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Consumer Financial Protection Bureau Launches Supervision Program for Nonbanks

On January 5, 2012, the United States Consumer Financial Protection Bureau (CFPB) officially began the first federal nonbank supervision program. This new program will be a component of the CFPB's bank supervision program, which began in July 2011. The CFPB's announcement came shortly after former Ohio Attorney General Richard Cordray was appointed to head the CFPB on January 4, 2012.¹

"Nonbanks" are generally defined as nondepository businesses which offer or sell financial products, but do not hold a charter for a bank, thrift, or credit union. Examples of nonbanks include mortgage lenders, mortgage servicers, payday lenders, consumer reporting agencies, debt collectors, and money services companies. Before the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) created the CFPB in July 2010, nonbanks had not been formally supervised at the federal level. Aside from a handful of state laws,² nonbanks were mainly subjected to after-the-fact enforcement based on such laws as the Truth in Lending Act, the Fair Debt Collection Practices Act and the Fair Credit Reporting Act.

Dodd-Frank gave the CFPB supervision over banks, thrifts, and credit unions with over \$10 billion in assets. The CFPB's supervisory jurisdiction now includes additional types of businesses, regardless of size: mortgage companies (origination, brokerage or servicing of residential mortgage loans secured by real estate and related mortgage loan modification or foreclosure relief services), payday lenders, and private education lenders.

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The CFPB is also authorized to supervise the "larger participants" in other nonbank businesses. After seeking public comment in July 2011, the CFPB identified the following six markets to consider for further enforcement efforts: debt collection, consumer reporting, prepaid cards, debt relief services, consumer credit and related activities, and money transmitting, check cashing, and related activities. Initial rules will soon be proposed for these markets. The CFPB also has authority under a "catch-all provision" to supervise any nonbank that it deems to be a risk to consumers.

The supervisory program itself will consist of individual examinations by the CFPB as well as required reports by the regulated entities. The content and frequency of the examinations will depend on such factors as the nonbank's volume of business, the types of products or services it offers, and the extent of state oversight. The CFPB Examination Manual, which governs regular bank supervision, will also control for

¹ Mr. Cordray's appointment was controversial, since it took place by executive action during a congressional recess period following his July 2011 nomination.

² The Supreme Court of Ohio was recently asked to determine if mortgage servicers are subject to the Ohio Consumer Sales Practices Act. See: <http://tinyurl.com/7xwc4dw>

nonbank supervision. The manual is available at <http://tinyurl.com/85go753>.³ Nonbanks' compliance with federal law will now be evaluated for the entire life cycle of a financial product instead of only after a law has been broken. Particular attention will be directed toward the nonbank's internal ability to monitor potential violations. Nonbanks will generally be informed of potential violations in advance of enforcement efforts and will be updated throughout the examination process.

Banks and nonbanks alike should also be mindful of the CFPB's new requirements concerning privileged documents. On January 4, 2012, the CFPB informed all institutions under its supervision that they must disclose privileged material upon request. The CFPB assured these institutions that turning over documents will not constitute a waiver of the privilege. The pertinent federal statute, 12 U.S.C. § 1828(x), reads: "The submission by any person of any information to any Federal banking agency . . . for any purpose in the course of any supervisory or regulatory process of such agency . . . shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information" But, 12 U.S.C. § 1813 limits the definition of "Federal banking agency" to "the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, [and] the Federal Deposit Insurance Corporation" -- the definition does not include the CFPB. The CFPB asserted that it will in fact be treated as a federal banking agency with respect to waiver; but, its position has not been tested in the courts. This will be a key issue to monitor going forward.

At the state level, a Memorandum of Understanding has been created to permit the CFPB to share information with state regulators and state regulatory associations. Regulators in 42 states and Puerto Rico as well as five state regulatory associations have already joined in the Memorandum of Understanding. Going forward, the CFPB has indicated that its next steps will include additional examination procedures specifically designed for nonbank financial products, supervisory rules for nonbanks deemed at risk by the CFPB, and obtaining additional feedback on its examination program.

The new supervision program is likely to pose a significant expense increase for nonbanks. These increased costs will include new compliance activities, federal audits, and enforcement actions. Keeping a close eye on the still-evolving rules and parameters set by the CFPB will be important in keeping these costs at a reasonable level.

³ See our initial review of the manual: <http://tinyurl.com/7veuxc6>

