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CFPB Initiates Large Bank Supervision Program

BY KEVIN L. PETRASIC

With the statement, “The new consumer agency is here to make sure that markets work for American families, and our bank supervision program is a big part of that,”[1] Elizabeth Warren, the Treasury’s Special Advisor on the Consumer Financial Protection Bureau (“CFPB”), officially launched the new agency’s bank supervision program. Notwithstanding the lack of a Director to run the fledgling agency, the CFPB is moving forward on one of the key elements of its mission – the supervision and oversight of large bank’s consumer financial protection compliance programs. Emphasizing that the CFPB will be hitting the ground running, Warren noted, “Starting on July 21, we will be a cop on the beat – examining banks and protecting consumers.”

Interestingly, the announcement was made through a July 12, 2011 press release issued by the Treasury Department, underscoring that, at least for now, official pronouncements regarding the CFPB’s work and agenda are emanating from Warren’s authority from the Treasury Secretary to “perform the functions of the [CFPB]” until a CFPB Director is confirmed by the Senate.[2]

In discussing the CFPB’s initiation of its bank supervision program, Warren highlighted the scope, staffing and training, and supervisory process that the CFPB will pursue, as well as immediate efforts and actions that the agency will take in establishing “channels of communication” with large banks (i.e., holding assets greater than $10 billion).

Bank Supervision Program Scope, Staffing and Training

As noted in the Treasury press release, the CFPB will oversee 111 banks in its bank supervision program, including all the subsidiaries and affiliates of these large banking organizations. According to the release, these banking entities collectively account for more than 80 percent of industry assets. Regarding the CFPB’s examination staff, the release indicates that the CFPB will manage its bank supervision program through examiners deployed out of satellite offices in Chicago, New York, San Francisco, and Washington, D.C. The regional offices will form the backbone of a regional focus oriented to the particular “business practices and dynamics in different markets throughout the country.” Importantly, the release notes that CFPB examiners “will spend much of their time on-site at depository institutions and at other consumer financial services companies.” While it appears that the intent is to deploy CFPB examiners soon after July 21, 2011, the extent and scope of authority that CFPB examiners will be able to exercise is unclear as long as the CFPB lacks a confirmed Director. This remains a significant issue and important challenge for the Administration.

Regarding the composition of the CFPB’s supervision staff, the new agency will benefit from the immediate incorporation into its ranks of many of the most seasoned and experienced consumer compliance examiners and managers from the federal banking agencies, as well as examiners and management with significant state experience.[3] This is an unprecedented collection of consumer compliance examiners and supervision experience representing a virtual “tour de force” of consumer financial compliance that will make the new agency an immediate and formidable federal regulatory presence with respect to both its bank and non-bank supervision programs.

Bank Supervisory Approach

With respect to the CFPB’s approach to bank supervision, the release discusses a process largely familiar to banks, including pre-examination scoping and review of information, data analysis, periodic on-site examinations, regular supervisory communications, and follow-up monitoring. Also familiar to the very largest banks, the CFPB intends to implement a “year-round supervision program . . . customized to reflect the consumer protection and fair lending risk profile of the organization.” It is unclear whether this includes resident examiners at the largest banks, but that is clearly within the realm of possibility and scope of the agency’s proposed bank supervision program.

A key aspect of the CFPB’s bank examination approach will be assessing banks’ internal procedures for monitoring consumer compliance issues and risks related to institution products and services. Several important references in this regard are the agency’s focus on “the entire life cycle of the product or service . . ., including how a product is developed, marketed, sold and managed,” and fair lending reviews “to detect and address potential discriminatory practices.” Finally, the release notes that “examiners will coordinate and work closely with CFPB’s enforcement staff to implement appropriate enforcement actions to address harm to consumers.”

Timing and Implementation

Regarding timing and deployment of its examiners, among the CFPB’s very first steps will be a series of workshops for its new examination staff. As described in the Treasury release, these sessions are intended to enable experienced examiners to “sharpen their skills” before being deployed, and to provide new examiners “extensive technical and professional skills training.” These sessions are expected to be held almost immediately following the July 21, 2011 deadline for the transition of consumer compliance examination staff from the federal banking agencies to the CFPB.

Simultaneously, the CFPB will be reaching out to banks and their affiliates to establish channels of communication. Institutions should anticipate substantive conversations given that CFPB staff is already reviewing information received from federal and state regulatory agencies. During the weeks following the July 21 transition, CFPB supervisory staff will be:

- familiarizing themselves with the structure, business strategies, operations, and risks of the banking organizations they will supervise;
- communicating and coordinating agency efforts with federal and state regulatory agencies;
- finalizing the agency’s bank supervision program and examination plans; and
- initiating the agency’s first round of on-site examinations.

This process will be described more fully via communications that will be sent to the 111 banking organizations over the next several weeks, as well as through informational roundtables that will begin in early August.

Agency and Industry Challenges

In addition to commencing its bank supervisory operations without a confirmed (or nominated) Director, the agency faces a multitude of challenges in getting its bank supervision program up and running. Certainly, there will be numerous operational and logistical issues just to establish, house and structure the day-to-day operations, policies and programs of the new agency, and these issues are made all the more difficult by the lack of an identified Director. These challenges are critical issues for the new agency as well as for the banking organizations and other industries it will regulate. Uncertainty creates the potential for an unstable regulatory environment, which could complicate the efforts of CFPB staff to conduct supervisory and examination efforts, as well as pose difficult challenges for effective communications and transparency of the new agency's oversight programs. More fundamentally, the potential exists for significant resource allocations at banking organizations to assimilate and adapt to the CFPB's bank supervision program, which will be further complicated by regulatory uncertainty. At least in the short term, regulatory compliance costs will likely increase as the CFPB implements and expands the scope of its bank supervision program.

An example of one of the most important aspects of the CFPB's efforts in establishing its bank supervision program will be the implementation of its Examination Manual. The manual is the primary document and principle source through which all examination activities will be conducted. The Examination Manual is important to communicate and set regulatory and supervisory expectations, as well as to promote and ensure consistency throughout the CFPB's bank (and non-bank) supervision program. Publication of the initial phase of the CFPB's Examination Manual is expected soon, and will be accompanied by a request for feedback and suggestions for improvements from all interested parties, including industry participants, consumer and community groups, and the general public. It is unclear as to whether the agency's first round of on-site examinations will be conducted pursuant to the Examination Manual, whether banks will have an opportunity to prepare for examinations based on the manual, and whether the "initial phase" of the manual will be the operative document for conducting on-site examinations. If the initial phase of the manual is used to conduct exams, then it is unclear what impact comments for improvement of the manual will have on the first round (and subsequent rounds) of the CFPB's bank examinations.

Another interesting and potentially problematic issue is how the agency will deal with banking industry challenges to its on-site examinations and supervisory findings, including what type of appeals process will be implemented to ensure fairness and avoid potential charges of arbitrary and capricious regulatory conduct. Equally compelling is who will be the ultimate arbiter of any appeals, particularly because the agency does not have a confirmed Director,[4] and what is the authority through which the staff will conduct its examination and supervisory activities.

As noted earlier, the Dodd-Frank Act appears to require the operations of the new agency to be conducted by the Director, including through delegations of authority from the Director to the agency's employees, representatives and agents.[5] The Director is also charged with establishing the various functional units and other offices of the CFPB. It remains to be seen whether there will be challenges to the CFPB's authority absent a confirmed Director. Most immediate are the challenges the agency confronts in getting up and running, including with respect to personnel issues, contracting authority, information systems and sharing, data protection, and all of the other critical infrastructure issues confronted by every federal and state regulatory agency – few, if any, of which have the CFPB's scope and breadth of mission.

Action Plan – Establish and Maintain Effective Communications

As with any new venture, the most important challenge is to understand the nature of the underlying risks to your banking organization's ongoing operations, policies and programs. In assessing the risks posed by the new CFPB and in understanding what you will need to do to anticipate and address potential issues that may be raised going forward, one of your most important steps should be to establish and maintain effective communications with your new regulator, as well as with industry peers and other advisers. This is not to suggest you should proactively reach out to initiate a dialogue with the CFPB (of course, you should engage with CFPB staff when invited to do so), rather you should inform yourself, and your subsidiaries and affiliates, regarding regulatory and supervisory issues and developments with the CFPB's bank supervision program that will unfold over the coming weeks and months. In particular, you should consider participating in all opportunities to comment on the CFPB's efforts to model and improve its bank supervision program, including providing comments on the agency's initial phase of its Examination Manual after it is published.

You should also carefully review any guidance issued by the CFPB and evaluate the potential operational, compliance, reputational, and other risks to your banking organization. When and where appropriate, it will be important to weigh in and provide comments and/or open a dialogue with regulators if you foresee issues that are potentially destabilizing to your existing operations or that raise significant costs with little or minimal apparent benefits. Key areas to monitor throughout your banking organization include the following:

- *Fair Lending programs and compliance;*
- *Truth in Lending and Regulation Z compliance;*
- *Truth in Savings Act compliance and bank overdraft protection programs;*
- *Mortgage lending programs, including compliance with the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Secure and Fair Enforcement for Mortgage Licensing Act;*
- *Credit card programs and Credit CARD Act compliance;*
- *Electronic Funds Transfer Act compliance and Regulation E issues;*
- *Equal Credit Opportunity Act issues;*
- *Lending and loan servicing activities generally;*
- *Fair Credit Reporting Act and Fair Debt Collection Practices Act issues;*
- *Deposit-related consumer credit product programs; and*
- *The reliance on federal preemption for activities, services and products offered by the organization.*

Paul Hastings attorneys are actively working with clients to identify and address issues and risks related to the development and implementation of the CFPB's bank and non-bank supervision programs, including identifying opportunities, when and where appropriate, to draft and provide comments to the CFPB on its programs.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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1 *See* U.S. Department of the Treasury Press Release (July 12, 2011).

2 Dodd-Frank Act § 1066.

3 According to the Treasury release, by the end of this month, the CFPB's supervisory staff will include "more than 100 staff members transferring directly from the Federal Deposit Insurance Corporation, the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision." The statement further notes that the agency "expects eventually to have several hundred examiners on board, coming from a variety of backgrounds, including state regulatory agencies and industry."

4 Pursuant to Dodd-Frank Act § 1013(a)(5), the agency will have an Ombudsman (appointed within 180 days after July 21, 2011) to act as a liaison with parties affected by the agency's actions and activities; however, it is unclear whether that person can be appointed by someone other than the Director.

5 Dodd-Frank Act § 1012(b).