

Consumer Finance Monitor (Season 8, Episode 26): The Impact of the Newly Established Priorities and Massive Proposed Reduction in Force (RIF) on CFPB Supervision

Speakers: Alan Kaplinsky, Paul Sanford, and Peggy Twohig

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm, and I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr, and I'll be moderating today's program. And let me just toot our horn for just a brief minute. Very recently, actually within the last couple of weeks, we reported on our blog that a podcast database service called Million Podcasts, it's the name of the company, ranked our Consumer Finance Monitor Podcast in the top 25 among hundreds of financial services podcasts nationally. They recently published a list of the top 100 financial services podcasts. Also, we were ranked as the top law firm podcast among the top 100 financial services podcasts, as well as the only one focused on consumer financial services, and very, very proud to report on that.

For those of you who want more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011 on the very same day that the CFPB became operational. So there's a lot of relevant industry content there. We also regularly host webinars on the subject of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at BallardSpahr.com. If you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or wherever you obtain your podcasts. And also, please let us know if you have any ideas for other topics that we should consider covering or speakers that we should consider inviting as guests on our show. Well, we are going to be talking once again about the CFPB today and in just a couple of minutes after I introduce our speakers, I will very briefly describe our topic and then we will get into what I should be a very interesting show.

Today I'm joined by two people who were formerly held very senior positions at the CFPB, and let me introduce each of them. First is Peggy Twohig. She's a recognized expert in federal consumer financial services, laws and related policy issues. She worked to protect consumers in financial services markets for close to 30 years in leadership positions she held at the Federal Trade Commission, Department of the Treasury and the CFPB. She was a founding executive of the CFPB when the agency was created in 2010, and she led the development of the first federal supervision program over non-bank consumer financial companies. Beginning in 2012 as head of the CFPB's Office of Supervision Policy, Peggy led the office responsible for developing supervision strategy for bank and non-bank markets and ensuring that federal consumer financial laws were applied consistently in supervisory matters across markets and regions.

During her government career, she has testified before Congress on legal and policy issues related to a wide range of consumer finance topics. Prior to her work in the CFPB, she was Director of the Office of Consumer Protection at the Department of Treasury where she supported the Obama Administration's proposal to create a new consumer agency, which ultimately became the CFPB, of course. Immediately prior to that, she served as Associate Director of Division of Financial Practices at the Federal Trade Commission. She was there for a period of 17 years, and then prior to that, was in private practice. So Peggy, a very warm welcome to you. I should say a welcome back because you have been on our podcast show before.

Peggy Twohig:

Thank you, Alan. It's a pleasure to be here again.

Alan Kaplinsky:

And a newcomer now to our show is Paul Sanford. Paul consults with financial services providers on navigating the regulatory environment, including trillion dollar financial institutions as well as large non-banks, service providers and technology companies. He performs a variety of engagements such as consent order remediation, merger assessments, exam preparedness, internal audits and training. He has 30 years of regulatory experience with three federal financial regulatory agencies in both safety and soundness and consumer protection. He was at the CFPB, the Comptroller of the Currency, and the FDIC. At the CFPB, he served as head of the Office of Supervision Examinations for the CFPB from 2012 to 2020 with the responsibility for ensuring the credible conduct of consumer protection examinations. I could go on and on with all your achievements, Paul, but I think we'll leave it at that, and I welcome you to our program.

Paul Sanford:

Thanks, Alan. It's a pleasure to be here and really appreciate the opportunity to join your show. So thank you for inviting me.

Alan Kaplinsky:

Okay, now let me describe to our audience what we're going to be talking about and the background that I think is essential for a whole bunch of questions that I have for Peggy and Paul. There was a memo that was sent to the CFPB staff from Mark Paoletta, chief legal officer of the CFPB, dated April 16th, 2025. It was called 2025 Supervision and Enforcement Priorities. That memo rescinded any prior priority documents that had been issued by the CFPB and includes an introduction and 11 points with directions. At the same time, on February 7th, Acting Director Russell Vought, who's also the director of OMB, ordered all work at the agency to stop and all exams were canceled at that time. Litigation that was brought by the union representing CFPB employees and some other parties was temporarily halted plans to terminate virtually the entire agency. On April 24th after the D.C. Circuit Court of Appeals allowed the CFPB to permit it to engage in a reduction in force, or we'll call it a RIF, if after "particularized assessments," they concluded that particular employees were not needed to perform statutorily-required functions.

RIFs were then announced that would lay off all but 200 employees. There were about 1,750 roughly employees at the time that the RIF was announced. Supervision would be left with no employees in two regional offices and a total of only 50 employees. The RIFs are now temporarily on hold by court order, and this case that I mentioned is working its way through the courts. It's been up and back before the district court and the D.C. Court of Appeals, and I'm sure at some point it may end up in the Supreme Court, but that's not where we're going to talk about today, the litigation.

We're going to be talking about how the new priorities that were laid out in the April 16th memo from Paoletta differ from the prior priorities of CFPB supervision and how the reduction in force, which would reduce supervision to only 50 employees, what impact that would likely have on CFPB supervision and examination. So we're going to do some level setting at the beginning and we're going to talk a lot about what Peggy and Paul did when they were at the CFPB, and then from there talk about the potential impact of the change in priorities. So let's start with you Paul. Could you briefly summarize how you prioritize what CFPB supervision resources when you were in charge?

Paul Sanford:

Sure, Alan. Thanks. I think what might be helpful to start off is to mention that Peggy and I were kind of two halves of the whole in supervision when we were there. So while I was head of the examination function that took place in the field, Peggy was head of policy and really made a lot of interpretations, the application of law, but also the prioritization process for where we went and what we looked into, what entities, what product lines, what regulations and such. So it was a very collaborative process between Peggy and I. Our backgrounds are complementary, so she'll cover more about the prioritization itself. But what we thought would be helpful as supervision is not really understood by everybody, it's kind of a small community and it's an interesting field, and so we thought it might be good to just cover and level set a little bit about what supervision has to with, and then I'll turn it over to Peggy to talk about prioritization.

So supervision, I mean, the goal of CFPB supervision program was to ensure that our consumer financial protection laws were being complied with, and there's something called compliance management systems, which are essential. It's a form of internal

routines and controls to make sure that you can comply with consumer financial protection laws. And a lot of what the supervision program did revolved around something called examinations, and these examinations were much like an audit, if people are familiar with that. So what would happen is we would go out request information from entities, we'd send an information request letter before the exam begins, meet with management, and then go on site, ask our questions, follow up, make additional information requests, interview management and employees, and also do transaction testing, because that's the only way you can really find out if things are working or not. And then once the examiners have evaluated the information, they would discuss the findings with management and issue a report with those findings and direct corrective action if it's necessary.

I think another key thing to be aware of with supervision is that they would be looking for root causes. So what were the failures? Were they people, process or technology? And that's really important because you have to go beyond just correcting the specific incident that you find. You really need to be looking across other product lines, across divisions to make sure there's no problems globally. So for instance, what if the failure happened to be that training is inadequate? And it might have to do with one product line, like credit cards, but we would expect that entity to look across the entire organization, to see if there is a broader problem with training that needs to be addressed.

The other thing I think I should point out is that supervision, unlike some other disciplines, is not a one and done type of affair. It's an ongoing iterative process. It establishes a supervisory relationship, and through that there can be ongoing monitoring of an entity of these practices, and also if there are issues that pop up, there can be targeted reviews, which are much more narrowly focused than exams. So again, the goal is really to prevent law violations and to encourage course correction of any problems before they get worse, and protect consumers.

Alan Kaplinsky:

Well, no, I just had one follow up question that I think would be helpful for the audience, and that is who did and who does the CFPB supervise and examine today? Dodd-Frank specified certain types of entities, banks and non-banks, and then gave the CFPB the authority through the promulgation of larger participant rules to add additional subcategories of the consumer finance industry. So maybe if you could just describe that, or Peggy?

Peggy Twohig:

Yeah, thanks, Alan. I think that's important background, so I'll cover that first before I turn to the prioritization process we used. So as background, the entities that CFPB supervised in these markets included the largest depository institutions in the country, so that would be banks, thrifts and credit unions with assets over \$10 billion and many non-bank consumer financial service companies. The non-banks included mortgage originators and servicers, payday lenders and private student lenders, and for those categories, it included market players of all sizes, and larger participants of other markets as defined by rules that were later issued after CFPB started up, including consumer reporting, debt collection, international money transfer, student loan servicing, and auto finance. So that was the landscape we had to cover over time during the time we were there.

Alan Kaplinsky:

And Peggy, just for clarification, the smaller banks and depository institutions that were not examined by the CFPB, they would continue to be examined for consumer compliance by their whoever it was, their principal credential regulator, am I right? The Fed, the OCC or the FDIC?

Peggy Twohig:

That's right.

Alan Kaplinsky:

And the non-banks were not supervised or examined at the federal level, although many of them were supervised and examined at the state level?

Peggy Twohig:

Right. That's right also. Not all, but some of the markets were.

Alan Kaplinsky:

Yeah, I'd like you to follow up with the description of the prioritization process.

Peggy Twohig:

Right. So turning to the prioritization process that we used, we conducted an annual risk-based analysis to plan our supervisory activities for all the markets we supervise, looking across the bank and non-bank markets at the same time, all those markets that I mentioned. So we had to consider all those entities and markets in prioritizing work. It was quite a canvas to have to consider. Our planning was driven by information about these markets and the risk posed to consumers in the markets from violations of federal consumer financial law, and I want to focus on that just to put a point on that, we were not considering the risk to the banks. We were considering the risk to consumers from violations of federal consumer financial law. So we collected information about the markets, the market participants, trends, consumer complaints, complaint history, compliance history, and other information to determine how to apply our supervisory resources.

Based on this data-driven approach, staff made recommendations that were then approved by the director. And I want to also point out that the CFPB is required by the statute to use a risk-based assessment to apply its non-bank supervisory resources. Although it's not legally required for depository supervision, we used the same process so that supervision resources were deployed where most needed, to protect consumers. We were transparent about this process, that this was the risk-based prioritization process we used, and we regularly published information about our supervisory findings and any policy changes through a publication called Supervisory Highlights.

Alan Kaplinsky:

Let me ask you about what the Dodd-Frank Act actually requires of the CFPB when it comes to conducting physical examinations of both banks, the large banks, more than 10 billion in assets, or the non-banks that it is required to supervise, either because of a requirement in Dodd-Frank or through the larger participant rules that it promulgated.

Peggy Twohig:

So let me tell you what the statute requires and then we'll talk about examinations in particular. The statute states that the CFPB shall require reports and conduct examinations on a periodic basis of non-bank providers of consumer financial services under its defined statutory jurisdiction for three purposes. One is to assess compliance with the requirements of federal consumer financial law. Two is to obtain information about the activities and compliance systems or procedures, and three, to detect and assess risk to consumers and markets for consumer financial products and services. The statute has similar language for the largest banks, meaning to require reports and conduct examinations, giving the CFPB exclusive authority to require reports and conduct examinations on a periodic basis of banks with over 10 billion in assets for those same three purposes that I mentioned. It doesn't use the word physical examinations, but it does use the word examinations when setting out the statutory duties that I mentioned.

Alan Kaplinsky:

Yeah. Okay. So now I want to get to the Paoletta memo dealing with the so-called new priorities. One of the directions in the Paoletta memo is to shift back CFPB supervision to the proportions that focused on depository institutions to non-banks to where it was in 2012 to a 70% depository and a 30% non-bank compared to the more recent split of 60% on non-banks to 40% depositories. So Peggy, when you were leading CFPB prioritizations, how did those proportions get set?

Peggy Twohig:

Well, the risk assessment process that I described drove the allocation between depository and non-bank sectors, and as I mentioned, one of the important aspects of our approach was that we looked across all the consumer financial markets,

looking at banks and non-banks at the same time to determine where we thought the biggest compliance risks were. Our goal was to create a level playing field so that for example, a non-bank mortgage company and a depository institution's mortgage business were looked at with the same level of oversight if they presented the same risk to consumers, and by the way, the statute requires that. The CFPB is tasked with ensuring that federal consumer financial law is enforced consistently without regard to the status of a person as a depository institution in order to promote fair competition.

But I also want to make one comment about the Paoletta memo's direction to shift back to the 2012 split. That seems arbitrary to me because there's no explanation, first of all, why they would have those percentages, and the 2012 as a year doesn't make sense as a baseline, and here's why: In 2012, the CFPB was just starting to implement its non-bank supervision program. Well, the large bank supervision program began the year before in 2011 when the authority for large banks transferred from the prudential bank regulators to the CFPB. The non-bank program on the other hand, which by the way, we were starting from scratch, couldn't even start until the CFPB had a director in early 2012, and then it could only start with certain non-banks markets until the rules were issued defining larger participants in other markets, which happened over the next few years.

Alan Kaplinsky:

Yeah, it really doesn't make any sense at all. So Paul, what do you think of the wisdom of focusing on the largest banks?

Paul Sanford:

So I think actually a little bit counter to what I would think makes sense based on my experience. We should keep in mind that the largest banks are also still being examined to some degree for consumer protection issues. The (bank regulators) still retained authority over a few consumer protection laws. They can also evaluate the compliance management system and issue their own compliance rating. So they don't have the majority of the consumer protection regulations to oversee, but they do have some responsibility. The other thing is that they've been being supervised for 160 years, and there's something that we refer to as a culture of compliance that exists at banks. So in my experience, you would want to focus more on the non-bank sector than on the banking sector. Non-banks just generally are without the same level of oversight that they've had from the federal banking agencies or what they receive from the CFPB, generally, and there are a lot of very good non-banks out there, they generally don't have the same understanding of what's required to have a strong CMS.

And this is particularly important in the area of emerging financial markets where you have fintechs that come in and the very nature of their business is to be disruptors, and so they don't tend to be as sensitive to the idea that there are regulations and laws that need to be followed. And so I think it's really important to be making sure that the weighting goes towards where the risks are, and the prioritization process that Peggy outlined really would drive the figures that we had result in. And I would say in the process when we went through this annually, we would also step back and look at the forest for the trees, because you can go through the prioritization process and you still need to say, "Do we have sufficient coverage across the different types of products and across both banks and non-banks?" And there's so some art to this as well as the science, and actually, if we had more examiner resources, I would argue that we would have to have been less rigorous in our prioritization because we could have covered more of the universe.

Alan Kaplinsky:

Right, right. Okay, let's turn to something else that's in the Paoletta memo. It states that the focus for supervision should be on "conciliation, correction and remediation of harms subject to consumer complaints," and "collaborative efforts with the supervised entities to resolve problems so that there are measurable benefits to consumers." How does that direction, Paul, differ from the approach when you were at the CFPB?

Paul Sanford:

Well, I think there's a few key points that we want to talk about here. Unfortunately, I think some of this seems like a overreaction or overcorrection to some of the things that have happened over the past few years where there has been unnecessarily inflammatory rhetoric in terms of entities being characterized as criminal organizations. There's a lot of entities out there providing legitimate financial services and they're trying to do the right thing.

An effective supervision program really depends on you having an open, honest dialogue with the entities, and that's based on trust. We actually had values that we followed and we would repeat them at every opportunity, like conferences amongst the regions and such, and those were humility, accountability, and trust. And while with a lot of places' values it can be just words, if you take this apart, you have to be humble as an examiner because you need to recognize that you might not be right, and you have to listen to the things that are being shared with you and make sure that you have your facts correct, and if there are good counter legal arguments, you have to hear those as well. And accountability means that you're willing to own up to that and say, "Okay, you're actually right and we're going to change our position based on our understanding that you share with us," and then what that leads to is trust.

So with trust, you can get things done quietly behind the scenes, working collaboratively with entities. It's a polite, respectful process. We're not their friends as examiners, there's no mistaking that, but there is a way that you go about doing supervision that gets really good results, and when I think you take this apart a little bit in terms of language used, I don't know that it's really consistent with the best outcomes. I don't think conciliation is really necessary if you have good actors who are actually trying to comply with the law. Mistakes happen, and so I think it's kind of unnecessary to take that approach. And in cases where you have bad actors, the solution CFPB has is an office of enforcement and those entities could be turned over to them for an investigation to pursue the matter further if we perceived that that was the right course of action.

So yeah, so I think there's a few key things there. Also, correction or remediation to consumer harms, as Peggy and I have pointed out, that is kind of central to the mission and so wouldn't argue with that, and that's an important aspect that needs to continue to happen as the Bureau moves forward.

Alan Kaplinsky:

Okay, yeah. So Peggy, the next area I'd like to focus on are the substantive areas, the laws that CFPB exams for compliance. The memo states that the focus of supervision in exams should be on "actual fraud," where there are "identifiable victims," with material and measurable consumer damages as opposed to matters where the consumers made the "wrong choices." And it lists the following priorities, mortgages, number one priority; the Fair Credit Reporting Act and Reg V; data furnishing violations; Fair Debt Collection Practices Act; Reg F, relating to consumer contracts and debts; fraudulent overcharges and fees; inadequate controls to protect consumer information resulting in actual loss to consumers. So my question, a couple of questions. How do these priorities compare to CFPB supervisions priorities before now, and how do these priorities fit with the direction in the memo to have a 70%, 30% depository non-bank allocation?

Peggy Twohig:

So for the list that's in the memo, mortgages, FCRA furnishing, FDCPA, fraudulent overcharges, inadequate controls, we had many of the same priorities in our supervision program in addition to other areas. It depended on all the information we collected and our analysis of where we thought the risks to consumers were the highest. For example, mortgage servicing was a very high priority, especially in the early years and particularly given the very serious problems with default mortgage servicing in the wake of the mortgage meltdown from the Great Recession. That's just one example. But going down the list, the FCRA, or the Fair Credit Reporting Act compliance, was a high priority from the very beginning, given decades of high levels of consumer complaints about credit reports, and that's why consumer reporting was the very first larger participant rule that we issued so we could directly supervise consumer reporting companies as well as the bank and non-bank furnishers to the consumer reporting system. So that was always important to us, that whole area.

Debt collection was also a priority from the start, and that was the second larger participant rule. Likewise, looking out for fraudulent or illegal fees were typically part of just about every exam. And finally, looking at what this memo refers to as inadequate controls to protect consumer information, or I think we called it data security practices, was folded into the mix of what we looked at over time. On data security, our focus was non-banks because the prudential regulators covered data security for banks, and actually, had the more pointed authority to cover that because they had authority to enforce the Gramm-Leach-Bliley safeguards rule and the CFPB did not. But in terms of the 70-30 depository non-bank split that the memo lays out, this list of substantive areas just shows why that split doesn't make sense.

For example, the memo states the top priority mortgages, but non-banks originated over 65% of residential mortgages in 2024, and the top five mortgage lenders were all non-banks. That's according to data from Inside Mortgage Finance. Non-bank

mortgage servicers also have gained market share in recent years to an over 50% of the market as reported by Inside Mortgage Finance in early 2024. And non-banks are particularly prominent in default mortgage servicing, which is where we found higher risk to consumers than in servicing performing mortgage loans. There's other examples. If FCRA furnishing is a priority, then you have to look at non-banks and not just banks. You have to look at non-bank mortgage servicers, auto loan servicers, student loan servicers and debt collectors, and if you're going to look at the Fair Debt Collection Practices Act, or FDCPA compliance, as you know, Alan, that means you're looking only at non-bank debt collectors because first-party debt collectors like banks are not even covered by the FDCPA. So this substantive list is internally inconsistent with the bank 70-30 depository-non-depository split that the memo lays out at the outset.

Alan Kaplinsky:

Yeah. Do you think, one other sort of question I have for you, by saying that they're going to focus on actual fraud, and they talk about that before they get to the various laws that they list, we're really probably talking about in terms of UDAAP, we're talking about the deception prong. Although they didn't say it expressly, could you read between the lines here to say they're not going to focus on the abusive and unfair prongs?

Peggy Twohig:

Well, it's hard to know. They didn't say that. But I would say that if you're going to focus on inadequate controls to protect consumer information, then if you're going to focus on data security, you have to use the unfairness prong of the UDAAP principles, because again, the CFPB does not have authority to enforce the GLB safeguards rule. So the main authority that would apply to that area would be unfairness.

Alan Kaplinsky:

Right, right. Thanks, Peggy. And Paul, another priority that they listed is to focus on providing redress to service members and their families and veterans. How does that compare to the prior priorities?

Paul Sanford:

Well, it's an important priority for the Bureau, of course, and what I did in prepping for today was I went back to the CFPB's website, and the enforcement section, you can go in and actually do keyword searches and other searches to look back over enforcement actions that have happened over the past 14 years or so. And I put in the word, veterans, and 17 consent orders came up. So it has been a priority for the Bureau. Note a couple other things, it has an Office of Servicemember Affairs, and while veterans issues are very important, there's a lot of other vulnerable populations as well, and so that's why the Bureau has set up other offices. So there's one office that looks out for the elderly, and it's a vulnerable population as we know. So those other populations need to be factored in as well.

And the last thing that I'll note here is that a significant number of the examiners that we hired and trained are actually veterans. So they were and will be, I'm sure, and continue to be very attuned to potential issues affecting both veterans and service members. So it's kind of baked in, to a degree, in terms of the supervisory process.

Alan Kaplinsky:

Sure, sure. And always, I guess you could say politically a bipartisan issue. Both Republicans and Democrats, both sides of the aisle always focused on that. So Peggy, let's talk about some of the things that they said they're going to or that they're going to de-prioritize. Loans for "justice-involved," individuals, medical debt, peer-to-peer platforms and lending, student loans, remittances, consumer data, digital payments. How did these compare to what was prioritized or not prioritized in the past?

Peggy Twohig:

So some of these areas were not prioritized in supervision, but not because there were not going to be problems, it was because CFPB's supervisory authority over certain markets and entities is more limited than that of CFPB's enforcement authority. So some of these areas were not covered by supervision for that reason. Some were, such as remittances. We

supervised for compliance with the remittance rule, especially when it was a new federal rule. We had to get a handle on how large remittance providers were complying with that new federal rule. We also supervised student loan servicing where we constantly found problems. So that was always in the mix. And this says it's not going to prioritize consumer data in the memo, but then earlier it said it was going to prioritize looking at information systems or inadequate controls to protect consumer information. So I don't know how that squares up and what that means, but I will say that if consumer data means looking at data security practices, as I mentioned before, that was an area we built into supervision over time, focusing on non-banks as I mentioned before.

Alan Kaplinsky:

Okay. One thing, just my own observation in terms of deprioritizing student loans, I can't think of a worst time to deprioritize that given the fact that I guess the moratorium on having to repay federal student loans is over and there's going to be a much more vigorous collection activities, and you would think that that's something that that would be on the priority list, not the depriority list, but that's...

Peggy Twohig:

I agree with you, Alan. You would think that would be a priority.

Alan Kaplinsky:

Yeah, you would. All right. Let's turn, Paul, to coordination with state and federal supervisors. Another area of direction is to respect "federalism," and not prioritize supervision where states have an exercise ample regulatory and supervisory authority and participate in multi-state exams unless required by statute. The memo also directs supervision to eliminate duplicative supervision where other federal agencies have authority. How did supervision coordinate with state or other federal supervisors previously, Paul?

Paul Sanford:

So as you point out, I mean, this was anticipated even in the statute in terms of an expectation that there'd be coordination across both state and federal regulators, and for us, with the limited resources we had, it was a priority to ensure that we had good collaboration and coordination, also sensitive to the potential burden of CFPB going in and doing work and making sure that it's not duplicative, or leveraging the work that's been done by other agencies. Some of that was intuitive for many of us, because a lot of our examination force came over from state and federal agencies. I myself had been executive secretary for the FFIEC, which is an inter-agency council that includes the states and all the federal regulators. Steve Antonakes, who was Peggy and my boss and deputy director as well, he was commissioner of banking for the state of Massachusetts.

And so this has always been something that the bureau had been focused on, and the coordination, as you, I think, started to point out with the multi-state process, CSBS had done a very good job of already looking across the different states and trying to make sure that they're reducing burden and leveraging resources and expertise, and we had a formalized program that we coordinated both through headquarters and the regional offices to try to ensure that we could cover the landscape efficiently. I think a key thing to note here is that the authorities between the states and CFPB are different, especially in the non-bank area, and the focus of the exams are correspondingly different. So it's not really duplicative when you look at the purpose of those exams, but coordination is really important and very helpful for the process.

Alan Kaplinsky:

The other thing I would point out is that there are very few states that require state bank examiners to examine for compliance with federal consumer financial services laws or consumer protection law. Their focus as a matter of state laws on state law compliance, both safety and soundness and consumer protection. The CFPB is very focused on federal law, not really focusing on state law. Even though there is coordination among the examiners, it's not like there's duplication going on. The examiners for the CFPB are looking at compliance with one set of laws, federal law, and the state banking departments looking almost exclusively at compliance with state law. Have I got that right?

Paul Sanford:

Yes, that's a great summary, Alan.

Alan Kaplinsky:

This is really a question for Peggy. May the CFPB satisfy statutory duties by relying on state departments of banking or other state regulators for non-banks and the prudential bank regulators for large banks? I think we may have answered that question already, but Peggy, what do you think?

Peggy Twohig:

The answer is clearly no. The CFPB cannot satisfy its statutory duties by relying on the state regulators or the prudential bank regulators for large banks. For large banks, the CFPB has exclusive authority to supervise for compliance with federal consumer financial laws under Title X. So the CFPB simply cannot rely on the prudential regulators to do the job it must do under the statute. There is some overlap with certain authorities, but it's very limited, and in addition, the top priority for the prudential bank regulators has been, and still essentially is safety and soundness, not consumer protection, which is why Congress transferred the authority for consumer protection to the CFPB in the first place. And for non-banks, Congress gave the CFPB new federal supervisory authority for compliance with federal consumer financial laws, because the states simply were not doing that job.

We've talked about why the states are... Alan, you mentioned the states are typically focused on state laws, especially licensing requirements and not federal laws, and I would add the states are often quite limited by their resource constraints and their authorities over different kinds of markets in different ways. And there are some areas the states really don't cover at all or to a very limited degree, including consumer reporting, fair lending and federal prohibitions on unfair, deceptive and abusive acts and practices. I would also note that I think the supervisory findings by CFPB year after year show why CFPB supervision was and is still needed apart from the statutory duties that Congress gave it. For example, soon after the CFPB was up and running, supervision found widespread deceptive marketing of credit card add-on products at many of the largest banks in the country. Those problems had not been addressed by the differential regulators, even though they had been going on for years. And after that, over the years, supervisory highlights reported on a regular stream of problems in non-bank and bank markets that simply had not been addressed by other regulators.

Alan Kaplinsky:

Okay. Thank you, Peg. Paul, with regard to leaving more supervision to the states, Dodd-Frank clearly reflected that Congress thought the states weren't doing enough. What are your thoughts about whether things have changed with the states that would change the level of duplication?

Paul Sanford:

Well, I think we have covered it pretty well up to this point in terms of the issues related to authorities and resources, and I think it's reflected in the fact that, for instance, the FDIC and the FRB both support the states with providing training both through their agencies and the FFIC to help them, because again, they don't have the same level of resources that the federal agencies do. And so I think the idea that this can be turned over to the states, the states are doing a very valuable function and they're focused on particular areas within their authority, and they do have resource constraints. So do the federal agencies, but the states particularly do. They have some real challenges there.

Alan Kaplinsky:

Okay. So Peggy, the next area would be called, I guess, generally application of the law. The memo states that the Bureau won't pursue supervision under "novel legal theories." What's your view on how this compares to how supervision examined for legal compliance previously? I don't think he was very specific about what he meant by novel legal theories, although you can look at the many, many lawsuits that the CFPB has dismissed with prejudice after Rohit Chopra was terminated and after Vought became acting director. And you can get some idea of that. I think he got rid of cases dealing with rent to own, with

that industry where the industry was taking the position that they're not subject to jurisdiction of the CFPB, but I don't know what else he's actually referring to there. But anyway, how did that compare? What do you think he's talking about and what is it that he wants to get rid of here?

Peggy Twohig:

So Alan, I don't know. I don't know what he means by novel legal theories and what he wants to get rid of. But I will say this, our supervision was based on gathering the facts and applying the law to whatever we found in exams. So that means we'd carefully analyze how the statutes or regulations apply to whatever facts we found. So the process of applying the law in the real world where there's evolving market practices always involves determining how the law applies to fact patterns that might be different than the ones that were encountered before, and certainly different than anything you'd find in established court precedent, which is often quite limited.

So our approach was when we found facts where consumers were or might be harmed, we didn't look the other way and not do our job just because there was no established precedent. We did our best to carefully analyze how the law should apply to those facts and make a call whether we thought there was a law violation or not. I have been both at the FTC and the enforcement side of things and then CFPB at the supervisory side for a long time, and I'm here to tell you that's what is required in looking at dynamic market practices.

Alan Kaplinsky:

Right. Let's turn to fair lending, okay? How does the disparate-impact executive order that was issued by President Trump and the statement in the Paoletta memo differ from the fair lending focus of the CFPB when you were there? For fair lending, the memo states it will not look at redlining or bias assessment based solely on statistical evidence, but only pursue matters with proven actual intentional racial discrimination and actual identified victims.

Peggy Twohig:

So for fair lending supervision, which was under my purview for part of the time I was there, but not all of the time, in looking at compliance with the Equal Credit Opportunity Act, mortgage underwriting and pricing were top focus areas with other types of lending and servicing reviewed in the mix over time. Redlining was a priority area and a consistent focus was examining for compliance with the Home Mortgage Disclosure Act requirements. The other thing I should note is for statistical evidence, the CFPB used the same type of statistical analysis that's been used in fair lending enforcement exams for decades by the federal prudential regulators and other federal enforcement and supervisory agencies.

It's important to point out that statistical modeling was used to analyze whether there were differences in treatment of similarly situated consumers that could not be explained by factors other than a prohibited characteristic like race, national origin, or sex. This was not necessarily a disparate-impact approach. This was used as evidence of disparate treatment. And in the memo, the memo states that the CFPB will only look at proven actual... This is a quote, "Proven actual intentional racial discrimination and actual intentional victims," end quote. In my view, that's basically an announcement that the CFPB is not going to do its job to supervise for and enforce fair lending laws. I mean, after all, the whole point of the agency's supervising and enforcement authority is to find out whether the law has been violated, not wait for a proven case to fall in its lap.

Alan Kaplinsky:

Yeah, and my guess is, and just a general feeling I have, that they're going to be... Am I right that in terms of your experience or Paul's experience, you don't find that many cases of intentional out-and-out discrimination? It's a lot more subtle than that, and that's the reason you look at the data and you compare protected classes and what the impact is on them versus others that aren't in a protected class. Am I right that it basically says they're getting out of the fair lending supervision business? I just don't think they're going to find some... Particularly with large banks, that would be shocking if any large bank was found to be engaged in intentional discrimination.

Paul Sanford:

I think an interesting part about this fair lending question, and you asked how often it is that you find actual intent. I mean, it happens from time to time. There were things where you have whistleblowers or recordings or emails or things of that where it's overt and you see it, but as you say, it can be a lot more subtle in the way that it carries out, and one of the things about the supervision program and what supervision entails, and you highlighted the word physical examinations. So what is an examination? Even the other regulators have a similar authority to do examinations. It doesn't say what an examination is in the statute, but it's been developed over the course of 160 years about what the best practices are, and a big part of doing supervision is physically going on site and engaging with management.

And I think what we all have in our own personal experience is people behave differently when folks are looking, and so a lot of what supervision has to do is when you're going in and checking and talking and meeting, they tend to have heightened awareness about their compliance management systems, about compliance with laws and regulations, and as a preventative measure, I think what the supervision program does by going in and conducting these exams and looking to see about the strength of their fair and responsible banking programs is it at least causes people to be thoughtful about it. So I think there's real value there in terms of doing exams that goes beyond just, are you going to look for something that's going to be overt discrimination.

Alan Kaplinsky:

Yeah, good points, Paul. Let's turn now to the RIF and the reduction in force, and just to refresh everybody's memory, what is being proposed is that at the end of the day, supervision will only have 50 employees and there will be two of the branch offices that won't have any employees. And so if they're actually carried out, what's your view on whether supervision will be able to perform its statutory duties? What are the statutory duties? Must there be examinations? So Peggy, do you want to, first of all tell, us what the statutory duties are and then I'd love your opinion on that question.

Peggy Twohig:

Sure. The statutory duties for supervision are spelled out in Title X, and we reviewed them before, but just to state them again in this context because it's important to keep in mind, the statute states that CFPB shall require reports and conduct examinations on a periodic basis of the non-bank providers of consumer financial services under CFPB's defined statutory jurisdiction for the three purposes I mentioned, including assessing compliance with requirements of federal consumer financial law. The statute has similar language for the largest banks, as we've talked about, giving the CFPB exclusive authority to require reports and conduct examinations on a periodic basis of banks with over 10 million assets for those same purposes.

And these duties must be carried out, when you get to the real world and how many entities we're talking about, over a huge number of supervised entities. This includes about 180, according to the latest list, depository institutions. Keep in mind, these are the largest banks in the country, including giant institutions and probably thousands of non-banks. We don't know the specific number for non-banks, but it's fairly likely in the thousands. In my view, there's no question the CFPB will simply not be able to perform its statutory supervisory duties if these planned RIFs are carried out.

Alan Kaplinsky:

So Paul, I'd like to see if you have the same opinion that Peggy has, that with 50 employees, you can't possibly do everything that's mandated by the statute. So I'd like your view on that, and then I wonder if you would address whether there have to be examinations. Could they just decide to supervise and have the entities that are subject to supervisory jurisdiction just provide information periodically, do away with physical exams, which are, I assume, more labor-intensive, at least they take longer to conduct that type of an examination because there's travel involved, et cetera. What's your thought, Paul?

Paul Sanford:

Sure. There's a lot baked into that question that you're asking. If we start with the very nature of exams and even thinking about what happens with a physical exam and whether there's a lot of travel involved, things have become pretty efficient over time, where when I started over 30 years ago, it was all on-site the entire time, and now I would say it's probably no more than

20% actual on-site time. So a lot of the work is being done remotely, which is very efficient. You still need that on-site portion. It's something all the regulators wrestle with, what's enough actual on-site physical presence that's important? So there is still monitoring that goes on that's already happening. So that is what you're describing, submission of information that's evaluated and then follow up questions were asked, and some conclusions can be drawn from that. So it's part of the supervision toolbox already, but it's not really sufficient in and of itself because when you're limited by the number of people, even if you don't go on-site, you're still going to only be able to do a certain amount of activity.

I think one thing to note here about supervision that a lot of folks don't appreciate is that a lot of what supervision does is prevent harm, and it's hard to justify because baked throughout all of this I think is this idea, this theme of excessive burden, but when you look at it and step back and say, "What is the cost?" In reality, there is a lot more harm prevented than what the cost of supervision is, and the cost of complying with the law is already the cost of complying with the law for entities. So supervision is just something else that is a tool to ensure that there's compliance with the law.

When it comes down to what would be sufficient to be able to go in and do the things that I've already described in terms of evaluating CMS, doing transaction testing, following up with the entity and issuing reports, they're... In my view, we had 400 examiners when I was in charge of OSE to conduct the examinations, and yes, we described a rigorous prioritization process that was irrespective of charter or license type. It was an innovation that Raj Date introduced that said, "Why are we looking at a bank and non-bank? We should be looking across product lines and then evaluating it that way."

But we always had to step back and say, "What do we absolutely have to do? Because we can't do supervision the way that it's traditionally done with the examination staff that we have." If I were in charge of supervision and had the resources, I actually lobbied for 700 to 1,000 examiners. I think 400 is enough to do large bank supervision in a way similar to the way the federal banking agencies do it, but in order to cover the landscape in terms of non-bank supervision, you really need about 700 to 1,000 examiners. So that would include not only regular periodic examinations, monitoring and targeted reviews when necessary, and that is again, because it's not one and done, it's an iterative process that there's based on the supervisory relationship between the entity and the supervisory examination force. So I think I probably laid out why 50 doesn't even come close to scratching the surface.

Alan Kaplinsky:

Yeah. What would you do with 50 employees? I mean, he doesn't even break down how many of that of the 50 are examiners and how many are in supervisory roles? And I mean, there's not a lot you could do, I wouldn't think.

Paul Sanford:

You would ruthlessly prioritize and you could do one of two things. You could either do pretty comprehensive reviews of only a very few entities, or you could do what was referred to as drive-by examinations, which there were periods in our history, and you've been around a long time, Alan, in this business and you saw where drive-by exams resulted in a number of bad things that happened later. We had the savings and loan crisis. And I can tell you the FDIC didn't hire examiners for eight years during that era, and there were insufficient oversight of entities and they got into trouble.

Alan Kaplinsky:

Yeah. One other thing, assuming that this RIF goes into effect and the CFPB remains in existence, they don't enact a law, Congress doesn't enact a law eliminating it, which I think is highly unlikely, although I think in the big beautiful bill that is being considered by Congress right now, I think there's still a provision in there that reduces the cap on funding for the CFPB to instead of 12% of the budget of the Federal Reserve, I can't remember the number it got reduced to, but it's way below that. Assuming they sort of do that for the remainder of Trump's term and then another election and there's a change in party, a change in leadership, I would imagine it's going to take a long time to ramp up to where things were before the new administration took over.

Either one of you, I'd like your reaction. I guess based on you were there right at the beginning, Peggy, you know how long it took to start the CFPB from scratch. You wouldn't be starting from scratch here, but it would be a lot less. It would be

nothing like the number of employees and the support that you had after you'd been at the CFPB for several years. I mean, I assume it's going to be very tough for any new leadership to sort of go back to where things were.

Peggy Twohig:

Well, I think that's absolutely right. It was a long lead up to be at full strength. That was including building out the non-bank supervision program in the first place, which hadn't existed before, and getting up to full strength. And to do a credible job, to do, in my view, an adequate job as mandated by the statute, you have to train examiners, you have to put time into that. It's not just an examiner could be hired and then immediately assigned to examine the mortgage servicing practices of the largest bank of the country. There needs to be experienced examiners that are working alongside that new examiner and training that goes with it. So there's a lot involved in getting the program up to speed. So as Paul described, it's a credible program that actually can do its job under the statute.

Alan Kaplinsky:

And I would think also just, and I'd like to get your thoughts, Paul, on the same question, that it's going to be more difficult to hire more people in the future. I mean, this history of when there's a change in party as president that things go from... It's just a totally different level of supervision and examination and everything else that the CFPB does. I know if I were somebody wanting to go to an examination, I'd worry how long is my job going to last. So what's your reaction to that, Paul?

Paul Sanford:

That's a great point, Alan. As everyone who's had been in a situation where they're potentially going to lose their job and this kind of whipsaw kind of back and forth with a potential for losing your job and not, it's caused a lot of people anxiety that has caused them to question their career choice and what is that they're doing. So in your point about retention could be a problem on a going forward basis, even to staff back up again. Another I think interesting point that you made had to do with the level of funding and where is this expense going. I remember one very sharp individual asked the deputy director, "What's the return on investment for supervision?" And his response was, "Several billion when you consider the return to consumers for the credit card add-on products alone," and the person just said, "Fair enough." Okay, so that kind of addresses that part of your question.

Just to kind of add on to the point that Peggy was making, and I think people don't necessarily realize this because we had established a culture, as I outlined, with humility, accountability and trust as values, and examiners are supposed to be polite and respectful. And on the outside now as a consultant working with entities that were going to experience their first CFPB exam, in light of all the rhetoric the past few years, they were kind of shocked by how polite and respectful and professional the examiners were. That doesn't happen by accident. You hire certain people that have a certain outlook on life in terms of being fair and balanced and good communicators, and then we would train them up.

Now, there's a commissioning process for examiners, I think people should appreciate. It takes three to five years of study and formal courses. They have to pass two examinations, a multiple choice test, and they have to sit down for an entire day in front of a panel of three examiners, and do a very structured process where they have to simulate an examination and they have to pass that assessment. So it is a very rigorous process. It takes a long time. We are very careful and thoughtful about how we did it, so we have a very competent in credible workforce. Entities love to take on our examiners and hire them away because they're very skilled individuals. Losing them and that entire cadre, it would be very difficult and take a long time to stand that back up again and it would be a very unfortunate outcome.

Alan Kaplinsky:

Yeah, okay. Peg, any final comments before we bring this to a close?

Peggy Twohig:

Just to add to what Paul was just saying, at the end of the day, it's consumers that lose out from shutting down the CFPB, which is essentially what this is doing.

Alan Kaplinsky:

Well, and I guess legitimate businesses lose out too, those that are really pay attention to compliance with the law. Hurts them too, right? Okay. Well, my thanks to both of you for sharing your time and your wisdom and experience in this area. I think this has been extremely helpful and I'm sure our audience will appreciate it. To make sure, for our audience, you don't miss any future episodes, please subscribe to our show on your favorite podcast platform, be it Apple, YouTube, Spotify, or wherever. You listen and don't forget to check out our blog, consumerfinancemonitor.com, for daily insights on the consumer finance industry. If you have any questions or suggestions for the show, please email us at [@ballardspahr.com](mailto:podcast@singular). Stay tuned each Thursday for a new episode. Thank you for listening and have a good day.