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Why CFPB's Disposal Of Supervisory Tool Is Problematic

By **Eric Mogilnicki and Jeremy Newell** (April 7, 2021, 4:48 PM EDT)

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During his confirmation hearing to serve as the first director of the Consumer Financial Protection Bureau, Richard Cordray explained that the bureau had a "bigger and more flexible toolkit" than he'd had as Ohio's attorney general, where he "had only two options to choose from": alleging a violation of law or doing nothing.[1]

He emphasized in particular "[t]he supervisory tool," which "offers the prospect of resolving compliance issues more quickly and effectively without resorting to litigation."[2]

Although the bureau has not been shy in pursuing public enforcement actions — and has obtained over $13 billion in consumer relief — it has also taken advantage of the flexibility of its mission and means to work constructively with financial institutions, behind the scenes and without fanfare, to prevent consumer harm.

Unfortunately, the bureau decided last week to throw away one of the tools in its toolkit: the supervisory recommendation. Reflecting on its first seven years of experience, the bureau had designed the supervisory recommendation in 2018 to provide a way to give more granular feedback to the institutions it supervises.

The bureau would continue to use a matter requiring attention:

> to communicate ... specific goals to be accomplished to correct violations of Federal consumer financial law, remediate harmed consumers, and address weaknesses in the compliance management system (CMS) that the examiners found are directly related to violations of Federal consumer financial law.[3]

However, the bureau established the supervisory recommendation because it realized that not every issue warrants a supervisory edict. This new tool allowed the bureau to "to recommend actions for management to consider taking ... when the Bureau has not identified a violation of Federal consumer law, but has observed weaknesses in the CMS."[4]

This new tool recognized the constructive role that the bureau's skilled supervisory staff can play in helping a financial institution recognize and improve on deficiencies in its compliance systems. It also

recognized that there is some point at which the bureau's authority to command ends, and its soft power to make suggestions and offer outside perspective and expertise begins.

In practice, supervisory recommendations still trigger substantial compliance efforts: Financial institutions take supervisory recommendations seriously because they value the substantive advice from, and their ongoing relationship with, their supervisor.

But, unlike a matter requiring attention, a supervisory recommendation invited continuing dialogue between the regulated and the regulator, and provided flexibility for a financial institution to determine how it can best address the supervisory concern — a particular benefit in a complex financial services landscapes that often requires something more than one-size-fits-all solutions.

This nuanced approach appears to no longer suit the bureau. On March 31, the CFPB rescinded its prior guidance, and explained that matters requiring attention would be used to convey all supervisory expectations, whether or not the bureau had found a violation of federal consumer law.[5]

The new bulletin made clear that, even when no law has been violated, the matter requiring attention "may specify corrective actions to be taken ... such as changes to practices and operations of payments of remediation to consumers."[6] As any parent will recognize, this is the "because I said so" theory of supervision.

There are at least four problems with the bureau's decision to stop making supervisory recommendations.

1. The bureau made this change without any public process or discussion.

This stands in contrast to the bureau's decision to create supervisory recommendations, which included a public process by which the bureau solicited feedback and information on its supervisory practices. The new bulletin provides no explanation for the change, and the bureau had never previously signaled that its prior system was not working appropriately.

In the absence of such an explanation, it is difficult to understand why the bureau would deprive itself of a useful tool, and return to a system that requires that the bureau always make demands, rather than recommendations, regardless of the relevant facts and circumstances.

2. By reducing all supervisory communications to matters requiring attention, the bureau lowers the quality of its own analysis.

When the bureau uses both matters requiring attention and supervisory recommendations, it requires itself to answer a simple question: Is this institution violating the law? The new policy ducks that issue, allowing the bureau to order remedies without finding any illegality.

Similarly, the new policy fails to explain how the bureau will be able to specify the necessary corrective actions when it has not identified the legal standard that is not being met.

3. The bureau lacks authority to order changes in policies and procedure that do not violate federal consumer financial law.

In setting forth the purpose of the CFPB, Title X of the Dodd-Frank Act states that "the Bureau shall seek

to implement and, where applicable, enforce Federal consumer financial law."[7] The bureau's supervisory authority is confined to "supervising covered persons for compliance with Federal consumer financial law."[8]

Nothing in the Dodd-Frank Act supports the bulletin's implicit claim that the bureau has limitless authority to micromanage a financial institution's practices, or to require that the institution send money to consumers, "without a related supervisory finding that a supervised entity has violated a Federal consumer financial law."[9]

Federal law empowers the CFPB to enforce laws and regulations, not to use its supervisory role to invent new rules on the fly.

4. Eliminating supervisory recommendations will deny examiners one method by which they were able to share and memorialize concerns with a financial institution's compliance management system.

On the margins, future examiners may hesitate to command an action they believe is advisable but not required by law. Indeed, one would certainly hope they would, as doing so is beyond their authority.

Put another way, by telling examiners that they may only issue orders, the bureau is reducing examiners' ability to provide useful recommendations. When this occurs, the bureau, financial institutions and consumers are all left worse off.

Final Thoughts

The bureau rescinded CFPB Bulletin 2018-01 in the same month as it rescinded the bureau's Statement of Policy Regarding the Prohibition on Abusive Acts or Practices. Like the CFPB's discarding of supervisory recommendations, the rescission of the abusive statement of policy came without notice or public input, and with only a cursory explanation for the bureau's action.

Taken together, these actions suggest that the CFPB is identifying and clearing away obstacles to its complete discretion to invent, as well as enforce, the law.

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[1] Richard Cordray, Testimony of Richard Cordray before the Senate Committee on Banking, Housing, and Urban Affairs (Sept. 6, 2011); https://www.consumerfinance.gov/about-us/newsroom/testimony-of-richard-cordray-before-the-committee-on-banking-housing-and-urban-affairs/.

[2] Id.

[3] CFPB Bulletin 2018-01, Changes to Types of Supervisory Communications (September 25, 2018).

[4] Id.

[5] CFPB Bulletin 2021-01, Changes to Types of Supervisory Communications (March 31, 2021).

[6] Id.

[7] 12 U.S.C. §5511(a).

[8] 12 U.S.C. §5511(c).

[9] CFPB Bulletin 2021-01.