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## REGULATION OF NON-DEPOSITORY COVERED PERSONS UNDER THE DODD-FRANK ACT

*The jurisdiction and rulemaking authority of the Consumer Financial Protection Bureau under Title X of the Dodd-Frank Act specifically extends beyond depository institutions, and includes supervisory and enforcement powers over non-depository providers of consumer financial products and services. The authors discuss the scope of the CFPB's jurisdiction over non-depository institutions and key provisions of its newly issued Supervision and Examination Manual.*

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Title X of the Dodd-Frank Act<sup>1</sup> reshaped the financial regulatory landscape by consolidating consumer financial protection authorities that had existed across seven different federal agencies into a new entity, the Consumer Financial Protection Bureau (the “CFPB” or the “Bureau”). The Bureau was established as an independent body to regulate the offering and provision of consumer financial products and services under the federal consumer financial laws, including Title X and its rules.<sup>2</sup> Among the authorities given to the Bureau to regulate such products and services are supervisory and enforcement powers over certain “non-depository” providers of financial products and services. This article

provides an overview of the CFPB’s authority to supervise and oversee entities that offer financial products and services that are not currently subject to a federal prudential regulator (generally referred to as “non-depository covered persons” or “non-depository financial institutions”).

### BACKGROUND

Dodd-Frank generally enables the Bureau to carry out its consumer protection functions in two ways:<sup>3</sup> The

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<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, 124 Stat. 1376 (2010). Title X of the Act is primarily codified at 12 U.S.C. Section 5481 *et. seq.*

<sup>2</sup> *Id.* at § 1011, 124 Stat. 1964.

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<sup>3</sup> The CFPB’s powers become effective at different times. While some of the Bureau’s authorities took effect when the Act was signed into law on July 21, 2010, most of the Bureau’s authorities were scheduled to go into effect on the “designated transfer date” determined by the Secretary, which was July 21, 2011. Designated Transfer Date, 75 Fed. Reg. 57,252 (Sept. 20, 2010).

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### IN THIS ISSUE

- REGULATION OF NON-DEPOSITORY COVERED PERSONS UNDER THE DODD-FRANK ACT

first is through the transfer of existing consumer protection powers from other federal regulators to the Bureau,<sup>4</sup> including the power to prescribe regulations under designated federal “enumerated consumer laws” that were in place prior to Dodd-Frank’s enactment.<sup>5</sup> The second way that the Bureau is enabled is through the establishment of new or “enhanced” consumer protection authorities that were not expressly provided by federal law to regulators prior to the Act. Such newly established powers include new rulemaking powers distinct from the rulemaking authorities provided under the enumerated consumer laws,<sup>6</sup> certain consumer compliance supervisory and enforcement powers over large financial institutions,<sup>7</sup> and limited enforcement and examination powers over smaller financial institutions.<sup>8</sup> The “enhanced” powers of the Bureau also include unprecedented consumer compliance supervisory and enforcement powers over certain non-depository financial institutions that are not currently subject to oversight of a federal prudential regulator.<sup>9</sup> In short,

these powers have the potential to give the Bureau supervisory authority over non-depository covered persons in a way that is very similar to the authority exercised by banking regulators over depository institutions. According to the Bureau, there are currently thousands of such nonbank companies and these nonbanks constitute a significant portion of the consumer financial marketplace.<sup>10</sup>

### LAUNCH OF THE NONBANK SUPERVISION PROGRAM

On January 5, the Bureau announced the official “launch” of its nonbank supervision program. The authority under the Act to exercise the Bureau’s powers is limited subject to the appointment of a Bureau Director and, in particular, the Act authorizes the Bureau to begin supervising nonbanks only once a Director of the Bureau is in place.<sup>11</sup> On January 4, 2012, the White House advised that President Obama, using a recess appointment, named Richard Cordray as the first Director of the CFPB. Accordingly, the Bureau has now undertaken actions for which a Director is required, including plans to begin supervision of non-depository

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<sup>4</sup> Dodd-Frank Act, § 1061, 124 Stat. at 2036-37. These regulators (or “transferor agencies”) generally include the federal banking agencies, the Federal Trade Commission, and the Department of Housing and Urban Development. The FTC will retain certain rulemaking and enforcement authorities, particularly those under the Federal Trade Commission Act (15 U.S.C. §§ 45, *et seq.*).

<sup>5</sup> These “enumerated consumer laws” are listed in the definition set forth under Subtitle A of Title X. Dodd-Frank Act, § 1002(12), 124 Stat. at 1957. On July 27, 2011, per Section 1063(i) of Title X, the Bureau published a final list of rules that it will enforce under the enumerated consumer laws. Identification of Enforceable Rules and Orders, 76 Fed. Reg. 43,569, 43,570-71 (July 21, 2011).

<sup>6</sup> These new rulemaking powers are primarily set forth in Subtitle C of Title X and section 1022 of Subtitle B of Title X.

<sup>7</sup> Dodd-Frank Act, § 1025, 124 Stat. at 1990.

<sup>8</sup> *Id.* § 1026(c), 124 Stat. at 1994.

<sup>9</sup> Section 1002(24) defines “prudential regulator” as “in the case of an insured depository institution or depository institution holding company (as defined in section 3 of the Federal Deposit Insurance Act), or subsidiary of such institution or company, the appropriate federal banking agency,” and in the case of an

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insured credit union, the National Credit Union Administration. *Id.* § 1002(24), 124 Stat. at 1962.

<sup>10</sup> Building the CFPB, CONSUMER FINANCIAL PROTECTION BUREAU, 8 (July 18, 2011), [http://www.consumerfinance.gov/wp-content/uploads/2011/07/Report\\_BuildingTheCfpb1.pdf](http://www.consumerfinance.gov/wp-content/uploads/2011/07/Report_BuildingTheCfpb1.pdf) (hereinafter, “Building the CFPB”).

<sup>11</sup> While the Secretary of the Treasury is authorized under subsection 1066(a) of the Act to perform certain functions of the Bureau until the Director of the Bureau is appointed, the authority of the Secretary is generally viewed as limited. Accordingly, many authorities granted to the Bureau under the Act presumably could not be exercised until a Bureau Director was appointed, including supervision of nonbank institutions and various enforcement powers. Prior to the appointment of Director Cordray, Raj Date was leading the Bureau’s day-to-day operations in his capacity as the Special Advisor to the Secretary of the Treasury for the Consumer Financial Protection Bureau. Mr. Date has been named the Bureau’s first deputy director by the Director.

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covered persons.<sup>12</sup> Statements from Director Cordray following his appointment indicate that supervision of non-depository covered persons will be a priority of the Bureau and that the Bureau will be active in such oversight.<sup>13</sup> The Bureau's issuances regarding the official launch of the nonbank supervision program immediately following Mr. Cordray's appointment also may indicate the importance that the Bureau will place on the supervision of nonbank covered persons.<sup>14</sup>

We note that there is currently a debate over whether the recess appointment of the Director is authorized. The Bureau is designed to be headed by a single Director, who is to be nominated by the President, subject to the advice and consent of the Senate. On July 18, 2011, President Obama nominated Richard Cordray, the head of the Bureau's Enforcement Division, to be the first Director of the CFPB. However the Senate defeated, by a 53-45 vote, a procedural motion to advance the nomination on December 8, 2011. Accordingly, a Director has not been confirmed by the Senate and a legal question exists as to whether the recess appointment has the same force of law as a Senate confirmation as contemplated under Dodd-Frank. In particular, an issue has been raised as to whether, at the time of the recess appointment, the Senate was, indeed,

in recess, since Republican members of Congress were holding "*pro forma*" sessions.<sup>15</sup>

The recess appointment on January 4 has been opposed by Senate Republicans who object to various aspects of the Bureau. Senate Republicans are said to be considering whether to file a lawsuit challenging the recess appointment.<sup>16</sup> There is also discussion about a business or industry group that will be subject to regulation by the CFPB bringing an action. The U.S. Chamber of Commerce, in particular, has been identified as a possible group to challenge the appointment through a lawsuit.<sup>17</sup> Questions about the validity of the Director's appointment could potentially lead to challenges of the authority of the Director and the CFPB, including authority to supervise nonbank covered persons and issue final rules associated with their regulation.

## **SUPERVISION OF NON-DEPOSITORY COVERED PERSONS**

### ***Scope of the Bureau's Supervisory Authority***

The Bureau's authority to supervise and oversee certain non-depository "covered persons" is provided in Section 1024 of the Act, which is part of Subtitle B of Title X.<sup>18</sup> A "covered persons" is defined in the Act as any person that engages in offering or providing a "consumer financial product or service," and any

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<sup>12</sup> Until the "larger participant" rule is finalized, the CFPB will only be able to supervise institutions in the mortgage, payday, and student lending markets.

<sup>13</sup> See, e.g., "A Discussion with Richard Cordray Consumer Financial Protection Bureau Director", Washington, D.C., January 5, 2012. Available at [http://www.brookings.edu/~media/Files/events/2012/0105\\_cordray/20120105\\_consumer\\_protection.pdf](http://www.brookings.edu/~media/Files/events/2012/0105_cordray/20120105_consumer_protection.pdf). "We will begin dealing face-to-face with payday lenders, mortgage servicers, mortgage originators, private student lenders, and other firms that often compete with banks but have largely escaped any meaningful federal oversight," Cordray said. In addition, the Bureau's associate director for nonbank supervision indicated in early January that the Bureau hopes to begin the notification and pre-exam scoping "within a month". See Kate Davidson, *Risk Assessments will Guide Nonbank Supervision: CFPB's Twohig*, AMERICAN BANKER, January 6, 2012. The nonbank supervision team recently contacted state officials as they begin to determine which companies pose the most risk, and which should be targeted for examination in the mortgage, payday, and student loan markets. *Id.*

<sup>14</sup> See "Consumer Financial Protection Bureau launches nonbank supervision program", at <http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-launches-nonbank-supervision-program/>.

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<sup>15</sup> Pro forma sessions are brief meetings of the Senate in which no business is conducted. See, e.g., [http://www.senate.gov/reference/glossary\\_term/pro\\_forma\\_session.htm](http://www.senate.gov/reference/glossary_term/pro_forma_session.htm). Although beyond the scope of this article, the legal issue arises under the Recess Appointments Clause of the U.S. Constitution (Article II, Section 2).

<sup>16</sup> See "Senate Republicans eyeing suit on Obama appointees", at <http://www.reuters.com/article/2012/01/11/us-usa-congress-lawsuit-idUSTRE80A01M20120111>. Among the potential problems with such suit are questions of standing and political repercussions. *Id.*

<sup>17</sup> *Id.* See also "U.S. Chamber may challenge Cordray recess appointment" at <http://www.chicagotribune.com/news/politics/sns-rt-us-cordray-chambertr8031m5-20120104,0,865630.story>.

<sup>18</sup> Note that a covered person is still subject to the Act even if it is not a covered person subject to the Bureau's supervisory powers under Subtitle B. See, e.g., *Defining Larger Participants*, 76 Fed. Reg. 38,059, 38,060 (June 29, 2011). (A covered person under Title X "will remain subject to any federal consumer financial law applicable to its activities regardless of whether such covered person is subject to the CFPB's supervisory authority.")

affiliate of such person if such affiliate acts as a service provider<sup>19</sup> to such person.<sup>20</sup> A “consumer financial product or service” is “any financial product or service ... offered or provided for use by consumers primarily for personal, family, or household purposes.”<sup>21</sup> The term generally includes, subject to Title X, extending credit and servicing loans; extending or brokering leases of personal or real property that are the functional equivalent of purchase finance agreements; providing real estate settlement services; engaging in deposit-taking activities; selling, providing, or issuing stored value or payment instruments; providing check cashing, check collection, or check guaranty services; providing payments or other financial data processing products or services to a consumer by any technological means; providing financial advisory services to consumers on individual financial matters or relating to proprietary financial products or services; collecting, analyzing, maintaining, or providing consumer report information or other account information; and collecting debt related to any consumer financial product or service.<sup>22</sup> The Act also provides a “catch-all” by including in the definition of financial product or service “... *such other financial product or service as may be defined by the Bureau.*”<sup>23</sup> The Bureau is to define such financial products or services by regulation in certain cases, including where the product or service is designed to evade law, is of a type that is permitted for a bank to offer, or otherwise is likely to have a material impact on consumers.<sup>24</sup>

<sup>19</sup> A service provider is “any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that participates in designing, operating, or maintaining the consumer financial product or service; or processes transactions relating to the consumer financial product or service.” Dodd-Frank Act, § 1002(26), 124 Stat. at 1962-63. Providers of certain support services (or other ministerial services) and providers advertisements for a consumer financial product or service through print, newspaper, or electronic media are not service providers (*i.e.*, solely by virtue of such services). *Id.*

<sup>20</sup> *Id.* § 1002(6), 124 Stat. at 1956.

<sup>21</sup> *See generally id.* § 1002(5), 124 Stat. at 1956. Products and services subject to Title X do not include those offered in the business of insurance or electronic conduit services. *Id.* at § 1002(15)(C), 124 Stat. at 1960. The term “electronic conduit services” is defined in § 1002(11), 124 Stat. at 1956.

<sup>22</sup> *Id.* § 1002(15)(A), 124 Stat. at 1957-60.

<sup>23</sup> *Id.* § 1002(15)(A)(xi), 124 Stat. at 1960 (emphasis added).

<sup>24</sup> *Id.* Specifically, if the Bureau finds that such financial product or service is (i) entered into or conducted as a subterfuge or

Under Section 1024, the CFPB is given express authority to institute a supervisory program for (and to examine) non-depository covered persons of *all sizes* in the mortgage,<sup>25</sup> payday lending, and private student lending markets.<sup>26</sup> The Act also provides the Bureau with authority to identify other types of covered persons to be subject to its supervision, but with the limitation that such covered persons be “larger participants” in other markets, as defined by the Bureau in consultation with the Federal Trade Commission.<sup>27</sup> Such markets may include, for example, consumer installment loans, money transmission, and debt collection.<sup>28</sup> In addition, the Bureau may supervise covered persons, following certain procedures (cause, notice, and a reasonable opportunity for such covered person to respond), based on information that such covered person is engaging, or has engaged, in conduct that poses risks to consumers.<sup>29</sup> Subtitle B of Title X also provides the Bureau with broad examination and supervisory authority over a service provider to a supervised non-depository covered person.<sup>30</sup>

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with purpose to evade any federal consumer financial law; or (ii) permissible for a bank or for a financial holding company to offer or to provide under any provision of a federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers.

<sup>25</sup> A covered person in the mortgage market includes a covered person that offers or provides origination, brokerage, or servicing of loans secured by real estate for use by consumers primarily for personal, family, or household purposes, or loan modification or foreclosure relief services in connection with such loans. *Id.* § 1024(a)(1)(A), 124 Stat. at 1987.

<sup>26</sup> The term “private education loan” is defined by reference to section 140 of the Truth in Lending Act, 15 U.S.C. 1650. *See* Dodd-Frank Act, § 1024(a)(1)(D), 124 Stat. at 1987.

<sup>27</sup> *Id.* § 1024(a)(2), 124 Stat. at 1987.

<sup>28</sup> *Defining Larger Nonbank Participants*, CONSUMER FINANCIAL PROTECTION BUREAU, <http://www.consumerfinance.gov/defining-larger-nonbank-participants/>.

<sup>29</sup> *Id.* § 1024(a)(1)(C), 124 Stat. at 1987. Such information may include complaints collected through the complaint system established under Subtitle A of Title X or information from other sources.

<sup>30</sup> *Id.* at § 1024(e), 124 Stat. at 1990 (providing that the service provider is subject to the authority of the Bureau under Section 1024 to the same extent as if such service provider were engaged in a service relationship with a bank, and the Bureau were an appropriate federal banking agency under section 7(c) of the Bank Service Company Act (12 U.S.C. 1867(c)). In

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## Larger Market Participants

In June 2011, the CFPB published a Notice and Request for Comment requesting input on how to define “larger participants” in certain consumer financial products and services markets.<sup>31</sup> The rule must be finalized by July 21, 2012. The larger participant rule will not impose substantive consumer protection requirements, but instead will enable the CFPB to begin a supervision program for larger participants in certain markets to, among other things, ensure that they are complying with existing federal consumer financial law.<sup>32</sup>

In the Notice, the CFPB suggested potential criteria and thresholds that could be used to define larger participants of a market, including annual number of transactions in the market; annual value of transactions (e.g., total loan volume); annual receipts or revenue; geographic coverage (e.g., number of states where engaged in business); asset size; and outstanding loan balances.<sup>33</sup> Per the proposed rulemaking, the thresholds used to define a larger participant under the criteria used might be based on an absolute approach (e.g., a covered person with an annual loan volume of \$X is a larger participant or doing business in a specified number of states), or could be based on a relative approach (e.g., every market participant having an annual transaction volume of a certain market share).<sup>34</sup> The Notice also sought comment on other issues related to the definition of a larger participant, such as whether the CFPB should tailor the criteria and thresholds to each market. For example, a larger participant in a market for consumer credit might be defined using criteria and thresholds different from those used in the market for consumer debt collection.<sup>35</sup>

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conducting any examination or requiring any report from a service provider, the Bureau is to coordinate with the appropriate prudential regulator, as applicable. *Id.* For a definition of “service provider” see *supra* note 19.

<sup>31</sup> Defining Larger Participants, 76 Fed. Reg. at 38,059.

<sup>32</sup> *Id.*; see also Building the CFPB, *supra* note 10.

<sup>33</sup> Defining Larger Participants, 76 Fed. Reg. at 38,060. The Notice expressly recognizes the requirement in the Act that, for purposes of computing activity levels of a market participant, the activities of a participant must be aggregated with the activities of non-depository affiliated companies. *Id.* (citing Dodd-Frank Act, § 1024(a)(3)(B), 124 Stat. at 1987).

<sup>34</sup> Defining Larger Participants, 76 Fed. Reg. at 38,060.

<sup>35</sup> *Id.*

As part of its supervision program, the Bureau noted that it is considering the establishment of a registration program for certain covered persons through future rulemaking (as authorized by the Act) to receive certain relevant information from covered persons.<sup>36</sup> The Notice specifically requested input on the data that the Bureau should collect through such a registration process to use in its larger participant determinations. The Notice also solicited comment regarding which markets for consumer financial products and services should be addressed in the initial rule, and specifically requested input on whether the following six categories, identified and further described in the Notice, should be covered: debt collection related to consumer financial products or services; consumer reporting; consumer credit and related activities (including automobile loans and unsecured consumer installment loans); money transmitting, check cashing, and related activities; prepaid cards; and debt relief services.<sup>37</sup> The Notice also solicited comment on whether other markets should be included in the CFPB’s rule.<sup>38</sup>

## Supervisory Powers

### Examination and Reporting

The supervisory powers provided to the Bureau under Section 1024 include the authority to conduct periodic examinations of and impose reporting requirements on covered non-depository financial institutions. The goals of the examination and reports are to (1) assess the covered person’s compliance with the requirements of federal consumer financial law; (2) obtain information about the activities and compliance systems or procedures of the covered person; and (3) detect and assess risks to consumers and to markets for consumer financial products and services. Title X requires that the Bureau exercise its examination and reporting authority using a risk-based approach, taking into consideration, as applicable: (A) the asset size of the covered person; (B) the volume of transactions involving consumer financial products or services in which the covered person engages; (C) the risks to consumers created by the provision of such consumer financial products or

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<sup>36</sup> Defining Larger Participants, 76 Fed. Reg. at 38,060 (citing Dodd-Frank Act, § 1022(c)(7), 124 Stat. at 1984; § 1024(b)(7), 124 Stat. at 1988). As stated in the Notice, the number of covered persons that may be subject to these registration requirements may be larger than the number that will be subject to the Bureau’s supervision under Section 1024(a)(1). Defining Larger Participants, 76 Fed. Reg. at 38,061 n. 18.

<sup>37</sup> Defining Larger Participants, 76 Fed. Reg. at 38,060.

<sup>38</sup> *Id.* at 38,061.

services; (D) the extent to which such institutions are subject to oversight by state authorities for consumer protection; and (E) any other factors that the Bureau determines to be relevant to a class of covered persons.<sup>39</sup> The Bureau is required to take certain measures to minimize regulatory burden to covered persons. For example, the Bureau is required to coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and state bank regulatory authorities, including with respect to examination and reporting.<sup>40</sup> To the fullest extent possible, the Bureau must also use reports of covered persons that have been provided to another federal or state agency and publicly reported information.<sup>41</sup>

In addition to the express examination and reporting requirements relating to non-depository covered persons, the Bureau is also given authority to collect information about certain persons pursuant to the general rulemaking authority granted to the Bureau under Section 1022 of Subtitle B. For example, to support its rulemaking and other functions, the Bureau is required to monitor markets for consumer financial products or services (taking into consideration various designated factors),<sup>42</sup> and is expressly authorized to collect information from covered persons and service providers, including by requiring them to file reports or other information with the Bureau.<sup>43</sup> In addition, in order for the Bureau to assess whether a non-depository is a covered person, the Bureau may require a non-depository to file reports or information with the Bureau.<sup>44</sup>

### *Registration and Recordkeeping*

Section 1024 establishes the CFPB's authority to require covered non-depository financial institutions to register with the Bureau and to follow certain recordkeeping requirements. This section also authorizes the Bureau to prescribe rules to ensure that non-depository persons are "legitimate entities" and are

able to perform their obligations to consumers.<sup>45</sup> Requirements under such rules may include background checks for principals, officers, directors, or key personnel, and bonding or other appropriate financial requirements.<sup>46</sup> The Bureau is required to consult with state agencies regarding such requirements and registration systems (including coordinated or combined systems for registration), where appropriate.<sup>47</sup>

The rulemaking authority granted to the Bureau under Section 1024 also enables the Bureau to prescribe rules regarding registration requirements for non-depository covered persons, which may include (subject to privacy and confidentiality considerations) the public disclosure by the Bureau of registration information to facilitate the ability of consumers to identify covered persons that are registered with the Bureau.<sup>48</sup> Such registration requirements are to be developed in consultation with state agencies (including with respect to the use of any coordinated or combined systems for registration), where appropriate.<sup>49</sup>

### **Enforcement**

Section 1024 gives the CFPB enforcement powers over covered non-depository financial institutions.<sup>50</sup> Enforcement actions taken by the Bureau with respect to non-depository financial institutions are, however, to be coordinated with the FTC (pursuant to an agreement).<sup>51</sup> Subtitle E of Title X of the Act provides general enforcement powers for the Bureau. Such powers

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<sup>39</sup> Dodd-Frank Act, § 1024(b)(2), 124 Stat. at 1987-88.

<sup>40</sup> *Id.* § 1024(b)(3), 124 Stat. at 1988.

<sup>41</sup> *Id.* § 1024(b)(4), 124 Stat. at 1988.

<sup>42</sup> *Id.* § 1022(c)(2), 124 Stat. at 1982.

<sup>43</sup> Note that the obligation of covered persons and service providers to submit to such information requests is not limited to covered persons that are subject to the supervisory program of the Bureau under Section 1024, but applies to such persons generally. *Supra* note 36 (citing *Defining Larger Participants*, 76 Fed. Reg. at 38,061 n. 18).

<sup>44</sup> Dodd-Frank Act, § 1024(b)(1), 124 Stat. at 1987.

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<sup>45</sup> *Id.* § 1024(b)(7)(C), 124 Stat. at 1988.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* § 1024(b)(7)(D), 124 Stat. at 1989.

<sup>48</sup> *Id.* § 1022(c)(7), 124 Stat. at 1984.

<sup>49</sup> *Id.*

<sup>50</sup> The CFPB recently announced that it will provide an early warning notice process for enforcement proceedings, which can help mitigate market participants' vulnerability. *Early Warning Notice*, CONSUMER FINANCIAL PROTECTION BUREAU (November 7, 2011), <http://www.consumerfinance.gov/wp-content/uploads/2011/11/EarlyWarningNotice.pdf>. The Bureau also recently requested comments on its proposed final rule on procedures that govern the process, described in Section 1042(b) of the Dodd-Frank Act, by which state officials notify the CFPB of enforcement actions. *See Proposed Collection; Comment Request*, 76 Fed. Reg. 71,932 (November 21, 2011).

<sup>51</sup> Dodd-Frank Act, § 1024(c)(3), 124 Stat. at 1989. This section also authorizes certain federal agencies to recommend that the Bureau initiate enforcement proceedings against covered persons. *Id.* at § 1024(c)(1), 124 Stat. at 1989.

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include the authority to conduct investigations as authorized under Title X, including to issue subpoenas,<sup>52</sup> and conduct hearings and adjudication proceedings to enforce compliance with Title X and other federal consumer law (unless specifically limited).<sup>53</sup> Subtitle E also confers litigation authority to the Bureau. Generally, if any person violates a federal consumer financial law, the Bureau may commence a civil action (in coordination with the Attorney General of the United States) to impose a civil penalty or to seek legal and equitable relief (including a permanent or temporary injunction as permitted by law).<sup>54</sup> Although the Bureau does not have authority to bring criminal enforcement actions, it is required to refer evidence of criminal conduct to the Attorney General.<sup>55</sup>

Subtitle E expressly provides the courts (or the Bureau) with jurisdiction to grant appropriate legal or equitable relief with respect to the violation of federal consumer financial law. Relief may include, for example, rescission or reformation of contracts; refund of moneys or return of real property; restitution; disgorgement or compensation for unjust enrichment; payment of damages or other monetary relief; public notification regarding the violation (including the costs of notification); limits on the activities or functions of the person; and civil money penalties depending on the degree of the violation and taking into account mitigating factors.<sup>56</sup> In addition, states are expressly authorized under Title X to take action to enforce Title X and its rules.<sup>57</sup>

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<sup>52</sup> Dodd-Frank Act, § 1052(b), 124 Stat. at 2019.

<sup>53</sup> Dodd-Frank Act, § 1053, 124 Stat. at 2025-28.

<sup>54</sup> *Id.* § 1054, 124 Stat. at 2028. Actions must follow the procedures for forum and timing for bringing action and are subject to the provisions relating to limitations under other federal laws. *See generally id.* § 1054(f), (g), 124 Stat. at 2029. Note that Section 1024 sets forth specific rules of conduct between the Bureau and the FTC in connection with civil actions brought by either agency. *Id.* § 1024(c)(3), 124 Stat. at 1989.

<sup>55</sup> Dodd-Frank Act, § 1056, 124 Stat. at 2031. The Bureau is also obligated to refer matters that may involve tax law non-compliance to the Internal Revenue Service. *Id.* § 1024(b)(6), 124 Stat. at 1988.

<sup>56</sup> *Id.* § 1055(a), 124 Stat. at 2030. Title X also sets forth procedures for assessing penalties and rights of the Bureau to modify penalties. *Id.* § 1055(c), 124 Stat. at 2030-31.

<sup>57</sup> *See generally id.* § 1042, 124 Stat. at 2012. If practicable, a state attorney general or state regulator is to provide a copy of any complaint and a description of the action to the Bureau and

## **Entities Excluded from Bureau Regulation**

Certain types of persons are exempt under Section 1027 and 1029 of the Act (part of Subtitle B of Title X) from Bureau rulemaking, supervision and/or enforcement. Subject to Title X, the CFPB generally does not have jurisdiction over merchants or sellers of nonfinancial goods or services.<sup>58</sup> Title X also generally exempts real estate brokers and agents; manufactured and modular home retailers (who do not offer or provide any consumer financial product or service); tax preparers; attorneys;<sup>59</sup> persons regulated by state insurance or securities regulators, persons regulated by the Securities Exchange Commission, the Commodity Futures Trading Commission, or the Farm Credit Administration; activities related to charitable contributions; and employee benefit and compensation

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the prudential regulator before initiating any action to enforce any provision of Title X or Bureau regulation. *Id.* § 1042(b), 124 Stat. at 2013. Although beyond the scope of this article, we note that Subtitle D of Title X expressly provides for the preservation of state law and, accordingly, states may generally continue to take action to enforce claims relating to consumer financial products and services. *See, e.g., id.* § 1041(a), 124 Stat. at 2011, which generally provides that state law is not preempted except to the extent inconsistent with Title X; *see also id.* § 1042, 124 Stat. at 2012-13, generally providing that a state may bring a civil action to enforce provisions of Title X, and to secure remedies, and also expressly preserving state authority with respect to regulatory proceedings arising solely under the law in effect in that state. Subtitle D also requires the Bureau to take certain consumer protection regulations in response to state action. *Id.* § 1041, 124 Stat. at 2011 (providing that the Bureau must issue a notice of proposed rulemaking whenever a majority of the states has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau). In early 2011 the CFPB and the Conference of State Bank Supervisors signed a memorandum of understanding that establishes a foundation of state and federal coordination and cooperation for supervising covered persons. *CFPB Implementation Team and CSBS Sign Information Sharing Memorandum of Understanding*, CONFERENCE OF STATE BANK SUPERVISORS, January 4, 2011, *available at* <http://www.csbs.org/news/press-releases/pr2011/Pages/pr-010411.aspx>.

<sup>58</sup> Dodd-Frank Act, § 1027(a), 124 Stat. at 1995.

<sup>59</sup> An independent contractor (including any attorney, appraiser, or accountant) would be deemed a “covered person” if they knowingly or recklessly participate in any violation of any provision of law or regulation, or breach of a fiduciary duty. *Id.* § 1002(25)(C), 124 Stat. at 1962.

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plans. Auto dealers are also generally exempt from Title X, so long as they are predominantly engaged in the servicing and sale or leasing of motor vehicles.<sup>60</sup> In addition, under Subtitle B, the Bureau, by rule, may conditionally or unconditionally exempt any class of covered persons, service providers, or consumer financial products or services, from Title X or its rules (taking into consideration factors specified in Title X).<sup>61</sup>

Notwithstanding the exemptions described above, Title X is clear that “excluded” persons may still be service providers subject to certain Bureau authority (e.g., required to respond to requests from, or requirements imposed by, the Bureau regarding information in order to carry out the responsibilities and functions of the Bureau and in accordance with Title X).<sup>62</sup>

## **SUPERVISION AND EXAMINATION MANUAL**

### ***Overview and Structure***

On October 13, 2011, the Bureau issued its first Supervision and Examination Manual, which is a guide to how the CFPB will supervise and examine consumer financial service providers under its jurisdiction for compliance with federal consumer financial law. The Supervision Manual is divided into three parts. The first part describes the supervision and examination process generally. The second part contains examination procedures, including both general instructions and procedures for determining compliance with specific laws (including the enumerated consumer laws<sup>63</sup>). Examination procedures include instructions with

respect to, for example, review of the institution’s compliance management and board of directors and management oversight, and review of the institution’s compliance program and consumer complaint response systems. The third part presents templates for documenting information about supervised entities and the examination process, including preparation of entity profiles and risk assessments, development of the supervisory plan and examination scope summary, and drafting and submitting examination reports.<sup>64</sup> Set forth below is a summary of certain key components of the Manual.

### ***Examination Scheduling***

Consistent with the Act, the Supervision Manual states that non-depository financial institutions will be identified for examination on the basis of risks to consumers, including consideration of the company’s asset size, volume of consumer financial transactions, extent of state oversight, and other factors determined relevant by CFPB. The Manual notes that examinations will be coordinated with state and prudential regulators as applicable.<sup>65</sup>

In addition to regularly scheduled examinations, the Supervision Manual says that the CFPB expects to conduct “Target” and “Horizontal” Reviews. Target Reviews will generally involve a single entity and will focus on a particular situation, such as significant volume of particular customer complaints or a specific concern that has come to CFPB’s attention. Horizontal Reviews will look across multiple entities to examine issues arising from particular products or practices, and determine whether supervisory measures or enforcement actions are needed. According to the Manual, supervised entities will generally be notified in advance of an upcoming examination.

### ***Examination Procedures***

The Supervision Manual addresses, among other things, pre-examination planning procedures for the Bureau. Generally, based on review and collection of information following procedures described in the Supervision Manual (and consistent with the Act), the Bureau conducts a risk assessment to determine the focus and scope of the examination, and also to determine specific informational requests from the

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<sup>60</sup> *Id.* § 1029, 124 Stat. at 2004.

<sup>61</sup> *Id.* § 1022(b)(3), 124 Stat. at 1981.

<sup>62</sup> *Id.* § 1027, 124 Stat. at 1995. Title X makes certain acts of a covered person or service provider expressly unlawful, including to fail or refuse, as required by federal consumer financial law: (A) to permit access to or copying of records; (B) to establish or maintain records; or (C) to make reports or provide information to the Bureau. *Id.* § 1036(a)(2), 124 Stat. at 2010-11.

<sup>63</sup> These include, specifically, procedures to review rules relating to unfair, deceptive, or abusive acts or practices, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Homeowners Protection Act, the Consumer Leasing Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Electronic Funds Transfer Act, the Truth in Savings Act, rules relating to the privacy of consumer of financial information under Gramm Leach Bliley Act, and rules relating to mortgage servicing.

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<sup>64</sup> The introduction to the Supervision Manual notes that the Bureau expects to continually update the Manual as compliance requirements evolve and expressly provides an e-mail for the industry (and other stakeholders) to provide comments.

<sup>65</sup> Dodd-Frank Act, § 1024(b)(3), 124 Stat. at 1988.



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institution.<sup>66</sup> The Supervision Manual specifies key documents and information relevant to the review, as well as factors to assess risk (e.g., consumer complaints, types of consumers using the institution's products or services, and the institution's handling of complaints, regulatory violations, and matters requiring attention identified in prior examinations by the CFPB or other regulatory agencies).

Detailed examination procedures are located in Part II of the Supervision Manual.<sup>67</sup> Briefly, during the course of an examination, the Bureau will collect and analyze available and requested information; conduct risk analysis; consider corrective actions (if any); and prepare and issue an examination report. The Manual describes examination follow-up, such as addressing negative findings, and states that a determination of whether informal supervisory measures or formal enforcement action (as described in the Act) is necessary will depend on the type of problem(s) found and the severity of harm to consumers.<sup>68</sup>

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<sup>66</sup> The Supervision Manual includes a "Risk Assessment" template, which is designed to evaluate risk to consumers from the activities of a supervised entity and to identify the sources of that risk. To determine risk, the template considers the "inherent risk" in a particular line of business or the entity as a whole, and the quality of controls implemented by the entity to manage and mitigate those risks. Inherent risk includes factors that increase the potential for unfair, deceptive, or abusive acts or practices, for discrimination, or for violations of other federal consumer financial laws. Inherent risk is based on factors including: (1) nature and structure of products (including whether profitability is dependent upon penalty fees, whether the terms of the product are subject to change at the discretion of the entity, and whether the entity reverses fees at a significantly higher rate than its competitors); (2) consumers to whom products are marketed (e.g., target marketing to certain populations or demographics, such as students, elderly, minorities, immigrants, low-income consumers); (3) marketing methods and sales organizations (including incentives and compensation and whether material is understandable and/or misleading); and (4) ongoing customer relationship management (including whether vendors with customer service responsibilities, including collections, are evaluated based on quality of service or level of customer satisfaction).

<sup>67</sup> The Supervision Manual advises that the examination will be similar to those of the prudential and, in some instances, state regulators.

<sup>68</sup> The Supervision Manual notes that self-correction will be encouraged, but some circumstances may nevertheless be sufficiently serious to warrant a public enforcement action.

## **Compliance Rating**

The Supervision Manual sets forth the procedure for examiners to determine, based on examination findings, the compliance rating of the organization, which follows the Federal Financial Institutions Examination Council Uniform Consumer Compliance Rating System.<sup>69</sup> The rating system is based on a scale of 1 through 5 in increasing order of supervisory concern. Each of the five ratings is described in greater detail in the Supervision Manual, which also discusses factors for examiners to include in assigning a consumer compliance rating (e.g., the nature and extent of present compliance with federal consumer financial law, the commitment of management to compliance and its ability and willingness to take the necessary steps to assure compliance, and the adequacy of systems, including internal procedures, controls, and audit activities designed to ensure compliance on a routine and consistent basis). Organizations with lower ratings (e.g., 3, 4 or 5) will need stronger supervisory attention and closer monitoring.

## **CONCLUSION**

Title X subjects non-depository providers of consumer financial goods and services to unprecedented federal oversight and examination by the Bureau, a new regulatory agency. Although the scope of such regulation and the manner in which it will be exercised remains to be seen, the potential latitude for supervision and examination granted to the Bureau in Title X is broad, and includes the Bureau's authority to extend the scope of its enforcement to participants as defined by rulemaking. Further, recent actions, as well as statements of Director Cordray, indicate that the Bureau may be active in its oversight of non-depository covered persons. Based on the Bureau's mandate, the Notice on how to define larger participants and the Supervision Manual, the covered persons most likely to be impacted appear to be those in industries that the Bureau determines pose the most risk to consumers and/or those determined by the Bureau to be the largest in their applicable markets. ■

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<sup>69</sup> The Supervision Manual restates the confidential treatment by the CFPB of all supervisory information, including examination reports and ratings, which will be handled in accordance with the regulation on the Disclosure of Records and Information. 76 Fed. Reg. 45,372 (July 28, 2011).

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