The Consumer Financial Protection Bureau:
A View From Above

Wednesday, June 25, 2014

Presented By the IADC Business Litigation Committee

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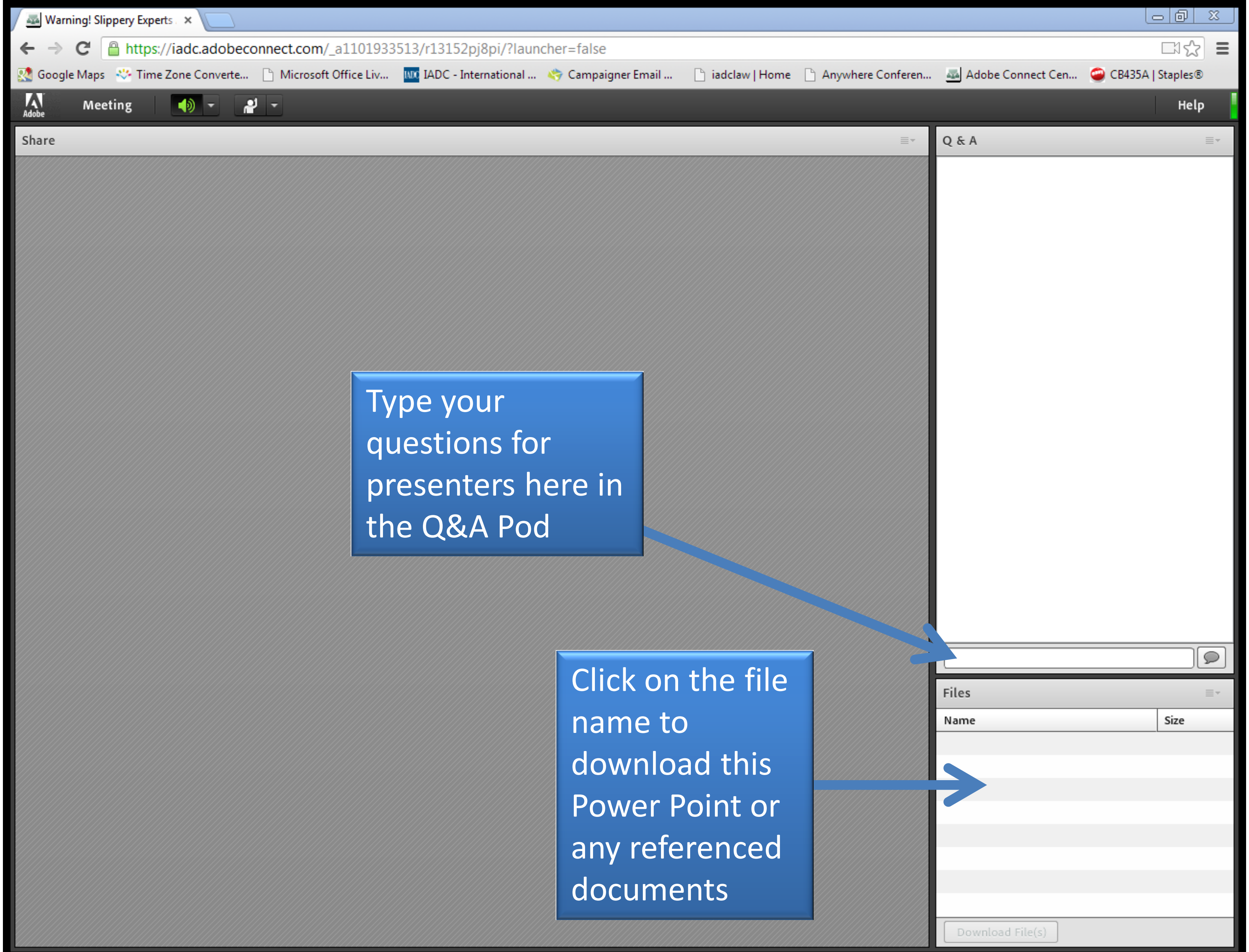

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The Consumer Financial Protection Bureau: A View From Above - Agenda

- Introduction
- The Dodd-Frank Wall Street Reform and Consumer Protection Act: How We Got Here
- CFPB: Overview and Structure
- CFPB Authority: Supervision and Enforcement
- Key Enforcement Actions
- Recent Regulatory Initiatives
- Questions and Concluding Remarks

History

- Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) into law in response to the 2007-2008 financial crisis.
- Dodd-Frank brought significant changes to the financial regulatory environment.
- The Dodd-Frank changes affect all federal financial regulatory agencies and almost every part of the nation’s financial services industry.
- The CFPB is designed to address a variety of issues that arose as a result of the crisis, including the perception that consumer protection was fragmented and inconsistent.

Agency History

- Created by Title X of the Dodd-Frank Act, the Consumer Financial Protection Act of 2010, to address "widespread failures in consumer protection and rapid growth in irresponsible lending practices."
- The Consumer Financial Protection Bureau ("CFPB") is divided into six (6) divisions.
  - Supervision, Enforcement and Fair Lending
  - Research Markets and Regulations
  - Office of Chief Operating Officer
  - General Counsel
  - Consumer Education and Engagement
  - External Affairs

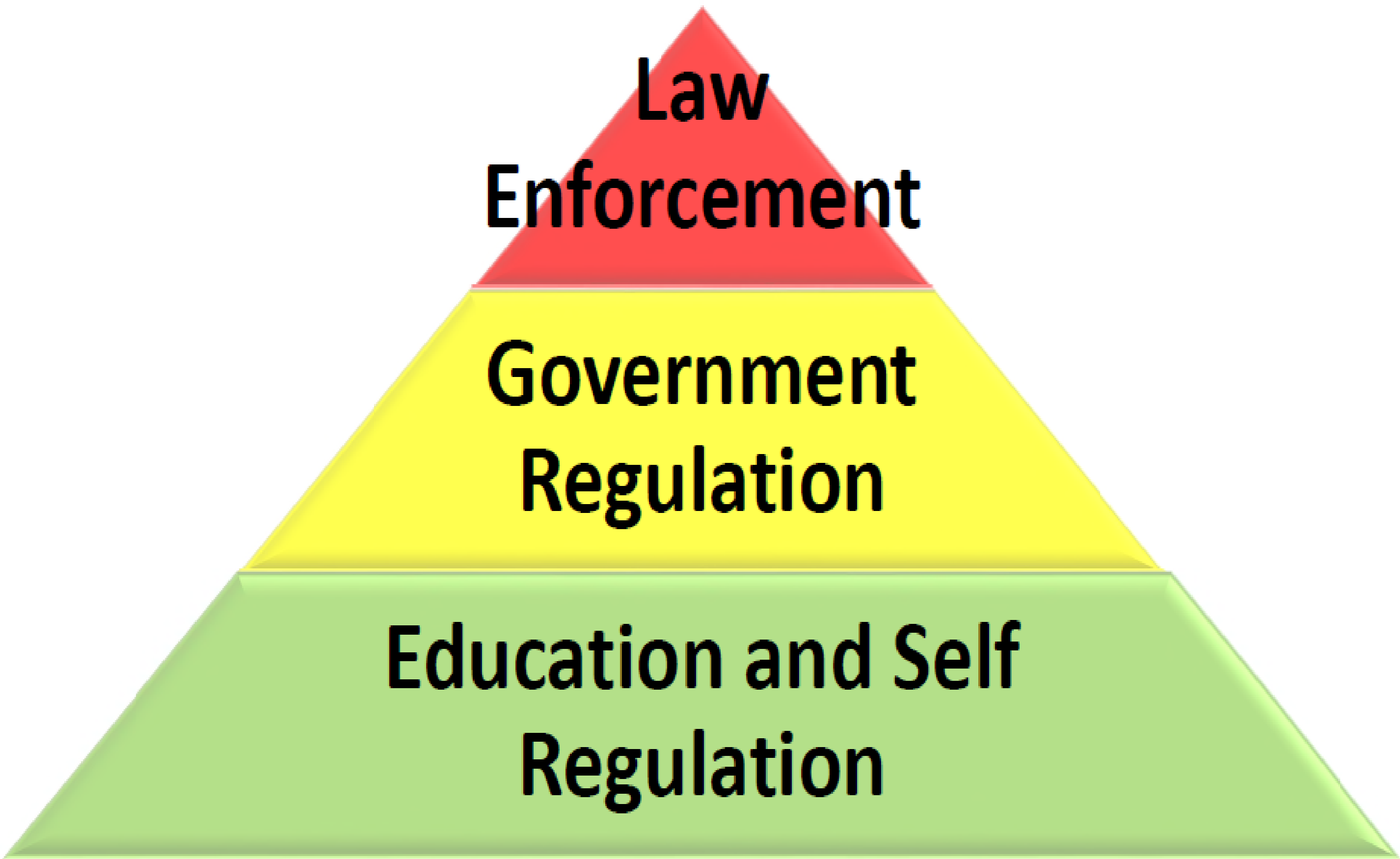
Agency History

- The CFPB was formed to:
  - Focus directly on consumers, rather than on bank safety and soundness or on monetary policy.
  - Heighten government accountability by consolidating in one place responsibilities that had been scattered across government.
  - Exercise responsibility for enforcement of consumer protection laws and supervision of providers of consumer financial products and services that escaped regular Federal oversight.
  - Protect consumers from unfair, deceptive, and abusive financial practices.

Agency History

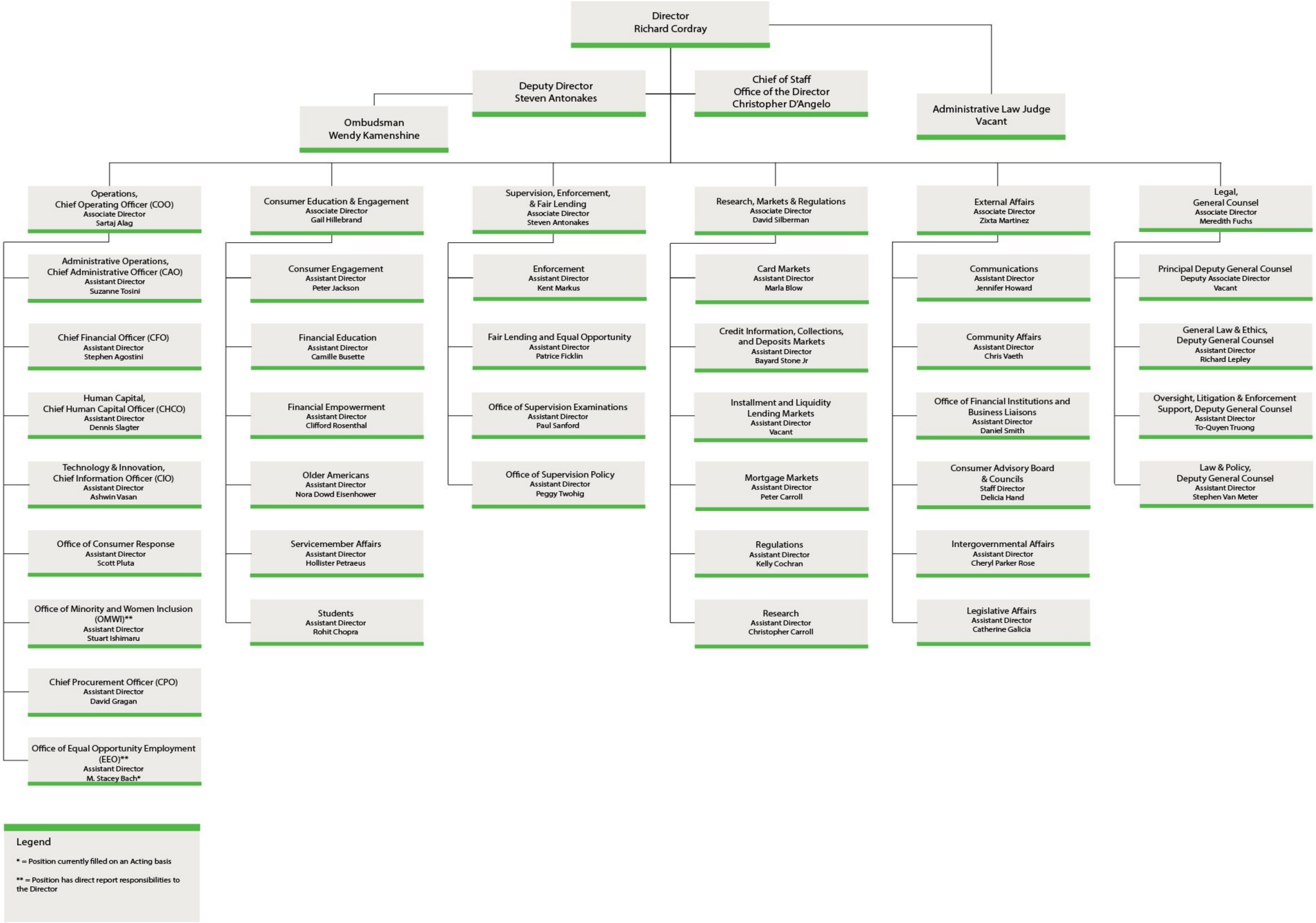
- The CFPB was formed to:
  - Promote financial education.
  - Research consumer behavior.
  - Monitor financial markets for new risks to consumers.
  - Enforce laws that outlaw discrimination and other unfair treatment in consumer finance.
  - Serve as a repository for consumer complaints.

The Consumer Protection Pyramid



Agency Facts

- The CFPB is headquartered in Washington, D.C.
- The CFPB has close to 1,000 employees.
- The CFPB's 2013 budget totaled almost $450 million.
- The head of the CFPB is Richard Cordray.
- The website is consumerfinance.gov.



Last updated: December 10, 2013

Inherited Laws

Laws inherited to the CFPB:

- Electronic Fund Transfer Act (except with respect to Section 920)
- Equal Credit Opportunity Act
- Fair Credit Reporting Act (except with respect to red flag rules and proper disposal of records
- Fair Debt Collection Practices Act
- Consumer Privacy
- Truth in Savings Act
- Section 626 of the Omnibus Appropriations Act, 2009 (mortgage advertising; foreclosure and modification scams)
- Supervision of non-insured depository institutions
- Consumer Leasing Act
- Interstate Land Sales Full Disclosure Act

Inherited laws (continued)

Mortgage Related Laws

- Truth in Lending Act ("TILA")
- Home Mortgage Disclosure Act ("HMDA")
- Real Estate Settlement Procedures Act ("RESPA")
- S.A.F.E. Mortgage Licensing Act
- Mortgage Advertising Rule (Regulation N)
- Alternative Mortgage Transaction Parity Act of 1982
- Home Owners Protection Act of 1998 ("HOPA")
- Home Ownership and Equity Protection Act of 1994 ("HOEPA")

Agency Structure – Core Functions

- Rule-making
- Supervision, and Enforcement
- Restrict unfair, deceptive, or abusive acts or practices (UDAAP)
- Process Consumer Complaints
- Promote financial education
- Research consumer behavior
- Monitor financial markets for new risks to consumers
- Enforce laws that outlaw discrimination and other unfair treatment in consumer finance

Firms under CFPB Jurisdiction

- Large depositories (more than $10 billion in assets).
- Lenders and loan servicers, including mortgage-related businesses, payday lenders, automobile lenders, and private student loan providers.
- Loan originators and acquirers, purchasers, sellers, and brokers.
- Sellers, providers, and issuers of stored-value instruments.
- Those engaged in check cashing, collecting, and guaranty services.
- Payment processors.
- Others, including credit reporting services and debt collectors.
- Service providers to any of the above persons.

Two Types of Authority

- SUPERVISORY AUTHORITY, which includes the power to examine and require reports from the persons that it supervises to:
  - assess compliance with Federal consumer financial law.
  - obtain information about such persons' activities and compliance systems or procedures.
  - detect and assess risks to consumers and to the consumer financial markets.
- ENFORCEMENT AUTHORITY, which allows it to bring to bear its arsenal of enforcement powers against an entity that has violated one of its inherited areas of jurisdiction or committed an unfair, deceptive, or abusive act or practice (UDAAP).

Supervisory Authority

Dodd-Frank gave the CFPB supervisory authority, which is the power to examine and require reports (think bank regulator), over:

- Very large banks (over $10 billion), thrifts, and credit unions, and their affiliates, and
- Nonbank covered persons of all sizes engaged in the following activities
  - Origination, brokerage, or servicing of residential mortgage loans secured by real estate, and related mortgage loan modification or foreclosure relief services, mortgage servicers are subject to examination
  - private education lending, and
  - payday lending markets

Supervisory Authority (continued)

- The CFPB also has the authority to supervise nonbank ‘‘larger participant[s]’’ in markets for other consumer financial products or services.

- The Bureau thus far has defined such ‘‘larger participants’’ in the debt collection and consumer reporting areas.

- Debt collection jurisdiction would cover 175 of the approximately 4,500 U.S. debt collectors, debt buyers, and collection law firms; i.e., those firms with over with more than $10 million in annual receipts.

Supervisory Authority (continued)

- The statutory framework for supervision of large depository institutions and their affiliates and for non-depository consumer financial service companies are largely the same.

- The purpose of supervision, including examination is to:

    - Assess compliance with federal consumer financial laws.

    - Obtain information about activities and compliance systems or procedures.

    - Detect and assess risks to consumers and to markets for consumer financial products and services.

Supervisory Authority (continued)

- CFPB examinations pose a risk of regulatory overload at financial institutions, which may be required to respond to multiple examinations. Dodd-Frank recognized this issue, and requires that the CFPB coordinate its supervisory activities with the supervisory activities of the prudential regulators and the state bank regulatory authorities.

- In keeping with that statutory mandate, CFPB entered into a Memorandum of Understanding (MOU) with the Federal Reserve, FDIC, the OCC, and the National Credit Union Administration.

Supervisory Authority

What does it mean?

The examination process is very similar to that of traditional bank regulators. The CFPB's Supervision and Examination Manual makes it clear that the CFPB will generally:

- Provide 30-60 days of notice prior to the on-site examination;
- Request documents before, during, and after the examination;
- Interview key employees;
- Close the examination by providing an examination report accompanied by a compliance rating from one (highest) to five (lowest); and
- Communicate supervisory concerns that require correction, and in some cases may form the basis for an enforcement action.

Enforcement Authority

- Nonbank entities are subject to the CFPB's regulatory and enforcement authority regardless of size or whether they are subject to the Bureau's supervisory authority; i.e., everybody is subject to enforcement action.
- The CFPB is in the position of drafting rules that interpret the inherited laws and is able to enforce compliance with those rules.
- The CFPB also has catch-all authority to address unfair, deceptive or abusive acts and practices (UDAAP) and is able to include a UDAAP, and in some cases a fair lending component, to each of its rules, thereby giving itself additional enforcement jurisdiction.

Enforcement is a Core Function of the CFPB

- Enforcement actions are used to define Agency authority and announce new Agency positions.
- Large Enforcement staff dwarfs other agencies.
- Fair lending staff member assigned to each supervisory exam for banks and nonbanks.

Sources of Enforcement Action

- Supervisory Exams
- Consumer Complaints – "State of the Art" call center and information handling systems
- Agency statement on whistleblowers – being given top priority
- Cross-referrals from and joint initiatives with other federal agencies, including the FTC, DOJ, and HUD
- Cross-referrals from and joint initiatives with the State Attorneys General
- Market Data Research

Enforcement Remedies

- Rescission or reformation of contracts
- Refund of money or return of real property
- Restitution
- Disgorgement or compensation for unjust enrichment
- Payment of damages or other monetary relief
- Public notification regarding the violation
- Limits on the activities or functions of the person against whom the action is brought
  - Civil Money Penalties
  - up to $5,000 per day for the violation of a rule imposed by the CFPB
  - up to $25,000 per day for the reckless violation of a federal consumer protection law, and
  - up to $1,000,000 per day for a knowing violation of a federal consumer financial law

UDAAP

- UDAAP = Unfair, Deceptive, or Abusive Acts or Practices
- Often it is through the UDAAP that the CFPB views consumer harm.
- In addition to the authority to enforce the laws that it has inherited, the Dodd-Frank gave the CFPB "catch-all" authority to restrict unfair, deceptive, or abusive acts or practices through regulation and enforcement.
- The existing UDAP standard is provided by the FTC Act and State "UDAP" statutes, but Dodd-Frank added the term "abusive," which may lead to more expansive interpretations regarding covered activity.
- CFPB considers "unfair," "deceptive," and "abusive" as three separate terms, each with its own meaning to be determined.
- Congress and Industry concerns that standard will be interpreted subjectively.

Traditional UDAP Standard

Section 5 of the FTC Act:

- "Unfair" – an act or practice is unfair if it :
  - Causes or is likely to cause substantial injury to consumers
  - Cannot be reasonably avoided by consumers; or
  - Is not outweighed by countervailing benefits to consumers or to competition
  - Public Policy may be considered with all other evidence
- "Deceptive" – an act or practice is deceptive where:
  - A representation, omission, or practice misleads or is likely to mislead the consumer
  - A consumer's interpretation of the representation, omission, or practice is considered reasonable under the circumstances
  - The misleading representation, omission, or practice is material"

New Term: “Abusive”

The CFPB may declare an act or practice abusive if it –

- materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- takes unreasonable advantage of —
  - a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
  - the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
  - the reasonable reliance by the consumer on a covered person to act in the interests of the consumer

The term will likely be defined by enforcement action (we’ll know it when we see it).

Potential Applications of UDAAP Standard

- Truth in Lending/RESPA disclosures
- Risk-based pricing notices
- Mortgage Loan Originator compensation
- Mortgage loan products and pricing
- Mortgage product advertising
- Credit card programs and pricing
- Overdraft protection programs
- Debit card practices and pricing
- Fees of any kind
- Information reporting and sharing: FCRA to Reg P
- Practices in industries that provide financing to consumers:
  - Payday
  - Automobile financing
  - Student loans
- Fair Lending

Enforcement Actions

- PHH Corporation
- Credit Cards – AMEX, JP Morgan Chase, Discover, and Capital One
- Mortgage Advertising
- Realty company
- Title Insurance company
- Payday, etc.
- Many more investigations, generally private unless revealed or resisted by target (look for Fair Lending)

Enforcement Actions - PHH Corporation

- CFPB served PHH with a Civil Investigative Demand in in May 2012
- The CID initiated an investigation into alleged insurance kickback practices and requested information regarding every aspect of PHH's mortgage operations, including documentation going back 11 years
- After several failed attempts to negotiate with CFPB staff to modify the CID, PHH filed a petition under CFPB procedures to set aside the CID as overly broad and in violation of Dodd-Frank
- The CFPB, per Director Cordray, denied the petition on September 20, 2012
- Lessons
  - Petitioners must be specific in their objections to a CID; e.g., they must specifically describe the burdens of compliance and why the information sought is not relevant to the investigation
  - Petitioners must follow the timing and other procedural requirements of the CID process
  - It is important for persons who receive CIDs to engage in the meet and confer process set out in CFPB regulations; CFPB will only consider issues that have been raised in the M&C process

Enforcement Actions - Credit Card

- CFPB launched enforcement actions against Discover Bank, and Capital One Bank (USA), N.A., for allegedly "deceptive acts or practices" in connection with their marketing, sale and operation of payment protection, credit monitoring and other add-on products to credit card consumers.

- Also pursued an action against AMEX Centurion Bank and other AMEX subsidiaries, alleging violations of "consumer protection laws . . . at all stages of the game – from the moment a consumer shopped for a card to the moment the consumer got a phone call about long overdue debt."

- CFPB is very interested in deferred interest products.
  - The burden is on the firm to make sure the customer understands how it works. For a deferred interest product, when does interest accrue. Is it consumer friendly or not?

- CFPB is interested in rewards programs
  - Do the credit card companies live up to their promises? Are credit card issuers properly marketing these products? Rewards programs many times are the primary reason for choosing a credit card.

Enforcement Actions - Credit Card (cont.)

- Where applicable, CFPB launched the action in coordination with the bank's primary bank regulator (AMEX – FDIC, FRB, OCC and Utah; Discover Bank – FDIC, and Capital One Bank – OCC)
- The result were refunds to consumers (AMEX - $85 million; Discover Bank - $200 million; Capital One Bank - $140 million, and JP Morgan Chase - $309 million) as well as civil money penalties to each regulatory agency involved

Enforcement Actions - Credit Card (cont.)

Capital One Bank (USA), N.A. is an example of CFPB practice

- Bank admitted no wrong-doing
- Action was brought by CFPB under its UDAAP authority
- The enforcement action based on behavior of the Bank's service providers
- The Consent Order
  - Required submission of a remediation plan to CFPB within 30 days
  - Required submission of a compliance plan, including an overhaul of the Bank's compliance management system, to CFPB for supervisory non-objection
  - Created new substantive disclosure and cancellation/refund requirements not found elsewhere in CFPB regulations
  - Required the Bank to submit a written policy governing the management of service providers to CFPB for supervisory non-objection
  - The above-changes also required Bank to address all consumer products, even those that were not the subject of the enforcement action

Enforcement Actions - Credit Card (cont.)

- In coordination with the enforcement actions against the credit card banks, CFPB issued CFPB Bulletin 2012-06 ("Marketing of Credit Card Add-on Products“)
- CFPB Bulletin 2012-06 sets forth CFPB expectations regarding the marketing and sale of credit card add-on products, including
  - Written policies and procedures
  - Periodic quality assurance reviews
  - Independent audits
  - Improved oversight of affiliates and third-party service providers
  - A consumer complaint resolution processes
  - Training for employees involved in the marketing, sale, and operation of products
- CFPB Bulletin 2012-06’s general requirements can be seen as applicable to all consumer products

Enforcement Actions - Credit Card (cont.)

- *In the Matter of Capital One Bank, (USA)* – July 18, 2012
- *In the Matter of Discover Bank* – September 24, 2012
- *In the Matter of American Express Centurion Bank* – October 1, 2012
- *In the Matter of JPMorgan Chase Bank, N.A. and Chase Bank USA, N.A.* – September 19, 2013

Enforcement Actions - Credit Card (cont.)

- What lessons were learned?
  - Development of the UDAAP standard through enforcement action and compliance bulletin rather than through the regulatory process
  - Requirement to develop CFPB-approved compliance plans and compliance maintenance systems
  - Exportation of the results of enforcement proceedings (e.g., disclosure and other substantive requirements) to the industry as *de facto* regulatory standards
  - Reliance on consumer complaints
  - Significant monetary penalties

Enforcement Actions - Mortgage Advertising

- CFPB and FTC announce the issuance of warning letters to approximately a dozen mortgage lenders and mortgage brokers advising them to "clean up potentially misleading advertisements, particularly those targeted toward veterans and older Americans."
- Actions stemmed from a joint "sweep," a review of about 800 randomly selected mortgage-related ads across the country, including ads for mortgage loans, refinancing, and reverse mortgages.
- The Sweep identified problems, such as:
  - Potential misrepresentations about government affiliation
  - Potentially inaccurate information about interest rates
  - Potentially misleading statements concerning the costs of reverse mortgages
  - Potential misrepresentations about the amount of cash or credit available
- Warnings may be the first step in enforcement actions against the companies.

Enforcement Actions - Realty Company

- In May 2014, the CFPB fined an Alabama realty company with a $500,000 penalty.
- The CFPB's allegation was that the realty company illegally disguised its connection with a title services firm owned by the same holding company in its customer contracts.
- The CFPB maintained that the failure to disclose that the title services firm was owned by the holding company was a violation of the Real Estate Settlement and Practices Act.
- Though the customer contract provided notice of the relationship between the two companies, the CFPB maintained the disclosure was illegally buried in text that made marketing claims about the company's prices.
- CFPB director stated "[d]isclosures give consumers the power to make informed financial decisions, and buying a house is among the biggest financial decision most people ever make."

Enforcement Actions-Title Insurance Co.

- In June 2014, the CFPB issued a consent order under which a New Jersey Title Insurance company agreed to pay a $30,000 civil money penalty for paying illegal kickbacks for referrals in violation of RESPA.
- The company paid commissions to more than twenty independent sales people who referred title insurance business to the company.
- The company paid referral commissions of up to 40% of the title insurance premiums it received from consumers to the individuals who solicited title insurance for the company.
- The commissions were deemed impermissible even though the individuals received W-2s. The CFPB maintained that the individuals acted as independent contractors and were not allowed to collect commissions.
- The matter was referred to the CFPB from HUD.

Enforcement Actions-Indirect Auto

- When a consumer purchases a car auto lenders work with the auto dealer to offer financing.
- Like any traditional bank, the auto lender considers the term of the loan, a consumer's credit history and other factors to determine the rate.
- Some auto lenders have agreements with the dealers that allow the dealers to "markup" the interest rate on the loan.
- These markups may be implemented in a way that leads to illegal discrimination.
- The CFPB found Ally Bank and Ally Financial (the "Allied Entities") violated the Equal Credit Opportunity Act.
- The CFPB ordered the Allied Entities to pay $80 million in damages to consumers who were injured by their discriminatory markup policy and to pay a $18 million penalty.

Enforcement Actions-Trends

- CFPB may begin the bring actions against individuals in management positions as they believe that will be a point of leverage.
- The CFPB gets referrals from other agencies. That will likely continue.
- Even though CFPB enforcement attorneys are not at an examination does not mean that enforcement actions are less likely. The supervision and enforcement attorneys are working together.

Vendor Management

- Third-party vendors help companies improve profitability and offer broader services. While the use of third-party vendors can give a company a competitive advantage, the loss of direct oversight can have risks.
- Because the CFPB has authority to supervise nonbank entities for compliance with federal consumer financial laws, vendor management standards that once only applied to banks will apply across the broader marketplace.
- Companies that utilize third parties to provide services cannot use that as a defense if there are questions about how those services are performed.
- The CFPB expects firms to be proactive in preventing consumer harm from outsourced services.
- Ensuring compliance is not easy given the number of third party relationships many banks have.

CFPB Office of Enforcement

- In June 2013, the CFPB issued a bulletin outlining four factors that comprise what the CFPB calls “responsible business conduct.”
  - Self-policing: proactive self-policing for potential violations. Is there a “culture of compliance”?
  - Self-reporting: voluntarily alerting the CFPB about the existence of a violation of law. Self-reporting should be prompt, proactive and not caused by external events.
  - Remediating Harm: Quick and complete remediation of harm
  - Cooperation during an Investigation: Affirmative cooperation with the CFPB during investigation and going beyond what the law requires
- These factors might favorably influence the CFPB when it exercises its enforcement jurisdiction.

Notable 2014 Initiatives & Enforcement Actions

- Fair Lending appears to be a focus.
  - *United States v. Ally Financial, Inc. and Ally Bank*, 2:13-cv-15180 (E.D.Mich. Dec. 2013)
  - *United States v. Synchrony Bank f/k/a G.E. Capital Retail Bank*, (D.Utah June 19, 2014 Consent Order)
- Debt Settlement Practices – Criminal Referral
- For-Profit Educational Institutions

Regulatory Initiatives for 2014 - Fair Lending

- One of CFPB's primary responsibilities and emphasis
- CFPB's fair lending unit has begun planning several rulemakings mandated by the Dodd-Frank Act, including those regarding
  - collection and reporting of small, minority- and women-owned business loan data under ECOA and
  - reporting of additional data fields for all companies required to report under HMDA
- "CFPB's Fair Lending and Enforcement offices have a number of pending fair lending investigations, including matters arising from the CFPB's supervisory activity and joint investigations with other federal agencies. While the details of ongoing investigations are confidential, the CFPB's conclusions will typically be made public if an enforcement action is filed at the conclusion of an investigation."

Fair Lending Report of the Consumer Financial Protection Bureau (December 2012)

Fair Lending (continued)

- On December 6, 2012 entered into a Memorandum of Understanding with the Department of Justice for information sharing and joint enforcement
- Participation in Federal Financial Fraud Enforcement Task Force's Non-Discrimination Working Group and Federal Interagency Task Force on Fair Lending with bank regulators
- Disparate Impact Analysis in Fair lending Cases
  – CFPB Bulletin 2012-04 (Fair Lending) (April 18, 2012)
  – Fully embraces the use of disparate impact analysis in lending discrimination cases
  – CFPB has likely initiated research into market data to find instances of disparate impact
- Creation of Academic Research Council made up of university economics professors; likely to be influential in advising CFPB on empirical studies in areas including fair lending

QM/Ability to Repay

Ability to repay – all new mortgages must protect consumers from taking on loans they don't have the financial means to repay

- Lenders must consider and document at least the following 8 factors:
  - current or reasonably expected income or assets;
  - current employment status;
  - the monthly payment on the covered transaction;
  - the monthly payment on any simultaneous loan;
  - the monthly payment for mortgage-related obligations;
  - current debt obligations, alimony, and child support;
  - the monthly debt-to-income ratio or residual income; and
  - credit history
- A borrower must have sufficient assets or income to pay back the loan
- Teaser rates may no longer mask the true cost of a mortgage; analysis must include fully phased-in rates

QM/Ability to Repay (continued)

Qualified Mortgages – lenders will be presumed to have complied with the Ability to Repay rule if they issue “Qualified Mortgages.”

Loan features –

- loan term may not exceed 30 years, may not provide for interest-only payments, balloon payments or negative-amortization
- Points and fees paid by the consumer may not exceed 3% of the total loan amount
- Cap on how much income may go toward debt – 43%

- No down-payment or credit score requirements
- Safe Harbor for QM loans that are not higher priced
- Effective Date: January 10, 2014

Mortgage Originator Compensation

- Restriction on upfront points and/or fees – must have a “zero/zero alternative
- General restrictions on compensation
  - May not be based on the terms of the transaction other than loan amount
  - Limited ability to participate in pooled compensation, profit-sharing, and bonus plans
  - Loan originators may not be paid by both consumers and other parties
- Other
  - bans general agreements requiring consumers to submit any disputes that may arise to mandatory arbitration
  - generally bans the financing of premiums for credit insurance
  - requires depository institutions to establish and maintain procedures to assure and monitor compliance with the SAFE Act

QRM/Risk Retention Rule

- Required by Dodd-Frank, institutions selling mortgages into the secondary market must retain a portion of the risk (5%) unless the mortgages qualify as "qualified residential mortgages" (QRM)
- The proposal
  - Loan features of QRMs generally match the QM criteria (i.e., no negative amortization, interest-only payments, etc.)
  - Required underwriting standards such as maximum debt to income, loan-to-value ratios, and credit history requirements
  - Required down payment of at least 20%
- Issuance of QM/Ability to Repay Rule may signal a broadening of the QRM standard

National Servicing Standards

CFPB issued new mortgage servicing rules in January 2013

- Clear monthly mortgage statements (TILA)
- Warning before interest rate adjustments (TILA)
- Prompt payment crediting and payoffs (TILA)
- Options for avoiding Forced-Place insurance Early information and options for avoiding foreclosure (RESPA)
- Error resolution and information requests (RESPA)
- Information management policies and procedures (RESPA)
- Early intervention and continuous contact with delinquent borrowers (RESPA
- Loss mitigation procedures (RESPA)

Questions for Presenters?

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