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DEVELOPMENTS AND UPDATES ON THE CONSUMER FINANCIAL PROTECTION BUREAU

Please contact our attorneys in our CFPB Task Force if you have any questions regarding this information.

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CFPB: OCTOBER ROUNDUP

Even though the Consumer Financial Protection Bureau ("CFPB" or "Bureau") does not yet have a director, the Bureau remains hard at work. With this Alert we identify the important steps that the Bureau undertook in October. Specifically, the CFPB:

- Published its Supervision Manual (1.0);
- Expanded its "Know Before You Owe" program;
- Addressed student loans; and
- Announced the head of the Office of Older Americans.

I. Supervision Manual

On Friday, October 14, 2011, the Bureau published its version of a Supervision and Examination Manual (the "Manual"). As its 1.0 title suggests, the financial services industry should consider the Manual to be a living document that grows along with the Bureau.

At present, the Manual is divided into four major parts (the CFPB itself identifies three parts; however, since it dedicated an entire section to mortgage servicing, for purposes of this Alert, we will treat that section as a stand-alone part). The Bureau plans to adopt more procedures organized by product line similar to the one created for mortgage servicing.

The Bureau issued the Manual to fulfill its statutory mandate to enforce federal consumer financial laws consistently. To that end, the Manual provides for examination procedures that are designed to be applied for all covered persons that offer similar product types, regardless of charter type. Nevertheless, notwithstanding the fact that the Manual is intended to represent a uniform standard, the Bureau admits that different entities will maintain different compliance systems, depending on their complexity.

Although not published in the Federal Register, and, thus, not formally out for comment, the CFPB requests that stakeholders provide feedback and suggestions for improvements to CFPB_Supervision@cfpb.gov .

We discuss each part below.

Part I – Compliance Supervision and Examination

Title X of the Dodd-Frank Act gives the CFPB authority to supervise certain consumer financial services companies as well as large depository institutions and their affiliates ("Supervised Entities").

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The Bureau will examine the Supervised Entities for compliance with Title X of the Dodd-Frank Act, which prohibits unfair, deceptive and abusive actions, as well as compliance with federal consumer financial laws.[i]

Specific examination procedures generally will be similar to those of the prudential regulators. Examiners will, among other things, collect and review information, conduct interviews, draw preliminary conclusions and share draft reports with prudential regulators. Nevertheless, the CFPB considers all supervisory information, including examination reports and ratings, highly confidential.

Reaction to a negative examination will depend on the facts and circumstances at issue. The CFPB can take informal supervisory measures or undertake more formal enforcement action. Self-correction is encouraged.

In addition to the regularly scheduled examinations, the CFPB will conduct "Target" and "Horizontal" Reviews. Target Reviews generally will involve a single entity and will focus on a particular situation, such as significant volume of particular customer complaints. Horizontal Reviews will be conducted across multiple entities to examine issues arising from particular products or practices and determine whether supervisory measures or enforcement actions are needed.

The CFPB may bring administrative enforcement proceedings or civil actions in Federal district court. The Bureau may obtain "any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law, including, but not limited to: rescission; restitution; disgorgement of unjust enrichment; damages; and civil money penalties." CFPB has no criminal enforcement authority. When the CFPB obtains evidence that a regulated entity or a customer has engaged in conduct that may constitute a violation of Federal criminal law, the CFPB is required to refer such findings to the Department of Justice for further review and action.

Part II – Pre-Examination Planning

Pre-examination planning consists of gathering available information and documents and preparing an Examination Information Request (the "Request"). The Request is a tailored list of information and documents that the Supervised Entity is asked to forward to the CFPB for offsite review or to make available when the examiners arrive onsite. The pre-examination planning process will vary depending on the size, complexity, business strategy, products, systems and risk profile of a particular Supervised Entity.

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Every examination will include a review of compliance management; any potential unfair, deceptive or abusive practice; and regulatory matters presenting risk to consumers. Every examination also must include a review for discrimination.

Once the examination is complete, the CFPB will discuss the preliminary findings with the Supervised Entity's management team. These findings are not final until an internal CFPB review is conducted, and, in the case of an insured depository or its affiliate, the prudential regulator has had the opportunity to review and comment on the draft report.

The CFPB has adopted the FFIEC Uniform Consumer Compliance Rating System (the "System"). The System is based on a scale of "1" to "5," in increasing order of supervisory concern. Different types of entities will not be subject to specific criteria relating to their particular industry.

Part III – Compliance Management Review

Every Supervised Entity must have an effective compliance management system adapted to its business strategy and operations. Additionally, the CFPB's examination will include review and testing of components of the Supervised Entity's compliance management system. The CFPB anticipates that a large banking organization will manage compliance much differently than an entity that is a sole-proprietorship.

A compliance management system should contain four interdependent control components: (i) board and management oversight; (ii) compliance program; (iii) response to consumer complaints and (iv) compliance audit. This compliance management system is how a Supervised Entity: (i) establishes its compliance responsibilities; (ii) communicates those responsibilities to employees; (iii) ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes; (iv) reviews operations to ensure responsibilities are carried out and legal requirements are met and (v) takes corrective action and updates tools, systems and materials as necessary.

A Supervised Entity should establish a formal, written compliance program and that program should be administered by a chief compliance officer. In the event that the Supervised Entity receives a compliant, it must be responsive and responsible in handling the complaint.

Part IV – Mortgage Servicing Examination Procedures

Servicers are required to comply with eight specific federal consumer finance laws: (i) RESPA, (ii) TILA, (iii) EFTA, (iv) FDCPA, (v) Homeowners Protection Act, (vi) FCRA, (vii) GLBA and (viii) ECOA. The examination procedures will include an assessment of the servicer's compliance with

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these laws. The examination also will consider risks that may include potentially unfair, deceptive or abusive acts or practices ("UDAAP") with respect to servicers' interactions with consumers. The standards that the CFPB will utilize in assessing the existence of a UDAAP are:

- **Deceptive.** A representation, omission, act or practice is deceptive when: (i) the representation, omission, act or practice misleads or is likely to mislead the consumer; (ii) the consumer's interpretation of the representation, omission, act or practice is reasonable under the circumstances and (iii) the misleading representation, omission, act or practice is material.
- **Unfair.** An act or practice is unfair when: (i) it causes or is likely to cause substantial injury to consumers; (ii) the injury is not reasonably avoidable by consumers and (iii) the injury is not outweighed by countervailing benefits to consumers or to competition.
- **Abusive.** An act or practice is abusive if it: (i) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or (ii) takes unreasonable advantage of: (a) a lack of understanding on the part of the consumer of the material risks, costs or conditions of the product or service or (b) the reasonable reliance by the consumer on a covered person to act in the interest of the consumer.

The mortgage servicing examination procedures are divided into nine "modules."

- **Module One: Servicing Transfers**. Examiners need to examine several areas for compliance relating to servicing transfers, loan ownership transfers and escrow disclosures. This includes a specific review to ensure that the notice of transfer of ownership required under TILA has been provided.
- **Module Two: Payment Processing and Account Maintenance.** This examination will include a review of, among other things, the timely posting of payments and use of suspense accounts. Another area of review will include fees — from property inspection fees and attorneys' fees to other routinized charges. Payoff statements and cancelation of private mortgage insurance will also be a focus.
- **Module Three: Customer Inquiries and Complaints.** Examiners are advised to review consumer complaints and call specific complaining consumers to interview them regarding their experiences. Examiners should determine whether the complaints were resolved adequately and in a timely manner.
- **Module Four: Maintenance of Escrow Accounts and Insurance Products.** Examiners need to assess compliance with RESPA's escrow disclosures and disbursements as well as any other risks

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to consumers, which may include penalties or unnecessary charges.

- **Module Five**: **Credit Reporting.** Examiners should compare the information contained in the servicer's system of records with the information reported to credit reporting agencies.
- **Module Six**: **Information Sharing and Privacy.** Examiners will assess compliance with GLBA's privacy requirements as well as FCRA's affiliate marketing rule.
- **Module Seven**: **Collections.** Examiners are advised to listen to a sample of the Supervised Entity's collection calls, including for those customers who have filed for bankruptcy. Note that the CFPB acknowledged that an exemption from the definition of "debt collector" exists for an entity that collects debts that were not in default when they were obtained by the servicer, and that this exemption is often used in the mortgage industry.
- **Module Eight**: **Loss Mitigation.** Examiners will obtain a sample of servicing records of customers who are delinquent or at imminent risk of default to assess loss mitigation activity. If consumer complaints or document review indicates potential concerns in these areas, examinations may also conduct interviews of consumers from the sample who sought loss mitigation in the prior year.
- **Module Nine**: **Foreclosures.** Examiners will be reviewing foreclosures for compliance with ECOA to ensure that no discrimination has occurred. Another issue that the examiners will focus on will be dual tracking (pursuing foreclosure and a foreclosure alternative at the same time). The CFPB's contemplation of ECOA violations as part of the foreclosure review is especially concerning.

Part V – Template

The Template provides industry with a roadmap of the risk assessment, supervision plan, examination scope summary and examination report. The template includes samples of: (i) the entity profile, (ii) the risk assessment, (iii) the supervision plan, (iv) the examination scope summary, (v) the examination report, (vi) the examination report cover and (vii) the examination report cover letter.

II. Know Before You Owe

In October, the CFPB proposed its fourth phase of the Know Before You Owe initiative relating to mortgage loans and began the Know Before You Owe initiative relating to student loans.

Mortgage Loans – Take Four (or Five…)

By way of background, the first three phases of the Know Before You

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Owe initiative for mortgage loans asked consumers and industry to comment on various aspects of a combined Good Faith Estimate ("GFE")/Early TIL disclosure. Phase One pitted the "Ficus" form versus the "Pecan." In this matchup, the CFPB asked for comment on the presentation of information on page one of the combined disclosures. Page two of the disclosure was the same for both models.

Phase Two pitted two credit unions against each other, this time, however, the CFPB requested comments on different versions of page two of the disclosure (page one was the same for both and included elements from Phase One's analysis).

Phase Three used a two-page model disclosure, but compared two different ARM loans — a 7/1 ARM and a 3/3 ARM. Shortly after Phase Three was announced, the CFPB proposed a model page three to the disclosure. However, since the CFPB did not provide for comparative versions of this page, the industry and public were not asked to comment as they were in the other phases.

This brings us to the present request for comment. In the Pinyon versus Yucca matchup, the CFPB is asking for comments with respect to the disclosure of a fixed-rate loan ("Pinyon") and a variable-rate (3/3) loan ("Yucca"). Comment is requested on a three-page form that is similar for both products; however, the ARM loan contains additional information relating to the variable-rate nature of the loan. Notable elements of the form include:

- **APR Disclosure**. The form does not inform the consumer of the APR on the loan until the third page. This is a significant departure from existing law which requires that the disclosure of the APR be more conspicuous than the disclosure of other required terms.
- **Cost of Funds**. The lender's cost of funds must be disclosed. Because this effort is not an official rulemaking, the CFPB has provided no guidance with respect to how a creditor will be required to obtain this data and disclose it. And, although this disclosure is mandated per Dodd-Frank, it wasn't until this fourth round of review that the CFPB included this disclosure for testing.
- **Payment and Interest Table**. The form departs from the MDIA-mandated "five column" table (*i.e.*, introductory rate, maximum five year, maximum ever, first adjustment, *etc.*) in favor of a more flexible approach that requires a disclosure of the payment and interest rate at the time that the loan terms mandate a change. Thus, if the loan is a three-year ARM, the first column will disclose the payments for years one through three, then the next column will disclose payments in years four and on. This flexibility is a welcome departure from the difficulty that many

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lenders faced with properly calculating the changes applicable in the first five years of the loan under MDIA.

- **Model Forms**. Note that these forms are "model" forms. Arguably the CFPB does not have the legal authority to mandate that lenders use a specific form (like HUD did for the GFE) (see Section 1032 of the Dodd Frank Act). Accordingly, use of any integrated disclosure form that the CFPB adopts will constitute a safe harbor in litigation, but remains optional at the discretion of the lender.

III. Student Loans

In Minneapolis, Minnesota, on October 26, 2011, Raj Date announced the CFPB's efforts relating to the student loan market. Invoking Robert Kennedy, Date noted that education is the "key to jobs — to income — to human dignity itself." In keeping with that thought, the CFPB, in conjunction with the Department of Education, are working on ways to improve the student loan market.

Date identified three concerns with the student loan marketplace:

- **Financial Aid Award Letters.** Schools offering financial aid do so via letters that are unique to that institution. This lack of standardization, however, makes it nearly impossible for a student to undertake an effective side-by-side comparison of the different offers. Additionally, there are no required disclosures for these letters. Thus, a school can describe an aid award in a manner that does not suggest that the student is getting a loan rather than an award. The result is that a student focuses on initial up-front costs and may not be able to calculate the long-term cost of the credit.
- **No Options Presented.** Schools are not required to disclose, and often do not volunteer information regarding the sources for student loan credit. Approximately 54 percent of students who take out private loans have not exhausted their federal loan options, and may not even be aware of loans available from the state or a non-profit organization.
- **Ability to Repay.** Students cannot easily determine how much debt is too much debt. Financial aid award letters do not inform the student what the total debt amount or anticipated monthly payment amount will be upon graduation. Students often just take a leap of faith that they will be able to afford the payment at some point in the future.

Keeping these concerns in mind, the CFPB has released for comment a draft one-page "financial aid shopping sheet." This shopping sheet is a model disclosure that colleges and universities can utilize to clarify the costs and risks of student loans upfront before students are enrolled.

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The form will facilitate side-by-side comparisons and will clearly distinguish between loans and scholarships.

The CFPB describes the form as a "thought starter" and welcomes input on the form from industry stakeholders as well as consumers.

IV. Office of Older Americans

On October 19, 2011, Skip Humphrey announced his new position as the head of the Office of Older Americans ("Office").

According to the Dodd-Frank Act, Congress directed the Office to improve the financial decision-making of seniors and to prevent unfair, deceptive and abusive practices targeted at them. Accordingly, the Office will:

- Give seniors the tools they need to make educated financial choices;
- Coordinate efforts to help seniors across a wide spectrum of interest groups;
- Gather research and information about trends and bad practices to help policymakers and the financial services industry address seniors' needs; and
- Protect against false and deceptive designations of financial counselors to make sure seniors have access to qualified financial advice.

The Office will consider the financial marketplace from the perspective of how well it is serving Americans who are over the age of 61; and will assist seniors in planning for retirement and long-term care. The Office can be contacted via: consumerfinance.gov/older-americans .

V. Outstanding Federal Register Publications

Topic	Comment Deadline	Status	Section Summary
Products and Services Offered to Servicemembers	September 20, 2011	Request for Comment; Notice	N/A
Alternative Mortgage Transaction Parity Act	September 22, 2011	Interim Final Rule with Request for Comment	July 22, 2011; Compliance with Section 1004.4 is optional until July 22, 2012 for federal housing creditors and state housing creditors not relying on preemption. On July 22, 2012, compliance is mandatory for all except as provided in Section 1004.4(d).
Clearance for Research and Development of Disclosure Forms	October 26, 2011	Generic Clearance Request	N/A

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Topic	Comment Deadline	Status	Section Summary
Proposed Collection; Comment Request (Consumer Complaints)	October 31, 2011	Notice and Request for Comment	N/A

i These laws are: (i) Alternative Mortgage Transaction Parity Act of 1982; (ii) Consumer Leasing Act of 1976; (iii) Electronic Fund Transfer Act (except for Section 920); (iv) Equal Credit Opportunity Act; (v) Fair Credit Billing Act; (vi) Fair Credit Reporting Act (except for Sections 615(e) and 628); (vii) Home Owners Protection Act of 1998; (viii) Fair Debt Collection Practices Act; (ix) Subsections (b) through (f) of Section 43 of the Federal Deposit Insurance Act; (x) Sections 502 through 509 of the Gramm-Leach-Bliley Act (except Section 505 as it applies to Section 501(b)); (xi) Home Mortgage Disclosure Act; (xii) Home Ownership and Equity Protection Act; (xiii) Real Estate Settlement Procedures Act; (xiv) S.A.F.E. Mortgage Licensing Act; (xv) Truth in Lending Act; (xvi) Truth in Savings Act; (xvii) Section 626 of Omnibus Appropriations Act of 2009; and (xviii) Interstate Land Sales Full Disclosure Act.

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