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CFPB Watch

January 6, 2012

Consumer Financial Protection Bureau Starts Nonbank Supervision Program

On January 5, 2011, the Consumer Financial Protection Bureau ("CFPB") launched the first federal nonbank supervision program. "We will begin dealing face-to-face with payday lenders, mortgage servicers, mortgage originators, private student lenders and other firms that often compete with banks but have largely escaped any meaningful federal oversight," said Richard Cordray the newly appointed director of the CFPB.

Coverage of the Nonbank Supervision Program

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), a "nonbank" is a company that offers or provides consumer financial products or services but does not have a bank, thrift, or credit union charter. Nonbanks include companies such as mortgage lenders, mortgage servicers, payday lenders, consumer reporting agencies, debt collectors, credit counseling agencies, and money services companies.

The CFPB's nonbank supervision will begin in phases. With a director appointed, the CFPB has the authority to oversee nonbanks, regardless of size, in certain specific markets: mortgage companies (originators, brokers, and servicers including loan modification or foreclosure relief services); payday lenders; and private education lenders.

For other markets, the Dodd-Frank Act also provides that that the CFPB can supervise nonbank "larger participants." Last summer, the CFPB sought public comment to develop an initial rule, identifying six possible markets for consideration: (1) debt collection; (2) consumer reporting; (3) prepaid cards; (4) debt relief services; (5) consumer credit and related activities; and (6) money transmitting, check cashing, and related activities. The CFPB has until July 21, 2012 to issue final rules identifying "larger participants." The agency also has authority to supervise any nonbank that it determines is posing a risk to consumers.

The CFPB's Approach to Nonbank Supervision

According to the CFPB, its nonbank supervision program "is designed to ensure that nonbanks comply with federal consumer financial laws and it is designed to assess risk to consumers arising from these businesses."

Features of the nonbank supervision program include conducting individual examinations and may also include requiring reports from businesses to determine what businesses need greater focus. The agency has said that "how often and to what degree the examinations are performed will depend on CFPB's analysis of risks posed to consumers based on factors such as the nonbank's volume of business, types of products or services, and the extent of state oversight."

For several months now, the CFPB has been hiring supervision and examination staff from state and federal bank and financial services regulatory agencies. Supervision staff will be reporting to regional offices in San Francisco, Chicago, Washington, D.C., and New York.

Challenges for Nonbank Providers of Consumer Financial Product and Services

The launch of the CFPB's nonbank supervision program has significant implications for legal and regulatory compliance and raises a number of new challenges for providers of consumer financial products and services. Nonbanks and their service providers will need to consider such issues as:

- The business's compliance with federal consumer financial laws for the entire life cycle of the product or service, including how a product is developed, marketed, sold, and managed;
- Examiners may conduct interviews with personnel and observe the business's operations; and
- Under Dodd-Frank there are significant whistleblower protections and the CFPB is actively soliciting tipsters to report potential violations of federal consumer financial laws.

In addition, the agency has said that "one important component examiners will be looking for is the nonbank's internal ability to detect, prevent, and remedy violations that may harm consumers."

The CFPB generally plans to inform nonbank consumer financial product and service providers of an upcoming evaluation and, when necessary work with the company to seek corrective actions. But, the agency has warned that, when necessary, "examiners will coordinate and work closely with CFPB's enforcement staff to bring appropriate legal actions to address harm to consumers."

Preparing for a Regulatory Examination

Nonbanks are now faced with the challenge of demonstrating compliance with federal consumer financial laws to the CFPB. Preparing for a regulatory examination by the federal government can be an extraordinary undertaking. To reduce and avoid surprises, nonbanks must understand the CFPB examination mindset and prepare for a broad range of scrutiny. In order to help reduce the risk of legal exposure, nonbanks should continuously assess their compliance with consumer financial laws, strengthen their compliance policies and processes to ensure that violations do not occur, and if necessary, remedy any potential violations.

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