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A PRACTICAL GUIDE TO CFPB COMPLIANCE EXAMINATION MANAGEMENT

CFPB compliance examinations tend to be more adversarial and yield more severe consequences for supervised entities than the banking industry has experienced with the prudential banking regulators. The authors describe what to expect and suggest practical steps – before, during, and after the examination – to help navigate the process.

By Andrew Sandler, Andrea Mitchell, and Susanna Khalil *

As on-site examinations of depository institutions and non-depository consumer financial service companies become more contentious and escalate more frequently to investigations and enforcement actions than ever before, it is imperative that supervised institutions invest the time and resources necessary to prepare for and manage their examination.

Prior to the enactment of the Dodd-Frank Act, prudential regulators performed compliance exams that were largely predictable and generally did not result in public or broad-reaching enforcement actions. Following the collapse of the housing market and enactment of the Dodd-Frank Act, the Consumer Financial Protection Bureau (“CFPB” or “Bureau”) was created and authorized to enforce most federal consumer financial laws by several means, including through compliance examinations. These are now being conducted from a more adversarial posture, yielding more severe consequences for supervised entities than the banking industry experienced in the past under the supervision of the prudential banking regulators. The

CFPB’s examination authority not only changes the game for depository institutions that were accustomed to the traditional, though typically more routine prudential regulatory examinations, it also affects non-depository financial service entities that were not previously subject to federal supervision. In an increasingly regulated business environment with new and evolving examination procedures, all of these entities are navigating uncharted territory.

This article provides some practical guidance on what to expect in a CFPB compliance examination and what your institution can do before, during, and after an on-site CFPB compliance examination to ensure that the examination is managed properly and yields the best results possible.

BEFORE THE REGULATORS COME KNOCKING

Proactively Preparing for the Examination

There is a broad range of actions that your institution can take to prepare for a compliance examination before

* ANDREW SANDLER is the Chairman and Executive Partner, and ANDREA MITCHELL is a partner in BuckleySandler LLP in Washington, D.C. SUSANNA KHALIL is an associate in the firm’s Los Angeles office. Their e-mail addresses are asandler@buckleysandler.com, amitchell@buckleysandler.com, and skhalil@buckleysandler.com.

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receiving notification that your institution will be subjected to one. In order to become familiar with the examination process, start by reviewing all the CFPB examination procedures, including the *Origination Examination Manual*, the *Servicing Examination Manual*, and the third-party oversight guidance. Thereafter, frequent the CFPB website in order to be aware of new and revised guidance that the CFPB regularly issues. Looking for updates should not be limited to examination guidance updates, but should extend to laws, regulations, and other relevant guidance that have changed since your institution's last compliance examination. Identifying such changes is integral to assessing whether your institution's controls and programs reflect the most recent requirements and anticipating any potential concerns that could arise.

To the extent past examinations, audits, and risk assessments raised any issues with your institution's programs, policies, or controls, ensure that those items have been addressed appropriately. Specifically addressing systemic issues is crucial to avoiding costly penalties, enforcement actions, and litigation. Because consumer complaints could trigger targeted reviews and have become one of the driving forces for the CFPB in identifying institutions for compliance examinations, your institution should also review its customer complaints on a regular basis, monitor the complaints for trends, and ensure that appropriate adjustments to business practices are made in response, especially for any egregious or recurring complaints.

Because the CFPB will not typically give notice well in advance – often weeks, not months - and given that the pre-examination requests will be extensive, your institution can and should begin pulling and organizing documents, such as policies and procedures, likely to be requested by an examination team. In addition, to the extent you become aware of weaknesses that the CFPB is likely to discover, you should consider preparing draft narrative responses in advance, which will allow you to research and document the best response without the time crunch that arises once the CFPB does in fact arrive. In certain circumstances, this will also allow you time to implement initial remediation, which to date has generally been well received by the CFPB.

Finally, just because your institution has not yet received a compliance examination notification, it is not too early to provide examination management training for employees who may interface with examiners and to identify the person who will serve as the day-to-day contact for the examination team should you receive notification of an impending examination. As always, care should be taken to make sure that employees

understand that all communications with examiners should be accurate and truthful. By the same token, certain information may be protected by the attorney-client privilege and, notwithstanding the CFPB's assertion that the privilege does not apply in the supervisory context, institutions should identify documents as privileged, where appropriate, when producing them to the Bureau to avoid waiving the privilege with respect to third parties.

Entities New to CFPB Supervision

Entities new to CFPB supervision are expected to have robust compliance management systems that reflect the size, product offering, service offering, and overall risk profile of the institution. While the CFPB will hold non-depository lending institutions to the same standard as depository institutions, the CFPB appears to be giving some latitude during the initial CFPB examination cycle to companies that have not been subject to federal supervision before by affording them time to develop compliance management systems that are on par with their bank peers. Institutions should not, however, rush to obtain or draft policies, procedures, programs, or training materials simply for the sake of completing them without regard to actual practices. Because institutions are examined on their practices, it is imperative to have policies, procedures, and programs that match actual practices.

CFPB Examinations and Prudential Bank Regulator Examinations

Even for entities that have been subject to federal supervision, CFPB examinations can be quite different from the prudential bank regulator examinations to which they are accustomed. One of the hallmarks of CFPB compliance examinations is the extensive information and document requests. You should expect that multiple employees will need to be dedicated to marshaling and drafting responses, generating extensive computer reports, and finding documents for CFPB requests before, during, and after the CFPB is on site. Effective and efficient project managers become critical as the coordination and burden of all the requests expand.

In addition, CFPB examinations are consumer centric – focusing on the impact of the institution's policies and procedures on consumers, rather than looking to an institution's strict compliance with relevant laws. In line with that, the CFPB heavily scrutinizes practices with potential implications on fair lending and unfair, deceptive, and abusive acts and practices. The CFPB may also examine related areas that are technically

outside the Bureau’s jurisdiction (*i.e.*, unfair, deceptive, or abusive acts or practices affecting businesses and potential Servicemember Civil Relief Act or Fair Housing Act violations) or outside the scope of the examination (*e.g.*, focusing on servicing during an origination examination).

In terms of communications during CFPB examinations, there is generally less dialogue between the CFPB examination team and the supervised entity than there is in a prudential regulatory examination. In addition, supervised entities frequently learn for the first time during the final examination meeting, known as the “soft exit” meeting, that the CFPB has identified one or more potential violations. CFPB examinations are frequently lengthier than prudential bank regulator examinations and may result in a supervisory letter rather than an examination report, particularly following a targeted examination or “review.” Finally, CFPB examinations diverge from traditional prudential bank regulator examinations in that CFPB enforcement attorneys often are present at the early stages of the examination, thus raising concerns about the role of such attorneys and how an institution should respond, which is discussed further below.

THE REGULATORS COME KNOCKING. NOW WHAT?

Enforcement Attorneys and the Attorney-Client Privilege

There is continuing controversy over the CFPB’s bringing enforcement attorneys to examination kick-off meetings and including such attorneys throughout the examination process. Supervised entities have a right to have in-house counsel or outside counsel present any time CFPB enforcement attorneys attend a meeting – even in the examination context. In order to avoid conflict, consider having a conversation at the outset of an examination with the examiner in charge to discuss the expected level of involvement of enforcement attorneys. If it is important to your institution that one of its attorneys be present whenever an enforcement attorney is present, you should consider communicating this to the examiner in charge before the on-site examination commences.

It should be noted that although generally most information and document requests in the examination context are not subject to typical privilege protections, to the extent that they are, the production of information or documents to the CFPB, or to any banking agency or

supervisor, does not waive any privilege that may be claimed with respect to third parties.¹

Communication with Examiners

Institutions should engage in a dialogue with the CFPB examination team early and often throughout the review, especially so you can promptly respond to the CFPB examiners if they raise any potential weaknesses. Early notice from an examiner that a violation may have occurred will enable your institution to provide the CFPB with additional information that may address the concern, or it may alert you to a previously unidentified issue that the institution can begin to investigate. Discussing concerns over factual and legal disputes can prevent misunderstandings and help build rapport with the examiner in charge. But that does not mean you should get too comfortable with the examiner – it is vital to treat all responses to the examiner’s questions, no matter how informal the communication, as a formal inquiry. Ensure that all requests are appropriately reviewed and considered, and that all responses are complete, accurate, and subject to review by the appropriate institution personnel. When having discussions of crucial importance relating to the examination in which a written response is not required *per se*, it is still beneficial to document the conversation in writing by either sending a letter or email to the examiner, drafting an internal memorandum to the file, or taking contemporaneous notes of the conversation.

Legal Interpretations

Communication with your examiner is especially crucial when it comes to legal interpretations. It is not uncommon for an institution to disagree with the examination team’s interpretation or application of the law during an examination, but there are steps you can take to resolve the dispute before these issues turn up in the examination report. First, you should discuss the issue with the examiner in charge. Preparing a letter or white paper that outlines your institution’s legal analysis will be important, particularly with respect to more complicated or more serious legal issues, because that will give your institution the opportunity to communicate its legal analysis in an unfiltered manner to the Bureau’s legal decision makers. If necessary, the institution can escalate the issue to the regional director or ask the examination team to confer with the Bureau’s legal or regulatory policy departments. If there is no consensus on the legal interpretation, then consider

¹ 12 U.S.C. § 1828(x).

engaging the Bureau's ombudsman to try to resolve the issue.

AFTER THE REGULATORS HAVE LEFT

Once the examiner concludes the on-site examination, there is no need to twiddle your thumbs. As a preliminary matter, you do not need to wait for an examination report to contest a finding. If you have followed the advice above and engaged your examiner early and often throughout the examination period, you can eliminate or at least limit controversial or negative findings before they ever make their way into an examination report. Engaging the examiner during the examination period and soft-exit meetings will also allow you to anticipate what some of the findings will be. Furthermore, to the extent you know or expect the final examination report will likely require certain changes, keep in mind that the final examination report may not give you very much time to implement the changes. As such, you will only benefit by taking

advantage of the additional time and commencing remediation promptly. If there is a delay in the examination report, this should not automatically be construed as indicia of negative examination findings. The CFPB's timeline for issuing examination reports has been lengthy due in large part to efforts to ensure accuracy and consistency among the regional offices.

CONCLUSION

Although CFPB compliance examinations thrust supervised entities into somewhat unfamiliar territory, institutions can proactively prepare for such examinations by performing internal reviews and revising procedures to conform to what is expected of them. Effective communication and prudent examination management during an on-site examination can help resolve issues on the front-end and facilitate coordination and rapport that could go a long way in helping your institution effectively navigate the compliance examination process. ■