



## Risk-Based Nonbank Supervision – CFPB Final Rule

### Executive Summary

The Bureau of Consumer Financial Protection (CFPB or Bureau) released a final rule on June 26, 2013 that establishes procedures by which the Bureau would subject a nonbank provider of consumer financial products and services, and the nonbank's affiliate service providers, to CFPB supervision when the Bureau has reasonable cause, based on consumer complaints or information from other sources, to determine that such person is engaging, or has engaged, in conduct that poses risks to consumers relative to the offering or provision of consumer financial products or services and the nonbank is not otherwise covered by the CFPB's supervisory authority. The final rule implements provisions under Section 1024 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, which give the CFPB authority to supervise, by order, any nonbank provider of consumer financial products or services under these circumstances, referred to as risk-based supervision, after providing notice to the person and a "reasonable opportunity" for the person to respond. A nonbank supervised by the CFPB pursuant to the risk-based supervision rule is permitted to petition for termination of CFPB oversight two years after the date of the order.

The final rule becomes effective August 2, 2013. It is substantially the same as proposed in May 2012 (see Regulatory Practice Letter 12-10).

### Background

The CFPB's risk-based supervision authority is separate from the Section 1024 authority to supervise nonbanks, regardless of size (i.e., in the specific markets of: mortgage companies (originators, brokers, and servicers including loan modification or foreclosure relief services); payday lenders; and private education lenders), nonbanks that are the "larger participants" in other markets identified by the CFPB, and the nonbank affiliates and service providers of the banking organizations under its authority. The CFPB has defined two markets under its Section 1024 "larger participants" nonbank authority (refer to RPLs 12-24 and 13-09) including the consumer debt collection market (debt collectors with more than \$10 million in annual receipts from debt collecting activities) and the consumer reporting market (companies that receive more than \$7 million in annual receipts from consumer reporting activities). The CFPB has proposed to define student loan servicing as a "larger participant" market and nonbank student loan servicers that handle more than 1 million borrower accounts as the "larger participants" of this market. A nonbank that does not meet these larger participant parameters could be subject to risk-based supervision, if the CFPB determines there is reasonable cause.

## Description

The final rule substantially follows the proposed rule with the minor modifications indicated below. In general, the final rule outlines the process the CFPB will use to implement the risk-based provisions of Section 1024, which permit the CFPB to supervise, by order, any nonbank or its affiliate service provider that the CFPB has “reasonable cause to determine” is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.

The Bureau indicates that the rule is not necessary to carry out its risk-based supervisory authority under Section 1024, but will serve to “establish a consistent procedure” for bringing a nonbank under supervision pursuant to this authority and provide “transparency regarding the procedures the Bureau intends to use prior to commencement of a proceeding.”

### Notice of Reasonable Cause

The Bureau may issue a *Notice of Reasonable Cause* (Notice) to any nonbank not otherwise under its supervision (nonbank covered person) if, based on consumer complaints or “information from other sources,” it may have “reasonable cause” to determine that the nonbank is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services. The Notice is required to:

- Describe the basis for the Bureau’s “assertion” that the Bureau may have reasonable cause to determine that the nonbank is engaging, or has engaged, in conduct that poses risks to consumers.
- Provide a summary of the documents, records, or other items relied on to make that assertion and initiate the Notice (*Note*: the summary information was added to the final rule).
- Inform the nonbank how to file a timely response and detail the required contents of a response (discussed below).
- Inform the nonbank that a supplemental oral response may be requested.
- Indicate that, in lieu of filing a response, the nonbank may voluntarily consent to the Bureau’s supervisory authority by filing an executed consent form attached to the Notice. Execution of the voluntary consent form:
  - Would not be considered an admission of having engaged, or of engaging, in conduct that poses risks to consumers.
  - Would result in the CFPB Director issuing an order to subject the nonbank to CFPB supervision for a period of two years.
  - Would waive “any right to a judicial review of such consent agreement.” The CFPB explains that this is to ensure “the parties do not litigate an agreement after it is executed.”
- Inform the nonbank that failure to respond, as set forth in the Notice, may result in a default determination by the Director without further opportunity to respond.

### Nonbank Response to the Notice

- Any written response to the Notice must be filed within 30 days of service (*Note*: this is an increase from the 20 days proposed).
- Failure to file a timely response would: a) result in a waiver of the respondent’s right to respond; b) authorize the Associate Director to issue a recommended

- determination regarding risk-based supervision of the nonbank; and c) authorize the Director to issue a final determination, based on the assertions in the Notice.
- Where a respondent wishes to contest the assertions in the Notice, the response would be required to:
    - Set forth the basis for the respondent's contention that it should not be subject to supervision;
    - Include all records, documents, or other items upon which the respondent relies; and
    - Include an affidavit signed by the respondent attesting that the information contained in the response is true, accurate, and without any omission that would cause the response to be materially misleading.
  - Any request for an oral response must be included in the written response and failure to do so would constitute a waiver of the respondent's opportunity to present a supplemental oral response.
  - Failure to timely raise an issue or to submit records, documents or other information with the written response would constitute a waiver of the respondent's opportunity to present that information.

### Supplemental Oral Response

The Associate Director of the CFPB's Division of Supervision, Enforcement and Fair Lending, or the Associate Director's designee, must respond to a request for a supplemental oral response within 14 days of receiving a timely filed written request. The CFPB response may impose limitations on the supplemental oral response, including the amount of time to present the response and the subjects to be addressed. Supplemental oral responses may be conducted by telephone or in person.

### Determination

The CFPB Associate Director would submit to the CFPB Director a recommended determination to provide the respondent with either an order that would bring the respondent within the Bureau's supervisory authority or a notification that the respondent is not subject to the Bureau's supervisory authority. Such a recommendation and supporting documentation would be due to the Director:

- Within 45 days after receipt of the respondent's timely submitted written response, if the respondent did not voluntarily agree to CFPB supervision.
- Within 45 days after service of the Notice to the respondent, if the respondent did not timely file a response.
- Within 90 days after service of the Notice, if the respondent requested a supplemental oral response.

The CFPB Director would be required to reach a final determination within 45 days of receiving the Associate Director's recommendation. The Director may accept, reject or modify the determination as proposed. Any determination not to subject the nonbank covered person to supervision would not preclude the issuance of another Notice or order at a later time.

### Termination of Supervision

A nonbank covered person that is subject to CFPB supervision pursuant to a risk-based order is allowed to petition for termination of the Bureau's supervisory authority two years after the date of the order and not more than annually thereafter. Requests for termination of supervisory authority must be supported with relevant information

including any actions taken by a respondent since issuance of the order to address the conduct that led to the issuance of the order. The CFPB Director must issue a written decision to either terminate or modify the order, or to deny the petition, within 90 days of receipt of the petition to terminate supervision.

### Confidentiality

The final rule expands the proposed confidentiality provisions to cover all materials submitted by a respondent, all documents prepared by, or on behalf of, or for the CFPB's use, and any communications between the CFPB and a person.

*Note:* Supervision of nonbank covered persons would encompass: (1) assessing compliance with the Federal consumer financial laws; (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. The Bureau may also conduct examinations of various scopes and may request information from supervised entities without conducting examinations.

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## Commentary

The CFPB's final risk-based supervision rule outlines the process the Bureau will use to bring nonbanks that are not otherwise subject to its supervisory authority under direct supervision based on "reasonable cause." The Bureau describes the process as informal, efficient, and streamlined – and it leaves little opportunity for nonbanks in receipt of a Notice to operate outside of the stated parameters for submitting additional information or filing responses to determinations. Little or no opportunity is available to obtain additional time and, as such, nonbanks must be prepared to respond quickly. The Bureau also offers limited guidance about how it will apply the rule, such as on an entity-by-entity basis or to capture certain smaller companies operating in the "larger participants" nonbank supervisory markets. Essentially, all nonbanks not under direct CFPB supervision are effectively "on notice" that they could receive "a Notice." Such companies should consider assessing their compliance with Federal consumer financial laws, the level of risk inherent in the consumer products and services they offer, and the controls in place to mitigate such risk. Particular attention should be given to fair lending considerations, as well as efforts to prevent violations of the unfair, deceptive, or abuse acts or practices laws, and especially to the intake and resolution of consumer complaints, which can serve as the basis for "reasonable cause."

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