



# How to Prepare for a CFPB Audit



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The economic recession that began in 2007 is largely attributed to banks and other financial firms that, in the absence of regulation, deceived consumers and sold them products that were simply financially unsustainable. For years after the downturn first began, members of Congress debated how to fix this problem in a way that was not just a one-time patch. Current Senator Elizabeth Warren, who was then a Harvard professor advocating for a consumer protection agency, eventually got her way. Legislation passed both houses of Congress early in President Obama's first term that established the Consumer Financial Protection Bureau. Warren led the bureau without an official appointment, though one was eventually named later. Years of work resulted in a series of policies issued by the bureau, officially called rules.

Perhaps the most impactful part of the Consumer Financial Protection Bureau's rules is its provision for strong oversight and audit of all kinds of companies. The federal agency reserves the right to audit mortgage lenders who offer adjustable rate mortgages, or ARMs, to their customers. This is largely to determine whether banks are still exploiting customers in a tough financial situation in order to sell them a lending product that they simply cannot afford or sustain. Other companies subject to audits include collection agencies, traditional consumer banks, and large businesses with extensive business in lending of any sort. Smaller financial institutions, investment firms, and even credit unions, are exempted from the law as long as they have less than \$2 million in assets or fewer than 500 first-lien mortgages currently in repayment.

These audits are tough. They're designed to look into every aspect of how a business offers its services, regulates its products, and educates both current and prospective customers. Preparing for such an audit is a very extensive task and often requires a team of professionals within the company in order to be done quickly and properly. When getting started with this process, there are a few guiding rules that will make it easier to have the right documentation and answers to common questions on hand.

## Understand the Consumer Financial Protection Bureau's Official Guidance

To help financial institutions better manage their internal processes as well as their external interaction with customers, the Consumer Financial Protection Bureau has developed official guidance for all kinds of relationships, lending products, and typical transactions. In most audits undertaken by the agency, the company will be quizzed on its understanding and implementation of these guiding rules and procedures. If they are simply unaware of the guidance as issued by the CFPB, they will run into real trouble almost as soon as the audit begins. If the agency senses that the company does not know this guidance, or does not take it seriously, the audit will be that much tougher.

To get ready for the audit, the very first step should be reviewing the company's internalization of CFPB guidance and an assessment concerning whether or not those guiding rules have been implemented across the organization. The following should be reviewed:

- Supervision and Examination Manual

The Consumer Financial Protection Bureau isn't secretive about its audits. The agency wants businesses to comply, and therefore it provides them with the very manual that its inspectors use when determining whether or not a company is complying with agency directives and federal regulations. This manual is available on [ConsumerFinance.gov](http://ConsumerFinance.gov), and it should be required reading for any official directly involved in the audit. Any areas that the company falls short within the manual should be highlighted and a plan should be made to correct those shortcomings immediately.

It's worth noting that the agency is currently offering what it calls "version 2.0" of the manual on its website. Those companies with the first edition of this manual should make sure to obtain the newest revision and look for any new guidance that might not have been present before.

## - Servicing Examination Manual

While the Supervision and Examination Manual is largely concerned with top-down policies that affect how the company does business, the Servicing Examination Manual informs companies of the best practices for handling mortgages, bank accounts, collection accounts, and much more. This manual is far more concerned with how the company interacts with the customers that it currently has. Ensuring that the guidance issued in this manual is fully implemented will set the company up for a greater chance of success during the audit, with a far lower risk of damaging fines or other regulatory penalties that the CFPB could potentially issue upon discovery of violations.

## - Third Party Oversight Guidance

Another key area of focus for the Consumer Financial Protection Bureau is its oversight of third parties that regularly deal with banks, and vice versa. This area of guidance is concerned with how banks work with outside investors who might trade their mortgages and other products on the open market. It's also concerned with how collection companies interact with referring agencies that sell them a debt. Though there is currently no official examination manual for this type of business relationship, the CFPB actively maintains a document with general rules and guidance for the pursuit of ethical, beneficial third party relationships.

This is an area of major concern for the Consumer Financial Protection Bureau, since many of the most damaging economic effects during 2007 originated with third party interactions between banks and investors. Companies involved in such transactions must make sure they understand these guidelines and they should check for implementation of relevant guidance prior to preparing for the broader audit.

## **A Note About Examination Manuals and Guidance Documents**

The Consumer Financial Protection Bureau is a very young government agency and one that is constantly revising its guidance for companies involved in complex financial transactions. Though it has had an official director for less than a year, the agency has already updated several of its examination manuals and guidance recommendations for companies in several sectors. Further updates are likely forthcoming. Businesses should make sure that they go into any audit with the latest documentation available. Even if older copies were obtained for previous audits and compliance checks, businesses will be held accountable for the very latest version of the manual at the time an audit commences.

## **Focusing on Compliance: Business Policies, Procedures, and Communications**

In the roughly two years since the CFPB came into existence, companies have been rushing to change policies and procedure that affect everything from consumer lending and adjustable rate mortgages to collection accounts and debt settlements. These policy changes have sometimes been minor, but others have been major changes to third party interactions, product availability, and more. The agency's audit process values those changes, but it also values communication within the organization. After all, a policy change is only good if every single individual involved knows that the change has happened and knows how it affects their daily work.

To that end, the Consumer Financial Protection Bureau will require a great deal of information on company policies, the procedure used when a policy is changed, and a list of people who are informed about every policy change and every implementation of agency guidance. Those working in human resources or company policy will be required to provide a few essential documents proving that policy changes and company communications are in line with CFPB expectations:

- A current copy of all company policies must be provided, along with the date that those policies were last updated in order to be in compliance with CFPB rules and recommendations.

- Those in charge of implementing company policies should be able to provide proof that policies are regularly reviewed. They should be prepared to provide testimony about how those policies are updated and how often such changes take place. They will be required to certify that all policies are up-to-date when interacting with regulators.

- The company must prove that all of its policies are easily available to all of its employees. Whether this is through an online portal or as part of the documentation issued during the hiring process, the CFPB's auditors will want to make sure that everyone is on the same page regarding financial transactions, customer servicing, and more.

- The company must show that it has a formal procedure in place for notifying all employees of crucial policy changes. This might be company mailing lists, in-office mailings, or issuance of new employee handbooks. Either way, proof must be provided and certified upon request.

- All companies must have version tracking implemented alongside their policy changes. This means that every single older version of company policies should be stored somewhere and, upon request, those older versions must be provided to the CFPB's representatives. It's important to note that version tracking can also be demonstrated electronically, since many of today's productivity programs allow for automatic versioning of new files.

- All policies implemented by the company need to specifically reference the regulation that imposes that policy. This means citing regulations as issued by the Consumer Financial Protection Bureau as well as by any other federal or state agency that governs how the company does business and offers its products to consumers or third party stakeholders.

### **Review and Certification of Training Programs Will Be Examined Next**

With the companies' policies and procedures reviewed, the agency's auditors will evaluate whether or not the company has made every effort to fall in line with regulations issued by every relevant federal agency. If the business has done this, the audit will proceed to the training procedure used when hiring new employees. If the agency deems current policies unsatisfactory, the business may have to make revisions and communicate those changes with existing employees before continuing. If the violations are egregious, fines may be required.

Training programs should already be in place, since it's hardly possible for complex financial services companies to take on new employees without any guidance or instruction. These training programs should have been developed in line with CFPB requirements, and that will be documented by hiring managers and training personnel by providing a few key pieces of documentation:

- A formal program of training for new hires must be in place. This training program must also be open to existing employees who feel they need to brush up on industry regulation and company rules. Documentation of this program will be required by the CFPB.

- Any training program considered mandatory either by the company or the Consumer Financial Protection Bureau must be tracked to prove employee participation. Training typically tracked by financial organization includes educational seminars in privacy, fair lending, non-discriminatory credit practices, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and more.

- Mandatory training in the areas listed above, as well as some additional areas based on the nature of the business, must take place at least annually. The CFPB does not permit training to take place more than 12 months apart and, if it does, the company could face penalties and fines for failing to properly implement regulatory policies.
- Training materials need to comprehensively cover company policies, how federal and state regulations are implemented, and how those regulations directly affect an employee's work.
- Any regulations cited within the training materials must be referenced. This includes referencing the agency, policy number, and revision of that policy, for easy reference by employees later on.
- The company will need to prepare documentation that shows its training program is current and in line with the very latest version of federal regulations, CFPB examination criteria, and official guidance issued by the agency. This may require the updating of company training documents prior to the audit so that the latest revision of these policies can be incorporated.
- Versioning must take place with training materials in the same way that it takes place regarding company policies and regulations. The company will need to show this version history to auditors in most cases, but it can be either electronic or in printed form. The company should be able to show what was updated, who made the change, and why the change was made, with each version it shows to auditors.
- Procedures must be in place to communicate with employees about changes to the training documents. This might include company email, hand-delivered mail, or other means.
- While new employee training applies to everyone, many companies allow their senior staff and executives to forego ongoing training in regulation and CFPB developments. This is an area of specific focus for the agency's auditors. The company must show that employees at all levels, from new hires to executives and board directors, has participated in this training no less than annually.

## **Privacy Policies Should be Documented, Printed, and Provided to Auditors**

The company would do itself a favor to review its current privacy policies prior to the beginning of an audit. One of the primary areas investigated by Consumer Financial Protection Bureau auditors is how the company handles its dealings with customers based on privacy laws and elective privacy protection. Better, more stringent policies are always looked on more favorably by regulators. Those involved with the development of such policies should be able to provide the following information in advance of the audit:

- A current copy of the company's corporate privacy policy and related restrictions
- Documentation that all employees had training in the privacy policy on at least an annual basis.
- The company must provide proof that it is actively monitoring all incoming and outgoing email for privacy concerns and potential violations. Furthermore, it must show that those emails are taking place in a highly encrypted environment that makes it much harder for external hackers to capture data that belongs to the organization, its employees, or its customers.
- The company must document all information accessible to its third party vendors and stakeholders. Be prepared to show documentation proving that those third parties have access only to the exact information they require and nothing more.
- Privacy must extend to the disposal of company papers and printed statements. This can involve the use of shredders or the contracting of a secure disposal company that destroys documents before they can be obtained by outside groups.
- Employee desks should never store non-public personal information when the employee is not present. The company should show that it has a policy requiring the secure storage of such documents when the employee leaves for lunch or goes home for the evening.

## **Lending Institutions Will Undergo a Fair Lending Analysis**

Banks must participate in the CFPB's fair lending policies, as well as similar policies that are enforced by other state and federal agencies. Once the CFPB's auditors have examined company policies, privacy guidelines and more, they'll next look at how applicants are evaluated and lending products are administered. If the team of auditors finds any area where fair practices are not being followed, they'll immediately recommend changes to the company's lending process or their consumer evaluation procedure.

Typically, the company will have a limited window of time to implement these recommendations. If they fail to do so, they may suffer financial penalties for their refusal to lend in a fair way according to current guidance. To avoid falling short of such requirements, all companies engaged in active lending should be ready to provide documentation about how they accept applications, evaluate consumer financial characteristics, and make a determination about the consumer's eligibility for mortgage products or other financial tools.

## **Consumer Complaints Handling Will Also Be Evaluated**

Though the Consumer Financial Protection Bureau is billed as the best way to keep companies accountable, the agency does like to see that financial institutions are enacting their own methods of fixing customer problems before the federal government must get involved. To that end, company officials must be able to prove a few things about customer complaints, recourse, and dispute resolution:

- All customers need to be provided with company contact information that allows them to submit a formal complaint about services rendered. This contact information can guide customers toward traditional mail, email, website complaint forms, live chat solutions, and more. Certified documentation of such contact methods should be prepared in advance.

- Any complaints submitted by customers must be assigned a tracking number. The complaint should then be extensively documented in case it needs to be reviewed in the future by the company, the consumer, or the CFPB. Proof of such tracking systems must be provided upon request.

- Employees should be trained on handling and directing consumer complaints. Proof of such training will need to be provided to the agency along with the documentation mentioned above.

### **Quality Control, Records Retention, and More**

In addition to information concerning customer complaints, the company must be able to show extensive documentation regarding how it handles quality control of lending products and customer servicing. These documents do vary between companies, and requirements enforced by the agency actually vary based on the type of industry the company is primarily associated with. For clarification about this documentation based on industry, company officials can consult the Servicing Examination Manual.

In line with privacy concerns, the company will need to document its policy of secure records retention for current and former customers, current and former employees, and any current or former third party business partners. Documentation should be certified and provided in advance in most cases.

## **A Long Process, and No Time to Waste**

An audit pursued by the Consumer Financial Protection Bureau is actually pretty extensive, but the waiting period prior to such an audit is not. Unlike other federal agencies, the CFPB typically gives companies notice of an audit between one and three weeks prior to its scheduled date. Businesses will not have months to prepare. For this reason, it's recommended that organizations of all sizes immediately begin preparing documentation, making needed changes, and organizing departments, so that they can be ready to meet with CFPB investigators very quickly.

With the right evidence on hand and proof that specific policies were implemented in line with the agency's recommendations, the audit itself will be pretty easy to pass. All it takes is document availability, certification, and a team of employees willing to interact with the agency on an ongoing basis.

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