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US consumer protection: developing a mutually beneficial model for consumers, regulators, and banks

"There are areas of overlap for the banking agencies and the CFPB [Consumer Financial Protection Bureau], and there are other areas where it may not always be clear where safety and soundness concerns stop and consumer protection begins … Compliance supervision will continue to be a major business line at all of the regulatory agencies."[1]

– Thomas Curry, Comptroller of the Currency

The fundamental importance of customers has been a major topic of the Bank Governance Leadership Network (BGLN) since its inception. At the 2009 inaugural summit, the issue was raised in the context of restoring trust in the industry. At the 2011 summit, participants discussed serving customers and clients profitably during the transition to the newly established CFPB in the United States.[2] And at last year's summit, there was discussion on how banks were losing control of the consumer agenda due to stronger consumer protection regulation, particularly as the CFPB moved out of start-up mode and the Financial Conduct Authority (FCA) was being formed in the United Kingdom.[3]

Today, banks increasingly believe that the enhanced regulatory focus on consumer and conduct issues will have a greater impact on retail banking than higher capital requirements and ring fencing will have on investment banking. One bank chairman remarked recently, *"The fundamental assumption has become that banks are pariahs, that they sell things to these poor unsuspecting customers, and that the value of add-on products is limited."* One director predicted, *"It is clear there will be more [consumer protection] regulation, it will be heavier handed, and that there will be higher expectations on the board."*

On February 25, Tapestry Networks and Ernst & Young welcomed 15 participants to New York for the BGLN's 24th meeting. Joining 10 bank directors and executives from major global banks were three regulators: Sally Belshaw, Office of the Comptroller of the Currency (OCC); Sandra Braunstein, Federal Reserve (the Fed); and Steve Kaplan, CFPB. Richard Hunt, from the Consumer Bankers Association, joined the dialogue, and Paul Saltzman, of The Clearing House, joined for the discussion of the state of politics surrounding large banks in the United States. The conversations, which focused mostly on large banks, generated several major insights:[4]

- The current regulatory environment creates significant challenges in consumer protection
- More intensive consumer issue supervision could negatively impact products and services
- Boards must become increasingly active in consumer issues

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[1] Thomas Curry, Remarks Before the FFIEC Consumer Compliance Specialists Conference (Arlington, VA, January 30, 2013), 3.

[2] See the section "Serving customers and clients profitably" in Bank Governance Leadership Network, "Global Banking Adapts to Adverse Economics and Restrictive Regulations," *ViewPoints*, November 10, 2011, 13–22.

[3] See Bank Governance Leadership Network, "An Increasing Tough Global Agenda for Consumer Protection: Is the UK FCA a Sign of the Future?" *ViewPoints*, December 13, 2012.

[4] All discussions were held under a modified version of the Chatham House Rule that encourages sharing of perspectives but absolutely forbids attribution to individuals or institutions. Comments made prior to or during the meeting are italicized. A list of participants can be found in Appendix 1, on page 13.

The current regulatory environment creates significant challenges in consumer protection

The creation of the CFPB was intended in part to consolidate federal consumer-protection powers within a single regulator and to broaden regulation beyond deposit-taking institutions. However, it has also obscured the fact that existing prudential regulators retained meaningful roles in consumer protection under their mandates. As one participant said at the BGLN meeting, *"Prudential regulators still have quite a bit of authority for consumer compliance, and they're using that authority,"* while other participants commented that is was also causing engagement and coordination challenges for banks.

Overlapping regulatory mandates for consumer protection generate complexity

The federal agencies have overlapping mandates in two ways: all of their remits include some aspect of fairness and consumer compliance, although their primary objective may differ, and they often oversee the same institutions (though one may regulate it at the holding company level and another at the national bank level). This has caused challenges, both among supervisors and between supervisors and banks.

The agencies' roles and priorities are as follows:

- **The CFPB.** As stated in Dodd-Frank, the CFPB's mandate is to "seek to implement and, where applicable, enforce federal consumer financial laws consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[5] The CFPB is the "primary rule-maker, supervisor, and enforcer of consumer protection laws and regulations"[6] for the 155 banks that have over $10 billion in assets and the tens of thousands of non-bank institutions that offer payday lending, mortgage lending, and private education lending.[7] The CFPB's mandate is complex, with one meeting participant describing it as follows: *"The CFPB is the new organization at the table … [It] has a different kind of mandate than before; it's not organized around an industry. [It is] responsible for issues that result in consumer impact, regardless of source."* The participant went on to say that the CFPB is *"not about safety and soundness,"* but that even its consumer protection mandate will be compromised *"if the trade-off is access."*

  The CFPB has currently gone through its "Dodd-Frank to-do list, including requirements to write 44 specific rules, publish 11 reports, and conduct four studies,"[8] clearing the way for it to determine its own priorities. A former CFPB official said, *"The CFPB is at an inflection point. It's done its Dodd-Frank work, it has surpassed the 1,000-employee count, and now it can pursue an independent strategy."* See Appendix 2 for some insight into the CFPB's emerging agenda.

- **The OCC.** The OCC is charged with assuring that any national banking association, federal branch or agency of a foreign bank, or federal savings association under its jurisdiction – 2,108 banking institutions in total – are safe and sound, comply with laws and regulations, and offer fair access to

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

[6] Morgan, Lewis & Bockius, *The Consumer Financial Protection Bureau: What is it and What to Expect* (Philadelphia: Morgan, Lewis & Bockius, 2012), 4.

[7] Consumer Financial Protection Bureau, "Strategic Plan 2013–2018."

[8] Karen Weise, "The Consumer Watchdog Is Having an Impact," *BloombergBusinessweek*, January 10, 2013.

financial services and fair treatment of customers.[9] The OCC oversees the enforcement of the fair lending provision of the Fair Housing Act. A meeting participant reiterated the OCC's mission, adding that fair access to financial services and fair treatment of customers have increased in importance and that the OCC sees *"consumer protection and compliance as important issues that will ultimately affect a bank's reputation [and thus safety and soundness]."* Furthermore, a participant noted that since Curry has taken control of the OCC *"fairness has become more prominent. [He] has raised the profile of consumer protection and shifted focus toward operational risk – the idea that bank practices and management can pose as much of a threat to safety and soundness as external forces."*

- **The Fed.** The Fed "works with other federal and state supervisory authorities to ensure the safety and soundness of financial institutions, stability in the financial markets, and fair and equitable treatment of consumers in their financial transactions."[10] Additionally, it oversees several consumer-oriented regulations, including the Community Reinvestment Act. The Federal Reserve oversees 5,000 bank holding companies, 850 banks that are both state chartered and members of the Federal Reserve System, and US operations of foreign banking organizations.[11] Before the meeting, one official said, *"The Federal Reserve has authority over bank holding companies … We look [to] them for financial stability, control functions, and their customer risk management at the corporate level."* That official noted that, given that the Fed retained a significant role in the consumer protection, post Dodd-Frank, *"the Federal Reserve Board sent a message when the CFPB was created by still wanting to have a separate division on consumer protection matters. [That department is] on equal status with every other division at the board – the board has been paying a lot of attention to these matters."* At the meeting, participants were told the Federal Reserve *"still oversees 800 banks for consumer compliance supervision."*

- **The Federal Deposit Insurance Corporation (FDIC).** The FDIC's mission is to "maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and managing receiverships."[12] It promotes and enforces "compliance with federal consumer protection laws, including those relating to fair lending and unfair and deceptive practices"[13] in more than 4,500 banks in the United States and is the primary federal regulator of banks that are chartered by the states that do not join the Federal Reserve System.[14] Though Dodd-Frank transferred the FDIC's compliance examination and enforcement authority for institutions with $10 billion or more in assets to the CFPB (it retained supervision with less than $10 billion), the joint public enforcement action against

[9] Office of the Comptroller of the Currency, *The OCC's Strategic Plan: Fiscal Years 2012–2016* (Washington, DC: Office of the Comptroller of the Currency, 2011), 2.

[10] Board of Governors of the Federal Reserve System, "Supervision and Regulation," in *The Federal Reserve System: Purposes and Functions* (Washington, DC: Federal Reserve Board, 2005), 59.

[11] Ben Bernanke, "The Federal Reserve's Role in Bank Supervision" (testimony before the Committee on Financial Services, US House of Representatives, Washington, DC, March 17, 2010).

[12] Federal Deposit Insurance Corporation, "FDIC Mission, Vision, and Values."

[13] Federal Deposit Insurance Corporation, "What is the Role of Consumer Affairs."

[14] Federal Deposit Insurance Corporation, "Who is the FDIC?"

Discover in September 2012 for deceptive marketing[15] demonstrated that the FDIC views consumer protection issues as a priority.

There is increased pressure to publicize consumer protection infractions

Many industry participants believe that regulators are under intense pressure to issue public orders and punitive fines against banks, and participants expect regulators to apply themselves to the task vigorously to show they are effectively fulfilling their roles. Richard Cordray, director of the CFPB, recently stated, "By issuing public orders that are very specific as to the conduct at issue, we have effectively signaled to other market participants that they need to clean up their own practices sooner rather than later."[16] The OCC has also shown a greater propensity to use public agreements and an official from the regulator shared data on the use of different types of enforcement actions showing that *"there are more actions in every category, with a higher number of publicly disclosed actions than ever before."* A major driver of these agreements has been consumer-related matters, such as mortgage foreclosures and unfair and deceptive practices, and the official expected that the OCC will use public actions even more in the future.

When regulators are more willing to enforce laws using long look-back time frames, potential liabilities for the industry increase enormously. At a recent BGLN meeting, one chief risk officer said, *"[The costs of litigation] are colossal if you add them up across the industry. There is more to come."* Settlements in the last year show the cost clearly: the $25 billion mortgage foreclosure settlement in March 2012 between the five largest mortgage servicers, the Justice Department, and 49 states – the largest federal-state civil settlement in US history;[17] the recent $8.5 billion settlement between 10 banks, the Fed, and the OCC to remedy improper mortgage foreclosure processes;[18] and the $210 and $112 million in fines levied on Capital One and American Express, respectively, last year.[19] One meeting participant suggested that many agencies have increasingly *"[turned to] public enforcement when other measures have not created corrective action."*

The agencies' focus on consumer matters highlights the political reality facing banks. One director noted, *"Consumer protection is popular with local politicians and stakeholders because they can show that they are doing something for the man on the street."* Consumer groups are active and have public support because of the current tarnished reputation of the banking industry. See "Is there an anti-large-bank bias in the United States?" on page 6. One meeting participant said, *"Some of it is misplaced, but there's a lot of anger in the public. The optics are that there are a lot of consumers that aren't doing well – it's part of the environment, and we can't just ignore it.*"

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[15] Consumer Financial Protection Bureau, "Federal Deposit Insurance Corporation and Consumer Financial Protection Bureau Order Discover to Pay $200 Million Consumer Refund for Deceptive Marketing," September 24, 2012.

[16] Richard Cordray, Prepared Remarks at the National Consumer Law Center Conference (Seattle, WA, October 25, 2012).

[17] David McLaughlin and Tom Schoenberg, "Foreclosure Settlement with Banks Filed in Federal Court," *Bloomberg*, March 12, 2012.

[18] Alan Zibel, Liz Moyer, and Brett Philbin, "Banks in Foreclosure Deal," *Wall Street Journal*, January 17, 2013.

[19] Ben Protess and Jessica Silver-Greenberg, "In Its First Action, Consumer Bureau Takes Aim at Capital One," *New York Times*, DealBook, July 18, 2012.

Dealing with multiple regulators presents numerous challenges

BGLN participants highlighted a number of concerns that the focus on consumer protection by multiple regulators raises:

- **Limited coordination among regulators.** Mr. Curry recently said "that his relationship with CFPB Chief Richard Cordray … is as important as his ties to the Federal Reserve and FDIC [Federal Deposit Insurance Corporation] officials," and he described the OCC and CFPB as "kind of in a dating stage now."[20] To improve regulatory coordination, the CFPB entered into a memorandum of understanding (MOU) with the prudential regulators in May 2012.[21] It was an important formal commitment; as one regulator noted, *"We are trying to coordinate and doing our best, but it's going to be messy for a while. Frankly, that's going to happen with a new agency."* Another participant added that agencies may need to *"revisit [the MOU] because there are some issues with assumptions made … that [may need] working through."* As such, there are still "growing pains" and the success of on-site coordination remains debatable as regulators find ways to optimize their interaction with banks.
- **"Competition" among regulators to outdo each other on consumer matters.** A meeting participant said, *"There can be this regulatory competition – 'regulatory Olympics' – with no regulator wanting to be the easy kid on the block."* In the aftermath of the financial crisis, all regulators want to be seen to be actively regulating banks, particularly on consumer protection. Consequently, as one director said before the meeting, *"We're finding ourselves squarely in between regulators with different views."* Another director remarked, *"Each entity is trying to outdo the other … We have not seen any consumer protection go away from an agency."*
- **Inconsistent supervisory approaches between agencies and within the CFPB.** Some participants noted that while enforcement within the prudential regulators tends to support supervision, within the CFPB, enforcement and supervision can operate more independently and may not be aligned. Prior to the meeting, a director observed, *"[The CFPB brings] enforcement attorneys on their exams, saying it's an integrated approach – I don't think it's working in the way they intended in cooperation and sharing practices."* Additionally, some in the industry have expressed concern that this *"inhibits free and open communication, and signals the CFPB's intention to use the examination process as a development ground for enforcement actions."*[22] One executive remarked before the meeting that *"there is complete inconsistency within the CFPB between enforcement and exam. Advice from exam is almost worthless because enforcement is doing something different."* By contrast, the OCC has a frontline-supervisor-first approach: the examiner in charge for each bank can draw upon specialist enforcement attorneys, but remains very much part of the process.
- **Regulators with the same facts coming to different conclusions.** Those close to the examinations process note that different federal regulators often look at the same facts and reach

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[20] Jesse Hamilton, "Bank-friendly Regulator Shirts to Revamp Reputation," *Bloomberg*, October 8, 2012.

[21] "Memorandum of Understanding on Supervisory Coordination," May 16, 2012.

[22] Alan Kaplinsky, "OIG to Look at Presence of CFPB Enforcement Attorneys in Exams," *Lexology*, March 6, 2013.

different conclusions. This is of particular concern when it comes to handling unfair and deceptive practices: five federal agencies – the CFPB, FDIC, Federal Reserve, OCC, and the National Credit Union Administration – have some oversight in judging what is unfair and deceptive. Although "unfair and deceptive" has been fairly well defined by case law, differences in perspective remain, with one regulator noting before the meeting, *"The CFPB is clearly looking differently at what is unfair and deceptive on sales practices – they will initially push what is unfair and deceptive further than we will."* (To date, the CFPB has not pursued an enforcement action under the new term "abusive," which was introduced under Dodd-Frank. When it does, the outcome could materially affect what can and cannot be done by banks.)

- **"Double Jeopardy" enforcements.** Participants raised the issue of double jeopardy, with one executive saying before the meeting, *"You work through a resolution with one regulator and … the other regulators need to take their own pound of flesh for being soft on the issue. We're finding ourselves in double or triple jeopardy, which makes us believe that you can't resolve an issue unless you have all the regulators at the table."* A meeting participant said, *"Double and triple jeopardy does seem troubling."*

Is there an anti-large-bank bias in the United States?

Meeting participants discussed whether there was an anti-large-bank bias in regulation and supervision. Many felt that the new biases are pro-consumer and anti-bank; regardless of bank size. However, there are signs smaller banks are being favored over larger ones. Participants discussed how *"The OCC has decided it wants payday lending outside of large banks."* Similarly, in a recent speech on the CFPB's recent Ability-to-repay rule, often referred to as the Qualified Mortgage (QM) rule, Mr. Cordray stated the CFPB's intention to "create room for smaller lenders such as credit unions to engage in mortgage lending" by extending QM status for balloon loans, liberalizing QM standards for portfolio loans and exempting some mortgage servicing rules for small banks.[23]

As the meeting discussion broadened, there was general agreement that large banks are being treated differently. As one participant commented, "*We thought anti-bank rhetoric would end after the election, but not only has it not gone away, but increased. The issue has become so political that facts don't matter."* The negative rhetoric has meant calls to break up large banks have grown, notwithstanding the many measures that have already been implemented to address the too-big-too-fail issue.

The question is what to do about it? Several participants strongly advocated a more systematic, broad-based campaign to positively influence public opinion, with one saying, *"Big banks need a coordinated approach – a fact-based communications strategy."* Another said, *"Industry needs to articulate its value creation."* An important ally for the industry may be the regulators, with one participant noting, "*The regulatory community understands this, but politicians are the challenge."*

[23] Richard Cordray, "Prepared remarks of Richard Cordray at a meeting of the Credit Union National Association," February 27, 2013.

More intensive consumer issue supervision could negatively impact products and services

Bank directors and executives recognize the need for consumer protection, with many conceding the industry has displayed instances of bad practices in the past that require remedial actions and, potentially, regulatory change. Correspondingly, regulators also acknowledge that their focus on applying existing consumer protection and compliance standards was insufficient. However, a more aggressive regulatory agenda raises a broad set of concerns that require attention and ongoing evaluation.

Product design and innovation may be constrained

Globally, supervisors are increasingly analyzing product design as part of their consumer protection mandate, and some are exercising de facto power of approval over bundling policies (e.g., checking account features, credit card offers, and financial-advice offerings). Products or product features that are in violation of consumer protection regulations are seeing hefty fines: the CFPB's fine on Capital One, referenced earlier, was for marketing practices associated with credit card add-on products, and the fine levied against American Express was for violating consumer protection laws "at every stage of the consumer experience, from marketing to enrollment to payment to debt collection."[24] One director observed before the meeting that some of these settlements highlight that the CFPB is looking *"at marketing, not just lending products, including the use of third parties and vendors."* At the meeting, a regulator said, *"[Regulation] has manifested itself in ways we wouldn't have dreamed of … We are now looking at all employees and third parties."*

Enhanced consumer protection regulation may significantly constrain innovation both directly, through the imposition of design principles, and indirectly, in the form of constrained pacing of new product introductions. The CFPB now has the ability to "determine what type of financial products can be provided to which consumers and at what cost."[25] The result could be a more slowly evolving, simpler array of products. One meeting participant expressed what many felt: *"If we don't have financial innovation, we're going to have generic products that are safe but don't add any value."* A regulator acknowledged, *"We understand the economy needs to be innovative, and we understand the regulatory burden can hamper that ability."*

Access to financial services may become more limited

Participants emphasized the need for balance, with one bank chairman saying before the meeting, *"The flip side of consumer protection and conduct is financial exclusion … Governments and politicians need to understand the more you tilt towards consumer protection and conduct, the more the financial exclusion grows and the more it will affect the public purse."* Another director stated, *"If the cost of safety and soundness becomes overly burdensome, you harm the industry more broadly, [and] you push financial products away from those that most need [them]."*

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[24] Consumer Financial Protection Bureau, "CFPB Orders American Express to Pay $85 Million Refund to Consumers harmed by Illegal Credit Card Practices," news release, October 1, 2012.

[25] "Dodd-Frank Act: Too Big Not to Fail," *Economist*, February 18, 2012.

The issue of access stimulated much discussion at the meeting. One director said there was *"a tension between having a conservative approach and making [financial services] accessible to all."* Financial advice is a prime example. In some countries, such as the United Kingdom, where certain types of commission-based advice have been banned, there has been a major withdrawal of any kind of financial advice for low- and middle-income families, for fear of complaints of misselling in the future. One director observed, *"Advice to individuals is very complex. At one extreme is not to give advice, and at the other is that customers have complex needs."*

Part of the solution in the past has been a reliance on disclosure. However, federal agencies seem to have different views on the protections offered by disclosure. One director said recently, *"Prudential regulators, e.g., the Fed, OCC, FDIC, used to look at this as an issue of disclosure, but obviously the CFPB is looking at this as a question of the harm done to consumers, which is very difficult. [Some have concluded that] disclosure processes weren't enough to keep consumers out of harm's way, so now there's a focus on the value proposition for consumers."* At the meeting, a director noted, *"This is how insurance got to suitability: even with simple insurance products, people don't want to read the [disclosures] … and the person sitting at the desk won't explain it properly, [so the regulators] therefore don't allow the product.*"

Regulation expanding to include sophisticated or wholesale clients

Banks are concerned that the new trend towards a more active regulatory agenda may seep into protections for sophisticated buyers and the wholesale side of the industry. The UK FCA has said that it does "not believe there is a clear divide between 'retail' and 'wholesale' markets" and says its approach "will recognize that activities in retail and wholesale markets are connected and that risks caused by poor conduct can be transmitted between them."[26]

To date, US regulators have not indicated that they will follow suit. However, at the meeting, several directors expressed real concern that the direction of policy is not positive. One director asked, *"How [will] consumerism … impact the institutional side and relations between banks?"* Another asked, *"What is the degree to which regulators and regulations will impact private wealth management business?"* Here, too, the issue of suitability arose. Said one director, *"Looking at the rhetoric, it looks like we're moving towards suitability," with another adding, "We're moving beyond consumer retail: what will be the standard for suitability?"*

There are no guiding regulatory principles on how to act

While the concept of fairness has been at the core of consumer protection for years, recent changes in law and practice have spurred the industry to reflect on how best to treat customers fairly. In the United States, the legal terminology has become less clear. One director said on the difficulties of assessing "unfair and deceptive," *"Did the customer have the ability to know what might happen and avoid it? … We have to consider, what information is the customer using to make the decision?"* While banks have navigated through the difficult question of assessing "fairness," another director noted that rather than asking what

[26] Financial Services Authority, *Journey to the FCA* (London: Financial Services Authority, 2012), 31.

evidence there is that customers have been treated unfairly, some banks are asking for positive evidence: *"What is the evidence of whether the customer was treated fairly?"*

At the meeting, participants focused on the lack of guiding principles. One director said, *"How should directors govern a concept like fairness? We spend so much of our board meetings talking about the concept because it is so elastic and vulnerable to retrospective evaluation."* Numerous participants advocated the establishment of principles that could guide supervisory and bank actions. They noted that key questions need to be discussed in order for banks, supervisors, and customers to achieve a common understanding of expected behaviors. For example, *"Where does the responsibility lie between consumers and banks?"* Similarly, *"What is the amount of risk a consumer should take?"* and *"Don't we need a definition of 'consumer'?"*

One bank participant asked the regulators, *"Are you trying to establish a concrete set of principles?"* Another asked rhetorically, *"Doesn't the absolute absence of principle destroy what you're trying to do?"* A regulator responded, *"The notion of establishing principles is tantamount to regulation from a philosophical or political bent. [Instead we're committed] to understanding what's actually happening in markets and addressing situations that are impacting markets or adversely affecting consumers."* A director responded, *"Maybe as opposed to principles, what are the ways you're thinking about or evaluating products?"*

Both regulators and directors are committed to continuing the discussion on guiding principles. A regulator stressed, *"It is important that dialogue continues and that everyone tries to move in the same direction."* Expressing optimism, a director noted, *"There is plenty of space to work together."*

Boards must become increasingly active in consumer issues

In the past, directors struggled with the exact role of the board in consumer protection and believed matters should be largely under the purview of senior management. Now, however, consumer protection matters are having an impact on business models, risk, and compliance, and both directors and executives believe the board has a critical role to play in addressing them. *"Consumer protection is a big, big issue [for boards],"* said one director.

Certainly, regulators have heightened expectations of boards for consumer protection. In the United Kingdom, the FCA has made it clear that consumer protection is a board-level issue, citing its link to strategy, business models, compensation structures, culture, and reputation. US regulators have signaled they too have heightened expectations of boards, for example, with the CFPB's insistence that fair lending programs be approved by the board and with the requirements in the $8.5 billion foreclosure settlement that boards approve compliance programs and mortgage servicing arrangements. Arguably, these expectations necessitate more director education on these issues ahead of approving the banks' programs.

BGLN participants have highlighted three important roles for boards in consumer protection: setting strong tone at the top; ensuring controls, risk management, and intelligence gathering are robust; and developing stronger relationships with supervisors.

Setting a strong tone at the top for consumer protection

Many meeting participants see an opportunity to shape the *"tone at the top"* regarding consumer issues. *"Expectations are set from the board,"* one participant noted, *"[and the board] should set a culture that you're going to treat your customers with respect."* Participants said directors can challenge their firms to provide and profit from mutually beneficial, trusting customer relationships. Directors can also push management to consider *"what is the connectivity of consumer protection to safety and soundness?"*

Before the meeting, one director asserted that boards and executives *"can inject principles … that act to regulate the behaviors of people. [The principles] are enduring and survive current management … For example, 'customer needs drive our actions' – so you identify customer needs, which ones you want to satisfy, and drive to provide services and products to satisfy them. Otherwise, you will sell anything [that people] are foolish enough to buy."* Several meeting participants said banks have been too focused on selling, with one stating *"When I moved into banking, it got into sell mode … They were selling products instead of marketing products."* Another noted, *"It's been driven into people that you sell stuff. Maybe we need to get into the idea that it's more about providing quality products."*

Ensuring controls, risk management, and intelligence gathering are robust

Both directors and executives are very concerned about the rapidly increasing costs of complying with consumer protection laws and dealing with supervisory audits and enforcement actions being undertaken by various agencies. These costs include settlements, new compliance staff and systems, and executive management time dealing with these issues. There are fears that the full extent of compliance costs is just starting to emerge: one bank chairman said, *"I think it will have a great impact in compliance and infrastructure."*

All three regulators at the meeting emphasized the necessity of robust controls. One said, *"We look at compliance management systems and assess if directors keep an eye on management and ensure that the bank has [strong controls] in place."* In response, a participant asked, *"How does consumer protection fit into a firm developing its risk appetite?"* Another asked, *"How do you do this in addition to traditional risk management?"* One participant said, *"Compliance executives should share their consumer protection tactics with the board."*

Two approaches came up in the meeting:

- **Conduct more robust product-review processes.** Boards can more assiduously review new products and processes. Prior to the meeting, several directors noted that over the last year, they spent more time understanding the product development and approval processes for institutional clients. Some reported that their audit committees were watching those processes more closely. One said, *"The audit committee charged the bank to evaluate how fees were set or product decisions were made, with a view to identifying where there were potentially adversarial customer relationships … but it's hard to tell which are high risk."* Describing their bank's approach, a director said, *"Whenever a new product comes out, we discuss the return, the reputation risk, and where [the product] fit[s] in the assets on the balance sheet. It shows … that we often don't really understand* *reputation risk across the business of some product innovations."* Speaking about the recent mortgage settlement, a participant said, *"When you are executing millions of transactions, when you build in that mistake, it can be enormous. Controls and compliance need to be better."* Another participant said, *"When you're looking at new products, if the product is structured in a way where you're going to make money when consumers are doing poorly, that is a problem going forward."*

- **Use customer complaint data as intelligence more effectively.** The CFPB has appealed to banks to publically scrutinize complaints of banking behavior. One industry observer described the CFPB as *"on a data-collecting whirlwind in 2012 … [It has been] gathering consumer complaints on a variety of products, including credit cards, mortgages, student loans, and has sought highly detailed information from lenders."* One director said customer complaints *"can be a way to find seeds of issues before they become larger"* and suggested that to stay ahead of regulatory action, there should be triggers whereby more-serious issues are sent to the board. At the meeting, a director noted, *"There's lots of information about customers … It's lagging, but there's a lot of customer complaints, and [it's important to elevate] what you're hearing."* A regulator agreed: *"You have got to listen to the voices … Pay attention to what's going on in social media. What are the emerging issues?"* Some said the CFPB's online searchable Consumer Complaint Database may help banks benchmark their complaint history (albeit the industry believes the data can sometimes be misleading if it is not adjusted for bank size).

Developing stronger working relationships between banks and supervisors

Given the many challenges of consumer protection, bank boards should engage their executive teams and supervisors in active dialogue on customer and client strategies. At the meeting, there was support for enhanced dialogue, with a participant saying, *"Boards should meet with regulators and have an active dialogue … It is critical these issues aren't taken with a light hand."* If directors and supervisors share the objective of better serving the needs of customers, they can play complementary roles, but coordination will be essential to keep the relationship from becoming overly intrusive and adversarial. A participant stated, *"You can't be a forward-looking regulator without trust. That can only be done with trust. If not, it will be a backward-looking, adversarial, enforcement-led regulator."* Another observed, *"When something has gone wrong [at a bank], it has been a flaw in the business model, or a flaw in culture or tone at the top. If those are executive and board issues, then [the regulator] needs to engage more with boards and executive management."* As consumer protection matters need to be more actively addressed by the board, it is vital that regulators and directors speak the same language. As one participant noted, *"Guidance by regulators has become more granular, [they] need to think about how boards can work at the regulatory level."* Similarly, one regulator recommended that directors and executives *"ask good questions and get beyond platitudes,"* as a step toward better communication.

Conclusion

Consumer protection continues to move up the agenda in regulatory and supervisory organizations, in Washington, DC, and in boardrooms and C-suites. As regulators develop new judgment-based approaches to supervision, shifting from *"a tick-the-box approach [with] a focus on controls to business models and culture and how banks run their business,"* they will need to be more open and engaged with the industry. Moreover, industry participants would like to see regulators coordinate their mandates and their oversight practices. For their part, banks will need to develop efficient means of interacting with multiple regulatory agencies and incorporating consumer protection into daily operations. Undoubtedly, boards have an indispensable role to play in this. One participant observed, *"Consumer protection is already a very important board-level issue for bank policy and risk management … [and] boards should be engaged."* A dialogue between banks, regulators, and other leaders in the financial services sector is vital to ensure that consumer protection regulation enables banks to serve customers fairly and profitably, and thus contributing to a vibrant economy. One participant remarked, *"There is need for these two deeply entrenched positions to be aired as opposed to the continuous mud-slinging that has been going on."*

About this document

The Bank Governance Leadership Network (BGLN) addresses key issues facing complex global banks. Its primary focus is the non-executive director, but it also engages members of senior management, regulators, and other key stakeholders committed to outstanding governance and supervision in support of the mission to build strong, enduring, and trustworthy banking institutions.

The BGLN is organized and led by Tapestry Networks with the support of Ernst & Young as part of its continuing commitment to board effectiveness and good governance. Tapestry Networks and Ernst & Young are independent organizations. Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. Ernst & Young is a global leader in assurance, tax, transaction, and advisory services to the banking industry.

ViewPoints aims to capture the essence of the BGLN discussion and associated research; it is produced by Tapestry Networks. Those who receive *ViewPoints* are encouraged to share it with those in their own networks. The more board members, members of senior management, advisers, and stakeholders who become engaged in this dialogue, the more value will be created for all.

Appendix 1: Meeting participants

Directors

- David G. Booth, Barclays
- Roy J. Bostock, Morgan Stanley
- Amy Woods Brinkley, TD Bank
- Donald E. Powell, Bank of America
- Leslie Rahl, CIBC
- Catherine A. Rein, BNY Mellon
- David Sidwell, UBS
- Diana L. Taylor, Citigroup

Executives

- Michael E. Collins, TD Bank
- Irene M. Dorner, HSBC

Regulators

- Sally G. Belshaw, Office of the Comptroller of the Currency
- Sandra F. Braunstein, Federal Reserve System
- Steve Kaplan, Consumer Financial Protection Bureau

Trade Associations

- Richard Hunt, Consumer Bankers Association
- Paul Saltzman, The Clearing House

Ernst & Young

- Amy M. Brachio
- William Schlich
- Donald T. Vangel

Tapestry Networks

- Peter Fisher
- Mark Watson
- Charles Woolcott

Appendix 2: Potential future priorities for the CFPB

- **Mandatory arbitration.** Dodd-Frank mandated that the CFPB study the impact of mandatory arbitration clauses, which "require consumers to settle disputes through binding arbitration rather than through the courts."[27] Consumer advocates have pressured the CFPB to "limit their use or ban them altogether."[28]

- **Overdraft fees.** Before the establishment of the CFPB, the Federal Reserve took steps to improve bank overdraft fee practices,[29] but the CFPB has signaled that it will investigate whether further changes are necessary because it believes "overdraft programs … have the capacity to inflict serious economic harm on individuals."[30]

- **Retirement savings.** Though the Securities and Exchange Commission and Department of Labor are the main regulators of US retirement savings vehicles and funds, Mr. Cordray recently said that retirement savings is an area "[the CFPB has] been exploring and [is] interested in in terms of whether and what authority we have."[31]

- **Remittances.** The CFPB is currently reworking a proposal for its remittance transfer rule, which is intended to improve the transparency of international money transfers. Banks and money transferors have said that the new rules have "created the biggest compliance challenge ever faced by the industry" and have called them unworkable.[32]

- **Direct-deposit advances.** The CFPB has made public comments on direct-deposit advances, also referred to as payday loans, saying that it will be more aggressive in shutting down illegal practices and that it "will be paying close attention to deposit-advance products at the banks that offer them."[33]

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[27] Victoria McGrane, "Consumer Watchdog Readies to Bare Its Teeth," *Wall Street Journal*, January 1, 2013.
[28] Ibid.
[29] Board of Governors of the Federal Reserve System, Press Release, November 12, 2009.
[30] Gary Stein, "Overdrafts," April 25, 2012.
[31] Carter Dougherty, "Retirement Savings Accounts Draw U.S. Consumer Bureau Attention," *Bloomberg*, January 18, 2013.
[32] Tracy Alloway and Shahien Nasiripour, "US Banks Warn on Money Transfer Rule," *Financial Times*, November 20, 2012.
[33] Maya Jackson Randall, "CFPB Chief Addresses Payday Lenders," *Wall Street Journal*, January 19, 2012.