Consumer Finance Monitor (Season 6, Episode 8): The Consumer Financial Protection Bureau's Proposals to Create Two Public Registries for Nonbanks: What You Need to Know, Part I

Speakers: Alan Kaplinsky, Rich Andreano, John Culhane, Michael Gordon, and Lisa Lanham

Alan Kaplinsky:

Welcome to our award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry.

This is a weekly podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former Practice Group Leader for more than 25 years, and now Senior Counsel of the Consumer Financial Services Group at Ballard Spahr, and I will be moderating today's program.

For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted our blog since 2011 when the CFPB became operational, and there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com.

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So today I am happy to be joined by my colleagues, Rich Adreano, John Culhane, Mike Gordon, and Lisa Lanham. Rich is the Practice Group Leader of our Mortgage Banking Group and the Co-Chair of our Fair Lending Team in our Washington, DC office. He assists clients with preparing for and handling CFPB mortgage-related examinations and enforcement actions and with a variety of mortgage-related regulatory issues.

John Culhane is a Partner in our Consumer Financial Services Group who works out of our Philadelphia office. He's known for his works on advising clients on interstate, direct and indirect consumer loan, and leasing programs. John's practice includes preparing clients for banking agency and CFPB compliance examinations and assisting in the defense of attorney general investigations and banking agencies and CFPB enforcement actions.

Mike Gordon is a Partner in our Consumer Financial Services group based in our Washington, DC office. Mike is a former Senior CFPB Official with over two decades of experience in consumer financial services law. Mike focuses on enforcement defense, compliance and exam readiness, et cetera, et cetera. And Mike is one of the two new members of our Consumer Financial Services Group. When I say new, meaning that they joined us last year.

And finally, last but not least, I'm happy to introduce Lisa Lanham, who is in our Mortgage Banking Group and our Consumer Financial Services Group, and she co-leads our firm's Fintech and Payment Solutions Team. Her practices focuses on financial services matters related to state licensing and federal approvals that are necessary to conduct business for a variety of asset classes and market participants.

So today we're going to be repurposing a very successful webinar that we recently conducted entitled the CFPB's Proposals to Create Two Public Registries for Nonbanks, What You Need to Know. And today we will focus on part one of the webinar. Next week will be part two.

Part one will concentrate or will focus on the very first public registry proposed by the CFPB that would require nonbanks to register with and submit information to the CFPB for publication in an online publicly available database. And that proposal would require companies to register when as a result of judgements or settlements or otherwise, they become subject to orders from local, state, or federal agencies and courts involving violations of the consumer protection laws.

Part two, next week, would require companies to register if they use certain terms or conditions in form contracts, such as waivers of consumer rights and arbitration provisions, regardless of whether such terms or conditions are lawful.

Both of these proposals are a very aggressive attempt by the CFPB to enhance its supervisory and enforcement authority, and they carry very significant potential implications for all nonbanks that are in the consumer finance industry.

So I am now going to turn to the first registry, and I'm calling it the orders registry. It got published in the Federal Register on January 30th. Comments are due by March 31. We're helping a number of clients provide input with respect to comment letters on this proposal. And if you're interested in talking to us about that, of course we'd be happy to talk to you.

As a general overview, and we're going to drill down much deeper on this, it covers certain "covered nonbanks" that would be required to register with and submit certain information to the CFPB when they become subject to certain orders from local, state, or federal agencies or courts, and that includes settlements, involving violations of certain consumer protection laws. And we'll enumerate that later in the program.

I already referred to the additional annual attestation requirement that's going to apply to register nonbanks that are subject to CFPB'S supervision. The registry itself will apply to all nonbanks that are considered covered nonbanks, doesn't matter whether or not the nonbank is already being supervised and examined by the CFPB. The other important point here is that the registration information will be publicly available on the bureau's website.

So this is the legal authority being relied upon by the CFPB Sections 1022, Section 1024. I'm not going to read these provisions. You can look at them. I would say as a general matter that this first registry probably, while I think it's very bad policy and overkill, it is probably going to be difficult to challenge from a legal standpoint. The second registry on the other hand, I think there are stronger grounds for going to court to challenge the CFPB about it.

So let me just make a, I guess you could say an editorial comment. According to the CFPB, this registry will allow it to more effectively monitor and reduce the risks to consumers posed by so-called repeat offenders. And of course, we've heard that mantra many times from Rohit Chopra. He does not like people who repeatedly violate the law, and this is one of many aspects of basically a mosaic that he has put together to go after repeat offenders.

However, the industry has raised serious concerns about the bureau's proposed registry, including that it seems more like a name-and- shame tactic rather than a useful tool. In our view, the registry bears great similarity to the CFPB's disclosure of unverified anecdotal complaint data in its consumer complaint database. Since the creation of the database, a primary concern of industry and one which we have often noted in our blog, has been that because complaints are often invalid, they don't serve as reliable evidence that the complained-about conduct occurred. The proposed rule would require registration of consent orders, not just litigated cases, not just judgements.

In most consent orders, the company doesn't admit any wrongdoing. Indeed, enforcement actions are very often resolved through consent orders, not because the company is engaged in the wrongful conduct that was alleged by the enforcement agency, but because enforcement actions are very costly to defend and they're a huge drain on a company's resources.

So with that introduction, I'm now going to turn the program over to Mike who's going to do some of the drilling down here.

Michael Gordon:

Thanks, Alan. And I completely agree with your editorial comments. And I would add that the bureau from its inception has had this dual mandate of supervising banks and nonbanks. And that was intentional from Congress. The idea was we need to level the playing field in terms of federal consumer protection in the financial regulatory space. And the bureau has struggled with how to attack the large and disperse nonbank market. And these registries represent a new tack and a novel and really expansive approach to conducting that oversight in the nonbank market participants. And so it is a new frontier.

The statutory authorities we'll talk about today exist within the bureau and we'll talk about the ones they're relying on, but they're using them under direction of Director Chopra in ways that the bureau hasn't done before. Both the registration of nonbanks, which they're opening up a new front there, as well as their use of the so-called market monitoring authority, which they rely upon as well in part for these registries.

So which kind of entities are going to be covered? These are nonbanks for this initial registry we're talking about now. It doesn't include depositories, it doesn't include states, and the bureau itself acknowledged how vast this potential community

could be. There could be they said 155,000 covered nonbanks by this orders registry. They guesstimate that 1 to 5% may have a covered order that would cause them to have to register here, but really those are rough estimates.

There's a subset of this group that, as we'll discuss later in the webinar, has an additional requirement, not just posting the orders but having an executive file an attestation. And that's a much smaller group and these are companies that are subject to the supervisory jurisdiction of the CFPB and that meet some other thresholds.

So for those who need a refresher, the bureau's enforcement jurisdiction covers many, many more nonbank entities than its supervisory jurisdiction, and it's that latter subset that has to do the attestation. So we'll cover more about that later, but that has important implications for the companies and what the burdens are.

I wonder, as I look at this, whether this is going to pave the way for future registries, either expanding on this one by expanding the types of information that need to be supplied or the types of companies that need to supply it. But like I said, it's the opening salvo in this nonbank registry tool that the bureau was given in its statute.

And of course, it's raised a lot of objections for the reasons that Alan touched on. For one, one can imagine how invested some people might be in the public, not just other regulators, but plaintiff's attorneys and others in seeing in one place all of these consent orders or other orders that might provide clues as to further investigation or targets for litigation. So with that, I will pass the baton.

Rich Andreano:

And thank you very much, Mike. And good day, everyone. Now, one of the important concepts here in addition to who is covered is what is covered and what are covered orders. And it is defined and we'll go through the slide and unpack. There's actually a lot of details here that the rule provides some additional guidance on, but a lot of the guidance is actually in the preamble to this.

Now, covered order, two initial concepts that are important, it's public and it's final. That's key. And then issued by an agency or court. We'll get into that a little bit in this list. And then whether or not issued upon consent or involuntary. So consent orders, as Alan had mentioned, are covered. The problem is a lot of people sometimes enter in consent orders because it's the cheaper thing to do. They think if they went to court they would win, but that's an expensive endeavor and draws a lot of attention from an entity in terms of its executive time, taking depositions, preparing for depositions, supplying documents. That's why a lot of people often agree to a consent order. That's one problem here with now publishing them the way the bureau intends to.

Now, final really means it is a final order. So for instance, preliminary injunction, temporary restraining order, interlocutory orders, those would not be covered. So this is really a final resolution in an order. Public is to get at the point that the bureau was not trying to venture into confidential supervisory territory, which is non-public. So if an order is non-public supervisory, then it's not covered. If part of an order is public and part is not because it's supervisory, the part that's not public would not be covered. You'd only have to register the covered or public parts of the provisions.

Now, it has to identify a covered nonbank as a party subject to the order. Key here, just doesn't have to identify them in the caption. Usually, there's a heading, CFPB v. whatever entity. As long as they're identified in the body of the order as a party being subject to the order, then that's sufficient.

However, if they're simply referenced, for instance, let's say someone's XYZ is subject to the order and the order mentions that XYZ has an affiliate ABC but doesn't say that ABC's subject to the order, it's just providing that information, that wouldn't make ABC an identified party that had to report that order. So either in the caption or in the body, somewhere it has to say XYZ is subject to this order to be identified.

Then it has to been issued by a federal, state, or local agency. Those are defined. The federal is quite broad. Of course, it includes the bureau itself. It includes all the banking regulators. It includes all the executive departments of the United States, so that's the cabinet level and other departments. But also includes government corporations and what's referred to in some of the statutes they reference as independent establishments. Basically, pretty much every federal agency or entity that can issue orders is going to fall within the definition. It's very, very broad.

Similarly, with the state, they actually define that more specifically rather than by reference to other statutes, it would include the attorney general or any regulatory or enforcement agency or authority. So not just agencies but authority, and a lot of times at state and local levels you have authorities. They would be covered. Similar, local regulatory or enforcement agency or authority of a municipality, a city, a county, just that is not a state, that would be local. So very broad concept again of what are those agencies.

Now again, it has to have public provisions, but these provisions have to impose obligations on the party that's subject to the order. So what could that be? Could be an injunction to engage in certain conduct or refrain from engaging in certain conduct. Could be to pay a civil money penalty. Could be to pay damages or make amends to consumers in some fashion. So it has to be obligations.

In contrast, if there was simply a declaratory judgment that said XYZ violated a law, but there were no ramifications coming from that, then that would not be covered. They're looking for orders that impose obligations, and part of the theory is that so the bureau can somewhat assess are people complying with those obligations.

Now, it has to allege and oppose obligations in connection with an alleged violation of a covered law. We'll get to that on the next slide. Obviously, a very important concept. And it has an effective date. Notice some retro activity here of January 1, 2017. This is what the bureau mulled about a bit. Would it only be orders on or after the effective date of the rule? No, they thought they needed to go back, and they picked January 1, 2017.

Now, the way the rule is proposed though, let's say someone was subject to an order dated January 1, 2017 or perhaps later, that order would still need to be in effect as of the date the final rule becomes effective to be a covered order. So you have to look at that. When did it go into effect and is it still in effect when the rule becomes effective? If the order doesn't state the specific effective date, then the date it is issued will be deemed the effective date by virtue of proposal.

Now, so we mentioned covered law, an important concept, and let's see what laws would be covered. Key here is laws sometimes can address a variety of topics. So the covered law here that we're looking at, the alleged violation would have to be in connection with the offering or provision of a consumer financial product or service. You can get many laws that cover a variety of conduct that goes beyond consumer financial products and services. This is only aimed at consumer financial products or services. And it's federal consumer financial law or any other laws to which the CFPB has authority over. This is broad. It includes the Consumer Financial Protection Act. It includes all the Dodd-Frank enumerated statutes, Equal Credit Opportunity, Fair Credit Reporting Act, Truth in Lending Act, Real Estate Settlement Procedures Act, the whole laundry list, the alphabet soup, as we refer to it often, of consumer protection regulations.

Also, would include the Military Lending Act because the bureau does have enforcement authority over that act. So it is a broad list of statutes, but again, only to the extent it's addressing the offering of a consumer financial product or service.

Then as you might expect, the Federal Trade Commission's unfair and deceptive acts and practices in Section 5 of the FTC Act, that is covered. In addition to that, however, also is any rule issued by the FTC under that authority or any order issued by the FTC or another agency under that Section 5 authority.

However, do you remember, that section also prohibits unfair competition. That's more of an antitrust concept. That is carved out. That would not be deemed a covered law. If the violation only relates to unfair competition, it would not be covered.

State laws, again here key, they're focusing on unfair, deceptive, or abusive acts or practices. What the bureau has done is listed in Appendix A to the proposal the statutes it thinks that are covered by state and it includes both general UDAP-type laws, laws that apply to conduct in general, and then industry-specific UDAP provisions as well.

Now, the bureau thinks it's been comprehensive, but it has requested comment on whether anyone believes any additional laws should be specified in Appendix A. And the way it drafted Appendix A, also it's meant to be somewhat of a living appendix because if there's a law that amends or succeeds any identified law, as long as it's materially similar to the predecessor law, it's deemed to be part of Appendix A. That's the way they handled the proposal. That way they don't have to keep constantly revising Appendix A when states make changes.

Then also state, consistent with the FTC Act approach that rules or orders if issued under Section 5 are covered, a rule or order issued under any of these identified state laws for purposes of implementing a UDAP prohibition is also covered. So quite broad.

With that now, I'd like to hand the presentation offer to John Culhane who will address the registration and annual reporting requirements.

John Culhane:

Thanks, Rich. So I'm going to talk about registration, attestation, and recordkeeping. There's a little bit of redundancy here because you sort of need to pick up all the definitions that have preceded this discussion. But I think we can go through these fairly quickly.

So we know who's going to be covered, a nonbank identified by name as a party subject to a covered order. Assuming that you are such an entity, you have 90 days to register, and that 90-day period is either going to run from the effective date of covered order, or if you're subject to a covered order that runs over into the effective date of the rule, then you've got 90 days from the effective date of the rule.

Covered orders have a fairly lengthy duration. They're assumed to be in existence for 10 years from the effective date unless there's an expressly provided termination date. And I think we all know that state attorneys general and government agencies are very reluctant to agree to a termination date in their order. The information to be submitted is what you'd expect, copy of the order identifying the governmental entity that issued it, stating the effective date and any expiration date, the laws that were violated or alleged to have been violated.

So let's now talk about attestation, or I think what we're going to be referring to it as is the provision that's going to make it very difficult and very expensive to find a chief compliance officer going forward.

So there's an additional requirement for attestation that applies to supervised registered entities. Supervised entities are the ones that you'd expect. They're the ones that CFPB can exercise supervisory jurisdiction over. So these are the ones that are identified in Section 1024 of Dodd-Frank. That includes mortgage companies and mortgage servicers, payday lenders, private education lenders, entities that are a larger participant under one of the existing larger participant rules, as well as entities as to whom the CFPB has invoked risk-based supervision. You may recall that there was a lot of discussion about this going back to April of last year. The CFPB made it clear that it was going to revive this dormant authority and start designating entities as posing risks and supervising them on that basis.

Okay, so those are the entities we're concerned about. Who's exempt?. There actually are a few entities that are exempt. Service providers that are only service providers are exempt. So this doesn't pick up every vendor of every supervised entity. Motor vehicle dealers that stay in their lane and just sell and service are exempt. And then we have a small entity exemption. But you've got to read this very carefully if you're going to rely on the small entity exemption. It picks up the definition of annual receipts that comes from the larger participant rule for consumer reporting agencies. That's basically tax income, but it's averaged over periods of time. It also picks up the income of affiliated entities. So if you're going to rely on that, you want to review that rule and the definition of annual receipts very carefully.

So let's talk about the annual attestation requirement. This is going to be pretty onerous actually, and I think it's intended to be onerous. A supervised entity that's subject to this requirement has to annually designate an attested executive for each covered order, and you probably have to designate an alternate too so that you have somebody available in case your designated entity leaves or changes duties or is subsequently put in a position where they're underneath the higher entity.

The attesting executive has to be the entity's highest-ranking senior executive officer, and it has to be a person who's got specific duties and knowledge and control. So compliance duties, knowledge of the entity's systems and procedures for complying with covered orders, and control over the entity's compliance efforts.

So really the CFPB's made it very clear that they want this attestation coming from the highest applicable level of management. They want this because they think it's going to motivate compliance, it's going to be an important part of anybody's compliance management system. And they want it because they want to be able to consider an enforcement action against the individual executive who provides the attestation if they decide that the attestation was improper.

How does this work? By March 31st of each calendar year, so the end of the first calendar quarter, you, the attesting executive are going to have to submit to the registration system a signed written statement with respect to each covered order. It has to describe the steps that you've taken to review and oversee the entity's activities that are subject to the order during the previous calendar year, and you have to attest whether to your knowledge, yes or no, no ambiguity here during the proceeding

calendar year any violations were identified or other instances of non-compliance were identified based on a violation of covered law. It includes injunctive relief, any other legal or equitable relief, any violation.

Now, the CFPB thinks that entities are or should be already doing this kind of monitoring, but they do ask if they should set minimum standards for this kind of review or if they should require additional information here.

So let's go to recordkeeping and we'll wrap up this part there. You do all of this, and then you have to keep your records for five years after submission to the CFPB. And those documents and records have to be made available to the bureau upon request and they have to be in a form that's sufficient for the CFPB to conduct an assessment of compliance. So we all know once this goes into effect, they're going to be requested routinely in every exam.

Now technically, you can submit a notice of non-registration as long as you have a good faith to believe either that you are not an entity that's required to comply here or that the order in question is not a covered order. It's really discretionary, but you have to comply once you become aware of facts or circumstances that would make that representation no longer accurate.

And the CFPB has said that if you do this and they believe it and they believe what you've said, then they won't bring an enforcement action against you based on failure to comply without some prior notice and opportunity to comply. They talked about looking at an alternative that would be to allow entities to skip filing as long as they could show they had a good faith belief that that was not required, but it doesn't seem likely that they're going to adopt that, although they did put it out there.

Lisa, let me turn it over to you and pass the baton so that you can discuss state requirements in the space that are already in place.

Lisa Lanham:

Well, thank you, John. So yeah, my practice largely focuses on helping nonbanks with matters of state law compliance and licensing compliance. So for me, reading through all of this with my colleagues, my general thought has just sort of been this is superfluous. We've been dealing with this for a very long time now.

Nonbanks, as you may know, are required to hold state licenses to engage in a variety of regulated activities as it is. Just naming a couple on the slide, commercial and residential mortgage brokering, lending and servicing, lead generation, commercial financing, private student loan lending and servicing, and a whole host of other regulated industries.

In order to obtain licenses, generally speaking, you apply through the NMLS or the Nationwide Multistate Licensing System and Registry. There are some licenses that are administered outside of the NMLS, but by and large they're all in there. And you have to complete and submit something that's called an MU1 Form, which includes disclosure questions and disclosure explanation sections that require you to provide yes or no answers to some regulatory action disclosure questions, which moving on to the next slide, include in the past 10 years has any state or federal regulatory agency or foreign financial regulatory authority or SRO ever, I'll just skip to number four, the bolded language, entered an order against the entity or a control affiliate in connection with a financial services-related activity?

So anytime that there is a public consent order, you are required to answer yes to something like this. With some sort of a public action by a regulator against you, you're required to answer yes to these questions and to provide an explanation for your response, your yes response, which usually includes a copy of the order or whatever it is that the regulator has, you've had to sign with them.

Just a very high-level note here, there are changes that are being proposed to these particular disclosure questions and explanations. We've been discussing it for a while now on the state level at conferences and what have you. Generally speaking, it's going to expand the amount of yes answers that nonbanks are required to give. We can give you, for anybody that's interested we can provide you with a copy of those. There's no proposed effective date just yet. We're still sort of working through what that language should be. But by and large, what the states are looking for are for you to provide more details about orders or actions like this as a part of your disclosure questions and explanations.

So just high level, there's certain things that you should be thinking about on the state level when it is that you're figuring out if you should answer yes or no to a particular question. And generally, the most determinative of the defined terms for making that determination is the definition of the word found. And found includes things like final adverse actions, consent decrees,

and orders in which the respondent has neither admitted nor denied the findings. And there's a lot of words here, but generally speaking, it excludes anything that would be private.

So if it's any sort of an action that you enter into with your state regulator that could be considered public, that isn't labeled some sort of private settlement agreement or private letter agreement or is just an administrative fine or penalty, you have to answer yes to your disclosure question and provide the proper explanation.

So going through this again, you have to provide your yes response. You have to provide a separate explanation for each event that results in a yes response. So if there are four things that you would be required to disclose in response to one question, you should be giving four explanations for the reasons why you're answering yes.

It alerts submitting a yes answer and a disclosure explanation, alerts the other state regulators to the regulatory action triggering the response. So that's a very important distinction here. Your obligation as a state license entity is to go into your record and answer yes or no and provide these responses, which then go to just your state regulators. It's not necessarily publicly disclosed.

From our perspective, it's the most important people, I guess, that are going to be seeing this, which is not always the public. Sometimes these things are very specific and they're not... Yeah, I've seen issues with financial statements come up as something that requires some sort of a consent order for whatever reason, and it's not anything that the public should be concerned about.

So it's fully within the discretion of your state regulators then to put it up on either a state-specific registry or in the NMLS Consumer Access, which is the public-facing website where you can look up your lenders, your brokers, your servicers, things like that, to see what might be out there.

So examples of these registries include Illinois, their Department of Financial and Professional Regulations Monthly Consolidated Reports on Enforcement Actions, these are things that are publicly available. You can see what's out there, you can read them. There's a couple of states that have state-specific registries, though I wouldn't say that there's a lot of them out there.

The second example is the NMLS Consumer Access, which again is the public record for consumers to look things up. And you can actually see what's out there by looking up either the lender or entity's name or their NMLS ID. Everybody has a unique ID. And you can actually see what's out there in terms of a regulatory action that the regulators have publicly disclosed, and you can even get copies of those agreements in whatever form it is.

Alan Kaplinsky:

Thanks to all our speakers today, my colleagues in the Consumer Financial Services Group of Ballard Spahr. And to make sure that you don't miss our future episodes, subscribe to our show on your favorite podcast platform, be it Apple Podcasts, Google, Spotify, or wherever you get your podcasts. Don't forget to check out our blog, consumerfinancemonitor.com, for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast@ballardspahr.com.

That completes our part one of our podcast show for today. Stay tuned next Thursday for part two, which is going to deal with the registry pertaining to contract terms. Thank you for listening and have a good day.