

InfoBytes Special Alert: CFPB Publishes Supervision and Examination Manual Including Mortgage Servicing Examination Procedures

October 17, 2011

On October 13, the Consumer Financial Protection Bureau (the "CFPB" or the "Agency") released the first edition of its Supervision and Examination Manual (the "Manual"). The Manual consists of three parts. Part I describes the Agency's compliance supervision and examination process; Part II outlines the Agency's examination procedures, including both general instructions and procedures for determining compliance with specific regulations; and Part III provides templates for reporting risk assessments, examination results, and supervision plans.

The Manual incorporates both the examination procedures and the ratings system developed by the Federal Financial Institutions Examination Council (the "FFIEC") for those laws recently transferred to the purview of the CFPB by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, including the Truth in Lending Act (the "TILA"), the Real Estate Settlement Procedures Act (the "RESPA"), and the Fair Credit Reporting Act (the "FCRA").

The Manual also includes a new set of examination procedures for entities that conduct mortgage servicing activities. The CFPB regulators plans to employ these newly developed mortgage servicing examination procedures, immediately, in connection with its ongoing investigations into the servicing practices of large banks, thrifts and credit unions (*i.e.*, institutions with over \$10 billion in assets) and their affiliates. The CFPB has indicated that its first round of servicing examinations will focus principally on issues related to the servicing of non-performing loans, concentrating on certain key areas of interest to the Agency such as (i) fees charged by servicers to borrowers in default, (ii) servicers' foreclosure referral processes, and (iii) servicers' loan modification processes.

The CFPB's General Compliance Supervision and Examination Process

The Manual states that the CFPB's compliance supervision and examination process will be guided by three overarching principals. First, the CFPB will evaluate the policies and practices of financial institutions with a focus on detecting, preventing, and correcting practices that present a significant risk of violating consumer protection laws and causing consumer harm. Second, in conducting supervisory activities, the CFPB will rely on the analysis of data pertaining to (i) the activities of regulated entities, (ii) the markets in which regulated entities operate, and (iii) the risks posed to consumers by activities of these entities in their operating markets. Finally, the CFPB will strive to apply its supervisory standards consistently as to both depository and non-depository institutions.

The Manual further explains that the examination schedule for both depository and non-depository institutions will be determined on the basis of risk to consumers posed by each institution, including considerations such as the institution's asset size, volume of consumer transactions, and extent of oversight by other regulators. Generally, the CFPB will notify entities of examinations in advance and, as required by law, will coordinate its examinations with state and prudential regulators. In addition to its regularly scheduled examinations, the CFPB also may conduct targeted and horizontal reviews.

In the event an examination uncovers a compliance issue, the Manual indicates that the CFPB has the option to take either an informal supervisory measure or a formal enforcement action, depending on the type of problem found and the severity of harm to consumers. If the CFPB opts to pursue a formal enforcement action against an institution, the Agency, in its discretion, may (i) launch an investigation, (ii) institute an administrative proceeding, or (iii) bring a civil action in Federal district court. Additionally, the Agency may refer matters outside of its jurisdiction to an appropriate prudential, other Federal, or state regulator. This authority to refer matters includes the power to refer criminal violations to the Department of Justice and tax violations to the IRS.

The CFPB's General Examination Procedures

In the Manual, the CFPB states that it views a robust compliance management system as critical to maintaining legal compliance and expects every regulated entity under its supervision to establish such a system. The Manual identifies four elements that the CFPB considers foundational in establishing an effective compliance management system: (i) adequate board/management oversight, (ii) a sound compliance program, (iii) a responsive and responsible process for handling consumer complaints and inquiries, (iv) and an independent compliance audit program.

Each CFPB examination will include an initial review of the supervised entity's compliance management system. The CFPB will consider the initial results of compliance management reviews as a key factor in determining the scope and intensity of its examinations.

The CFPB's Mortgage Servicing Examination Procedures

The Manual also sets forth a framework for testing whether a regulated entity's mortgage servicing practices comply with applicable consumer protection laws. The framework will be used in connection with examination of the regulated entity's routine servicing, default servicing, and foreclosure practices.

With respect to routine servicing activities and certain of default servicing activities, CFPB examiners may review the entity's servicing records for evidence that its loan boarding procedures, payments systems, customer call centers, credit reporting practices, information sharing/privacy policies, and debt collection practices fail to comply with applicable federal consumer protection statutes and regulations. Additionally, with respect to an entity's foreclosure activities and certain of its default servicing activities, CFPB examiners may review an entity's servicing records for evidence that its loss mitigation and foreclosure practices discriminate against protected classes in violation of Federal anti-discrimination statutes and regulations. This means that compliance with traditional fair lending principles will now be evaluated across activities spanning the life of a loan rather than being limited to origination-related activities.

Application of the Manual

Presently, the guidance set forth in the Manual will be used in examinations of large banks and depository institutions (*i.e.*, institutions with over \$10 billion in assets) currently falling under CFPB supervision. Once Congress confirms a CFPB Director, the Agency will seek to expand its supervisory jurisdiction to mortgage brokers, payday lenders, sales finance companies and certain other entities. If this expansion occurs, the Agency likely will release additional examination procedures specific to these lines of business.

For a copy of the CFPB's Supervision and Examination Manual, please see:

<http://www.consumerfinance.gov/guidance/supervision/manual/>.

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