

MCCATHERN

February 2013 Banking and Mortgage Regulatory Update

For monthly updates on compliance issues email mortgage@mccathernlaw.com with your request.

CFPB Examinations and Ratings

Title X of the Dodd-Frank Act establishes the Consumer Financial Protection Bureau (CFPB). A large portion of the CFPB's duties include conducting examinations and audits of supervised entities. This monthly update will address the Consumer Compliance Rating system that evaluates an entity's compliance with the consumer protection laws and determines whether the systems currently in place will ensure continuing compliance.

Consumer Compliance Ratings:

After an examination, supervised entities are given a confidential consumer compliance rating that determines the entity's overall compliance "grade." The ratings are based on a scale from 1 through 5, with a score of "1" represents the highest rating and lowest level of supervisory concern. Correspondingly, the higher the rating, the higher degree of supervisory concern. The following is a general overview of the ratings:

- *Consumer Compliance Rating 1:*

Entities with this rating are considered strongly compliant. Management and staff are sufficiently capable of effectuating compliance. The entity is considered to have an efficient system of procedures and controls and any changes in consumer protection statutes are promptly instituted in the entity's policies, procedures and training. If there are any violations, they are relatively minor and are easily correctable. The entity shows no signs of discriminatory acts or practices. An entity with this rating gives no cause for supervisory concern.

- *Consumer Compliance Rating 2:*

This rating signifies a generally strong compliance position. A system of procedures and controls has been established to ensure compliance, but violations have still occurred. These violations involve technical aspects of the law or result from oversight on the part of the operating personnel. Modifying the compliance program and/or establishing additional review/audit procedures may eliminate many of the violations. Training is satisfactory and there is no evidence of discriminatory acts or practices, reimbursable violations or practices resulting in repeat violations.

- *Consumer Compliance Rating 3:*

Generally, entities with a rating of 3 are less than satisfactory in maintaining compliance. It is a cause for supervisory concern and requires more than normal supervision by the Bureau to remedy the deficiencies. There have been numerous violations and previously identified practices resulting in violations may be left uncorrected. If any overcharges are present, they involve few consumers and are minimal. There is no evidence of any discriminatory acts or practices. Increased efforts to effectuate compliance are required because the numerous violations are indicative of management not devoting sufficient time and attention to consumer compliance. The entity requires strengthened operating procedures and controls, and this can be accomplished by designating a compliance officer and developing and implementing a comprehensive and effective compliance program. Additional supervisory measures may be needed to eliminate the violations and prevent further problems with compliance.

- *Consumer Compliance Rating 4:*

This entity requires close supervisory attention and monitoring to promptly correct serious compliance problems. There are numerous regulatory violations and overcharges, if present, affect a significant number of consumers and involve a substantial amount of money. There is usually a history of past violations and those past violations remain uncorrected. Further, discriminatory acts or practices may be present. There is clear evidence that management has failed

to provide sufficient effort to ensure compliance, and there may be a lack of interest in administering an effective compliance program. Internal procedures, if they exist, have not proven effective and are seriously deficient.

- *Consumer Compliance Rating 5:*

These are the worst offenders and are in need of the strongest supervisory attention and monitoring. The entity is substantially non-compliant with consumer statutes and regulations, and management has demonstrated an unwillingness or inability to operate within the regulation guidelines. Previous attempts to obtain voluntary compliance have been unproductive. The entity exhibits evidence of discriminatory acts or practices, substantial overcharges and serious repeat violations.

Role of the Board of Directors and Management

Ultimate effectiveness of an entity's compliance with the new consumer protection statutes and regulations (and therefore receiving the best possible consumer compliance rating) rests with the dedication and actions taken by the entity's board of directors or other management personnel. CFPB examiners will look at many areas to determine the actions taken by the board of directors or similar managerial authorizes, including:

- 1) Whether there are clear expectations about compliance, not only within the entity, but also to service providers.
- 2) Whether clear policy statements regarding consumer compliance have been adopted.
- 3) Whether an appropriately qualified and experienced chief compliance officer has been appointed and whether the entity has provided for other compliance officer with authority and accountability. In smaller entities, a full-time compliance officer may not be necessary, however, there should be managers with clear responsibility for compliance management and compliance staff should be assigned to carry out this function in a manner commensurate with the size of the entity and nature and risks of its activities.
- 4) Whether a compliance function to set policies, procedures and standards has been established.
- 5) Whether the entity has allocated resources to the compliance function commensurate with the size and complexity of the entity's operations and practices, the Federal consumer financial laws and regulations to which the entity is subject and necessary to avoid the potential consumer harm associated with violations of such laws and regulations.
- 6) Whether the entity has addressed consumer compliance issues and associated risk of harm to consumers throughout product development, marketing and account administration, and through the entity's handling of consumer complaints and inquiries.
- 7) Whether the entity has required audit coverage of compliance matters and reviewed the results of periodic compliance audits.
- 8) Whether the entity has provided for recurring reports of compliance risks, issues, and resolution through a committee structure or to the board.

Having a compliance-committed leadership group is essential to running an efficient and successful business, which ultimately translates into more time growing your business and less time dealing with regulators and examinations.

This update is not to be considered an offering of legal advice and does not constitute an attorney-client relationship. If you are interested in a more specific and tailored analysis of the compliance-related issues associated with the Dodd-Frank Act, and how it affects your business, please contact Arnold Shokouhi, McCathern's Managing Partner and head of the Banking & Mortgage Section, at arnolds@mccathernlaw.com or 214.741.2662.