

May 21, 2018

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552

Re: RFI Regarding the Bureau's Supervision Program
[Docket No. Bureau- 2018-0001]

Dear Ms. Jackson:

The American Financial Services Association (“AFSA”)¹ appreciates the Bureau of Consumer Financial Protection’s (the “Bureau”) request for comments and information (“RFI”) regarding the Bureau’s supervision program (the “Supervision Program”).

AFSA believes that the enhancements are warranted and will result in a more efficient and effective Supervision Program. In particular, AFSA believes that the Bureau should reevaluate its approach to supervision in the following ways.

First, the Bureau should reevaluate its approach to supervision, which can sometimes be adversarial. Such an approach is more harmful than helpful to the process. Rather than acting as an opponent of regulated entities, the Bureau’s supervision team should focus on rooting out genuine consumer harm and deterring bad actors through reasonable, transparent, and measured exam activities.

Second, the Bureau should reevaluate the larger participant rules based on an objective set of standards that may be applied across all markets.

Third, the Bureau should take steps to reduce the regulatory burden it imposes on institutions while deploying those Bureau resources more efficiently. To do this, AFSA proposes that the Bureau avoid examining on topics sufficiently addressed under existing prudential and state regulators’ supervision programs.

AFSA believes that a reevaluation of the Supervision Program, in the manner just described, would be best performed under a commission, rather than single director, structure. Although AFSA appreciates the intent and effort shown by the Bureau with this (and the similar) RFIs, it views a structural change in the Bureau as the best way to ensure lasting reform.

¹ Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

After discussing AFSA’s recommendations for the Bureau’s supervision philosophy and the need for structural reform, AFSA’s letter lays out the high cost of Bureau supervision. Next, our letter includes responses to the Bureau’s specific questions covering all aspects of supervision, including: the timing, frequency, and scope of supervision; how information is requested; what information is requested; onsite examinations; communication during an exam; what should happen when violations are found; how supervisory findings should be appealed; supervision publications; and communication with other agencies. Our letter also includes suggestions for remediation and recommended changes to the examination procedures for auto finance.

I. Reevaluating the Bureau’s Supervision Philosophy

AFSA recommends that the Bureau reevaluate its examination approach, the larger participant rules, and its coordination with other agencies.

A. Examination Approach

The Bureau’s approach to supervision in general, and exams in particular, should be cooperative rather than adversarial. Legitimate, state-licensed financial institutions should not automatically be viewed by Bureau examiners as bad actors. Indeed, all parties are best served by an approach through which regulated entities feel free to discuss requirements and challenges with the Bureau.

To facilitate a more cooperative exam environment, the Bureau should focus its exams on the identification of practices that are inconsistent with regulatory requirements and linked to concrete consumer harm. The regulatory requirements against which institutions are assessed during an exam should be made known, through the notice-and-comment procedure required by the Administrative Procedures Act (“APA”), and available to supervised institutions before the exam begins.²

To aid regulated entities’ understanding of the rules and expectations against which they will be measured, the Bureau should also, as appropriate, issue interpretations of its rules, as it did in 2014 to address how Regulation Z’s Ability-to-Repay Rule applies to successors-in-interest.³

AFSA further recommends that the Bureau reevaluate the action it takes as a result of exam findings and consider only pursuing enforcement action where an entity has acted with recklessness or in bad faith.

B. Larger Participant Rules

In the context of its supervision program review, the Bureau should reconsider the markets over which it has asserted supervisory authority through issuance of larger participant rules. In addition to giving the Bureau supervisory authority over banks, thrifts, and credit unions with assets over \$10 billion, as well as their affiliates, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank Act”) specifically enumerates several markets over which the Bureau has supervisory authority, including the residential mortgage, private

² This is contrary to the way in which the Bureau issued the policy change regarding dealer compensation. Instead of issuing a rule using the procedures laid out in the APA, the Bureau issued a 5-page guidance document entitled *CFPB Bulletin 2013-02: Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act* that upended the market and was used in both enforcement actions and supervision. The policy change was immediate and financial institutions were given no time to come into compliance.

³ Docket No. CFPB-2014-0016.

education lending, and payday lending markets. The Dodd-Frank Act further provides the Bureau with authority to supervise larger participants of other consumer financial markets as defined by Bureau rules.

To date, the Bureau has defined larger participants in the following markets: consumer reporting, consumer debt collection, student loan servicing, international money transfer, and automobile financing. In doing so, the Bureau often explained why a particular market was considered “large,” but failed to explain why such market required federal supervision. This absence of such explanation suggests an approach equating market size alone to the need for federal supervision. The Bureau’s adoption of this view was suggested in the context of its issuance of the student loan servicing rule, which reflects that, “the Bureau is not required to determine the level of compliance risk in a market before issuing a larger participant rule.”⁴

The larger participant rule for the vehicle finance market, for example, also seems to be issued without consideration of whether such a market demands federal supervision. Instead, the Bureau’s rationale for supervision appears focused on the fact that most consumers obtain and finance vehicles, not whether federal regulation of the market that provides such financing is warranted.

AFSA believes that it is time for the Bureau to reconsider its larger participant rules to determine which markets should be subject to federal supervision, based on an evaluation of a defined set of criteria. The criteria considered by the Bureau should cut across all markets and should include risks presented to consumers by each market, as well as the presence of effective state regulation and supervision of the market.

C. Coordination with Other Agencies

To minimize regulatory burden and use resources more efficiently, the Bureau should better coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and the state regulatory authorities. The Bureau should make a risk-based determination to prioritize areas of examination and minimize examinations which are likely to be duplicative of areas within the scope of prudential or state regulators. The Bureau should avoid examining on topics sufficiently addressed under existing prudential and state regulators’ supervision.

II. Structural Reform at the Bureau

While AFSA appreciates the Bureau’s intent and effort in seeking public engagement through RFI process, we believe that structural change to the Bureau would better facilitate lasting reform. The Acting Director and new appointees can change procedure, policy, and most challenging, agency culture, but all of this can be reversed with a change of administration.

AFSA urges the Bureau to endorse legislation to replace the current single regulator structure with a bipartisan five-member commission similar to that in place at other independent regulatory agencies. A commission structure will more readily provide the necessary safeguards to prevent the Bureau from exceeding its stature authority.

⁴ 78 FR 73386.

III. The High Cost of Bureau Supervision

Bureau supervision comes at a high cost without commiserate consumer benefits. The costs of undergoing a Bureau examination are significant, even absent any findings. Unachievable expectations by the Bureau in connection with exam exacerbate such costs. The Supervision Program should be reformed so that the requests and expectations are reasonable and that the burden placed on an institution is considered in formulating and setting a timeframe for responses to such requests. Exams should not be a “gotcha” exercise, but an effort to root out true violations of consumer financial laws.

A. Bureau examinations are far more costly than the Bureau realizes.

The Bureau does not appear to understand the significant costs associated with an exam. For example, in its request for comments on the proposed larger participant rule for auto finance, the Bureau estimated that the total labor cost for an exam is about \$27,611 because all that would be required is a low-level compliance officer and a small fraction of an attorney. This estimate is low by a significant degree.

Indeed, AFSA members’ experience has been much different. A Bureau examination requires “all hands on deck,” plus substantial outside counsel costs. Specifically, a number of in-house attorneys, business persons, IT professionals, outside counsel, and outside consultants are directly involved with Bureau examinations. Examinations result in material compliance costs and lost time, as well as divert significant time and attention away from conducting the business. Just as there is a dedicated Bureau exam team, an exam requires dedicated company personnel to manage the exam, including responding to requests and findings. For examinations, the larger and more complex the company is the greater the costs.

A more accurate estimate for the total cost of an examination would be \$750,000 to \$1,000,000. Larger and lengthier examinations can cost over a million dollars in staff time, outside counsel, and consultants. One AFSA member company spent more than \$200,000 on outside counsel fees alone to assist with examination findings.

The increased cost of compliance is even greater. Larger participants have hired and trained additional personnel, made systems changes, revised procedures, and enhanced their compliance management systems. The costs of administration have a disproportionate burden as compared to even the potential for minimal benefit.

B. The Bureau sets forth costly, and unachievable, expectations of perfection.

Institutions spend significant resources attempting to ensure 100% compliance with the law, but even the best-designed controls may fail at times. An error rate is not a pattern or practice of non-compliance. Examiners must consider identified errors and mistakes in the context of an institution’s larger compliance program. For instance, at times the Bureau issues a “matter requiring attention” (“MRA”) on the basis of having identified several small issues that, while not in of themselves violations, in the Bureau’s view constitute a failure of the institution’s compliance management system (“CMS”). These generalized CMS MRAs are often unnecessarily burdensome on both the supervised entity and the Bureau, and they create unrealistic expectations of “perfect” compliance.

Compliance program issues have also, at times, appeared to be the sole reason for a less than satisfactory compliance rating. While an institution’s compliance program is a key component of a compliance rating, it should be considered as one of many components, and not serve as the sole basis for a rating.

The Bureau should engage in a cost-benefit analysis prior to bringing any enforcement action. Unreasonable regulatory expectations result in higher compliance costs, ultimately driving higher costs for consumers and limiting innovation. Examination and enforcement-driven compliance costs should be balanced to ensure that their actual value to consumers outweighs any costs that may ultimately trickle-down to consumers.

IV. RFI Questions

The Bureau is seeking feedback on all aspects of its Supervision Program, including but not limited to the topics outlined below.

1. The timing, frequency, and scope of supervisory exams.

a. Timing

There are three places timing matters – when an exam begins, when an exam ends, and how much time the Bureau gives companies to comply with new regulatory requirements.

An exam should not begin (nor document requests be made) the week of a major holiday unless there is an urgent, identifiable, and documented need. This may seem like a small issue, but we believe it is an important point to make. Employees should not be made to give up spending the holidays with their families because the Bureau sends a document request the day before Christmas Eve.

As for the end of an exam, it is important that exams be closed in a timely manner. One AFSA member waited 18 months for an examination close out, which created uncertainty. Examinations should begin and end expediently to provide an interval of normal operation. The long duration of the examination process prevents institutions from having an interval of normalcy between examinations. On a related note, AFSA suggests a minimum period of at least six months between examination results and the next examination.

The last issue with timing is that the Bureau must provide more time to implement regulatory changes. Financial institutions need sufficient time to implement new regulatory requirements and evaluate them using their internal compliance and control frameworks before the Bureau examines for compliance.

New regulatory requirements often create new technology needs that must be addressed across the industry. Financial institutions are also frequently reliant on third-party service providers to create and implement these changes. The Bureau should not underestimate the time it takes to identify, develop, test, and implement new technology.

b. Frequency

The Bureau needs to develop a better sequence of exams. The Bureau should conduct one exam of institutions, rather than several in sequence. Bureau exams on the same issue should not occur more frequently than once every three years.

We also ask that the Bureau incorporate reasonable intervals between exams, taking the size of the financial institution into account in the exam schedule. Some AFSA members subject to the Bureau's supervision authority have limited resources and small compliance and legal teams. Often these financial institutions are state-regulated

and so may undergo a number of state exams each year, along with exams conducted by the Bureau. As explained below, it is challenging for these financial institutions to undergo multi-state exams, a Bureau fair lending exam and a Bureau CMS exam in the same year.

Better sequencing is needed because exams are labor-intensive endeavors. Moreover, while the focus of consecutive exams may differ, there is often substantial duplication of requests. Institutions are often addressing feedback from one exam at the same time they are preparing for, or being subject to, a second exam. This results in the expenditure of a significant number of resources and places a substantial strain on the financial institution.

In addition to developing a better sequence of exams and limiting duplication of requests, the Bureau should weigh more heavily its experiences with financial institution management and the compliance management systems and controls used by management in determining how frequently exams need to be conducted for a particular institution. Possibly, the Bureau should consider conducting fewer exams for entities that have shown sufficient controls.

c. Scope

The Bureau should scale back its examination standards. For instance, supervision should not be used for general information-gathering. The standards the Bureau is using to examine its regulated entities for their level of compliance are far-reaching, and not well grounded in comparison to the common audit examinations that covered entities experience with states.

Instead, Bureau exams should be more focused. The purpose of the exam should be clearly stated and the exam should stick to the outline presented at the outset. The scope of the exam should be carefully designed based on an evaluation of the nature, size, and complexity of the institution's operations and the products it offers. Moreover, the Bureau should prioritize and conduct examinations for compliance with specific requirements based on potential for genuine consumer harm. The Bureau should not focus on compliance with technical requirements in order to find a violation.

One way to conduct more focused exams would be for examiners to engage with institutions in advance of commencing examinations and issuing document requests. This would ensure that such examinations, and attendant requests, are adequately targeted and risk-driven. Consumers are better protected by a targeted, rather than a one-size-fits-all, approach to examinations.

Another important part of focused exams is limiting them to the examination of compliance with formal rules issued subject to the Administrative Procedures Act. Exams should not include attempts to determine whether institutions are compliant with generalized guidance.

When the scope of examinations expand beyond assessing compliance with formal laws, rules, and regulations, institutions are left in the dark as to the genuine requirements to comply. They are provided no opportunity to assess their own compliance and align policies and procedures with the Bureau's expectations prior to examination. In the auto finance context, the impact of such overreach has been seen most notably in Bureau enforcement of its 2013 disparate impact bulletin. The bulletin was issued absent fulfillment of the requirements of the Administrative Procedures Act and specific implementing guidance was never issued.

Not only should exams be more focused, but it is crucial that they be objective. The Bureau has been making liberal use of the “unfair, deceptive, or abusive acts or practice (“UDAAP”) doctrine to find violations. While UDAAP commonly refers to types of laws that are intended to prevent businesses from engaging in deceptive practices, the Bureau emphasizes the first prong of UDAAP, *i.e.* the “unfair” prong, which was not commonly used. Bureau examiners use the “unfair” prong of UDAAP to claim that companies that, while in full compliance with all applicable laws in an examined area, are still in violation of the Bureau requirements because the practice or conduct is subjectively deemed by the examiners to be unfair to consumers. The examined financial institution’s compliance is thus subject to being judged by the particular whim of the examiner, rather than based upon express, objective statutory law. The Bureau’s examination practices make it impossible for a company to style its compliance model with an assurance that it will pass muster in the examination. Isn’t this unfair?

2. The timing, method or process used by the Bureau to collect information and documents from a supervised entity prior to the commencement of an examination. Typically, the Bureau sends an examination Information Request (IR) to a supervised entity prior to the commencement of an examination. An IR is a list of information and documents that the supervised entity is asked to provide to the Bureau for off-site review or to make available when examiners are onsite at the entity. An IR is typically sent to an entity at least 60 days prior to the onsite start of an examination.

The timing of IRs should be adjusted to improve on-site examination efficiency. All deadlines for required documentation should be reasonable. Financial institutions need adequate time to comply with the often burdensome delivery and format requirements included in IRs. Requests should therefore be issued at least 90 days in advance and require delivery of materials at least 7 - 14 business days before on-site reviews. This will give financial institutions sufficient time to prepare materials and give examiners time to review those materials fully prior to on-site examinations. If the Bureau does not give financial institutions more reasonable response deadlines, the Bureau should at least be flexible in providing extensions to response dates, as necessary to ensure the resources required to respond are appropriately calibrated. This is especially critical for data requests. The Bureau should not underestimate the extensive time and resources required to develop and validate the results of each data request.

It would also be more efficient if the Bureau publicized model IRs with baseline requests for subjects in the Supervision and Examination Manual. This would facilitate preparation in advance of receiving institution-specific IRs, and provide necessary guidance for institutions as to the form and content of documentation that may be requested.

One final point – when feasible, the Bureau should coordinate IRs with state regulators.

3. The type and volume of information and documents requested in IRs.

The Bureau’s IRs should be closely tailored to the subject of the exam, narrowly focused, and specific. Doing so will help the Bureau gather the information it needs in a more efficient manner. If the IR is targeted, the response is likely to be more targeted, and therefore more beneficial to any analysis by the Bureau. IRs should ask for the information necessary, and only the information necessary, to evaluate the institution’s practices relative to the specific subject matter of the exam. Overbroad requests make the examination process less efficient.

In order to more efficiently gather information, AFSAs recommends that the Bureau's IRs:

- (1) Not ask for data going back several years;
- (2) Not request account level data;
- (3) Be limited to materials already in use and, thus, not require an institution to create new documents;⁵
- (4) Not incorporate assumptions inconsistent with an institution's existing operations;
- (5) Include definitions that are consistent with industry use and understanding of terms;
- (6) Be subject to a quality control process prior to issuance to ensure dates are accurate;⁶ and
- (7) Are reasonable in the context of a financial institution's size, capacity, and systems.

When issuing an IR, the Bureau should work with institutions to facilitate production in a manner both acceptable to the Bureau and feasible for the institution. To be more specific, an understanding of institution's data storage systems, including the information available and the time period covered, should be developed by the Bureau before it issues a data request. The Bureau should hold a pre-examination meeting with appropriate financial institution staff to better focus, tailor, and if necessary, narrow any data request. Holding such a meeting would allow the Bureau to understand the data on which its analyses are based and help to ensure the data is reliable before making a request or conducting an analysis.

Where an IR has been a source of confusion, or reported as being overbroad by multiple institutions, such IR should be clarified or revised prior to being used with another institution. Along the same lines, the Bureau could consider soliciting feedback from institutions about specific questions in use on an ongoing basis to ensure IRs are as effectively and efficiently drafted as possible.

The Bureau should, to the greatest extent possible, exclude from its collections in the examination process documents that are subject to the attorney-client privilege. Such an exclusion will enable institutions to have more open lines of communication with their attorneys, resulting in better and more informed decision-making. The Bureau should only request the voluntary production of privileged information when the information is critical to the exam, no other non-privileged source for the information exists, and the material does not involve advice regarding the Bureau. Where the collection of privileged materials is necessary, and no feasible alternative exists, the Bureau should be mindful that such materials are kept confidential and never shared with enforcement staff.

4. The effectiveness and accessibility of the CFPB Supervision and Examination Manual (Exam Manual). The Exam Manual provides internal direction to supervisory staff, including summaries of statutes and regulations and specific examination procedures for use by examiners in conducting exams. It is published on the Bureau's website to promote transparency and assist the public in understanding how the Bureau oversees supervised entities.

The Exam Manual should provide helpful guidance. By that, we mean that the Exam Manual should help the industry come into compliance and prepare for examinations. It should clearly set out the Bureau's interpretation of the regulatory requirements, the analysis behind those requirements, and the metrics that it will use to actually assess compliance.

⁵ IRs should not require financial institutions to create new documents or materials (other than responses to direct questions from the Bureau). In other words, financial institutions should not be required to create documents or compilations of information that are not already used in the normal course of business.

⁶ IRs with inaccurate date ranges pose a significant burden to institutions.

First, the Exam Manual should comport with the Bureau’s regulations, its most recent official interpretations, and relevant case law and only reference laws over which the Bureau has supervisory authority. For example, the Truth in Lending Act (“TILA”) section of the automobile finance portion of the Exam Manual currently includes references to TILA disclosures that do not apply to automobile finance. The Exam Manual also refers to the Servicemembers Civil Relief Act a law over which the Bureau does not have supervisory authority. These aspects of the Exam Manual should be updated. Likewise, the Exam Manual should be updated routinely to incorporate relevant information from Bureau Bulletins.

Second, the Exam Manual should clearly reflect that the Bureau bears the burden of proof for proving a violation. Indeed, the Exam Manual should emphasize to examiners that the regulated entity does not bear the burden of proving that it did not violation a regulation.

Third, to the extent the Bureau intends to designate specific practices as constituting UDAAPs, the Bureau should issue standalone guidance to this effect, rather than merely including such information in the Exam Manual. Such guidance is important to ensuring that institutions can align their business practices with the Bureau’s expectations. The guidance should include examples of “abusive” acts similar to the examples provided for “unfair” and “deceptive” acts.

Finally, the Exam Manual should demonstrate a clear understanding of the market. Some Bureau examiners, for example, need a better understanding of indirect auto finance. Often lost on examiners is the fact that finance companies (even “captive” auto finance companies) do not control dealers. This is an important point in auto finance and should be clarified in the Exam Manual.

For a more detailed explanation of the changes need to the indirect auto finance section of the Exam Manual, see Section VI below.

5. The efficiency and effectiveness of onsite examination work. Typically, while onsite, examination teams may review documents and data, hold meetings with management, conduct interviews with staff, make observations, and conduct transaction testing.

AFSA has several recommendations to increase the efficiency and effectiveness of onsite examination work.

First, the exam team should be calibrated appropriately and the examiners ready. Examination teams should be staffed with an appropriate proportion of experienced personnel in comparison to new examiners (both in terms of examinations in general and the specific financial institution). Examiners should fully review documents and evaluate data prior to arriving for the onsite portion of the exam. They should tailor their onsite activities appropriately based on the materials reviewed.

Second, exams should remain focused on their original purpose. Follow-up questions should be limited in both number and scope, and the Bureau should take care to ensure follow-up questions are not duplicative. Examiners should take into account the complexity of a follow-up question when determining the amount of time provided for response, so that institutions have the opportunity to provide as comprehensive an answer as possible.

Third, meetings should be held periodically throughout the exam so that concerns, including complicated questions, can be discussed and addressed. Sometimes concerns can be more effectively and efficiently communicated during an oral conversation than in writing. When requesting meetings, examiners should ensure

that institutions are provided adequate time and information to identify the correct employees and allow such employees to prepare for an interview. Examiners should also be mindful of a particular employee's scope of knowledge and limit questions to those within the purview of an employee's range of duties.

In recent examinations, the exam teams have only been onsite every other week. This cadence has been helpful to the supervised entities and allows those employees participating in the examination more space to tend to their other responsibilities. The Bureau should formalize this examination format in its operating procedures.

Fourth, onsite examination timetables should be realistic. Examiners need at least one week (exclusive of travel time) to account for orientation and training prior to onsite work.

Fifth, in closing meetings, the Bureau should provide clear direction on next steps for that exam and detailed feedback about known issues to be corrected. Exam teams should emphasize solutions. Where potential issues are identified, the examination staff should be focused on working with examined institutions to develop solutions.

6. The effectiveness of Supervision's communications when potential violations are identified, including the usefulness and content of the potential action and request for response (PARR) letter. A PARR letter provides an entity with notice of preliminary findings of conduct that may violate Federal consumer financial laws and advises the entity that the Bureau is considering taking supervisory action or a public enforcement action based on the potential violations identified in the letter. Supervision invites the entity to respond to the PARR letter within 14 days and to set forth in the response any reasons of fact, law or policy why the Bureau should not take action against the entity. The Bureau often permits extensions of the response time when requested.

Reforms are needed to address the PARR letter process. Regulated entities currently have no insight into the PARR process, including the specific information on which a finding is based and how any response will be analyzed by the Bureau.

To begin with, PARR letters should be clearer. Each PARR letter should set out the Bureau's legal analysis in an open and transparent manner. For every potential violation, the PARR letter should: (1) identify the exact obligation in question, (2) cite the regulation that is the source of that obligation, (3) state the facts regarding the financial institution's conduct as the Bureau believes them to be, and (4) provide the Bureau's analysis, including interpretations and standards, of why the facts constitute a violation of the obligation.

Building on the first two points, the Bureau should be specific in PARR letter about suspected violations. Without a specific information and legal analysis, it is difficult for companies to respond adequately. Often, PARR letters provide little information as to the basis of issues raised. While such information may be communicated orally, this does not provide institutions with an adequate record of the issue to which they are responding. An explanation of any examination findings and individual transaction files that support claims would greatly facilitate the provision of adequate responses to PARR letters, particularly in the context of UDAAP claims.

Regarding the third and fourth point, the Bureau's legal staff should be closely involved in the PARR process. Bureau attorneys should verify that the Bureau's analysis comports with the law, the Bureau's regulations, official interpretations, and relevant case law. If a procedure or practice is in accordance with state law, it should not be deemed a violation of federal law. Attorneys should also be available to review and discuss the PARR letter's

analysis when regulated entities have legal concerns with the examiners' interpretation of the underlying law or how it applies to the facts.

Not only should PARR letters be specific, they should be limited in scope to violations that may support an enforcement action. Other issues, such as those with no material impact on consumers or that have been resolved through the exam, should be addressed through the supervisory process. Institutions respond to PARR letters at great expense; therefore, the Bureau should reserve the PARR Letter for those issues that truly will serve as the basis for an investigation.

The Bureau should not include in PARR letters issues that an institution identifies as a result of its own compliance testing or internal audit process. Such inclusion creates a disincentive to institutions to engage in robust testing and auditing and undermines the Bureau's goal of promoting strong institutional CMS frameworks.

Additionally, the Bureau should not regulate through issuance of a PARR letter—meaning, unclear or ambiguous areas of law should not be the subject of a PARR letter, but rather should be addressed by rule subject to notice and comment.

Currently, financial institutions have 14 days to respond to a PARR letter, which is too short of a timeframe. Respondents should have, as the standard, 30 days. To assemble a PARR letter response, an institution must research the facts at issue, research the law, draft the letter—often with the help of outside counsel—validate the facts in the letter, and get approval from varying levels of management and, perhaps, the board of directors, in advance of submission. Additionally, data has to be run and reviewed. Sometimes, loan-level reviews are required. It is difficult, if not impossible, to complete these tasks in the current 2-week timeframe provided. Even though extensions are often granted, the additional time is not guaranteed and is often limited. If an extension is necessary in practically every case, there is no reason why the initial timeframe should not be longer.

After a financial institution responds to a PARR letter, there are additional steps the Bureau should take. For instance, the Bureau should respond to the legal arguments set forth in PARR responses. If the Bureau rejects a financial institution's argument. It should explain the legal basis for that rejection.

A process for providing feedback after receiving the PARR response needs to be defined by the Bureau. Currently, the Bureau stops communicating for many months about issues raised in a PARR response, but eventually demands further information or action from the institution on short timelines.

Once an institution submits its response to the PARR letter, it can wait for months to hear back from the examination staff. The Bureau should implement a process for providing routine updates to institutions. Unresolved PARR letters that remain open for a significant amount of time create significant uncertainty for institutions.

Finally, to make the PARR letter process more open and transparent, the Bureau should provide anonymized data on the PARR process. The data could identify those issues being addressed via PARR letters and would demonstrate to the industry that the PARR letter process has a genuine effect on the Bureau's ultimate decision-making.

7. The clarity, organization, and quality of communications that report the results of supervisory activities, including oral communications from examiners and Supervisory Letters and Examination Reports.

Supervisory Letters and Examination Reports should provide a clear analysis of relevant law and regulations. Like PARR letters, these documents should fully demonstrate the involvement of the Bureau's legal staff, including an element-by-element analysis of any alleged violation.

AFSA has a number of recommendations for the Supervisory Letters and Examination Reports. Before going into our detailed recommendations, we emphasize that the Bureau should have the burden of proof to establish its case. Accordingly, a financial institution should be viewed as innocent with respect to any alleged violation until proven otherwise by the Bureau.

AFSA's recommendations include:

- (1) Giving financial institutions an opportunity to preview and correct the facts on which the Bureau's report will rely. The Bureau's conclusions must be based on an accurate understanding of the facts. The Bureau should allow institutions to review the facts on which its conclusions will be based and, if necessary, correct any inaccuracies.
- (2) Customizing Supervisory Letters and Examination Reports. Exam results should not be based on template language. This approach results in vague and unhelpful letters at best and often in illogical letters with confusing language. An examination report should be customized for each examination. Each report should be reviewed by a specific Bureau legal professional as a quality control function.
- (3) Setting timeframes. There is often significant delay in the receipt of Supervisory Letters and Examination Reports, contributing to uncertainty for businesses in the interim. The Bureau should address this by setting specific timeframes by which it will provide Supervisory Letters, Examination Reports, and other feedback.
- (4) Clarity between oral and written communications. Examiners should be clear about what they are looking for and what they find. While verbal communications from examiners can be helpful, examiners should be given clear guidance regarding what information can be shared orally so that there is no dissonance between what is written and what is orally communicated.
- (5) Identifying violations in writing. Before moving a case to enforcement, issuing a penalty, or asking for a settlement, examiners should have to express, clearly and in writing, what violation occurred. The post-examination exit should be held after written results have been provided, so that the examiners can work with institutions to develop solutions to any issues found.
- (6) Clarifying the standards on which an MRA or "matter of understanding" ("MOU") is made. It is unclear on what basis the Bureau determines whether an institution will receive an MRA or an MOU; at times, the apparent arbitrariness of such decisions creates the impression of disparate treatment. The Bureau should clarify the standards on which the decision to issue an MRA or an MOU is made, to facilitate equitable treatment of institutions, and to assist Bureau examiners in determining the most appropriate course of action.

Instituting these reforms would dramatically increase the efficiency and effectiveness of the Supervisory Letters and Examination Reports.

8. The clarity of matters requiring attention (MRA) and the reasonability of timing requirements to satisfy MRAs. An MRA is used to address violation(s) of Federal consumer financial law or compliance management weaknesses. MRAs often require a written response to the Bureau and will include a due date for completion.

The lack of clarity, consistency, and effective communication regarding MRAs is problematic. This is an area where significant improvements can be made.

Improvements can begin with the MRA itself. The basis for an MRA is not always clear from the report of examination. When this is the case, financial institutions often struggle to determine the requirements to satisfy the MRA. It would be helpful if, in addition to the MRA itself, the Bureau provided supplementary information as to the basis for any MRAs, and the specific requirements for satisfaction thereof, where not adequately described elsewhere.

The MRA itself should include clear legal analysis. MRAs should fully demonstrate the involvement of the Bureau's legal staff, including a specific element-by-element analysis of any alleged violation. MRAs should not be created using templates. They should be written specifically for each set of facts. MRAs should be reviewed by a specific Bureau legal professional as a quality control function. The Bureau should not use MRAs to address compliance management concerns or other issues independent of strict violations of law.

The MRA process can also be improved by modifying the requirement that an institution provide written progress reports in response to MRAs. This requirement has, at times, been overused and resulted in an ineffective use of resources. Written progress reports should not be required in all instances. In particular, where there is a short implementation period for an MRA, written progress reports may not be valuable. A written response to an MRA also lacks value given that at the point in time in which an MRA is issued a regulated entity has already expressed any dissatisfaction with the Bureau's findings.

Also unclear is the standard for issuance of an MRA versus a "finding." The factors used to determine whether something constitutes an MRA or a "finding" should be defined and articulated to regulated entities. Indeed, there are certain issues that should not be resolved with MRAs. For example, MRAs should not be issued for technical violations that had no actual consumer impact or minimal error ratios that do not amount to a substantial and systemic compliance failure. Neither should MRAs be used to document self-identified and reported issues that have already been fixed. Furthermore, similar or identical MRAs should not be tagged to multiple institutions (*i.e.*, "industry MRAs"), as these function more like a rulemaking. And finally, neither isolated instances nor anecdotal information should be used as the basis for MRAs. MRAs should be limited to a demonstrated control or process break.

Finally, we recommend that the Bureau establish a process for closing MRAs, which are often left open by the Bureau long after they have been resolved by the institution. It would be helpful if the Bureau timely resolved MRAs so that institutions could stop reporting on progress related to such MRAs and devote resources back to the business.

9. The process for appealing supervisory findings.

Fear of retribution prevents the appeals process for supervisory findings from being effective. The appeals process cannot be effective while the Bureau has discretion to respond to objections by enhancing the damages it will seek. The Bureau should establish a binding value on damages for the violations identified in an examination prior to a financial institution's appeal decision. Appeals should be reviewed by an independent party within the Bureau who is not associated with the supervisory team, possibly the Ombudsman's Office. The same team or person that originally reached the conclusion should not review an appeal.

In addition, the Bureau should make the appeals process more transparent. One way to accomplish this would be to provide anonymized data on the appeal process that identifies those issues being addressed and demonstrates to the industry that the process has a genuine effect. This is similar to what the prudential regulators do and it provides useful guidance for other financial institutions. Another option would be for the Bureau to respond to the legal arguments set forth in the appeal. If the Bureau rejects a financial institution's argument, it should explain the legal basis for that rejection.

An appeals process, likely separate from the supervisory appeals process, should be created where the Bureau decides to refer a matter to enforcement notwithstanding the institution's PARR response. Referral to enforcement has substantial adverse impact and the Bureau should provide a channel for such determinations to be appealed in appropriate circumstances.

10. The use of third parties contracted by supervised entities to conduct assessments specified in MRAs, or to assess the sufficiency of completion of an MRA.

The use of third parties contracted by supervised entities to conduct assessments in MRAs or to assess the sufficiency of the completion of an MRA should be limited. Financial institutions should generally be able to rely on their internal audit and compliance functions. The financial institution should only be required to undertake the substantial costs of engaging third parties where lapses in its existing oversight functions necessitate additional independence.

When that is the case, the Bureau should provide flexibility. Financial institutions must be allowed to onboard and retain third parties in a manner consistent with the institution's third party risk management program. Allowing flexibility here will result in better results for all parties involved.

11. The usefulness of Supervisory Highlights to share findings and promote transparency. The Bureau periodically publishes Supervisory Highlights to apprise the public about its examination program, including the concerns that it finds during the course of its work.

Supervisory Highlights can be a useful way for the Bureau to apprise the public about its Supervision Program. The report can provide the regulatory analysis that financial institutions need to inform operations. Accordingly, it should be used to provide as much detail about exam findings as possible without jeopardizing confidentiality. Supervisory Highlights should present anonymized cases with detailed legal analysis, including the element-by-element discussion.

However, Supervisory Highlights should not be a substitute for clear guidance and regulation. Unfortunately, sometimes guidance to which regulated entities are expected to adhere is included in Supervisory Highlights. This

is contrary to the open and transparent process advocated by the Bureau. The Bureau cannot rely on its periodic highlights to serve as a substitute for amending regulatory requirements or issuing guidance. Any new interpretations of laws should be released with notice and comment in a formal rulemaking process. Supervisory Highlights cannot be the source of “guidance” or “interpretations” that effectively constitute new regulatory obligations.

An example of the Bureau using Supervisory Highlights as a substitute for regulation can be found in the Summer 2017 issue. In that issue, the Bureau writes, “entity(ies) required applicants to provide names of references, including work colleagues, neighbors, and family members, on the loan applications. On its loan applications, the entity(ies) represented, directly and by implication, that the references would only be contracted to verify information and evaluate creditworthiness ...”⁷ The entities examined were cited for a UDAAP violation because they marketed products to the references.

In the next paragraph, in a separate examination, it says “entity(ies) indicated that these references would be ‘checked’ implying that they would be contacted only at loan origination.”⁸ Here the bad act was contacting the references during collection to locate the borrower.

These are clear instances of examiners making up new disclosure requirements based on their sense of fairness (it is a UDAAP to contract references other than at origination unless you have previously disclosed all the reasons for which you may contact references), without any prior guidance or interpretation issued to supervised entities. The Bureau further compounded the problem by putting lenders on notice of this new disclosure requirement by publishing the information in the Supervisory Highlights, rather than following the Administrative Procedures Act.

12. The manner and extent to which the Bureau can and should coordinate its supervisory activity with Federal and state supervisory agencies, including through use of simultaneous exams, where feasible and consistent with statutory directives.

AFSA stresses the need for coordination in supervisory activities with state regulators. The Dodd-Frank Act requires the Bureau to coordinate examinations with state regulators that have supervisory authority over covered non-depositories and must rely on existing reports required by those state regulators “to the fullest extent possible.” However, coordination is not the same thing as “piling on.” It is extremely difficult to take part in several exams at the same time where true coordination does not exist.

Where agencies are covering the same topics, coordination needs to occur to minimize the burden on all participants. The supervised entity should not have to produce different documents in different forms to a variety of examiners all at once. Without coordination between the examiners, all the business is doing is responding to examiners, not actually conducting business.

Greater coordination with regard to subject matter, information requests, and timing would greatly improve regulatory efficiency. To ensure coordination and efficiency, agencies should take a number of steps, including:

- (1) Identifying clear leaders in the context of coordinated exams;
- (2) Sharing findings between agencies others;

⁷ Bureau of Consumer Financial Protection, Supervisory Highlights. Summer 2017. p. 30.

⁸ *Id.* at 30 & 31.

- (3) Reusing the materials provided in response to IRs to limit the burden of production, even if exams are not held simultaneously;
- (4) Harmonizing and tailoring data requests to avoid redundant data production and review;
- (5) Limiting data requests to the information needed to assess the stated scope of the exam; and
- (6) Resolving issues in concert so that when violations are found, financial institutions are not subject to punishment for the same issues by different regulators at different times.

AFSA also wants to take this opportunity to note that there is not the same data uniformity among nonbanks as there is with banks. This needs to be taken into consideration in the context of exams.

V. Remediation

The issue of remediation is not covered in the Bureau's RFI questions, but nevertheless, we believe it should be addressed.

AFSA strongly advocates that the Bureau adopt clear standards for remediation requirements. Similarly to the standards for MRAs discussed above, the Bureau should create clear, consistent standards for what alleged violations will require remediation activity. The standards should be based on measurable, concrete financial impact to consumers. Token remediation should not be required for technical violations that had no actual consumer impact.

VI. Changes to the Examination Procedures for Auto Finance

In the RFI, the Bureau asks for feedback on the effectiveness and accessibility of the Supervision and Examination Manual. The Exam Manual provides internal direction to supervisory staff, including summaries of statutes and regulations and specific examination procedures for use by examiners in conducting exams.

AFSA has several comments on the section of the Exam Manual dealing with auto finance. There are a number of errors in the examination procedures for auto finance (the "Procedures") that we ask the Bureau to remedy.

Our primary concern is that some of the language in the Procedures has, and could continue to, lead to confusion during examinations. For example, throughout the Procedures auto finance transactions are referred to as "loans" made by "lenders." Although this may be consistent with industry jargon; it is an inaccurate legal description of the majority of auto finance transactions.

While a fraction of auto finance transactions are loans made by banks, credit unions, and other lenders directly to borrowers, most auto finance transactions occur in an auto dealership between a dealer (*i.e.*, seller) and a buyer, and are structured as credit sale transactions. Credit sale transactions are substantively different from loans, *i.e.*, the subject matter of a loan is money, and the subject matter of a credit sale is goods or services.

It is important the Procedures clearly differentiate between these two different legal structures, as well as recognize that loans and credit sales are subject to different laws and disclosure requirements. For example, there are state laws that govern credit sales and even more specifically, motor vehicle retail installment sales, rather than loans, and provide for distinct maximum finance charge rates, permissible fees, and other substantive requirements. Further, TILA requires different disclosures for credit sales and loans, *e.g.*, the former require a disclosure of the total sales price of the goods and services, whereas the latter do not. Given that the vast majority

of auto finance transactions are structured as credit sales, the AFSA believes that the Procedures should focus primarily on credit sale transactions and the obligations of auto finance companies engaged in these activities.

As it stands, however, the Procedures primarily refer to “lenders,” “borrowers,” “dealers” “servicers” and “auto loans,” and make an occasional reference to “direct” and “indirect” loans. In the vast majority of auto finance, more appropriate terms are “funding source,” “buyers,” “sellers,” “assignees” and “credit sale transactions.” Although using the common words (lenders, loans, etc.) may make the Procedures easier to read for outsiders, we are concerned that by not using the proper nomenclature, the Procedures are blurring the legal distinctions between loans and credit sales, leading to confusion during exams.

Here are four examples of the confusion:

- (1) *Origination Process*: The Procedures direct examiners to focus on the supervised entity’s “origination” process, both in the Examination Objectives and in specific instructions for examiners to obtain access to, or a walkthrough of, the entity’s online origination interface and online applications. While this would, without question, apply in the case of a direct loan transaction where the finance company would be providing TILA and other disclosures to the consumer, the vast majority of transactions are credit sales originated by dealers. To the extent consumers directly interface with auto finance companies prior to the purchase of their credit sale contract, it is typically in order to complete an application and get a preapproval prior to visiting the dealership. Therefore, in the majority of credit sale transactions, all pre-consummation disclosures are made by dealers, and auto finance companies will generally have only limited control over a dealer’s process, and will only see applications and credit sale documentation in the event a dealer decides to offer to sell a given credit sale transaction to the auto finance company. Even in the instance where the supervised entity may have provided dealers with form credit sale contracts, they often still accept and purchase transactions documented on commercially available forms.
- (2) *Risk-Based Pricing Notices*: Because most auto finance companies are purchasing credit sale transactions from dealers, they generally do not have a Risk-Based Pricing (“RBP”) rule notice obligation. Without the appropriate distinction between credit sales finance and loan transactions brokered by dealers, examiners may believe that supervised entities are violating the RBP rule by failing to have RBP notice procedures in place even where such notices are not required.
- (3) *TILA/UDAAP Advertising Requirements*: The Procedures include a section on compliance with TILA and UDAAP advertising requirements. However, few auto sales finance companies produce advertisements subject to TILA or UDAAP, as both are focused on advertising directed towards consumers. Sales finance companies generally advertise rates and terms to dealers, not to consumers. Dealers sell credit sale contracts to many different finance companies and banks, and are responsible for the advertisements they direct to consumers.
- (4) *Disclosures*: By not distinguishing between loan and credit sale transactions, examiners may look for TILA loan disclosures when they should be looking for credit sale disclosures. The Procedures’ section on closed-end credit disclosures instructs examiners to look for disclosures that are unlikely to appear in the credit sale contracts they are reviewing. For example, disclosures relating to the assumption of the “note” and a “no-guarantee to refinance” statement are only required in real estate-secured transactions. Auto finance transactions are rarely, if ever, secured by real property. Instructing examiners to look for

disclosures “as applicable” when such disclosures are highly unlikely to be necessary may unnecessarily complicate examinations.

In addition to distinguishing more clearly between loans and credit sales transactions, AFSA has identified a few other areas that could be clarified. They are, as follows:

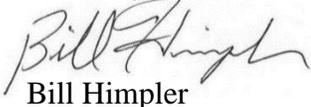
- (1) *Guaranteed Automobile Protection (“GAP”)*: GAP is described as an “insurance policy” in the Procedures. GAP, as provided by auto finance companies, is a form of debt cancellation or waiver product in most states, and not treated as insurance under most states’ insurance codes. While insurance and GAP are treated similarly for TILA disclosure purposes, it is inaccurate to characterize GAP products as insurance except for those sold in the few states that regulate them as insurance.
- (2) *Extended Warranty*: The Procedures appear to conflate warranties and vehicle service contracts (“VSCs”). VSCs are contractual agreements often subject to specific state laws, and are not warranties under any state or federal law. There are many federal and state laws that apply to warranties that are inapplicable to VSCs.
- (3) *Fair Debt Collection Practices Act (“FDCPA”)*: The Procedures note that FDCPA governs collection activities conducted by third-party collection agencies, as well as servicer collection activities if the servicer acquired the loan when it was already in default. While this statement is technically true, few auto sales finance companies purchase seasoned contracts. They purchase them shortly after the dealers originate them, usually well before the first payment is due. Consequently, it would be an extremely rare circumstance for the FDCPA to apply to an auto sales finance company’s collection activities. Thus, to avoid confusions, the Procedures should make clear to examiners that in most cases, the FDCPA will not apply to the entities under examination, but only to service providers engaged by the entities for debt collection services.
- (4) *Repurchase Programs*: The Procedures make reference to “repurchase” programs for repossessed cars. AFSA believes that it is important to point out that there is no transaction between a consumer and finance company that can accurately be characterized as a “repurchase” program. The consumer is the owner of the repossessed vehicle until the repossessing finance company accepts it in satisfaction of the debt or, more commonly, sells it pursuant to the applicable state’s Uniform Commercial Code (“UCC”) Article 9 provisions. It appears that the Bureau is referring to the UCC Article 9 right to redeem a repossessed vehicle when it uses the term “repurchase.” But in describing this as a “program,” the Procedures imply it is an option the secured party need not offer rather than a right it is legally obligated to observe. A debtor’s right to redeem collateral after repossession is the law nationwide under the UCC.

VII. Conclusion

AFSA appreciates the Bureau's interest in evaluating the overall efficiency and effectiveness of its Supervision Program. In particular, AFSA believes that the Bureau should reevaluate its sometimes adversarial approach to supervision. As part of that, the Bureau should take steps to reduce the regulatory burden it imposes on institutions while deploying Bureau resources more efficiently. This is also an appropriate time for the Bureau to reexamine the larger participant rules.

We hope the Bureau finds our recommended changes and enhancements helpful. Should the Bureau have any questions regarding our recommendations, we are happy to provide additional information. Please contact me by phone, 202-466-8616, or email, bhimpler@afsamail.org, with any questions.

Sincerely,



Bill Himpler
Executive Vice President
American Financial Services Association