The Consumer Financial Protection Bureau: A New Regulatory Dynamic

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In recent years, certain politicians and media personalities have made reference to the Consumer Financial Protection Bureau (CFPB). As a federal agency, the CFPB is rather young. The legislation creating the bureau was not signed into law until July 2010.

The CFPB, however, exercises considerable authority in regulating businesses that deliver financial products and services to consumers. Objectives include:

- Writing rules, supervising companies and enforcing consumer financial protection laws.
- Promoting financial education.
- Restricting unfair, deceptive or abusive acts or practices.
- Monitoring financial markets for new risks to consumers.
- Enforcing laws that outlaw discrimination and unfair treatment in consumer finance.

The oversight extends to non-bank companies, as well as to financial institutions primarily regulated by longstanding mandates and other federal agencies. The bureau's mission also emphasizes educating consumers and presenting relevant information in a comprehensible manner. Appreciating the scope and focus of the CFPB begins with understanding the events that led to passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act)*.

The Financial Crisis and Passage of the Dodd-Frank Act

From 2007 through 2009, global economies experienced a significant financial crisis. For the United States, this crisis became known as the "Great Recession" and was the most serious economic downturn facing the nation since the Great Depression. This crisis marked a breaking point for the national economy, in which a variety of practices developed that significantly reduced home and investment values, leaving many consumers with insurmountable debt.

In the years leading up to the financial crisis, risky practices developed in the home mortgage industry. Many of these practices displayed a lack of adequate due diligence by lenders and were difficult to understand by homebuyers. Examples of these practices included:

- "No doc" loans became common, which allowed individuals to obtain mortgages with little to no documentation or verification of income, assets or employment. Use of interest-only option adjustable rate mortgages (ARMs) and features such as negative amortization were trending upward and often led to individuals owing more than the value of their homes. A mortgage with negative amortization may work against the borrower, as it gives the borrower the option of paying less interest than the interest amount due. The remaining unpaid interest is added back to the principal and essentially increases the borrower's principal balance instead of lowering it.

- Pre-payment penalties became common in the mortgage industry, making it unattractive for consumers to pay off mortgages before scheduled amortization dates.
- "Robo-signing," or the automatic signing of mortgage documents without review, became common.

Such practices in the mortgage industry presented considerable risk to consumers, as well as to investors backing those mortgages. Consumer complaints of unfair foreclosures were common.

As the financial crisis continued to unfold, a significant number of American consumers were affected. Some mortgagees faced foreclosure. Others faced mortgage terms that placed considerable strain on family finances. Unemployment increased, resulting in losses of income. Those consumers who had not obtained a risky mortgage, had maintained good credit and retained employment, often faced sharp declines in home values that limited their options for selling a house and relocating or leveraging home equity.

In 2010 after the crisis had largely passed, the U.S. Financial Crisis Inquiry Commission concluded that "the crisis was avoidable and was caused by: (a) widespread failures in financial regulation, including the Federal Reserve's failure to stem the tide of toxic mortgages; (b) dramatic breakdowns in corporate governance, including too many financial firms acting recklessly and taking on too much risk; (c) an explosive mix of excessive borrowing and risk by households and Wall Street that put the financial system on a collision course with crisis; (d) key policy-makers ill prepared for the crisis, lacking a full understanding of the financial system they oversaw; and (e) systemic breaches in accountability and ethics at all levels." In other words, the commission concluded that the financial crisis was the result of systemic failures.

In the aftermath of this crisis, Congress sought to prevent history from repeating itself by passing the Dodd-Frank Act, which established the CFPB to serve as a source of regulatory enforcement and advocacy for consumer financial concerns.

A New Type of Agency

The CFPB serves as a single advocacy resource for consumer financial concerns and is not bound to a particular product or financial area. In addition to consolidating consumer protection responsibilities from other regulatory agencies, the bureau distinguishes itself from other federal agencies through its communication to consumers. Unlike other regulatory agencies, the bureau delivers messages and guidance written in a more "consumer friendly" manner that is easier for consumers to read and understand.

The CFPB takes steps to be more accessible to consumers and interactive in their efforts to be a strong consumer resource. For example, the bureau's "Ask CFPB" service allows consumers to find answers online to commonly-asked questions for topics such as reverse mortgages, credit reports and scores, and student loans, while the "Tell Your Story" service enables consumers to share personal finance experiences with online readers.

"Action Letters," one of the CFPB's first consumer education efforts, serves as a tool to help consumers respond to debt collectors. While this service initially received considerable criticism from the debt collection industry for being too broad in scope, this and the other communication efforts illustrate the importance the bureau places on both protecting and educating consumers.

CFPB Authority

Effective July 21, 2011, all financial institutions with more than $10 billion in assets face CFPB supervision. Accordingly, this authority covers banks with a regional or national footprint.

Oversight also extends to nonbanks posing risk to consumers. A June 26, 2013, CFPB newsroom announcement defined such entities as: "companies that offer to provide consumer financial products or services, but do not have a bank, thrift or credit union charter. The bureau must base such reasonable cause determinations on complaints collected by the bureau, or on information from other sources, such as judicial opinions and administrative decisions." Therefore, businesses providing financial products or services to consumers must now evaluate how CFPB oversight might apply to them and the risks they face of noncompliance.

As an example, payday lenders and other businesses that emerged in previous decades to provide short-term loans to individuals are subject to CFPB authority. While such businesses provide loans to individuals who may not be able to borrow from traditional banking institutions, the interest rates and payment terms may make it onerous or impossible for consumers to pay off such debts. Businesses providing such financial products now face CFPB oversight, as do other nonbank entities, regardless of size, including mortgage companies (originators, brokers and servicers providing loan modification or foreclosure relief services) and private education lenders.

Initiatives and Regulatory Implementation

Since its inception, the CFPB has enacted significant consumer protection measures, which include the following.

Effective Oct. 3, 2015, the Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA) mortgage disclosures will be combined in what the CFPB described in May 2011 as its "Know Before You Owe" project. This combined act will affect how home purchase transactions and home mortgages are offered by requiring new loan estimate and closing disclosures.

Effective Oct. 28, 2013, Regulation E (subpart B): Remittance Rule for International Money Transfers was amended. International money transfers can be used by individuals living in the United States to send funds to family members in another country and are also used for exchanging funds with citizens stationed at U.S. military bases abroad.

When international money transfers occur, the currency exchange rates at the time determine the monetary sum the recipient receives. Prior to the amendment of Regulation E, financial services organizations were not required to provide related disclosures and many consumers were unaware that currency exchange rates affected the total amount of funds forwarded to the recipient. The amended Regulation E requires three new disclosures clarifying international money transfer details.

As a result of these changes, many community banks determined that the time and costs required to comply with the new requirements

exceeded the benefits and they simply stopped offering international money transfer services. Larger financial institutions and nonbank entities offering this service must continue to meet these new requirements.

On Oct. 24, 2012, Debt Collection Examination Procedures were released. The Dodd-Frank Act gave the CFPB supervisory authority over businesses engaged in debt collection, including nonbank entities. The examination procedures provide a framework for assessing the quality of an entity's compliance management systems and for identifying acts or practices that materially increase the risk of violating federal consumer financial laws.

IN ADVISING CLIENTS ON RISK MANAGEMENT, CONSIDER REGULATORY RISK ALONGSIDE LEGAL, REPUTATIONAL, FINANCIAL AND OPERATIONAL RISKS.

Prior to the financial crisis, large debt collection agencies faced varying degrees of oversight from the Federal Trade Commission (FTC) and the Better Business Bureau (BBB). With its consumer advocacy mission, the CFPB brought an enhanced level of scrutiny to large debt collection agencies (which would be the first to be examined). As a result, many debt collection firms are now conducting audits pertaining to debt collection risk assessments, compliance management systems and debt collection exam procedures.

Effective Oct. 13, 2011, Mortgage Servicing Examination Procedures were established. Mortgage servicing practices were viewed by many as a significant contributing factor in the financial crisis, and the CFPB sought to address situations in which consumers felt their concerns were not handled properly or where they had been foreclosed upon unfairly.

The procedures apply to businesses involved in routine servicing, default servicing and foreclosure, as well as banks. On Dec. 21, 2011, significant changes applicable to three different regulations were made, including Regulation B, Equal Credit Opportunity, RESPA and TILA. These changes address appraisal copies and accompanying notices, RESPA servicing and TILA servicing. In addition, new underwriting standards were developed for mortgages, including Ability to Repay (ATR) considerations.

The changes established what is known as a Qualified Mortgage (QM). Among other provisions, QM requirements bar what are deemed to be harmful loan features, such as interest-only periods, negative amortizations and balloon payments. Loan terms also cannot exceed 30 years for such mortgages. QM rules took effect on Jan. 10, 2014, and have had a significant impact on the mortgage industry, which has had to make numerous changes incorporating new documents and timing requirements.

Finally, the CFPB has taken an active enforcement role in consumer protection, which is a role that could subject businesses to substantial financial penalties for noncompliance.

Actions Taken Against Financial Organizations

Since its inception, the CFPB has collected millions of dollars from various businesses for regulatory violations. In some instances, collected funds were released to consumers, while in other instances the funds collected were regarded as fines. Examples of actions include the following:

- In December 2014, an organization and debt collector were ordered to pay $2.5 million in relief for illegal lawsuits and unauthorized debits to military service members.
- In February 2015, the CFPB secured $480 million in debt relief for current and former students who had obtained private student loans to enroll at campuses of a for-profit college company. The new owner of the college campuses is prohibited from private student loan lending for more than seven years and has agreed to a series of new consumer protection measures.
- In February 2015, a subprime credit card company was ordered to refund $2.7 million to approximately 98,000 consumers affected by illegal credit card fees.
- In March 2015, the CFPB issued an enforcement action against a nationwide debt collection agency for presenting "deceptive threats of criminal prosecution and jail time" to consumers.
- In March 2015, a lender was sued by the CFPB for presenting false reverse mortgage advertising. The CFPB charged the lender engaged in deceptive advertising by claiming U.S. Government affiliation with its reverse mortgage product.

The strong enforcement actions illustrate the critical need for awareness among businesses that may be affected by the bureau's regulations.

Impact of CFPB on the Broader Business Community

While the oversight encompasses large financial institutions, its greatest impact may be on nonbanking businesses that previously did not face the levels of regulation faced by traditional financial institutions. As stated above, such nonbank businesses include collection agencies, mortgage lenders, payday loan businesses and other providers of short-term loans, as well as payment processors.

The CFPB is establishing itself as a vigilant advocate for consumer concerns, and its impact may indirectly go beyond the financial services sector. Accordingly, CPAs and other advisors close to the financial services sector should consider the following issues.

The CFPB is placing a greater burden of proof on businesses rather than consumers when consumer complaints arise. Such trends are being noticed by banks and other businesses not formally regulated

by the CFPB. In response, more detailed documentation is being compiled for consumer transactions. Businesses should evaluate whether their documentation and retention practices sufficiently protect the business if consumer complaints are made.

Despite political rhetoric decrying increasing degrees of regulation, the CFPB's activity is indicative of regulatory momentum after many years of deregulatory trends. All businesses need to recognize that federal and state regulatory agencies have an increasingly important role in commerce and market oversight. At a minimum, this should cause businesses to evaluate their own governance structures, risk management processes and documentation standards.

In advising clients on risk management, consider regulatory risk alongside legal, reputational, financial and operational risks. For banks, recognize that the rules will impact bank activities. For nonbank companies, determine if the CFPB has oversight authority and identify those activities falling under its purview. For non-financial companies, consider the current regulatory environment and determine if any of the business's activities are subject to regulation by federal or state agencies.

Recognize that the cost of complying with expanded regulation is high. For nonbank lenders and financial services companies, the addition of staff and enhancement of processes necessary to comply with new regulation has significantly increased expenses. Banks involved in consumer finance activities (even if not regulated by the CFPB) have also experienced an increase in regulatory costs, due to enhanced monitoring procedures as other agencies (such as the FDIC, Federal Reserve Bank and OCC) are conducting their own reviews with a more "consumer friendly" perspective. Businesses outside of the financial sector may be dealing with other aspects of regulatory expansion, and these organizations will also face increasing costs to comply.

The creation and activities of the CFPB have had, and will continue to have, significant impacts on the financial services sector and consumers, and the general business community will potentially be impacted as well. As businesses look for advisory services, it's important for CPAs to have a basic understanding of how the regulatory environment is changing and how their clients may be impacted. ■

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