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Regulatory Practice Letter

June 2012 – RPL 12-10

Risk-Based Nonbank Supervision - CFPB Proposed Rule

Executive Summary

The Bureau of Consumer Financial Protection ("CFPB" or "Bureau") released a proposed rule on May 24, 2012 that would establish procedures by which the Bureau would subject a nonbank provider of consumer financial products and services to CFPB supervision when the nonbank would not otherwise be covered by the CFPB's supervisory authority. The proposed rule would implement provisions under Section 1024 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act,* which give the CFPB authority to supervise any nonbank provider of consumer financial products or services when it has reasonable cause, based on consumer complaints or information from other sources, to determine that such person is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services ("risk-based nonbank supervision"). The statute further provides that the CFPB would make a determination to supervise such a nonbank by order, after providing notice to the person and providing reasonable opportunity for the person to respond. A nonbank supervised by the CFPB pursuant to this rule would be permitted to petition for termination of the CFPB's supervision two years after the date of the order.

The CFPB's risk-based nonbank supervision authority is separate from the Section 1024 authority to supervise nonbanks, regardless of size, in the specific markets of: mortgage companies (originators, brokers, and servicers including loan modification or foreclosure relief services); payday lenders; and private education lenders. It is also separate from the authority to supervise the "larger participants" in other markets identified by the CFPB as well as the affiliates and service providers of the banking organizations under its authority (please refer to RPLs 12-05 and 12-07).

Comments are requested no later than July 24, 2012.

Background

The Dodd-Frank Act gives the CFPB broad authority to supervise nonbank providers of consumer financial products and services. Following the appointment of Richard Cordray as CFPB Director in January 2012, the Bureau announced the launch of its nonbank supervision program. Nonbanks will be subject to the same supervisory and examination processes and standards as banking organizations.

For purposes of the proposed rule, nonbanks include any person that engages in offering or providing a consumer financial product or service, and any affiliate of that person that acts as a service provider to the person, except for banks, thrifts and credit unions with total assets of more than $10 billion and their affiliates, and also banks, thrifts and credit unions with total assets of $10 billion or less. A "person" is defined as an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity.

Description

The proposed rule outlines the process the CFPB would use to implement the risk-based provisions of Section 1024, which permit the CFPB to supervise any nonbank that it has "reasonable cause to determine" is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.

Notice of Reasonable Cause

As proposed, the Bureau would provide a nonbank identified through consumer complaints or "information from other sources" (a "nonbank covered person") with a *Notice of Reasonable Cause* ("Notice") stating that the Bureau may have reasonable cause to determine that such covered person is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services. In particular, the Notice would be required to:

- State the basis for the Bureau's assertion (based on consumer complaints collected through the CFPB or information from other sources).
- Inform the nonbank respondent how to file a timely response, and of the required contents of a response (discussed below).
- Inform the nonbank respondent that a supplemental oral response may be requested.
- Indicate that, in lieu of filing a response, the respondent may voluntarily consent to the Bureau's supervisory authority by filing an executed consent form attached to the Notice. Such consent would be applicable for a period of two years.
- Inform the respondent that failure to respond, as set forth in the Notice, may result in a determination by the CFPB Director without further opportunity to respond.

Nonbank Response to the Notice

- Any written response to the Notice must be filed within 20 days of service.
- Failure to file a timely response would: a) result in a waiver of the respondent's right to respond; b) authorize the CFPB Assistant Director to issue a recommended determination regarding risk-based supervision of the nonbank; and c) authorize the CFPB Director to issue a final determination, based on the assertions in the Notice.
- Where a respondent wishes to contest the assertions in the Notice, the response would be required to:
  - Set forth the basis for the respondent's contention that the respondent should not be subject to supervision;
  - Include all records, documents, or other items upon which a respondent relies; and
  - Include an affidavit signed by the respondent attesting that the information contained in the response is true, accurate, and without any omission that would cause the response to be materially misleading.

- Any request for an oral response would be required to be included in the written response and failure to do so would constitute a waiver of the respondent's opportunity to present a supplemental oral response.
- Similarly, failure to timely raise an issue or to submit records, documents or other information with the written response would constitute a waiver of the respondent's opportunity to present that information.

Voluntary acceptance of CFPB supervision would not be considered an admission of having engaged, or of engaging, in conduct that poses risks to consumers. Respondents entering into the consent agreement would waive the right to a judicial review of the agreement.

Supplemental Oral Response

The Assistant Director of the CFPB would be required to respond to a request for a supplemental oral response within 14 days of the written request. Such a response would be required to indicate the date, time, and relevant information relating to the conduct of a supplemental oral response. Supplemental oral responses are expected to focus on the arguments of the respondent and the CFPB Deputy Assistant Director for Nonbank Supervision that support their respective legal and factual assertions and would generally be conducted by telephone. The Assistant Director would be permitted to impose limitations on the conduct of a supplemental oral response.

Determination

The CFPB Assistant Director would submit to the CFPB Director a recommended determination to provide the respondent with either an order that would bring the respondent within the Bureau's supervisory authority or a notification that the respondent is not subject to the Bureau's supervisory authority. Such a recommendation and supporting documentation would be due to the Director:

- Within 45 days after receipt of the respondent's written response, if the respondent did not voluntarily agree to CFPB supervision and the response was timely submitted.
- Within 45 days after service of the Notice to the respondent, if the respondent did not timely file a response.
- Within 90 days after service of the Notice, if the respondent requested a supplemental oral response.

The CFPB Director would be required to reach a final determination with 45 days of receiving the Assistant Director's recommendation. The Director may accept, reject or modify the proposed determination.

Termination of Supervision

A nonbank covered person that is subject to CFPB supervision pursuant to a risk-based order would be allowed to petition for termination of the Bureau's supervisory authority two years after the date of the order and not more than annually thereafter. Requests for termination of supervisory authority would be required to be supported with relevant information, including any actions taken by a respondent since issuance of the order to address the conduct that led to issuance of the order.

Based on the respondent's petition, the Deputy Assistant Director for Nonbank

Supervision would be required to make a proposed recommendation to the Director within 30 days of receipt of the petition, and the Director would be required to make a final determination on the petition within 90 days of its receipt.

Commentary

CFPB Director Richard Cordray stated in the Bureau's releasing press statement that the proposed rule would allow the CFPB to reach nonbanks they would not otherwise supervise. No additional information was provided to indicate how the CFPB intends to use this authority, including whether it would be applied on an entity-by-entity basis or to capture smaller companies operating in the "larger participants" nonbank supervisory markets to be defined by the CFPB. Similarly, the basis for determining "reasonable cause" is quite open-ended given that the CPFB may rely on consumer complaints as well as "information from other sources" without further clarifying what these other sources could be.

As such, all nonbank providers of consumer financial products or services are effectively on notice that they could potentially be subject to the CFPB's risk-based supervision. For nonbanks, which have generally operated outside of Federal oversight until now, adjusting to CFPB supervisory and examination authority will likely prove to be a significant adjustment (the CFPB has stated that the same standards and approaches applicable to banks would be used for nonbanks).

Consumer protection and the customer experience should now be counted among a company's top strategic and cultural drivers, and a business issue to be considered at the board level and across all operations and functions. All companies should assess the potential for CFPB supervision of their organizations, beginning with internal assessments of applicable regulations and broader consumer risk factors on an enterprise-wide basis, along individual lines of business and by product life-cycles, including an assessment of the controls environment to mitigate such risk. Close attention should be given to both a company's receipt and resolution of consumer complaints (across multiple sources), considering that the CFPB intends to use complaints as a tool for determining examination scope for individual entities as well as more broadly to guide its focus on individual consumer markets. The CFPB is likely to focus on similar issues for nonbanks as being considered under its bank supervision authority, including the perceived fairness, clarity and transparency of consumer financial products and services.

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