CFPB Enforcement Risks: Navigating the Complex Regulatory Landscape

Millions of dollars in settlements for discriminatory lending and student loan practices. Millions of dollars more in penalties for the mishandling of credit card products and accounts. Financial institutions operate in a challenging regulatory landscape and have experienced a surge in regulatory scrutiny over the last several years. Recent enforcement actions and rulemakings by the Consumer Financial Protection Bureau (CFPB) pose significant compliance risk for financial institutions. At this point, it is unclear how the CFPB will be affected by the November elections, adding yet another level of uncertainty for organizations. Successfully navigating the CFPB landscape requires an in-depth understanding of the evolving regulations and the insurance and risk management solutions to mitigate potential exposures.

A BRIEF HISTORY OF THE CFPB

The CFPB was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act after the 2008 financial crisis. The agency seeks to transform practices in consumer finance, enforce federal consumer financial laws, and protect consumers in the financial marketplace. Under Dodd-Frank, the CFPB has authority to supervise banks, thrifts, and credit unions with more than $10 billion in assets, as well as many non-bank financial institutions.

CFPB enforcement actions are increasing. So far, the agency has provided billions of dollars in relief for millions of customers. This year, the CFPB:

- Continued its enforcement actions against alleged discriminatory lending, illegal private student loan practices, and abusive credit card practices.
- Sought to regulate how banks and other consumer financial companies manage risk.
- Formally proposed its Dodd-Frank arbitration rule. If finalized, the arbitration proposal would significantly change current practice given the wide use of class action waivers by the financial services industry. This would likely impose more costs on covered providers.

Enhanced policy forms that are now available to insurance buyers aim to eliminate gaps and conflicting terms and conditions in excess casualty insurance coverage.

ENFORCEMENT TRENDS

DISCRIMINATORY LENDING

The CFPB and the US Department of Justice (DOJ) have joint authority to target auto lenders, credit card companies, student lenders, and mortgage lenders for alleged discriminatory patterns and practices. The agencies rely on enforcement policies that are not fully disclosed to the public or creditors subject to CFPB regulation. Using the Equal Credit Opportunity Act (ECOA), the agencies are increasingly bringing actions against creditors that discriminate against applicants in credit transactions because of race, color, religion, national origin, sex, marital status, age, and income.

For example, in two significant enforcement actions in 2016, the CFPB:

- Entered into a $20 million settlement with a major auto manufacturer's financial subsidiary for discriminatory lending practices. The CFPB asserted that the practice of dealer markup — where manufacturers set a standard interest rate for its loan but allow dealers to markup the interest rate based on the credit risk of the consumer and retain the increase — indirectly led to the auto manufacturer's discriminatory lending practices. This was found even though the auto manufacturer never had access to information about the race or ethnicity of the relevant consumers.
- Entered into a $10.6 million consent order with a mortgage lender, alleging that from 2011 to 2013 the lender violated the Fair Housing Act and ECOA. The agency alleged that the mortgage loan policies and practices unlawfully discriminated against minorities through discriminatory instructions to the lender's employees and discrimination based on statistical modeling.

In addition to monetary penalties, the CFPB has often required that defendants undertake remedial actions, such as:

- Investing in community programs and increasing outreach related to responsible credit management.
- Reducing interest rates for minority consumers.
- Reoffering favorable credit terms to affected minority consumers.

STUDENT LOANS

Last year, the CFPB found that more than eight million borrowers were in default on more than $110 billion in student loans, a problem that may be driven by breakdowns in student loan servicing. The CFPB announced that it was prioritizing its enforcement against companies that engage in illegal servicing practices. For example:

- The CFPB imposed a $4 million penalty against a bank for alleged illegal student loan servicing practices, including impairing customers' ability to minimize costs and fees and charging illegal late fees.

CREDIT CARDS

The CFPB has also demonstrated a heightened focus on interactions between credit card providers and third-party debt collectors. Earlier this year, the CFPB entered into a consent order with a banking institution for allegedly misrepresenting the annual percentage rates (APR) of consumer credit card debt that it sold to debt collection agencies. The bank agreed to pay nearly $5 million to approximately 2,100 affected consumers and $3 million in penalties. It also agreed to undertake additional measures to better document, verify, and inform consumers about their related debts.

TRANSFERRING REGULATORY RISKS

More companies are looking for ways to manage increasing regulatory risks, with many turning to risk transfer solutions such as directors and officers liability (D&O), errors and omissions (E&O) liability, and cyber insurance. These policies can provide coverage for:

- Regulatory actions, investigations, and demands.
- Unfair or deceptive practices, including violations of consumer protection laws.
- False advertising.
- Fees and compensations.
- Unauthorized use of confidential and/or proprietary information.
- Electrical failure of systems and/or networks.
- Hacking.

In today's heightened regulatory environment, insurance programs should be reviewed to determine what coverage may be available. Work with your insurance advisors to ensure that these coverages work together and complement each other.

ANALYTICS

A strong understanding of risk and volatility is an important part of managing regulatory risks. The more information organizations have about their exposure, the better they can identify opportunities to optimize their insurance programs to account for new regulatory requirements. As the frequency of enforcement actions increase, companies should assess their exposure to potential fines and penalties (see SIDEBAR).

Probable maximum loss (PML) curve methodology can help organizations to better assess the potential magnitude of a CFPB fine or penalty. The PML curve focuses on the potential severity associated with an enforcement action.

SPOTLIGHT

Financial Implications

CFPB enforcement actions typically have two types of financial implications for companies.

- **Consumer redress:** This is designed to compensate consumers for the harm they have suffered, which is scaled according to the magnitude of the violation.
  - Penalties have ranged from $30,000 to more than $2 billion.
  - The largest consumer redress penalty was assessed against a non-bank mortgage loan servicer.
- **Civil money penalties:** These are fines for violations, which are used to compensate consumers where available redress is insufficient.
  - Fines have ranged between $5,000 and $100 million, with an average penalty of $5.8 million.
  - The CFPB issued a $100 million fine — its largest penalty to date — against a bank charged with fraudulently opening two million customer accounts.

Marsh's Risk Financing Optimization (RFO) tool can help assess an organizations exposure to D&O, E&O, and cyber liabilities. RFO is a detailed assessment of your risk tolerance and specific risk profile that can:

- Identify and quantify key risk drivers.
- Help determine the appropriate attachment points and limits.
- Offer insight into how your insurance program is (or should be) priced.
- Evaluate the capital efficiency of various retention and limit options.
- Provide an audit trail for insurance purchasing decisions backed by data.

AN UNCERTAIN FUTURE

The CFPB continues to take strong stances in enforcement actions and rulemaking. However, the outcome of the November elections may substantially affect the agency; although precisely how is currently difficult to predict. President-elect Trump's administration and a Republican-controlled Congress will likely seek to limit the CFPB's authority, including:

- Replacing and restructuring its leadership model.
- Subjecting its funding to congressional oversight.
- Scaling back the agency's enforcement authority.
- Restricting how it pursues cases.

The new administration may look to an October 2016 US Court of Appeals decision that held that the CFPB's structure was unconstitutional. In addition, Republicans in Congress previously proposed legislation that would transform the CFPB into a more traditional commission, like the US Securities and Exchange Commission. Democrats, however, will have either 48 or 49 seats in the upcoming Senate, which will allow them to filibuster legislation that does not have the support of a least some of their members. Although it remains to be seen exactly how the CFPB will be affected, financial institutions will need to continue to take notice of the agency as they consider their regulatory and compliance risk.

A strong understanding of potential regulatory exposures can help you determine the best insurance program to protect your organization against CFPB enforcement actions. Work with your insurance advisors to understand and anticipate regulatory actions.