

Supervisory Highlights

Summer 2013

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1. Introduction

In the two years since the Bureau began to exercise its supervisory authority, the CFPB has continued to develop, expand, and improve its supervision program as it gained valuable experience through its reviews of both bank and nonbank compliance with Federal consumer financial laws.¹ Since the last issue of *Supervisory Highlights*,² CFPB supervisory actions have required changes to compliance management systems to prevent violations and reduce risks to consumers. CFPB's supervisory activities led to a public enforcement action, resulting in approximately \$6.5 million in remediation to over 50,000 consumers. In addition, as a result of the CFPB's examination activities, a number of supervised entities self-identified violations and made restitution to approximately 10,000 additional consumers.

In this and future issues of *Supervisory Highlights*, the CFPB will review the development of the Bureau's supervision program and share certain key findings from our supervisory activities in order to help industry limit risks to consumers and comply with Federal consumer financial laws. In Supervisory Observations, we highlight findings in the areas of compliance management systems, mortgage servicing, and fair lending. Under Supervision Program Developments, this issue addresses the CFPB's supervisory priorities, the reorganization of supervision functions in Washington, D.C., and examiner staffing and training.

The CFPB supervises depository institutions (banks, thrifts, and credit unions) with total assets of more than \$10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Act to supervise nonbanks, regardless of size, in certain specific markets: mortgage

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act Section 1002.

² The first issue was released on October 31, 2012, and can be found at:
<http://www.consumerfinance.gov/reports/supervisory-highlights-fall-2012>.

companies (originators, brokers, servicers, and providers of loan modification or foreclosure relief services); payday lenders; and private education lenders.

The CFPB can also supervise the “larger participants” in other nonbank markets as the Bureau defines by rule. The Bureau has issued two rules defining larger participants: one rule for the consumer reporting market that went into effect in September 2012, and the other for the debt collection market that went into effect in January 2013. A proposed larger participant rule for the student loan servicing market was issued in March 2013.

This report highlights supervision work completed between November 2012 and June 2013. Any questions or comments can be directed to CFPB_Supervision@cfpb.gov.

2. Supervisory Observations

2.1 Compliance Management Systems

As noted in the first issue of *Supervisory Highlights*, compliance management is vital to the prevention of violations of Federal consumer financial laws and the resulting harm to consumers. Because of the importance of a robust compliance management system (CMS), this issue of *Supervisory Highlights* addresses CFPB expectations for an effective CMS. The CFPB expects every entity it supervises to have an effective CMS adapted to its business strategy and operations. A CMS is how a supervised entity:

- Establishes its compliance responsibilities;
- Communicates those responsibilities to employees;
- Ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes;
- Reviews operations to ensure responsibilities are carried out and legal requirements are met;
- Takes corrective action, and
- Updates tools, systems, and materials, as necessary.

The CFPB does not require entities to structure their CMS in any particular manner. Large banking organizations with complex compliance profiles and a wide range of consumer financial products and services will likely manage compliance differently than entities that may be owned by a single individual or feature a narrow range of financial products and services. Other entities may outsource functions with consumer compliance-related responsibilities to service providers.

The CFPB also understands that supervised entities will organize their compliance management programs to include compliance not only with consumer-related laws that are within the scope of CFPB's supervision responsibilities, but also those under the jurisdictions of state or other

Federal agencies. However compliance is managed, entities are expected to structure their CMS in a manner sufficient to comply with Federal consumer financial laws and appropriately address associated risks of harm to consumers.

Though the CFPB performs on-site examinations, it expects compliance management systems to be in place in the normal course of business, not just in preparation for an examination. The CFPB is committed to an open dialogue with its supervised entities about their compliance management systems, and has provided CMS-specific procedures within the *Supervision and Examination Manual*,³ which can be used by an entity to self-assess the effectiveness of its CMS.

2.1.1 CMS Findings

Nearly every examination or targeted review conducted by the CFPB contains an assessment of an entity's CMS, whether it is an assessment of how the entity manages its compliance program enterprise-wide, or how the entity meets its consumer compliance responsibilities within a specific product line.

The CFPB has found, through supervisory work, that nonbanks are more likely to lack a robust CMS, as their consumer compliance-related activities have not been subject to examinations at the federal level for compliance with Federal consumer financial laws prior to the Bureau's existence. The CFPB has identified one or more instances of nonbanks that lack formal policies and procedures, have not developed a consumer compliance program, or do not conduct independent consumer compliance audits. Lack of an effective CMS has, in a number of instances, resulted in violations of Federal consumer financial laws. In these instances, the CFPB expects the institution to implement appropriate corrective action, and in general, both banks and nonbanks have committed to improving their CMS accordingly.

CMS deficiencies noted in nonbanks are generally related to the supervised entity's lacking a CMS structure altogether. CFPB examinations have noted instances where nonbanks do not have a separate compliance function; rather, compliance is embedded in the business line. Policies and procedures and employee training developed within the business line can lead to various problems. For example, employees have not been trained in the legal requirements

³ The Manual can be found at: <http://www.consumerfinance.gov/guidance/supervision/manual/>.

applicable to their jobs, resulting in situations where similar consumer contacts are inconsistently handled within the same entity.

The CFPB has seen consumer complaint response handled in a similar manner, with the business line that received the complaint addressing the issue without any type of centralized method for tracking issues across the entity. Internal quality assurance and monitoring reviews handled only within the individual business line increases the risk that issues identified and addressed within one business line may not be identified or addressed in a similar manner within another. In addition, entities that maintained these decentralized monitoring practices did not conduct any type of roll-up reviews or trend analysis of findings across the entity as a whole, which hindered the entity's ability to identify systemic issues or to determine the root cause of regulatory violations or internal control weaknesses. In this regard, the CFPB has noted violations of Federal consumer financial law that have occurred because a nonbank has failed to address an issue across the entity as a whole.

The majority of banks examined by the CFPB have generally had an adequate CMS structure; however, several institutions lacked one or more of the components of an effective CMS, which creates an increased risk of noncompliance with Federal consumer financial laws.

The most common weakness identified during CFPB CMS reviews in banks is a deficient system of periodic monitoring and independent compliance audits, which will be discussed in further detail below. The CFPB has noted that an effective CMS implements both a system of periodic monitoring reviews and an independent compliance audit. The periodic monitoring reviews are conducted by either the individual business lines or the compliance department on a relatively frequent basis, generally monthly or quarterly, and allow the individual business lines or the compliance department to self-check their processes and ensure day-to-day compliance with Federal consumer financial laws. The independent compliance audit then conducts similar assessments on a less frequent basis, usually annually, to ensure that compliance with Federal consumer financial law is ongoing, that the CMS as a whole is operating properly, and that the board is aware of consumer compliance issues noted as part of these independent reviews.

An entity that lacks periodic monitoring and instead relies on the independent compliance audit to identify regulatory violations and CMS deficiencies increases its risk that violations and weaknesses will go undetected for long periods of time, potentially leading to multiple regulatory violations and increased consumer harm. Additionally, these entities increase the risk that insufficiencies in the periodic monitoring process may not be identified; that the board is not made aware of regulatory violations or program weaknesses; or that practices or conduct by

employees within the business lines or compliance department that are unfair, deceptive, abusive, discriminatory, or otherwise unlawful could go undetected.

2.1.2 CMS Elements

Although the CFPB does not require any specific CMS structure, supervisory experience has found that an effective CMS commonly has four interdependent control components:

1. Board of directors and management oversight;
2. A compliance program;
3. A consumer complaint management program; and
4. An independent compliance audit.

When all of these four control components are strong and well-coordinated, a supervised entity should be successful at managing its compliance responsibilities and risks. A discussion of each of these components follows.

BOARD OF DIRECTORS AND MANAGEMENT OVERSIGHT

All financial service providers have either a board of directors or one or more controlling persons that oversee the operations of the provider. In a bank, the board of directors is ultimately responsible for developing and administering the CMS. In a nonbank offering consumer financial services, the ultimate responsibility may rest with a board of directors in the case of a corporate entity or with a controlling person, senior management, or some other body.

An effective board of directors communicates clear expectations and adopts clear policy statements about consumer compliance, not only within the entity itself, but also to its service providers.⁴ The board should establish a compliance function within the entity, allocating sufficient resources to that function, commensurate with the entity's size, organizational complexity, and risk profile. The board should ensure that the compliance function is appropriately staffed with a qualified chief compliance officer, and other additional compliance managers who have the authority and accountability necessary to implement the compliance

⁴ See CFPB Bulletin 2012-03 (April 12, 2012) for the CFPB's expectations on service provider relationships (http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf).

management program, with clear and visible support from senior management, as well. Management should ensure a strong compliance function and provide recurring reports of compliance risks, issues, and resolutions to the board or to a committee of the board.

In a financial services provider that does not have a board of directors, the controlling person or senior management should undertake similar measures to ensure an effective compliance program.

COMPLIANCE PROGRAM

The CFPB expects supervised entities to establish a formal, written compliance program, generally administered by a chief compliance officer. A compliance program includes the following elements:

- Policies and procedures;
- Training;
- Monitoring; and
- Corrective action.

A well-planned, implemented, and maintained compliance program will prevent or reduce regulatory violations, protect consumers from noncompliance and associated harms, decrease the costs and risks of litigation affecting revenues and operational focus, and help align business strategies with outcomes. A discussion of these four elements follows.

Policies and Procedures

Management should develop, and the board should approve, a system of policies and procedures that address every consumer financial product or service offered by the entity. Policies and procedures should be formal, written documents that detail consumer compliance responsibilities and instruct employees on the appropriate methods for executing these responsibilities. Policies and procedures are expected to address compliance with all applicable Federal consumer financial laws in a manner designed to prevent violations and to detect and prevent associated risk of harm to consumers. Management and the board are expected to ensure that the policies and procedures are maintained and modified regularly to remain current and to serve as a reference for employees in their day-to-day activities.

Training

A critical element of a compliance program is providing employees with regular training on their consumer compliance responsibilities. The consumer compliance training program should be current, complete, effective, and commensurate with the entity's size and risk profile. It should include training on not only the regulatory requirements imposed by Federal consumer financial laws, but also those imposed by the entity's own consumer compliance-related policies and procedures. Management and staff should receive regularly-scheduled training that reinforces and helps implement written policies and procedures.

In addition to training employees, a compliance program should ensure that board members receive sufficient information, including training, to enable them to understand the entity's consumer compliance responsibilities and the commensurate resource requirements.

Monitoring

Management and the board should develop a system of risk-based periodic monitoring reviews in order to ensure that transactions and other consumer contacts are handled in accordance with Federal consumer financial laws and with the entity's own policies and procedures. These periodic, risk-based reviews allow the individual business lines to identify procedural or training deficiencies within their operations in an effort to promptly identify and correct weaknesses.

Corrective Action

If monitoring reviews identify areas of weakness within a business line's operations, management should implement corrective actions to address the issues. Further, management should follow up on these corrective actions to ensure that the violation of law or program deficiencies have been resolved. Findings should be escalated to management and the board, where appropriate.

CONSUMER COMPLAINT MANAGEMENT PROGRAM

Financial service providers should be responsive to complaints and inquiries received from consumers. In addition, entities should monitor and analyze complaints to understand and correct weaknesses in their programs that could lead to consumer risks and violations of law.

Key elements of a consumer complaint management program include:

- The establishment of channels through which the entity can receive consumer complaints and inquiries. Such channels may include telephone numbers or email addresses dedicated to receiving consumer complaints or inquiries.
- The proper and timely resolution of all complaints;
- The recordation, categorization, and analysis of complaints and inquiries; and
- Reviews for possible violations of Federal consumer financial laws.

Entities should organize, retain, and analyze complaint data to identify trends, isolate areas of risk, and identify program weaknesses in their lines of business and overall CMS.

INDEPENDENT COMPLIANCE AUDIT

A compliance audit program provides a board of directors or its designated committees with a determination of whether policies and standards are being implemented to provide for the level of compliance and consumer protection established by the board. These audits should be conducted by a body independent of both the compliance program and the business functions. Audits should cover consumer sales as well as customer services. The audit results should be reported directly to the board or a board committee.

The audit schedule and scope is expected to be appropriate for the entity's size, its consumer financial product offerings, and structure for offering these products. The compliance audit program should address compliance with all applicable Federal consumer financial laws, and also identify any significant gaps in policies and standards.

2.2 Mortgage Servicing

Since the CFPB launched its supervision program, it has focused on the risks to consumers in mortgage servicing at both bank and nonbank entities. During the past two years, the CFPB has reviewed servicing practices, including:

- Servicing transfers;
- Payment processing; and
- Loss mitigation.

2.2.1 Servicing Transfers

During its reviews of mortgage servicing, the CFPB detected risks to consumers in transfers of the servicing of loans among institutions. For example, examiners found noncompliance with the requirements of the Real Estate Settlement Procedures Act (RESPA)⁵ to provide disclosures to consumers about transfers of the servicing of their loans. In other reviews, examiners noted lack of controls relating to the review and handling of key documents – such as loan modification applications, trial modification agreements, and other loss mitigation agreements – necessary to ensure the proper transfer of servicing responsibilities for a loan. For example, examiners noted that one servicer conducted some due diligence on transferred servicing data but did not review any individual documents that the prior servicer had transferred, such as trial loan modification agreements.

As another example, at one servicer, examiners determined that documentation the servicer received in the transfer was not organized or labeled, and as a result, the servicer did not utilize existing applicable information, in particular, documents delinquent borrowers submitted to the prior servicer in connection with applications for loss mitigation. Because these practices created a risk of engaging in unfair practices, the CFPB expects the servicer to take corrective action, including linking imaged documents received in the transfer to the loan account in the servicer’s systems. The CFPB also expects the servicer to ensure that it reviews documents to determine if they may be used in loss mitigation efforts, and that the documents are stored and organized appropriately.

2.2.2 Payment Processing

Servicers are responsible for processing loan payments and handling tax and insurance payments through escrow accounts. In its reviews, CFPB noted several issues related to these responsibilities.

In one instance, a servicer provided inadequate notice to borrowers of a change in the address to which they should send payments. This constituted a potentially unfair practice impacting thousands of borrowers. Examiners alerted the entity to this concern during the course of the

⁵ RESPA, 12 USC 2601 *et seq.*, is implemented through Regulation X, 12 CFR Part 1024.

examination, and the entity acted promptly to ensure that it did not impose late fees or other delinquency fees, or any other negative consequences, as a result of borrower actions attributable to the change.

As an example of concerns related to escrow accounts, one servicer decided – without notice to borrowers – to delay property tax payments from December of one year to January of the next. Instead of paying these taxes in December, which would have been consistent with past practice and the annual escrow statement, it paid the taxes in January of the following year, resulting in the borrowers' inability to claim a tax deduction for the prior year. The servicer failed to provide notice to consumers of the change, which affected thousands of consumers. CFPB cited an unfair practice for failing to provide notice regarding the change in date for property tax payments from escrow accounts. To remedy the situation, it is directing the servicer to identify impacted borrowers and compensate those harmed by this practice.

In another review, the CFPB determined that a servicer paid certain property taxes late, in violation of RESPA. The CFPB directed the servicer to pay any fees associated with the late payment, and to investigate whether consumers experienced any additional harm as a result of the late payments. Further, at the CFPB's direction, the servicer will notify consumers of the late payment and fee payment, and solicit information from borrowers about any additional harm caused by the late payment. If any such harm is identified, the servicer will remediate it.

Examiners have found violations of the Homeowners Protection Act (HPA)⁶ at several servicers. In one examination, examiners found excessive delays in processing borrower requests for private mortgage insurance (PMI) cancellation. Additionally, in cases where PMI was canceled, the servicer improperly handled unearned PMI premiums in violation of the HPA. The CFPB required the servicer to amend its policies and procedures relating to PMI cancellation. The servicer also must conduct a review to determine whether borrowers were subject to additional harm caused by delays in processing PMI cancellations.

Additionally, examiners have found certain issues regarding default-related fees. Examiners identified a servicer that charged consumers default-related fees without adequately documenting the reasons for and amounts of the fees. Examiners also identified situations

⁶ 12 USC 4901 *et seq.*

where servicers mistakenly charged borrowers default-related fees that investors were supposed to pay under investor agreements. Servicers have refunded these fees to borrowers, often during the CFPB's examination.

2.2.3 Loss Mitigation

Another key area in mortgage servicing that presents risks to consumers is the loss mitigation process.⁷ CFPB examiners have found several issues related to various aspects of loss mitigation, including:

- Inconsistent borrower solicitation and communication;
- Inconsistent loss mitigation underwriting;
- Inconsistent waivers of certain fees or interest charges;
- Long application review periods;
- Missing denial notices;
- Incomplete and disorganized servicing files;
- Incomplete written policies and procedures; and
- Lack of quality assurance on underwriting decisions.

When examiners identify these issues, CFPB expects corrective action, and in the case of violations, directs the servicer to improve its policies and procedures governing the handling of loans in loss mitigation and the documentation of servicer actions, as well as training appropriate personnel on the new policies and procedures. Additionally, CFPB has directed servicers to engage in specific corrective actions appropriate to the circumstances, such as: reviewing loss mitigation decisions and related fees or charges to borrowers to determine whether any reimbursement is appropriate, conducting periodic testing to monitor areas of concern, and providing reports to CFPB on progress completing these corrective actions.

In addition to general compliance risks, weak compliance management surrounding loss mitigation processes creates fair lending risk. CFPB expects that entities servicing mortgage loans will implement fair lending policies, procedures, and controls to ensure that they are

⁷ “Loss mitigation” refers to an alternative to foreclosure offered by the owner or assignee of a mortgage loan that is made available through the servicer to the borrower.

complying with the Equal Credit Opportunity Act.⁸ While the appropriate program will vary from financial institution to financial institution, CFPB expects that at a minimum, entities servicing mortgage loans will conduct fair lending training for loss mitigation staff, and will engage in effective and timely fair lending risk assessments, compliance monitoring, and testing of fair lending risks.

Examiners have reviewed communications with borrowers in the course of the loss mitigation process. In one examination, examiners found that the servicer's procedures for requesting missing or incomplete information were cumbersome and made it difficult for consumers to provide the correct documentation. CFPB expects the servicer to improve the instructions it provides to borrowers in its communications. In another examination, examiners found that the servicer's communications to borrowers about the status of loan modification applications and documents submitted were deceptive. CFPB directed the servicer to change the language it used in these communications and to train employees responsible for developing communications to borrowers to prevent future violations.

Discussions have also occurred with major mortgage servicers about the upcoming mortgage servicing rules recently adopted by the CFPB, which take effect on January 10, 2014. The importance of compliance with these rules has been emphasized, and the examination materials that will be used to assess compliance with these new provisions have been published, well in advance of the compliance deadline.

2.3 Fair Lending – Provision of Adverse Action Notices

An additional focus of the CFPB continues to be reviewing compliance by banks and nonbanks with fair lending laws and regulations: the Home Mortgage Disclosure Act (HMDA)⁹ and the Equal Credit Opportunity Act (ECOA). As a result of its reviews in this area to date, the CFPB

⁸ ECOA, 15 USC 1591 *et seq.*, is implemented by Regulation B, 12 CFR Part 1002.

⁹ HMDA, 12 USC 2801 *et seq.*, is implemented by Regulation C, 12 CFR Part 1003.

reminds entities under its jurisdiction of their responsibilities regarding the provision of adverse action notices.

The CFPB has noted that some lenders are not complying with various aspects of the adverse action notification requirements under ECOA and Regulation B. ECOA requires creditors to provide notification of any adverse action taken on an application, unless the applicant is currently delinquent or in default.¹⁰ Furthermore, ECOA requires that the creditor provide or make available a specific statement of reasons for such action.¹¹ Finally, a creditor must send an adverse action notice to an applicant within 30 days of receipt of a completed application.¹² The CFPB has found instances where supervised entities violated ECOA and Regulation B by failing to comply with either the provision, content, or timing requirements for adverse action notices.

In such instances, the CFPB has directed the entities to develop and implement plans to ensure that the appropriate monitoring and internal controls are in place to detect and prevent future violations. Supervised entities should maintain compliance management systems that ensure notifications are sent to consumers with the appropriate content and within the timeframes required under Regulation B. For example, loan servicers should have systems in place to determine whether borrowers who apply for a change in the terms of credit are entitled to adverse action notices. Some institutions may find it helpful to arrange for independent, internal reviews of loan files to ensure that the documentation supports the action taken and that all timing requirements are met. In addition, institutions should provide comprehensive periodic training to management and staff regarding compliance with ECOA and Regulation B, including compliance with provisions on adverse action notices.

¹⁰ 15 USC 1691(d)(1); 12 CFR 1002.9(a)(1), Official Staff Commentary, 12 CFR 1002.2(c)(2)(ii)-2.

¹¹ 15 USC 1691(d)(2)-(3); 12 CFR 1002.9(a)(2).

¹² 12 CFR 1002.9(a)(1). Additionally, the failure to provide adverse action notices may also constitute violations of the Fair Credit Reporting Act (FCRA), 15 USC 1681 *et seq.*

2.4 Significant Violations Detected

2.4.1 Public Enforcement Action

Since the last issue of *Supervisory Highlights*, supervisory activities have resulted in the following public enforcement action, which emphasizes the importance of monitoring the activities of service providers.

On June 27, 2013, CFPB announced that it had ordered U.S. Bank and one of its nonbank partner companies, Dealers' Financial Services (DFS), to end deceptive marketing and lending practices targeting active-duty military. The two companies must return about \$6.5 million to servicemembers for failing to properly disclose all the fees charged to participants in the companies' Military Installment Loans and Educational Services (MILES) auto loans program, and for misrepresenting the true cost and coverage of add-on products financed along with the auto loans. In particular, through its supervisory work, the CFPB found that U.S. Bank required servicemembers to repay their auto loans using the military allotment system – which deducts payments directly from a military member's paycheck before that salary is deposited in his or her bank account – but did not properly disclose the processing fee charged for using the allotment system or how often payments would be taken by allotment. Under the CFPB orders, the companies have agreed to stop deceptive practices, pay restitution to servicemembers, provide refunds or credits without any further action by consumers, stop requiring the use of military allotments, improve disclosures, and submit required reports to demonstrate their compliance with the orders.

2.4.2 Non-Public Supervisory Actions

In addition to the public enforcement action above, supervisory activities have resulted in remediation to approximately 10,000 additional consumers. In some instances, this remediation was initiated by the supervised entity and reported to the CFPB, further emphasizing the importance of robust compliance management systems in the early detection and resolution of violations of Federal consumer financial laws. These examples of remediation span many of the markets under the CFPB's supervisory authority, such as banks, mortgage servicers, and short-term, small dollar lenders.

3. Supervision Program Developments

3.1 Recent Supervisory Guidance

The CFPB is committed to providing guidance to both industry and the public as its supervisory program priorities develop over time.¹³ As the CFPB continues to develop and refine its supervisory program, we have intentionally employed a strong quality control function to ensure consistency in our supervisory activities. Some of our recent guidance includes fair lending examination modules, as well as bulletins concerning auto finance and mortgage servicing transfers.

3.1.1 Equal Credit Opportunity Act (ECOA) Baseline Review Modules

In July 2013, the CFPB added new fair lending examination procedures to the *Supervision and Examination Manual* to help streamline fair lending reviews. These procedures, known as the Equal Credit Opportunity Act (ECOA) Baseline Review Modules (the Modules), will be used by examiners during ECOA baseline reviews¹⁴ to identify and analyze fair lending risks, facilitate

¹³ Guidance bulletins and other relevant information can be found at: <http://consumerfinance.gov/guidance/>.

¹⁴ ECOA baseline reviews are one type of fair lending review conducted by the CFPB, in addition to ECOA targeted reviews and Home Mortgage Disclosure Act (HMDA) reviews. An ECOA targeted review includes an in-depth look at a specific area of fair lending risk, and is conducted using the ECOA Examination Procedures within the Manual. A HMDA review includes transactional testing for HMDA data accuracy, and is conducted using the HMDA Examination Procedures within the Manual.

the identification of certain types of ECOA and Regulation B violations, and inform fair lending prioritization decisions for future CFPB reviews.

The CFPB is publishing the Modules in order to provide supervised entities a better understanding of how the CFPB identifies potential fair lending risks. In addition, supervised entities can use the Modules to develop fair lending compliance programs that are appropriate to the size and nature of their business.

When a baseline review is scheduled, examiners and the Office of Fair Lending will determine which modules should be completed. Once the appropriate modules have been selected, and in advance of the review, examiners will send the supervised entity information requests that correspond with the selected modules. In addition to information request responses, examiners may review other sources of information to complete the Modules, including publicly available information about the entity and information obtained at interviews or other supervisory meetings with the entity.

Findings identified in the Modules are not determinative of whether a supervised entity has violated the law; rather, the Modules are designed to identify risks of such violations. Any fair lending risks found in a particular review will be assessed to determine what, if any, further actions should be taken given the known information about the particular entity.

As always, the CFPB welcomes feedback and comments regarding this compliance tool and others to address fair lending concerns. Feedback may be addressed to: FairLending@cfpb.gov.

3.1.2 Auto Finance¹⁵

In March 2013, the CFPB released a compliance bulletin reminding certain lenders offering auto loans through dealerships that they could be held responsible for unlawful, discriminatory pricing. Discriminatory markups¹⁶ in auto lending may result in tens of millions of dollars in

¹⁵ This Bulletin can be found at: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

¹⁶ Markups occur when an indirect auto lender has a policy that allows the dealer to “mark up” the interest rate above the indirect auto lender’s buy rate. In the event that the dealer charges the consumer an interest rate that is higher than the lender’s buy rate, the lender may pay the dealer what is typically referred to as “reserve” (or “participation”),

consumer harm each year. In particular, the bulletin provides guidance for indirect auto lenders within the CFPB's jurisdiction on ways to limit the fair lending risk of dealer markup and compensation policies in accordance with ECOA.¹⁷

The CFPB recommends that indirect auto lenders take steps to ensure that they are operating in compliance with fair lending laws as applied to dealer markup and compensation policies. These steps may include, but are not limited to:

- Imposing controls on dealer markup, or otherwise revising dealer markup policies, and monitoring and addressing the effects of markup policies as part of a robust fair lending compliance program;
- or
- Eliminating dealer discretion to markup buy rates and fairly compensating dealers using a different mechanism that does not result in discrimination.

3.1.3 Mortgage Servicing¹⁸

In February 2013, the CFPB released guidance to residential mortgage servicers and subservicers about risks to consumers relating to transfers of servicing. This Bulletin noted the CFPB's commitment to carefully review servicers' compliance with applicable Federal consumer financial laws related to servicing, such as the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act,¹⁹ and prohibitions on unfair, deceptive, or abusive acts or practices (UDAAPs). The Bulletin emphasizes that even if conduct

compensation based upon the difference in interest revenues between the buy rate and the actual note rate charged to the consumer in the retail installment contract executed with the dealer.

¹⁷ The ECOA makes it illegal for a creditor to discriminate in any aspect of a credit transaction on prohibited bases including race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise, in good faith, of a right under the Consumer Credit Protection Act. 15 USC 1691 *et seq.*

¹⁸ This Bulletin can be found at: http://files.consumerfinance.gov/f/201302_cfpb_bulletin-on-servicing-transfers.pdf.

¹⁹ 15 USC 1692 *et seq.*

does not violate any specific prohibitions in other statutes, the conduct may nonetheless constitute a UDAAP under the Dodd-Frank Act.²⁰

In addition, the Bulletin advises servicers that CFPB examiners will direct particular attention to the following areas:

- How a transferor servicer has prepared for the transfer of servicing rights and/or responsibilities;
- How a transferee servicer handles the files transferred to it; and
- For loans with loss mitigation in process, what policies the transferor and transferee have implemented, including what procedures they adopted, to facilitate the transfer of information, documents, and payments and to communicate with the borrowers accurately about the status of loss mitigation applications.²¹

Section 2.2, above, discusses supervisory observations related to servicing transfers, as well as other mortgage servicing practices.

3.2 Program Implementation

3.2.1 Headquarters Reorganization

When the CFPB began its supervisory operation, it established two offices in Washington, D.C. to oversee its supervisory program. The Office of Large Bank Supervision took responsibility for the supervisory authority transferred from other federal agencies – examining institutions with assets over \$10 billion, and their affiliates. The Office of Nonbank Supervision was tasked with building a program to supervise the consumer compliance activities at nonbank entities – a role

²⁰ The CFPB Supervision and Examination Manual provides further guidance on how the UDAAP prohibition applies to supervised entities.

²¹ The Bulletin also provides an overview of the servicing transfer-related provisions of the new mortgage servicing rules, which take effect on January 10, 2014. These rules will require servicers to maintain policies and procedures that are reasonably designed to achieve the objectives of facilitating the transfer of information during mortgage servicing transfers.

that had not existed previously at other Federal agencies. In order to improve program efficiency across the combined bank and nonbank markets, in December 2012, the CFPB realigned its Headquarters supervision staff into two new offices: the Office of Supervision Examinations and the Office of Supervision Policy. Our regional examination workforce was organized from the outset without regard to entity type.

The Examinations office focuses on many of the processes and the work vital to support CFPB examiners throughout the country. This office oversees our efforts to:

- Plan and appropriately execute examinations to evaluate compliance with Federal consumer financial laws in light of our resources and priorities;
- Recruit, train, and commission examiners; and
- Ensure policies and procedures are followed.

The Policy office, organized by product or service market such as mortgage lending, oversees efforts to:

- Develop supervision strategy and policy across both bank and nonbank markets;
- Ensure policy decisions for supervision across markets, charters, and regions are consistent with the law and the CFPB mission; and
- Provide ongoing expert support to examiners in each product market.

3.2.2 Examiner Training and Staffing

Since the outset of the CFPB's supervision program, examiner recruiting has been a central priority. As the CFPB works to reach a steady state, the focus remains on recruiting staff who can bring a broad range of skills and experiences to the examination program, including in-depth knowledge of Federal consumer financial laws. In particular, as of July 1, 2013:

- CFPB Supervision staff includes over 300 examiners. A significant majority of them have experience in examinations at federal or state regulators, or from private industry.
- Nearly 100 of our examiners are commissioned, either coming to the CFPB with commissioning credentials from other agencies, or earning commissions through the CFPB's interim commissioning process. The CFPB is currently developing its own

commissioning program similar to those utilized by the prudential regulators, but focused on the CFPB’s unique mission.

- Examiners are supervised by our regional teams, who have significant experience in the consumer financial protection arena, and supported by headquarters staff.

The CFPB continues to develop and provide training opportunities to further strengthen the expertise of our examination staff, especially with regard to the CFPB’s recently introduced mortgage rules, and to ensure the broad knowledge necessary to examine both banks and nonbanks.

3.2.3 Risk-Based Approach to Examinations

Our singular focus on consumer protection, combined with the wide range of both entities and products that fall under the CFPB’s supervisory authority, requires use of an examination prioritization process that focuses on the greatest risks to consumers.

Our focus on consumer protection influences another aspect of our approach to supervision. In particular, our risk assessments are made not just on an entity or organization-wide basis, but also at the consumer business unit level, what we call “Institution Product Lines” or IPLs. This approach allows for comparisons of products across entities and aligns with the CFPB’s objective of ensuring that Federal consumer financial laws are enforced consistently across the marketplace, without regard to business structure, type of charter, or location.

Several factors influence the CFPB’s examination priorities, including a risk-based prioritization of the entities, products, and markets under the CFPB’s jurisdiction. This risk-based analysis assesses a number of factors,²² including:

²² The factors incorporate the risk factors that the CFPB is required to take into account with respect to its nonbank supervision program under Dodd-Frank Act Section 1024(b)(2).

Product Markets:

- **Market Size:** the relative product market size in the overall consumer finance marketplace; and
- **Market Risk:** the potential risk to a consumer from new or existing products offered in the market.

Institution Product Lines:

- **Institution Product Size:** an entity's market share or level of activity within a product market; and
- **Field and Market Intelligence:** other relevant information about a supervised entity (which may include a variety of factors including complaints, strength of compliance systems, and management commitment to compliance).

4. Conclusion

Through its supervisory program, the CFPB examines financial institutions to determine their compliance with Federal consumer financial law, to obtain information about their activities and compliance systems and procedures, and to detect and assess risks to consumers or markets for consumer financial products and services. The CFPB plans to periodically publish *Supervisory Highlights* to provide general information about its supervision program without identifying specific institutions (except for enforcement actions already made public) and to help communicate the standards of conduct expected of supervised entities. The CFPB's goal is to help ensure a financial services marketplace that operates in accordance with Federal consumer financial law and works well for both consumers and the businesses that serve them.