' employees did not always state during subsequent phone calls that the calls were from debt

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[12] *See* 12 CFR 1022.43(e) and 15 USC 1681s-2(b).

[13] 15 USC 1692e(11).

collectors. Supervision directed the debt collectors to improve training with regard to the FDCPA's requirement to provide these disclosures.

2.2.2 Failure to implement consumer requests regarding communications

The FDCPA requires debt collectors to limit their communications with consumers in certain ways. Among other things, the law generally prohibits a debt collector from contacting a consumer the debt collector knows is represented by an attorney,[14] and it prohibits a debt collector from contacting a consumer at his or her place of employment if the debt collector "knows or has reason to know that the consumer's employer prohibits the consumer from receiving such communication."[15] During one or more examinations, examiners determined that debt collectors had inadequate systems in place to comply with these requirements, creating a risk of violating the FDCPA. When consumers made verbal requests regarding phone calls, such as a request not to be called at work, the debt collectors' agents would note the request in one of several places in the account notes. The debt collectors did not, however, remove or block the affected telephone numbers in their dialer systems. Not removing or blocking the numbers and the placement of do-not-call request notes in different places by different teams of agents created risks that a consumer would receive calls that violated the FDCPA. Supervision directed the collectors to improve their training so that agents would annotate accounts and check for dialing restrictions in a consistent manner.

2.2.3 Reasonable written policies and procedures under Regulation V

Regulation V requires furnishers to "establish and implement reasonable written policies and procedures regarding the accuracy and integrity of the information relating to consumers" that it furnishes to a CRA.[16] Examiners determined that one or more debt collectors that furnish to CRAs had failed to meet this requirement. The policies and procedures reviewed lacked

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[14] 15 USC 1692c(a)(2).

[15] 15 USC 1692c(a)(3).

[16] 12 CFR 1022.42.

sufficient guidance with respect to how employees should handle consumer disputes made pursuant to Regulation V. At times, the policies and procedures also contradicted legal requirements, such as requiring employees to respond to some disputes by deleting tradelines instead of conducting an investigation.[17] Additionally, the policies and procedures did not provide adequate guidance on identifying disputes made under Regulation V and/or made under the FDCPA. Identifying these types of disputes is important because these laws have different requirements for companies that respond to disputes and because they confer different rights and protections on consumers. Supervision directed the debt collectors to establish and implement reasonable written policies and procedures as required by Regulation V.

2.3 Mortgage origination

In mortgage origination examinations, Supervision continues to evaluate compliance with rules implemented pursuant to Title XIV of the Dodd-Frank Act.[18] While examiners have found that supervised entities, in general, effectively implemented and demonstrated compliance with the rule changes, there were instances of non-compliance with certain Title XIV rules, as discussed in detail below. There were also findings of violations of disclosure requirements pursuant to the Real Estate Settlement Procedures Act (RESPA),[19] implemented by Regulation X; the Truth in Lending Act (TILA),[20] implemented by Regulation Z; and consumer financial privacy rules, implemented by Regulation P.[21]

[17] *See* CFPB Bulletin 2014-01 (Feb. 27, 2014) (discussing the obligation of debt buyers, debt collectors and others who furnish information to CRAs to investigate disputes instead of deleting tradelines), *available at* http://files.consumerfinance.gov/f/201402_cfpb_bulletin_fair-credit-reporting-act.pdf.

[18] The Title XIV rule changes cover loan originators (12 CFR 1026.36), the ability-to-repay (12 CFR 1026.43), appraisals and valuations (12 CFR 1002.14 and 12 CFR 1026.35), high-cost mortgages (12 CFR 1026.31 and 12 CFR 1024.20), and escrows for higher-priced mortgage loans (12 CFR 1026.35).

[19] 12 USC 2605 *et seq.*

[20] 15 USC 1601 *et seq.*

[21] 12 CFR Part 1016.

2.3.1 Failing to fully comply with the requirement that charges at settlement not exceed amounts on the good faith estimate by more than specified tolerances

Regulation X provides zero tolerance for increases from the estimates set forth in the consumer's good faith estimate (GFE) for the origination charge, the credit or charge for the interest rate chosen, the adjusted origination charge, and transfer taxes.[22] At one or more entities, examiners found GFEs that listed certain estimated charges that Regulation X does not permit to increase at settlement, yet the actual charges at settlement for these items increased. In such cases, Supervision required the entities to provide restitution to the borrower.

For certain other charges, such as lender-required services and government recording charges, the sum of such charges at settlement may not be greater than 10 percent above the sum of the amounts included on the GFE for these items.[23] In one or more examinations, examiners found that the GFE included estimated charges for which the sum could not increase by more than 10 percent at settlement, yet the sum of actual charges at settlement exceeded the 10 percent tolerance.

Further, Regulation X states that the loan originator is bound, within the tolerances discussed above, to the settlement charges and terms listed in the GFE unless a revised GFE is provided before settlement or the GFE expires.[24] A revised GFE may be provided if there are changed circumstances as specified by Regulation X.[25] The loan originator must document the reason for any revised GFE provided to the consumer and must retain such documentation for no fewer than three years after settlement.[26] In one or more examinations, Supervision determined that loan originator(s) failed to properly document changed circumstances to support charges that increased at settlement beyond the allowable tolerances.

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[22] 12 CFR 1024.7(e)(1).

[23] 12 CFR 1024.7(e)(2).

[24] 12 CFR 1024.7(f).

[25] *Id.*

[26] *Id.*

Supervision required the entities to develop and implement a corrective action plan that included new procedures to address the root cause of the violations and ensure compliance with applicable tolerances. Loan originators were also required to properly document changed circumstances, and to image and retain that documentation for the required period. In addition, supervised entities were required to provide remediation to affected consumers who were improperly charged excessive amounts.

2.3.2 Failing to fully comply with requirements for completion of HUD-1 settlement statements

Regulation X requires the use of the HUD-1 or HUD-1A (the "settlement statement") in every settlement involving a federally-related mortgage loan for which there is both a borrower and a seller, and sets forth specific instructions for completion of the settlement statement.[27] The settlement statement must state actual settlement charges paid by the borrower and seller, and must separately itemize each third-party charge paid by the borrower and seller.[28] Violation of any of these requirements is a violation of Regulation X.[29]

At one or more entities, examiners found that supervised entities violated Regulation X by non-compliance with these requirements, including, for example, the following:

- Third-party fees listed on the settlement statement not matching corresponding invoices;
- Inaccurate addition of dollar amounts, resulting in inaccuracies on the settlement statement;
- Failure to specifically identify on the settlement statement the recipient of fees for third-party services; and
- Appraisal fees on the settlement statement for loans where an appraisal was not required or was not obtained.

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[27] 12 CFR 1024.8.

[28] 12 CFR 1024.8(b).

[29] 12 CFR 1024.8(c).

These violations demonstrated weaknesses in the supervised entities' monitoring and corrective action processes regarding compliance with Regulation X. In response, Supervision directed the entities to complete system changes to enhance compliance oversight and prevent further such violations. Additionally, Supervision directed the entities to conduct a further review of their loan files to determine whether additional consumers were similarly affected, and to provide restitution to all affected consumers.

2.3.3 Failing to fully comply with requirements to provide homeownership counseling disclosure

Regulation X requires a lender to provide a loan applicant with a clear and conspicuous written list of homeownership counseling organizations that provide relevant counseling services in the loan applicant's location not later than three business days after receipt of a loan application.[30] Examiners found in one or more examinations that the list was never provided to the consumer and other instances where the list was not provided within three business days of receiving the application. Generally, these violations were due to weaknesses in the entities' monitoring for compliance with regulatory requirements. Supervision notified the entities' management of these violations and appropriate corrective action was taken to improve the entities' compliance management system and prevent future such violations.

2.3.4 Failing to fully comply with the requirement to provide accurate loan servicing disclosure statement

Regulation X requires that within three business days after applying for a first-lien mortgage loan, a consumer must be provided with a servicing disclosure statement that states whether the mortgage loan may be assigned, sold, or transferred.[31] In one or more examinations, examiners determined that loan servicing disclosure notices provided to consumers failed to provide accurate information about the loan originator's intent to retain, assign, sell or transfer servicing. These violations were not detected by the supervised entities through regular monitoring processes and procedures. Supervision notified the entities' management of these

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[30] 12 CFR 1024.20(a)(1).

[31] 12 CFR 1024.33(a).

violations and appropriate corrective action was taken to improve the entities' compliance management system and prevent future such violations.

2.3.5 Failing to fully comply with consumer financial information privacy requirements

Regulation P requires a clear and conspicuous initial notice to a customer that accurately reflects the loan originator's privacy policies and practices.[32] During one or more examinations, examiners found instances in which a loan originator maintained multiple versions of the initial privacy notice, which were inconsistent with each other, or more than one version of the notice was found within individual loan files. Further, some privacy notices did not identify affiliates or properly disclose that nonpublic personal information was shared with affiliates. These violations reveal weaknesses in the supervised entities' management oversight and monitoring and corrective action functions. Supervision notified the entities' management of these violations and appropriate corrective action was taken to improve the entities' compliance management system and prevent future such violations.

2.3.6 Failing to require employees engaged in loan originator activities to register with the NMLSR

Under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)[33] and its implementing regulation, Regulation G, covered financial institutions may not permit employees of the institution to act as mortgage loan originators for the institution unless such employee is registered with the Nationwide Mortgage Licensing System and Registry (NMLSR).[34] Further, TILA and its implementing regulation, Regulation Z, require loan originator organizations to ensure registration of loan originators pursuant to the SAFE Act and Regulation G.[35] Regulation G defines the activities of a mortgage loan originator to generally

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[32] 12 CFR 1016.4(a)(1).

[33] 12 USC 5101 *et seq.*

[34] 12 CFR 1007.102 and 103.

[35] 12 CFR 1026.36(a) and (f).

include taking a residential mortgage loan application (including indirectly receiving the information contained in the application in order to make an offer or negotiate a loan) and offering or negotiating terms for a residential mortgage loan.[36] Regulation Z defines the activities of loan originators to generally include, among other activities, taking an application, or offering or negotiating an extension of consumer credit.[37]

During one or more examinations, examiners found violations of Regulation G and Regulation Z in connection with one or more entities' failures to require employees who were engaged in covered loan originator and mortgage loan originator activities to be registered with the NMLSR. Specifically, Supervision found that one or more supervised entities did not require employees acting as underwriters for home equity closed-end loans to be registered with the NMLSR when the underwriting activities included taking an application by indirectly receiving the information contained in the application in order to make an offer or negotiate a loan, and offering terms or counter-terms to borrowers. As a result, Supervision directed one or more entities to identify all employees who engage in covered mortgage loan originator or loan originator activities, and to ensure such employees register with the NMLSR.

2.3.7 Failing to reimburse borrowers for understated APRs and finance charges

Regulation Z requires lenders to provide to borrowers a disclosure of the finance charges and annual percentage rates (APRs) within specified accuracy tolerances, and further requires reimbursement to borrowers for understatements of the finance charges or APRs in excess of the accuracy tolerances.[38] During one or more examinations, examiners determined that supervised entities violated Regulation Z by failing to identify understated APRs and required reimbursement. Moreover, examiners determined that the supervised entities had weak monitoring and corrective action processes that did not identify these violations. In such instances, the supervised entities were directed to reimburse affected borrowers and upgrade

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[36] 12 CFR 1007.102.

[37] 12 CFR 1026.36(a).

[38] 12 CFR 1026.18(d), 22(a), and 23(g).

their processes to minimize future occurrences and detect any understatements that nevertheless might occur.

2.4 Mortgage servicing

While Supervision continues to be concerned about the range of legal violations identified at various mortgage servicers, it also recognizes efforts made by certain servicers to develop an adequate compliance position through increased resources devoted to compliance. One or more servicers have made significant improvements in the last several years – for example, examiners observed compliance audits that thoroughly assessed the business unit's internal control environment, clearly identified issues with compliance, detailed management's response, set a target date for resolving the identified issues, and completed the necessary adjustments promptly. At one or more servicers, these audits were part of a wider and adequately resourced compliance framework. Moreover, one or more servicers conducted formal reviews of information technology structures and identified the inadequacies causing earlier problems, including system outages. These reviews led one or more servicers to replace outdated systems, such as deficient document management systems. Supervision continues to see that the inadequacies of outdated or deficient systems pose considerable compliance risk for mortgage servicers, and that improvements and investments in these systems can be essential to achieving an adequate compliance position.

2.4.1 Servicing policies, procedures, and requirements

In planning mortgage servicing examinations, Supervision continues to seek input from established housing counselor networks with broad experience of the issues and challenges that individual consumers confront in their dealings with mortgage servicers.

Regulation X requires servicers to maintain policies and procedures reasonably designed to achieve specific objectives that include: providing timely and accurate information; properly

evaluating loss mitigation applications; and facilitating oversight of, and compliance by, service providers.[39]

In reviewing for these requirements, examiners found policies and procedures reasonably designed to meet the specific objectives laid out in the regulation at one or more servicers. However, examiners found that one or more servicers violated Regulation X because their policies and procedures were not reasonably designed to achieve the following objectives:

- Upon the death of a borrower, promptly identifying and facilitating communication with the successor in interest of the deceased borrower with respect to the property secured by the deceased borrower's mortgage loan.[40] One or more servicers lacked any policies and procedures for identifying and facilitating communication with successors in interest.

- Identifying with specificity all loss mitigation options for which a borrower may be eligible.[41] One or more servicers sent letters to certain borrowers soliciting loss mitigation applications when the servicer's own records showed that the borrowers were not eligible for any loss mitigation option.

- Properly evaluating a loss mitigation application for all options for which the borrower may be eligible based on the loan owner's requirements.[42] One or more servicers evaluated the borrower only for the loss mitigation options that a servicer representative preselected for the borrower.

- Facilitating the sharing of accurate and current information regarding the status of any evaluation of a borrower's loss mitigation application and the status of any foreclosure proceeding among appropriate servicer personnel, including service provider personnel

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[39] 12 CFR 1024.38(a), (b).

[40] 12 CFR 1024.38(b)(1)(vi).

[41] 12 CFR 1024.38(b)(2)(ii).

[42] 12 CFR 1024.38(b)(2)(v).

responsible for handling foreclosure proceedings.[43] In one or more instances, a servicer's foreclosure attorney sent a foreclosure referral letter to the borrower after the borrower entered into a loss mitigation agreement with the servicer.

Regulation X also requires servicers to maintain certain documents and data on each mortgage loan account serviced by the servicer in a manner that facilitates compiling such documents and data into a servicing file within five days.[44] Among other things, servicers must maintain a schedule of all transactions credited or debited to the mortgage loan account in such a manner.[45] Examiners found that one or more servicers were neither able to compile a servicing file within five days nor to produce a schedule of fees charged to borrowers in such files.

In the above cases where examiners detected policies, procedures, or requirements not in compliance with Regulation X, Supervision directed servicers to implement policies, procedures, and requirements compliant with Regulation X and to monitor for their effectiveness.

2.4.2 Loss mitigation applications

Regulation X sets forth requirements for soliciting, completing, evaluating, and notifying borrowers of the outcomes of loss mitigation applications. As part of these requirements, a servicer receiving an incomplete loss mitigation application must include in its acknowledgment notice to the borrower, a reasonable date by which the borrower should submit the missing documents and information necessary to complete the application.[46] One or more servicers violated this requirement when they gave borrowers 30 days to submit missing documents, but denied borrowers for loss mitigation before the 30 days elapsed. Supervision directed one or more servicers to implement controls to ensure that borrowers receive a reasonable amount of time to submit missing loss mitigation documents before denying an application.

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[43] 12 CFR 1024.38(b)(3)(iii).

[44] 12 CFR 1024.38(c)(2).

[45] 12 CFR 1024.38(c)(2)(i).

[46] 12 CFR 1024.41(b)(2)(ii).

When denying a loss mitigation application, a servicer must permit borrowers to appeal a denial for any trial or permanent loan modification program available to the borrower if the servicer received the complete application 90 days or more before a scheduled foreclosure sale.[47] In cases in which a borrower has the right to appeal, a servicer must, in its decision letter on the borrower's loss mitigation application, inform the borrower of the appeal right and the date by which the borrower must file the appeal.[48] One or more servicers provided denial letters that failed to communicate a borrower's specific right to appeal. The letters instead generically stated that the borrower may have a right to appeal if the borrower submitted a complete loss mitigation application at least 90 days or more before a scheduled foreclosure sale. By not making an advance determination of whether individual borrowers were actually entitled to an appeal, one or more servicers left borrowers to determine for themselves whether they had a right to appeal the denial of a loan modification. Examiners cited one or more servicers for violating Regulation X. Supervision directed the servicers to include more specific appeal language in their denial letters where appropriate, rather than including generic appeal language in every denial letter.

Regulation Z states that a "contract or other agreement relating to a consumer credit transaction secured by a dwelling . . . may not be applied or interpreted to bar a consumer from bringing a claim in court pursuant to any provision of law for damages or other relief in connection with any alleged violation of any Federal law."[49] Examiners found one or more servicers required borrowers to sign waivers agreeing that they had no "defenses, set-offs or counterclaims to the indebtedness of borrowers pursuant to the Loan Document" in order to enter mortgage repayment and loan modification plans. Defenses, set-offs and counterclaims pertain to a contract or other agreement to a consumer credit transaction secured by a dwelling. As borrowers were likely to read the waiver as barring them from bringing claims — including Federal claims — related to the mortgage, Supervision cited the

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[47] 12 CFR 1024.41(h).

[48] 12 CFR 1024.41(c)(1)(ii).

[49] 12 CFR 1026.36(h)(2).

waiver language as deceptive and directed one or more servicers to remove it from all loss mitigation agreements.[50]

2.4.3 Homeowners Protection Act

The Homeowners Protection Act (HPA) requires automatic termination of borrower-paid private mortgage insurance (PMI) on the "termination date" if, on that date, the borrower is current on payments.[51] The HPA defines "termination date" as the date on which the mortgage's principal balance is first scheduled to reach 78 percent of the original value of the property securing the loan (irrespective of the outstanding balance for that mortgage on that date).[52] Examiners found one or more servicers violated the HPA by failing to automatically terminate PMI for borrowers that are current on their loans on the termination date. Supervision directed one or more servicers to reimburse affected borrowers and to correct their termination procedures.

In addition to termination, the HPA provides that a borrower may initiate cancellation of PMI coverage by submitting a written request to the servicer. For a borrower who has initiated cancellation, the HPA provides that, if the borrower meets certain requirements, PMI shall be cancelled on the "cancellation date."[53] The HPA defines "cancellation date" as, at the option of the borrower, either: (1) the date on which the principal balance of the mortgage is first scheduled to reach 80 percent of the "original value" of the property (regardless of the outstanding balance), or (2) the date on which the principal balance of the mortgage reaches 80

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[50] 12 USC 5536(a)(1)(B).

[51] 12 USC 4902(b)(1).

[52] 12 USC 4901(18).

[53] 12 USC 4902(a). Those requirements are:

- The borrower must have a good payment history;
- The borrower must be current on the loan;
- The borrower must satisfy any requirement of the holder of the mortgage for certification that the borrower's equity in the property is not subject to a subordinate lien; and
- The borrower must satisfy any requirement of the holder of the mortgage for evidence (of a type established in advance and made known to the borrower by the servicer) that the value of the property has not declined below the original value.

percent of the “original value” of the property based on actual payments.[54] Examiners found that one or more servicers represented to borrowers seeking to cancel PMI that they had to wait until the mortgage balance reached 75 percent of the property’s current value, and until 24 months after origination to cancel PMI. Supervision determined these statements, which conflicted with both the HPA and relevant investor guidelines, to be deceptive.[55] Supervision directed one or more servicers to revise the borrower-initiated PMI cancellation practices and to reimburse borrowers who paid premiums after they were incorrectly denied PMI cancellation.

The HPA requires that servicers return any unearned PMI premiums to the borrower within 45 days after cancelling or terminating a borrower’s PMI.[56] One or more servicers violated the HPA when they held unearned premiums longer than 45 days – for example, for an average of 152 days. One or more servicers also violated the HPA by keeping unearned premiums in borrower escrow accounts indefinitely rather than returning them directly to borrowers within 45 days. Supervision directed one or more servicers to implement new procedures and update applicable policies to ensure that they refunded unearned PMI premiums to the borrower within 45 days as required by the HPA.

2.4.4 Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act (FDCPA) applies to debt collectors, including entities that regularly collect or attempt to collect, directly or indirectly, debts owed or due or asserted to be owed or due another.[57] Mortgage servicers are generally debt collectors under the FDCPA if the loan was in default at the time the servicer obtained the loan.[58] Many servicers charge fees to

[54] 12 USC 4901(2).

[55] 12 USC 5536(a)(1)(B).

[56] 12 USC 4902(f)(1).

[57] 15 USC 1692a(6).

[58] *See Bailey v. Sec. Nat. Servicing Corp.*, 154 F.3d 384, 387 (7th Cir. 1998) (stating that if a mortgage servicer “seeks to collect on the original note technically remaining in default . . ., then he is a ‘debt collector’ under the Act so long as the debt was in default at the time he obtained or purchased it.”); 15 USC 1692a(6)(F)(iii) states that an entity is

borrowers to make payments over the phone. However, the FDCPA prohibits collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.[59] One or more servicers violated the FDCPA when they charged fees for taking mortgage payments over the phone to borrowers whose mortgage instruments did not expressly authorize collecting such fees and/or reside in states that do not expressly permit collecting such fees.[60] Supervision directed one or more servicers to review mortgage notes and applicable state law, and to only collect pay-by-phone fees where authorized by contract or state law.

One or more servicers violated the FDCPA when they sent debt validation letters listing debt amounts that the servicer could not verify as accurate. The servicers listed estimates of the debt amount rather than the actual amount the borrower owed. Examiners cited this practice as violating the FDCPA, and Supervision directed one or more servicers to list only accurate and verifiable debt amounts in its debt validation letters.

Examiners found one or more servicers violated the FDCPA when they failed to send debt validation letters to borrowers within five days after the initial communication about the debt, where the borrowers' loans were in default when servicing rights were obtained. Examiners cited this practice as a violation of the FDCPA, and Supervision directed one or more servicers to revise their procedures to ensure that their debt validation notices contained accurate statements of the debt and that they retained documentation to support the debt validation amounts provided in the notices.

2.5 Student loan servicing

The Bureau continues to examine federal and private student loan servicing activities, primarily assessing whether entities have engaged in unfair, deceptive, or abusive acts or practices

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not a "debt collector" under the FDCPA if the debt being collected "was not in default at the time it was obtained" by that entity.

[59] 15 USC 1692a(6).

[60] *See, e.g., Shami v. Nat'l Enterprise Sys.,* Civ. No. 09-722, 2010 WL 3824151, at *2 (E.D.N.Y. Sept. 23, 2010).

prohibited by the Dodd-Frank Act. As in all applicable markets, Supervision also reviews student loan servicers' practices related to furnishing of consumer information to CRAs for compliance with the FCRA and its implementing regulation, Regulation V. In the Bureau's student loan servicing examinations, examiners have identified several unfair or deceptive acts or practices, as well as FCRA and Regulation V violations.

2.5.1 Allocating partial payments

Examiners identified practices related to partial payments of the type noted in previous editions of *Supervisory Highlights*. Specifically, examiners continue to find entities engaging in the unfair practice of depriving consumers of an effective choice as to how to allocate these partial payments. Most servicers handle multiple student loans for one borrower in combined student loan accounts. Servicers bill borrowers for the sum of the minimum monthly payments for each loan. When a borrower makes a payment that is less than that sum – a "partial payment" – borrowers can direct payments to individual loans. Most servicers have adopted a default payment allocation methodology that governs how such partial payments are allocated among loans in an account when a borrower does not provide instructions.

When a servicer allocates a partial payment proportionally, typically all loans are left delinquent and may each accrue a separate late fee. During one or more examinations, examiners identified servicers that were allocating partial payments proportionally among all loans in the account and failing to communicate the ramifications of this allocation methodology to the affected consumers. In addition, these servicers did not adequately communicate the borrowers' ability to direct payments themselves, nor in some cases did these servicers provide borrowers with the ability to direct payments to individual loans. In some of these cases, the total amount of late fees charged was higher than if the servicer or borrower allocated the payment in another manner. Examiners determined that this practice of failing to give consumers an effective choice of how to allocate payments and of proportionally allocating partial payments in a way that maximizes late fees was unfair because the resulting higher late fees constituted a substantial injury that was not reasonably avoidable or outweighed by countervailing benefits to consumers or competition.

As a result of examiners' findings, one or more servicers changed their allocation methodology so that they allocate partial payments among current loans to the loan with the highest interest rate first, and then the loan with the next highest interest rate. One or more servicers also agreed to provide improved disclosures regarding their allocation methodology and borrowers' ability to direct payments to individual loans.

2.5.2 Issues involving payment systems

Examiners found several issues involving the manner in which servicers' systems process payments. Examiners cited one or more servicers for the unfair practice of processing automatic debits early. Most student loan servicers allow borrowers to make payments on an automatic, recurring basis that are scheduled on the same day every month (usually the due date). Examiners found on one or more occasions that malfunctions in servicers' systems were causing payments to be triggered earlier than the scheduled date. Malfunctions like these could be unfair if they result in substantial, unavoidable injury — here, overdraft fees or non-sufficient funds fees at the consumer's bank resulting from unexpected debits — that is not outweighed by countervailing benefits to consumers or competition. Supervision directed servicers to develop better controls to detect and address system malfunctions of this type, while acknowledging that servicers had already taken some positive steps in response to the processing issues that were identified.

Examiners identified another unfair practice relating to the automatic debit policies of one or more servicers. For borrowers making payments using auto-debits, when a due date falls on a day when the banks are closed (for example, on weekends or holidays), payments are typically processed on the next business day. Because student loans are daily-simple-interest loans, the delay can cause additional interest to accrue. Examiners found that one or more servicers were not crediting payments back to the due date when this delay occurred — a practice that would reverse the additional interest accrual. Examiners also found that one or more servicers did not tell consumers that additional interest would accrue as a result of the auto-debit policy. The examiners found that this practice of failing to credit back to the due date without making clear to users that such payments would not be credited back to the due date and that additional interest would accrue in the interim period was unfair because the injury, aggregated across all borrowers who repay using auto-debit, constituted a substantial injury that was not reasonably avoidable or outweighed by countervailing benefits to consumers or competition. Supervision directed servicers to cease this practice.

2.5.3 Misrepresentations regarding dischargeability of student loans in bankruptcy

CFPB examiners continue to find supervised entities making deceptive statements to consumers about discharging student loans in bankruptcy. Previous editions of *Supervisory Highlights* have reported deceptive statements to consumers that their student loans were not dischargeable. While student loans may be more difficult to discharge than other loans,

applicable law provides that they are dischargeable if a borrower proves that repayment would pose an "undue hardship."[61]

Recently, examiners have observed one or more servicers deceptively conveying to consumers that their loans are not dischargeable because those consumers have completed bankruptcy. Similar to the statements highlighted in the Fall 2014 edition of *Supervisory Highlights*,[62] examiners found that these statements were also deceptive in light of the fact that borrowers often have avenues to reopen bankruptcy cases or otherwise raise "undue hardship" challenges to the enforceability of student loans. Supervision directed the entity or entities to cease deceptive communications about bankruptcy.

2.5.4 Misrepresentations about late fees

Examiners determined that certain statements by servicers about late fees on Department of Education-held loans are deceptive. While Department of Education loan notes allow for the charging of late fees, the Department of Education does not, at this time, charge late fees on its loans and it instructs its servicers not to do so. Bureau examiners found that one or more servicers were making representations to consumers that late fees may be charged on loans held by the Department of Education. Supervision directed one or more entities to cease making deceptive statements about late fees for loans owned by the Department of Education.

2.5.5 Paying off loans – best practice

Some servicers are taking proactive steps to help borrowers understand what payments they owe. As background, the Bureau has received reports from some borrowers that they are having difficulties when they attempt to pay off their student loans. One particular concern arises when a borrower makes a large lump sum payment, attempting to pay off the entire loan or account, but falls short of the total amount due. Many student loan servicers do not inform borrowers that the payoff attempt failed and cease communicating regularly with the borrower for a significant period of time because the borrower has paid enough to cover subsequent months

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[61] 11 USC 523(a)(8).

[62] *See Supervisory Highlights: Fall 2014*, Section 2.5, *available at* http://files.consumerfinance.gov/f/201410_cfpb_supervisory-highlights_fall-2014.pdf.

and does not have a monthly payment due, even though a small balance remains on the loan or account. When this type of situation occurs, borrowers may be left unaware that a balance remains, resulting in months or years of interest accrual, tradelines remaining open in borrowers' credit reports, and potential delinquency or default when monthly payments are again due months or years later.

Examiners observed that one or more servicers continued to communicate with these borrowers during the paid ahead period. These communications convey the remaining balance on the borrower's loans, which can help borrowers seeking to fully pay off their loans understand that they still owe money.

2.5.6 Furnishing and Regulation V

As discussed earlier in this edition of *Supervisory Highlights*, the FCRA and its implementing regulation, Regulation V, require companies that furnish information on consumers to CRAs to establish and implement reasonable written policies and procedures regarding the accuracy and integrity of the information they furnish. Whether policies and procedures are reasonable depends on the nature, size, complexity, and scope of the entity's furnishing activities. Many student loan servicers have extensive furnishing operations, sending information on millions of consumers to CRAs. During one or more student loan servicing examinations, examiners found policies and procedures that were insufficient to meet the obligations imposed by Regulation V.

At one or more servicers, examiners deemed policies and procedures inadequate, which resulted, in part, from a failure to adequately consider and incorporate the guidelines in Appendix E to 12 CFR 1022. For example:

- Policies and procedures only provided cursory instructions to employees on how to handle investigations of consumer disputes;
- Policies and procedures did not address internal controls such as verifying random samples; and
- Policies and procedures did not consider periodic evaluations of the entities' practices, such as their investigations of disputed information, corrections of inaccurate information, means of communication, and other practices that may affect the accuracy or integrity of information furnished to CRAs, nor was there any documented and regular practice of reviewing exception reports from CRAs.

In light of the extensive nature, size, complexity, and scope of the furnishing activities of one or more student loan servicers, examiners found that these policies and procedures were not reasonable as required by Regulation V. Supervision directed one or more servicers to enhance their policies and procedures regarding the accuracy and integrity of information furnished to CRAs, including by correcting the conduct described in the bullets listed above.

3. Fair lending

3.1 Underwriting disparity findings and remedial actions

CFPB examination teams conduct targeted Equal Credit Opportunity Act (ECOA) reviews at institutions in order to identify and evaluate areas of heightened fair lending risk. These reviews generally focus on a specific line of business, such as mortgages, credit cards, or automobile finance. These reviews typically include a statistical analysis and, in some cases, a loan file review that assesses an institution's compliance with ECOA and its implementing regulation, Regulation B, within the specific business line selected.

A CFPB targeted ECOA review usually begins with the submission of a request for information and data to the institution. Once responses are received, the examination team works together with CFPB economists and analysts to conduct a preliminary review of the information produced by the institution, analyze the accompanying data, and detect areas of heightened fair lending risk. Areas of heightened fair lending risk may be detected in an institution's policies and procedures; through statistical analysis of the data, considering whether similarly-situated applicants and borrowers may have been treated differently because of a prohibited basis; or other circumstances.

The next two stages of a targeted ECOA review are the selection of focal points and the on-site review. Focal points are selected from among the areas of heightened fair lending risk identified during the preliminary stages of an examination. Examples of focal points that may be selected through this process are underwriting, pricing, redlining, or steering on a prohibited basis.

The on-site portion of an examination that follows selection of the focal points generally includes a review of the institution's fair lending compliance management system and an in-depth analysis of the chosen focal points. The in-depth analysis may include a tailored

assessment of the institution's policies and procedures as well as interviews with loan officers, underwriters, other staff, or consumers. The in-depth analysis may also include a loan file review that focuses on a particular segment of the applicant pool – such as marginal applicants, outliers, or applicants who receive exceptions – or a particular question, such as whether the level of assistance provided to similarly-situated applicants was the same.

3.1.1 Underwriting reviews

CFPB examination teams have conducted numerous examinations to determine whether statistical disparities in underwriting outcomes are attributable to race, national origin, or some other prohibited basis characteristic. Many of these examinations have concluded without findings of discrimination. In one or more examinations, however, examiners concluded that the disparities resulted from illegal discrimination in violation of ECOA.

In one or more examinations, examiners concluded that a supervised entity violated ECOA by denying qualified African-American, Hispanic and/or Asian applicants for loan products more frequently than other, similarly situated non-Hispanic white applicants on the basis of race and/or national origin. In these types of examinations, Bureau economists use information provided by an institution to model its underwriting processes for several mortgage products. The economists often use a marginal effects measure to determine the differences in probability of denial for African-American, Hispanic, and Asian applicants relative to non-Hispanic white applicants. This analysis accounts for the legitimate, non-discriminatory credit characteristics considered by an entity in its underwriting processes. In one or more examinations, the analysis identified potential discriminatory denial disparities in multiple product areas.

Focal points were selected and in these particular reviews, examiners conducted file reviews to gain a better understanding of the disparities identified in the statistical analysis. They observed legitimate, non-discriminatory factors unrelated to race or national origin that explained many of the differences in outcome, but not the disparities associated with applicants in one of the prohibited basis groups. Those disparities remained unexplained after the comparative file review. The Bureau sent one or more institutions a Fair Lending Potential Action and Request for Response (PARR-FL) letter communicating potential ECOA findings. After careful consideration of any responses, Supervision cited one or more institutions for an ECOA violation. In these types of matters, institutions are required to provide appropriate relief.

3.1.2 Methodologies that can be used to understand underwriting disparities

In CFPB underwriting reviews, which typically evaluate potential disparities in denial rates, Bureau economists may rely upon marginal effects, in addition to other methods of analysis, such as odds ratios, to measure whether outcomes differ based on race, national origin, sex, or other prohibited bases.

As their name implies, odds ratios measure the ratio of the odds of two different events. In the context of an underwriting analysis, the ratio reflects the odds of a loan application denial between groups of borrowers. For example, in an analysis that compares denial rates for Hispanic and non-Hispanic white applicants, an odds ratio greater than one indicates that the odds of a Hispanic applicant being denied exceed the odds of denial for a non-Hispanic white applicant. However, the "odds" conveyed by an odds ratio are not the same as probabilities and the magnitudes of odds ratios can be difficult to interpret.

For example, an odds ratio of three does not indicate that the denial rate for the test group is three times the denial rate for the control group. An odds ratio of three could result from a number of scenarios, including:

- the test group is denied in 25% of cases, versus 10% of cases for the control group,
- the test group is denied in 75% of cases, versus 50% of cases for the control group,
- the test group is denied in 99% of cases, versus 97% of cases for the control group.[63]

For this and other reasons, the Bureau may use other methods of analysis, including marginal effects to gain a better understanding of the nature and relative magnitude of any underwriting disparities. In contrast to odds ratios, the marginal effect expresses the absolute change in denial probability associated with being a member of a prohibited basis group. Interpreting these marginal effects is straightforward. For example, a marginal effect of 0.10 in an

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[63] An odds ratio in the context of an underwriting analysis is the ratio of the odds of a loan application denial— that is, "the probability of being denied" divided by "the probability of not being denied (that is, approved)" — for the test group and the control group, respectively. In the first example above, the odds ratio is calculated as [0.25 / 0.75] / [0.10 / 0.90], which equals 3. The second example produces an identical odds ratio, since [0.75 / 0.25] / [0.50 / 0.50] also equals 3. The odds ratio for the third example is [0.99 / 0.01] / [0.97 / 0.03], which is about 3.06.

underwriting analysis means the test group will be denied in 10% more cases compared to the control group. Expressed another way, the probability of denial for the test group is 10 percentage points higher than the probability of denial for the control group. When the CFPB calculates marginal effects, it also considers a conditional marginal effect, which provides the increased chances of denial for a group holding all other factors constant, and thus controls for other, legitimate credit characteristics that may affect the probability of denial.

An additional benefit of marginal effects is that they can be compared across groups and institutions. Marginal effects may also be compared to the institution's overall approval and denial rates in the specific product reviewed. In this manner, the CFPB can contextualize the disparity to determine whether it warrants additional inquiry. Marginal effects also may allow us to decide that a particular disparity does not merit additional inquiry. The CFPB selects from among this and other methodologies depending on the focal points identified and other facts related to the specific review.

3.1.3 Varying file selection methods

If a file review is conducted, the methods used to select files may vary depending on the purpose of the review. For example:

- Declined applicants in the group that was potentially discriminated against may be compared with similarly-situated approved applicants in the control group to identify any legitimate, nondiscriminatory explanations for the different treatment. In addition, examination teams may compare denied control group borrowers with approved borrowers in the target group to determine whether any explanations for different treatment apply equally across groups.

- When statistical analysis has been conducted, a sample may be selected and reviewed to determine whether any legitimate decision-making criteria were not captured by the statistical model.

- A file review may help examiners identify evidence of any differences in quality of assistance provided to applicants on a prohibited basis, or evidence of illegal redlining or steering.

- Examiners may review files to determine whether there is any evidence that prohibited bases were explicitly considered in the underwriting process.

- Examiners may review “outlier applicants” in order to understand why applicants who appear to be well-qualified are nonetheless denied, or why applicants who appear poorly qualified are nonetheless approved. Or, examiners may review “marginal applicants,” for whom the underwriting decision is less clear, in order to understand how loan officers make decisions on these files.

In each examination where a file review is conducted, the review is tailored to that examination’s risk-based focal points. If the examiners identify examples of files that may provide evidence of discrimination, they share the files with the institution to obtain the institution’s explanation. If, following the statistical analysis and the file review, the examination team believes that there may be a violation of ECOA, the CFPB may share the findings with the institution in a PARR-FL letter.[64]

When examiners identify underwriting disparities that violate ECOA, Supervision will require the institution to pay remuneration to affected borrowers, which may include application or other fees, costs, and other damages. Institutions also may be required to re-offer credit. In addition, institutions must identify and address any underlying CMS weaknesses that led to the violations.

3.1.4 Managing underwriting risks

There are a number of steps that institutions can take to limit the risk of ECOA violations due to disparate outcomes in underwriting:

1. Ensure that internal monitoring processes review underwriting practices for potential discrimination. Depending on the size and complexity of the institution, consider using statistical methodologies to understand potential disparities.

2. If potential disparities are identified, take steps to determine any root causes of the disparities, including any factors that may be having a disparate effect on a prohibited basis, whether borrowers were wrongly declined, and whether illegal discrimination may have occurred.

[64] The PARR-FL letter process is described in this edition of *Supervisory Highlights* beginning on page 38.

3. Take appropriate remedial action in the event that discrimination is identified, such as remunerating borrowers who were wrongly denied on a prohibited basis and re-offering credit.

4. Ensure that policies and procedures given to loan officers have clear guidance with respect to:

    a. Making alternative product offerings to applicants and documenting the choice of a particular product.

    b. Applying credit standards to reach underwriting decisions, and documenting the decision-making process.

    c. Granting exceptions to credit standards, and documenting the justifications for the exceptions.

3.2 Settlement update: Ally Financial Inc. and Ally Bank

In December 2013, together with the Department of Justice (DOJ), the Bureau ordered Ally Financial Inc. and Ally Bank to pay $80 million in damages to consumers harmed by Ally's auto loan pricing policies that resulted in discrimination. The Bureau found that Ally had a policy of giving dealers the discretion to increase or "mark up" consumers' interest rates, and paying dealers for those markups. Between April 2011 and December 2013, Ally's discretionary markup policy resulted in African-American, Hispanic, and Asian and Pacific Islander borrowers paying more for auto loans than similarly situated non-Hispanic white borrowers. Ally is also required to pay a settlement administrator to distribute the $80 million in damages to harmed borrowers. Pursuant to the order, Ally also has begun to address the discriminatory effects of its pricing policies after the settlement period. Ally will continue to assess potential discriminatory pricing annually during the term of the order, and pay refunds to minority borrowers for any discriminatory pricing identified.

On June 26, 2015, the settlement administrator sent letters to Ally borrowers identified as potentially eligible for remediation from the settlement fund. These packages contain instructions, in English and Spanish, on how consumers can participate in the settlement. Upon request, materials translated into Mandarin, Cantonese, Vietnamese, Korean, and Tagalog will be made available. Consumers have until October 2015 to respond, after which the agencies will determine the final distribution amount for each eligible borrower. The agencies anticipate allocating the entire settlement fund to harmed borrowers.

4. Remedial actions

4.1 Public enforcement actions

The Bureau's supervisory activities resulted in or supported the following public enforcement actions.

4.1.1 Citibank

On July 21, 2015, the Bureau ordered Citibank, N.A. and certain of its subsidiaries to provide an estimated $700 million in refunds to eligible consumers harmed by illegal practices related to credit card add-on products and services. Roughly seven million consumer accounts were affected by Citibank's deceptive marketing, billing, and administration of debt protection and credit monitoring add-on products. A Citibank subsidiary also deceptively charged expedited payment fees to nearly 1.8 million consumer accounts during collection calls. Citibank and its subsidiaries will pay $35 million in civil money penalties.

Pursuant to the Dodd-Frank Act, the CFPB has the authority to take action against institutions engaging in unfair, deceptive, or abusive practices, or other violations of federal consumer financial law. The CFPB's order requires that Citibank:

- Conveniently reimburse consumers affected by these practices;
- End unfair billing practices so that consumers will no longer be billed for credit monitoring products if they are not receiving the promised benefits; and
- Cease engaging in illegal practices by prohibiting Citibank from marketing all add-on products by telephone or at the point of sale, or engaging in attempts to retain consumers in these products by telephone, until it submits a compliance plan to the CFPB.

4.1.2 Discover Bank

On July 22, 2015, the Bureau took action against Discover Bank and its affiliates for illegal private student loan servicing practices. The CFPB found that Discover overstated the minimum amounts due on billing statements and denied consumers information they needed to obtain federal income tax benefits. Thousands of consumers encountered problems as soon as their loans became due and Discover gave them account statements that overstated their minimum payment. Discover denied consumers information that they would have needed to obtain tax benefits and called consumers' mobile phones at inappropriate times to contact them about their debts.

The CFPB concluded that the company and its affiliates violated the Dodd-Frank Act's prohibitions against unfair and deceptive acts and practices as well as the Fair Debt Collection Practices Act. The CFPB's order requires Discover to refund $16 million to consumers, pay a $2.5 million civil money penalty, and improve its billing, student loan interest reporting, and collection practices.

4.1.3 Paymap Inc. and LoanCare LLC

On July 28, 2015, the CFPB announced an enforcement action against Paymap Inc. and LoanCare LLC for deceiving consumers with advertisements for a mortgage payment program that promised tens of thousands of dollars in interest savings from more frequent mortgage payments. Paymap and LoanCare advertised that consumers who enrolled in the Equity Accelerator Program would have a new, biweekly payoff schedule that would lead to significant interest savings because of the more frequent payments. In fact, the Equity Accelerator Program did not make more frequent payments on consumers' mortgages, and Paymap's claims of tens of thousands of dollars in interest savings were made without any supporting evidence.

The CFPB found that Paymap and LoanCare violated the Dodd-Frank Act's prohibition against deceptive acts and practices. Under the terms of the orders announced, Paymap will return $33.4 million in fees to consumers and pay a $5 million civil money penalty, and LoanCare will pay a $100,000 civil money penalty.

4.1.4 Residential Credit Solutions, Inc.

On July 30, 2015, the CFPB announced an enforcement action against Residential Credit Solutions, Inc. for blocking consumers' attempts to save their homes from foreclosure. The

mortgage servicer failed to honor modifications for loans transferred from other servicers, treated consumers as if they were in default when they weren't, sent consumers escrow statements falsely claiming they were due a refund, and forced consumers to waive their rights in order to get a repayment plan. Residential Credit Solutions has agreed to pay $1.5 million in restitution to victims and a $100,000 civil money penalty for its illegal actions.

4.1.5 Citizens Bank

On August 12, 2015, the CFPB announced a public enforcement action against Citizens Bank (formerly known as RBS Citizens), Citizens Financial Group, and Citizens Bank of Pennsylvania, which are related subsidiaries that operate retail branches and offer deposit accounts in about a dozen states. For almost six years, the banks committed unfair and deceptive practices in violation of the Dodd-Frank Act by failing to credit the full amounts on deposits made into consumers' checking and savings accounts. Citizens told consumers that deposits were subject to verification, implying that they would take steps to ensure consumers were credited with the correct deposit amount. But in cases where the bank scanner misread either the deposit slip or the checks, or if the total on the deposit slip did not equal the total of the actual checks, Citizens did not fix mistakes that fell below a certain dollar amount (initially $50, later reduced to $25).

Over the years, by ignoring the discrepancies, the banks denied their customers millions of dollars. The Bureau's order requires Citizens to pay approximately $11 million in restitution to consumers who did not receive all the money that should have been deposited into their accounts. Citizens must include any fees the consumers incurred related to the under-crediting (including but not limited to any overdraft fees, non-sufficient funds fees, and monthly maintenance fees) and a reasonable estimate of interest on these amounts. Citizens will also pay a $7.5 million civil money penalty.

4.1.6 Fifth Third Bank

On September 28, 2015, the CFPB announced an action against Fifth Third Bank for illegal credit card practices. The CFPB found that Fifth Third's telemarketers deceptively marketed the bank's "Debt Protection" credit card add-on product during calls and online from 2007 to 2013. For example, telemarketers did not tell some cardholders that by agreeing to receive information about the product, they were being enrolled and would be charged a fee. In addition, from December 2011 through September 2012, Fifth Third sent cardholders product "fulfillment kits" that contained incorrect descriptions of the product's cost, benefits, exclusions, terms, and conditions. Among other things, Fifth Third's illegal practices included:

misrepresenting costs and fees for coverage; misrepresenting or omitting information about eligibility for coverage; and illegal practices in the enrollment process.

The CFPB's action against Fifth Third's deceptive marketing of credit card add-on products requires the bank to provide an estimated $3 million in restitution to eligible harmed consumers and pay a $500,000 civil money penalty. This is the 11th credit card add-on enforcement action the Bureau has taken against companies for illegal practices in the marketing or administration of add-on products and services.

4.2 Non-public supervisory actions

In addition to the public enforcement actions above, recent supervisory activities have resulted in at least $107 million in restitution to more than 238,000 consumers. These non-public supervisory actions generally have been the product of CFPB supervision and examinations, often involving either examiner findings or self-reported violations of Federal consumer financial law during the course of an examination. Recent non-public resolutions were reached in the areas of credit cards, deposits, mortgage origination, and mortgage servicing.

5. Supervision program developments

Supervision continues to seek ways in which its operational efficiency can be increased with a renewed focus on recruiting highly qualified and talented examination staff. Further, training is provided on a regular basis to Bureau examiners to ensure their knowledge of regulatory changes. As of September 10, 2015, the Bureau has approximately 442 examination staff, with more than 180 of its examiners commissioned either through the CFPB's internal process or holding commissions from previous service with other regulators. All examiners are supported by regional management and headquarters staff.

5.1 Examination procedures

5.1.1 Fair Lending Potential Action and Request for Response (PARR-FL) letters and mandatory referrals to the U.S. Department of Justice

In the event that the Bureau is considering referring an institution to the DOJ, the Office of Fair Lending (FL) may send a Fair Lending Potential Action and Request for Response (PARR-FL) letter to the institution.[65] A PARR-FL letter may be sent when a potential ECOA violation is identified, either through the supervisory process or through an enforcement investigation.

[65] In the last issue of *Supervisory Highlights*, non-FL PARR letters and the ARC process were described; *see* http://files.consumerfinance.gov/f/201503_cfpb_supervisory-highlights-winter-2015.pdf.

Generally, a PARR-FL letter will:

- Identify the laws that FL has preliminarily identified may have been violated and describe the possible illegal conduct;
- Generally describe the types of relief available to the Bureau;
- Inform the relevant institution of its opportunity to submit a written response presenting its positions regarding relevant legal and policy issues, as well as facts through affidavits or declarations;
- Describe the manner and form by which the institution should respond, if it chooses to do so, and provide a submission deadline, generally 14 calendar days, for timely consideration;
- Inform the relevant institution that FL is considering recommending that the Bureau refer the institution to the DOJ; and
- When appropriate, inform the relevant institution that FL is considering recommending corrective action, specifically noting when it is considering recommending enforcement action.

Typically, when a PARR-FL letter results from supervisory activity, FL will send the PARR-FL letter prior to finalizing the examination report or supervisory letter. FL carefully considers the institution's response before reaching a final decision about whether to cite an ECOA violation and/or refer the matter to the DOJ. Depending on the response, FL may determine that there is no violation of law, and that, therefore, a referral is not appropriate. If FL decides to cite a violation, the examination report or supervisory letter will convey the final findings to the institution, and the institution also will be informed of any decision to refer the matter to the DOJ.

Pursuant to Section 706(g) of the Equal Credit Opportunity Act,[66] and the CFPB-DOJ Memorandum of Understanding (MOU)[67] regarding fair lending coordination, executed on December 6, 2012, the Bureau must refer a matter to the Department of Justice, Civil Rights

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[66] 15 USC 1691e(g).

[67] *See* Memorandum of Understanding between the Consumer Financial Protection Bureau and the United States Department of Justice Regarding Fair Lending Coordination, *available at* http://files.consumerfinance.gov/f/201212_cfpb_doj-fair-lending-mou.pdf.

Division, Housing and Civil Enforcement Section (DOJ), when it has reason to believe that a creditor has engaged in a pattern or practice of lending discrimination. A referral, however, does not deprive the Bureau of authority to take independent supervisory or enforcement action. Thus, the Bureau's referral of a matter to the DOJ is in addition to the Bureau's independent supervisory and enforcement authority. The Bureau will consult with the DOJ to coordinate our respective actions, as appropriate.

5.1.2 Automobile finance new examination procedures

On June 10, 2015, the CFPB announced the addition of new Automobile Finance examination procedures to the *CFPB Supervision and Examination Manual (Manual)*.[68] Examiners will be assessing potential risks to consumers and whether auto finance companies are complying with requirements of federal consumer financial law. The procedures have been organized into modules that follow the lifecycle of an automobile finance transaction, from advertising to servicing. Among other things, examiners will be evaluating whether auto finance companies are fairly marketing and disclosing auto financing terms, providing accurate information to credit bureaus, and treating consumers fairly when collecting debts.

5.1.3 Updated mortgage origination examination procedures

The CFPB has also updated the Mortgage Origination examination procedures in the Manual.[69] The procedures were updated to incorporate the TILA-RESPA "Know Before You Owe" Integrated Disclosure Rule and to make technical corrections. The procedures are consistent with updates made to the FFIEC-approved[70] Truth in Lending Act/Regulation Z and Real Estate Settlement Procedures Act/Regulation X procedures, and are organized by module.

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[68] *See* Supervision and Examination Manual, *available at* http://www.consumerfinance.gov/guidance/supervision/manual/.

[69] *Id.*

[70] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the CFPB.

5.2 Recent CFPB guidance

The CFPB is committed to providing guidance on its supervisory priorities to industry and members of the public.[71]

5.2.1 Revised appeals process

On November 3, 2015, the CFPB released a revised appeals process that implements changes to the CFPB's Supervisory appeal process as originally published in CFPB Bulletin 2012-07.[72] The Bureau is implementing reforms to take into account structural changes within the agency and experience gained from the supervisory appeals process to date, with the goal of improving efficiency, consistency, transparency, and fairness to supervised institutions.

The revised policy, as amended:

- Expressly allows members of the Supervision, Enforcement, and Fair Lending (SEFL) Associate Director's staff to participate on the appeal committee, replacing the existing requirement that an Assistant Director serve on the committee;
- Permits an odd number of appeal committee members in order to facilitate resolution of appeals;
- Limits oral presentations to issues raised in the written appeal;
- Provides additional information regarding how appeals will be decided, including the standard the committee will use to evaluate the appeal;
- Prevents an institution from appealing adverse findings or an unsatisfactory rating related to a recommended or pending investigation or public enforcement action until the enforcement investigation or action has been resolved; and
- Changes the expected time to issue a written decision on appeals from 45 to 60 days.

The revised policy will apply to appeals of any report of exam emailed on or after September 21, 2015. Under the revised policy, institutions seeking to file an appeal should direct the appeal to the following mailbox devoted solely to appeals: CFPB_SupervisoryAppeals@CFPB.gov.

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[71] These guidance documents are published at http://www.consumerfinance.gov/guidance/.

[72] *See* http://files.consumerfinance.gov/f/201510_cfpb_appeals-of-supervisory-matters.pdf.

5.2.2 Bulletin on RESPA compliance and marketing services agreements

On October 8, 2015, the Bureau released Bulletin 2015-05,[73] which provides an overview of the prohibition on kickbacks and referral fees under RESPA,[74] describes the Bureau's enforcement experience investigating Marketing Services Agreements (MSAs), and notes the substantial legal and regulatory compliance risks posed by such agreements. The Bureau's experience in this area has exposed significant concerns about the use of MSAs in ways that evade the requirements of RESPA.

RESPA Section 8(a) prohibits the giving and accepting of "any fee, kickback or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."[75] Section 8(c)(2) provides that "[n]othing in this section shall be construed as prohibiting . . . the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or services actually performed."[76] The bulletin notes that, even in instances where MSAs appear to be legally compliant on their face, the legal and compliance risks of implementing and monitoring these types of agreements may be greater than mortgage industry participants have previously realized, and the Bureau's enforcement and supervisory activities have revealed situations in which payments made for "services rendered" or "goods actually provided" were in fact compensation for referrals. Any agreement that entails exchanging a thing of value for referrals of settlement service business involving a federally related mortgage loan likely violates RESPA, whether or not an MSA or some related arrangement is part of the transaction.

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[73] *See* CFPB Compliance Bulletin 2015-05, *available at* http://files.consumerfinance.gov/f/201510_cfpb_compliance-bulletin-2015-05-respa-compliance-and-marketing-services-agreements.pdf.

[74] 12 USC 2601 *et seq.*; *see also* 12 CFR Part 1024.

[75] 12 USC 2607(a); *see also* 12 CFR 1024.14(b).

[76] 12 USC 2602(c)(2); *see also* 12 CFR 1024.14(g).

5.2.3 Bulletin on interstate land sales full disclosure act amendment

On August 10, 2015, the Bureau released Bulletin 2015-04, which provides information to developers and other interested parties relating to a recent amendment to the Interstate Land Sales Full Disclosure Act (ILSA).[77] The amendment exempts from ILSA's registration and disclosure requirements the sale or lease of a condominium unit that is not exempt under 15 USC 1702(a). A "condominium unit" is defined for purposes of this new exemption as a unit of residential or commercial property to be designated for separate ownership pursuant to a condominium plan or declaration provided that upon conveyance:

> (1) the owner of such unit will have sole ownership of the unit and an undivided interest in the common elements appurtenant to the unit; and
>
> (2) the unit will be an improved lot.[78]

Developers are not required to file notice with or obtain the approval of the Bureau in order to utilize the exemption.[79] The Bureau's ILSA regulations also provide that a developer is responsible for maintaining records to demonstrate that the requirements of an exemption have been met if a developer elects to take advantage of an exemption.[80] The Bureau will continue to process filings made by developers seeking to fulfill their obligations under ILSA and its implementing regulations.

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[77] *See* Amendment to the Interstate Land Sales Full Disclosure Act, *available at* http://files.consumerfinance.gov/f/201508_cfpb_bulletin-on-interstate-land-sales-full-disclosure-act-amendment.pdf; Public Law 113-167, 128 Stat. 1882 (2014).

[78] 15 USC 1702(d).

[79] 12 CFR 1010.4(d).

[80] *Id.*

5.2.4 Bulletin on private mortgage insurance cancellation and termination

On August 4, 2015, CFPB released Bulletin 2015-03. This bulletin describes private mortgage insurance (PMI) cancellation and termination rights that the Homeowners Protection Act of 1998 (HPA) provides to borrowers, and gives examples of instances in which servicers failed to properly cancel or terminate PMI.[81] The compliance bulletin also describes internal PMI cancellation guidelines that many investors (such as Fannie Mae and Freddie Mac) have created, which may include PMI cancellation provisions beyond those that the HPA provides. It describes CFPB's observations from examinations in which servicers improperly confused or replaced HPA requirements with elements of investor guidelines, and cautions servicers to remember that investor guidelines cannot restrict the PMI cancellation and termination rights that the HPA provides to borrowers.

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[81] *See* CFPB Compliance Bulletin 2015-03, *available at* http://files.consumerfinance.gov/f/201508_cfpb_compliance-bulletin-private-mortgage-insurance-cancellation-and-termination.pdf.

6. Conclusion

The Bureau recognizes the value of communicating program findings to CFPB-supervised entities to aid them in their efforts to comply with Federal consumer financial law, and to other stakeholders to foster better understanding of the CFPB's work.

To this end, the Bureau remains committed to publishing its *Supervisory Highlights* report periodically in order to share information regarding general supervisory and examination findings (without identifying specific institutions, except in the case of public enforcement actions), to communicate operational changes to the program, and to provide a convenient and easily accessible resource for information on the Bureau's guidance documents.