Regulatory Practice Letter

January 2012 – RPL 12-05

Cordray Appointed CFPB Director; Nonbank Supervision Begins

Executive Summary

On January 4, 2012, President Obama appointed Richard Cordray to serve as the Director of the Bureau of Consumer Financial Protection ("CFPB" or "Bureau"). The appointment was made as a recess appointment under the President's executive authority but has been questioned by some lawmakers and members of the public who say the Congress had not met the legal requirements to be considered in recess.

With a director in place, the CFPB may fully exercise the authorities granted to it by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act"). These authorities include the expansion of the Bureau's supervisory authority beyond large banks and credit unions to include nonbank providers of consumer financial products and services pursuant to Section 1024 of the Dodd-Frank Act. On January 5, 2012, Mr. Cordray announced the launch of the CFPB's nonbank supervision program. The CFPB intends to begin this program immediately with mortgage companies (originators, brokers and servicers including loan modification and foreclosure relief services), private education lenders and payday lenders. The CFPB also has authority to supervise nonbanks that are "larger participants" in other markets for consumer financial products and services. A proposed rule to define "larger participants", as well as to identify the other consumer markets, is expected to be released by the CFPB shortly.

Background

Section 1011 of the Dodd-Frank Act provides that a Director, appointed by the President "by and with the advice and consent of the Senate," shall serve as the head of the CFPB. The Director serves for a term of five years. The Director is also responsible for appointing a Deputy Director to serve as the acting Director in the Director's absence. Section 1066 grants the Secretary of the Treasury. prior to the appointment of a Director, the authority to carry out the CFPB's functions related to the transfer of authority from the Federal Reserve Board, Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, Federal Trade Commission and the Department of Housing and Urban Development (collectively, the "prudential regulators"), which broadly translates to supervision of large banks and credit unions (with more than $10 billion in total assets) and their affiliates and service providers, as well as the enforcement of the Federal consumer financial laws. This transfer occurred July 21, 2011.

Section 1024 of the Dodd-Frank Act gives the CFPB authority to supervise nonbank providers of consumer financial products and services that:

- Provide or offer residential mortgage loan origination, brokerage, or servicing, including loan modification or foreclosure relief, as well as provide or offer private education loans and payday loans irrespective of size;
- Are a "larger participant" of a market for other consumer financial products and services as defined by rule; or
- The CFPB has reasonable cause to determine, through consumer complaints or other sources of information, is engaging in conduct that poses risks to consumers with regard to consumer financial products and / or services.

In June 2011, the CFPB released a Notice and Request for Comment to solicit input on the definition of a "larger participant" in the market for consumer financial products and services. The Notice also identified six possible markets to be covered by the CFPB's supervisory authority: debt collection; consumer reporting; consumer credit and related activities; money transmitting, check cashing and related activities; prepaid cards; and, debt relief services. The Dodd-Frank Act requires a final rule to be released no later than July 21, 2012.

In July 2011, the Offices of Inspector General for the Federal Reserve Board and the Department of the Treasury released a report stating that the CFPB's supervision of nonbanks under Section 1024 is a "newly established" Federal consumer financial regulatory authority (rather than one to be transferred to the CFPB from another Federal agency) and required the placement of a Director in order to be exercised. Among other things, this restriction applied to the CFPB's authority to:

- Prescribe rules requiring the filing of reports for the purpose of determining whether a nondepository institution should be supervised by the CFPB; and
- Supervise nondepository institutions under Section 1024, including the authority to:
    - Prescribe rules defining the scope of nondepository institutions subject to CFPB's supervision;
    - Prescribe rules establishing recordkeeping requirements that CFPB determines are needed to facilitate nondepository supervision; and
    - Conduct examinations of nondepository institutions.

Description

Appointing the Director

Chronology

- September 17, 2010 - President Obama named Elizabeth Warren Assistant to the President and Special Adviser to the Secretary of the Treasury on the Consumer Financial Protection Bureau and charged her with the responsibility to set up the new CFPB.
- July 18, 2011 - President Obama nominated Richard Cordray to serve as the Director of the CFPB. At that time, Mr. Cordray had been working with the CFPB since December 2010 as the head of the Bureau's enforcement division.
- July 21, 2011 - The CFPB began formal operations with the transfer of authorities from the prudential regulators.
- August 1, 2011 - Raj Date was named Special Adviser to the Secretary of the Treasury on the Consumer Financial Protection Bureau to lead the day-to-day

operations of the CFPB. He replaced Elizabeth Warren, who stepped down in July 2011.

- October 6, 2011 – The Senate Committee on Banking, Housing and Urban Affairs passed the nomination of Mr. Cordray to serve as the CFPB Director by a 12-10 vote along strict party lines.
  - Senate Republicans had pledged in May 2011 not to confirm any CFPB Director unless structural changes were made to the CFPB, including replacing the single Director's position with a five-member bi-partisan commission.
- December 8, 2011 – The full Senate voted 53-45 to close off debate on the nomination of Mr. Cordray as CFPB Director, falling short of the 60 votes needed to proceed with the confirmation vote.
  - The Senate Republicans again voted as a block, except for one who voted "yes" and one who voted "present".
- January 4, 2012 – President Obama used a recess appointment to place Mr. Cordray as the CFPB Director. Mr. Cordray subsequently named Raj Date to serve as the CFPB Deputy Director.
  - Because of the recess appointment, Mr. Cordray will serve as CFPB Director until the end of the next session of Congress, which is December 2013 (rather than the statutory five-year term).

Reported Concerns about the Recess Appointment

Some lawmakers and members of the public have suggested that the Congress was not officially in recess at the time of Mr. Cordray's appointment because neither the House nor the Senate had given its permission for the other to recess (as required by the Constitution), and the Senate has been conducting "pro-forma" sessions every three days. Some have questioned whether the CFPB Director's position is the type of position permitted to be filled through a recess appointment and still others have questioned whether a recess-appointed director receives the full authorities permitted a Senate-confirmed Director, citing a number of provisions in the text of the Dodd-Frank Act that make direct reference to a "Senate confirmed" director. Legal challenges to the validity of the appointment are anticipated to come from any of a number of sources including Congress, industry trade groups, and specific entities.

The White House and Mr. Cordray have each stated that the appointment is legitimate and Mr. Cordray is moving forward to fully implement the authorities and powers of the CFPB.

On January 12, the Department of Justice publicly released a memo dated January 6 that concluded the pro-forma sessions conducted by the Senate, where no business was conducted, were not sufficient to interrupt the intrasession recess and that the President had the authority to exercise his recess appointment. The opinion also noted that such an interpretation and the director's appointment could still be challenged in the courts.

Nonbank Supervision Program

Director Cordray announced the launch of the CFPB's nonbank supervision program on January 5, 2012, the day after his appointment as Director. The program will be conducted in the same manner as the CFPB's bank examination program and will be guided by the CFPB's recently released Supervision and Examination Manual (refer to Regulatory Practice Letter 11-25).

Pursuant to Section 1024 of the Dodd-Frank Act, the CFPB has the authority to supervise certain nonbanks regardless of size, including mortgage companies (originators, brokers, and servicers including loan modification or foreclosure relief services); payday lenders; and private education lenders. The CFPB is prepared to begin this process immediately.

Section 1024 also gives the CFPB the authority to supervise "larger participants" of markets for other consumer financial products and services that the CFPB defines by rule. A proposed rule to define a "larger participant" and to identify the markets to be considered is expected to be released soon.

Supervisory Process

The CFPB states the nonbank supervision program will include conducting individual examinations and may also include requiring reports from businesses to determine what businesses need greater focus. How often and to what degree the examinations are performed will depend on the 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. Such information will be taken from publicly available sources or from other State and Federal regulators. CFPB examiners will be trained in both bank and nonbank supervision and, in particular, will:

- Look at a nonbank's consumer financial products and services with a focus on risk to consumers.
- Review the nonbank'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.
- Conduct interviews with personnel and observe the nonbank's operations.
- Seek corrective actions, including strengthening the company's programs and processes, where violations of Federal consumer financial law are identified and, where appropriate, bring legal action to address harm to consumers.

State Cooperation

The CFPB states that the nonbank supervision program will be coordinated with State regulators, when applicable. In January 2011, the CFPB entered into a Memorandum of Understanding ("MOU") with the Conference of State Bank Supervisors to "establish a foundation of state and federal coordination and cooperation for supervision of providers of consumer financial products and services." The MOU is intended to promote consistent examination procedures through joint consultation on the standards, procedures and practices used by State regulators and the CFPB to conduct compliance examinations.

The CFPB notes that 42 States and Puerto Rico, as well as five State regulatory associations had joined the MOU as of January 5, 2012.

Next Steps

The CFPB identifies the following "next steps" to implement its nonbank supervision program:

- Expand ongoing supervision of mortgage servicers to nonbank mortgage servicers;
- Publish additional examination procedures tailored to the types of consumer financial products and services offered by nonbanks;
- Propose an initial rule to begin defining which companies meet the test for "larger participants" in certain nonbank markets;
- Publish rules to establish procedures to supervise a nonbank company where the CFPB has reasonable cause to believe it poses risks to consumers;
- Continue ongoing communications with State and Federal regulators with a more specific focus on examination planning; and
- Continue to obtain feedback on its supervision program from nonbank financial services companies, banks, thrifts, and credit unions, Federal and State agencies, consumer and community groups, and the public.

Other Authorities

In addition to supervising nonbanks, the appointment of a Director permits the CFPB to now:

- Prohibit unfair, deceptive and abusive acts or practices ("UDAAP"); and
- Prescribe rules and require new model disclosure forms for consumer financial products and services both initially and over the appropriate term of the product or service.
    - The CFPB has been actively soliciting industry and consumer input on revised disclosure forms for mortgage origination and closing, private student loan terms and credit card agreements.
- Gain voting representation on the board of the Federal Deposit Insurance Corporation and the Financial Stability Oversight Council.

Commentary

The CFPB and its new director are moving full speed ahead despite the flurry of attention surrounding the President's recess appointment. The release of the Department of Justice's January 6 legal opinion supporting the legality of the appointment does not appear to have fully dispelled the issue All indications seem to imply that there will be a challenge to the legality of the appointment at some point from somewhere, though no actions from within the financial services industry have yet been filed. It is worth acknowledging, however, that any litigation will likely take a very long time to complete and it is uncertain how much of the efforts of the CFPB could ever be changed or undone once a decision is ultimately reached.

In addition to Mr. Cordray's recess appointment, President Obama also made three recess appointments to the National Labor Relations Board ("NLRB") on January 4. Three entities, the National Right to Work Foundation, the Coalition for a Democratic Workplace and the National Federation of Independent Business have filed a legal action to challenge the NLRB appointments. Any determination would likely affect Mr. Cordray's appointment as well.

All entities within the purview of CFPB oversight, especially nonbanks that have not previously been subject to Federal supervision, should anticipate and prepare for the significant impact the CFPB will bring to bear on consumer protection. The placement of a Director permits the CFPB to exercise broad authorities granted by the Dodd-Frank Act, including writing new rules and supervising nonbanks. In his first public speech as Director, Mr. Cordray noted the "twin promises of the Dodd-Frank Act" - the Bureau will have a singular focus on protecting consumers in the financial marketplace and large banks and nonbanks will be held to the same standard. The CFPB has been actively preparing for this by:

- Building the "*Know Before You Owe"* program, which currently solicits input on new disclosures for mortgage originations, private student loan offers and credit card agreements. (These could be finalized when ready.)
- Opening complaint portals directly on its Web site for information about consumers' credit card and mortgage loan transactions with new portals for other products and services to be available by year end 2012.
- Opening an informant and whistleblower portal directly on its Web site.
- Directly soliciting input on consumers' experiences, good or bad, with bank and nonbank providers of consumer financial products and services through its "*Tell Your Story*" button on the CFPB Web site and targeted email campaigns (sent directly from Richard Cordray).

Presumably the CFPB will use much of the information gained through these sources to guide its decisions to target specific areas of the industry as well as specific entities. Most assuredly, the Bureau will begin its nonbank supervision looking at mortgage originators, private student lenders and payday lenders though, based on the Bureau's efforts with regard to banks, they will not necessarily focus only on the largest companies. A recent KPMG conducted survey of Chief Compliance Officers found that entities subject to CFPB supervision (banks, nonbanks and credit unions) expect the CFPB to focus on such consumer protection areas as consumer disclosures and notices, UDAAP, service member affairs, fair lending and loan originations, including duty of care, in the next six to twelve months. The industry at large also anticipates active enforcement by the CFPB at both the national and regional levels and a questioning of "industry standards" under a new lens of consumer protection and "fairness."

Mr. Cordray has also pointed out that by gaining all of its authorities, the CFPB is free to fully utilize those authorities to address the "problems facing consumers," including supervisory and enforcement actions. He noted that most nonbanks have previously "escaped any meaningful federal oversight" and will likely find the new supervision program a challenge. Similarly, he drew a distinction between the many unsupervised nonbanks and "responsible businesses, including community banks and credit unions."

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Financial Services Regulatory Practice

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