ALERTS

Consumer Financial Protection Bureau Issues Final Rule Regarding Supervision of Nonbanks That Pose Risks to Consumers

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On June 26, 2013, the Consumer Financial Protection Bureau (the "Bureau") issued a final rule setting forth procedures for determining whether a nonbank covered person should be brought within its supervisory authority pursuant to Section 1024(a)(1)(C) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act"). The Act authorizes the Bureau to supervise "nonbank covered persons"[1] when the Bureau has reasonable cause to determine that such persons are engaging, or have engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services. The Bureau's reasonable cause determination must be based on complaints collected by the Bureau; however, the Bureau may also include information collected from other sources. Considerations relevant to the Bureau's assessment of risk include whether the nonbank covered person's conduct involves potentially unfair, deceptive or abusive acts or otherwise violates applicable federal consumer financial law.

In addition to the Bureau's Section 1024(a)(1)(C) supervisory authority, the Bureau also has supervisory authority over: (1) nonbank covered persons of any size that offer or provide: (a) residential mortgage loans, including origination, servicing, or brokerage services; (b) private education loans; and (c) payday loans; and (2) larger participants of markets of other consumer financial products or services, which the Bureau defines by rule. The procedures established by the final rule will be used only to assess whether a nonbank covered person will be subject to the Bureau's

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supervisory authority based on a reasonable cause determination. Therefore, the Bureau will likely have no reason to make such a determination if a nonbank covered person is already subject to the Bureau's supervisory authority pursuant to one of the other enumerated bases.[2]

Nonbank covered persons subject to the Bureau's supervisory authority will be required to provide reports and to permit the Bureau to conduct examinations on a periodic basis for the purposes of: (1) assessing compliance with the requirements of federal consumer financial law; (2) obtaining information about activities and compliance systems or procedures; and (3) detecting and assessing risks to consumers and to markets for consumer financial products and services. This supervisory authority extends to all of the nonbank covered person's activities involving consumer financial products or services, not just the products or services that rendered the nonbank covered person subject to supervision.

The final rule outlines a four-part process that the Bureau must follow when making its reasonable-cause determination:

1. *Issuance of Notice of Reasonable Cause*. The Bureau will initiate the supervisory process by delivering a Notice of Reasonable Cause ("Notice") to a person stating that the Bureau may have reasonable cause to determine that the respondent ("Respondent") is a nonbank covered person that is engaging, or has engaged, in conduct that poses risks to consumers with regard to consumer financial products or services. Under the final rule, a Notice does not constitute a notice of charges for any alleged violation of federal consumer financial law or other law.

2. *Opportunity to Respond*. The Respondent may provide a written response to the Bureau within 30 days of receipt of a Notice, including a request for an opportunity to present a supplemental oral response in person or by telephone. Failure to respond in a timely manner to a Notice will result in a waiver of the right to respond and may result in a default determination. Alternatively, the Respondent may voluntarily consent to the Bureau's authority.[3] The proceedings under the final rule are informal and do not constitute an adjudication under the Administrative Procedure Act. Accordingly, no discovery is permitted, as a supplemental oral response does not constitute a hearing on the record, and no witnesses may be called.

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3. *Determinations*. The Associate Director of Supervision, Enforcement, and Fair Lending will make a recommended determination to the Director of the Bureau within: (a) 45 days after receiving a timely filed response; (b) 45 days after the service of a Notice when a Respondent fails to file a timely response; or (c) 90 days after service of a Notice if the Respondent requests an opportunity to present an oral response. The Director will make a determination whether to adopt the Associate Director's recommended determination within 45 days.

4. *Post-Determination Procedures*. If the Director subjects the Respondent to the Bureau's supervision, the Respondent must wait two years before it can petition for termination of the order. The Respondent may only submit one petition per year. Not later than 90 days after submission of a petition, the Director will issue a written decision either terminating or modifying the order, or denying the petition.

Due to the short 30-day time frame permitted for response, nonbank covered persons should be proactive in compiling documents, records, or other evidence that supports why they should not be subject to the Bureau's supervisory authority. To be prepared for a Notice, nonbank covered persons should focus on managing indicia of consumer risk, including their procedures for handling consumer complaints, and should review their compliance with all aspects of federal consumer financial law.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] The final rule, effective Aug. 2, 2013, applies to any person that engages in offering or providing consumer financial products or services,including their affiliated service providers. It does not apply to insured depository institutions or credit unions, or, in the case of such entities with assets of more than $10 billion, their affiliates. The final rule is available at http://www.gpo.gov/fdsys/pkg/FR-2013-07-03/pdf/2013-15485.pdf.

[2] Potentially, however, if the Bureau believed that a nonbank covered person qualified for supervision under another provision of Section 1024 and such entity disagreed, and the Bureau believed that there might be

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reasonable cause to determine that the nonbank covered entity was engaging, or had engaged, in conduct that posed a risk to consumers, the Bureau could use the procedures set forth in the final rule to establish supervisory authority under Section 1024(a)(1)(C).

[3] A Respondent's voluntary consent can be given in one of two ways: (1) by completing and executing the consent agreement provided with the Notice; or (2) by negotiating a consent agreement with the Bureau. If the Respondent chooses the former option, the respondent will be subject to the Bureau's supervisory authority for two years before the respondent may petition for a termination order. Alternatively, if the Respondent chooses the latter option, the duration of supervision must be specified in the negotiated consent agreement.

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