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Federal Reserve Issues Policy on Consumer Compliance Supervision for Nonbank Subsidiaries of Bank Holding Companies and Foreign Banking Organizations

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Related Practices:

- Financial Services Law

On September 14, 2009, the Federal Reserve Board (FRB) issued an important policy relating to the FRB's supervision of nonbank subsidiaries of bank holding companies (BHCs) and foreign banking organizations (FBOs). The policy requires the FRB staff to conduct risk-focused consumer compliance supervision of, and to investigate consumer complaints against, these entities with respect to activities covered by those consumer protection laws and regulations within the FRB's enforcement jurisdiction. In its press release accompanying the policy, the FRB indicated that the policy "is designed to improve the [FRB's] understanding of the consumer compliance risk that certain products and services may pose to the holding companies and consumers and to guide supervisory activities for these entities." The FRB policy will likely open a new chapter in the supervision of BHCs and FBOs, and many of those entities will be required to devote an increased level of resources to their consumer compliance programs.

Background

The new policy builds on a joint pilot project that the FRB launched in 2007 along with the Federal Trade Commission, Office of Thrift Supervision, and two associations of state regulators. The pilot focused on a select group of non-depository lenders with significant subprime mortgage operations.

Scope of Supervision

The policy provides for FRB supervision of eleven consumer protection laws: (1) the Truth in Lending Act; (2) the Equal Credit Opportunity Act; (3) the Home Ownership and Equity Protection Act; (4) the Fair Credit Billing Act; (5) the Consumer Leasing Act; (6) the Fair Credit Reporting Act; (7) the Fair Debt Collection Practices Act; (8) the Home Mortgage Disclosure Act; (9) the Truth in Savings Act; (10) any FRB rules promulgated under the Federal Trade Commission Act; and (11) the Real Estate Settlement Procedures Act.

Risk Assessments

Under the new policy, the FRB initially will conduct consumer compliance risk assessments for nonbank subsidiaries of BHCs and FBOs. While it may be possible to conduct these activities off-site, onsite discovery reviews may be necessary.

For nonbank subsidiaries of Large Complex Banking Organizations, updated or initial institutional profiles and consumer compliance risk assessments should be completed by the end of the fourth quarter of this year, with supervisory plans for 2010 completed by the end of the first quarter of 2010. Updated or initial institutional profiles and consumer compliance risk assessments for all other nonbank subsidiaries of BHCs and FBOs must be completed by the end of the first quarter of 2010, with any necessary supervisory work identified and scheduled by the end of the second quarter of 2010.

Supervisory Activities

Based on these risk assessments, as well as a review of consumer complaints, the FRB will plan supervisory activities. These supervisory activities will be risk-focused and will include continuous monitoring, discovery reviews, and targeted or full-scope examinations with transaction testing, as appropriate. In addition, consumer complaints will be investigated.

Targeted or full-scope examinations will result in ratings based on the Consumer Compliance Risk Management rating system. The possible ratings are Strong, Satisfactory, Fair, Marginal, or Unsatisfactory. The consumer compliance rating will be "appropriately considered" when the Bank Holding Company rating or the U.S. Combined Assessment is assigned to the organization.

The results of the consumer compliance examinations will be transmitted in writing to senior management of the nonbank subsidiary, as well as the BHC or the senior oversight function for any FBO's U.S. operations, as applicable. This document will highlight significant examination findings and recommendations for corrective actions.

Impact

Historically, consumer compliance at the nonbank subsidiaries of BHCs and FBOs received little attention from the FRB. Absent a large number of consumer complaints or other indications of a problem, these companies could expect to address consumer compliance issues on their own. For many companies, this meant that compliance was not a priority item. The residential mortgage crises, the downturn in the U.S. economy, and the prospect for the creation of a new Consumer Financial Protection Agency have created a renewed focus on consumer compliance issues. The FRB's decision to undertake an active role in the supervision of consumer compliance by nonbank subsidiaries of BHCs and FBOs is, at least in part, a reflection of these developments.

For nonbank subsidiaries of BHCs and FBOs, the new policy will likely result in a "sea change" in the way that they will be required to manage consumer compliance issues. These companies will need to address compliance in an active, rather than reactive, manner. They can look to the experience of their affiliated banks to get a sense of the scope and depth of the examination and supervision to which they will be subject. Management should devote appropriate resources to reduce their risk profiles and to build a culture of compliance within their companies.

BHCs and FBOs also need to take the new policy seriously. The FRB has made clear that the consumer compliance ratings of their nonbank subsidiaries will be taken into account when the Bank Holding Company rating or the U.S. Combined Assessment is assigned to the organization. This should create an incentive for BHCs and FBOs to treat consumer compliance as a priority item.

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