Evaluation Report
2024-SR-C-007
February 26, 2024

Consumer Financial Protection Bureau

The CFPB Can Enhance Certain Practices to Mitigate the Risk of Conflicts of Interest for Division of Supervision, Enforcement and Fair Lending Employees

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

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Executive Summary, 2024-SR-C-007, February 26, 2024

The CFPB Can Enhance Certain Practices to Mitigate the Risk of Conflicts of Interest for Division of Supervision, Enforcement and Fair Lending Employees

Finding

The Consumer Financial Protection Bureau can enhance certain practices to mitigate the risk of conflicts of interest for Division of Supervision, Enforcement and Fair Lending (SEFL) employees. Specifically, the Office of Supervision Examinations (OSE) should formally adopt an examiner rotation policy and implement an assignment tracking mechanism to mitigate the risk of regulatory capture—the risk that sustained exposure to the same regulated entity increases a regulator's susceptibility to becoming less independent and objective.

We found that OSE has informal practices for rotating and tracking examiners assigned to supervised entities. OSE does not have a formal policy to ensure that examiners rotate to assignments at other supervised entities within a specified time frame. Additionally, OSE does not use a system, application, or monitoring tool to track examiner assignments to ensure that examiners rotate.

By establishing a formal rotation policy and a tracking mechanism for examiner assignment data, OSE can ensure that rotations are monitored and implemented effectively. Periodically rotating examiners will also promote objectivity, cross-training, and broader expertise among examiners while reducing the risk of regulatory capture.

In addition, we identified a matter for management consideration related to establishing a process for employees to attest to their impartiality when beginning work on a new matter.

Recommendations

Our report contains two recommendations designed to further enhance the CFPB's approach to mitigating the risk of conflicts of interest. In its response to our draft report, the CFPB concurs with our recommendations and outlines actions that have been or will be taken to address each recommendation. For our recommendation related to OSE developing and implementing a formal examiner rotation policy, we have reviewed documentation associated with the action taken by the CFPB, and we believe that the agency has taken sufficient action to close this recommendation. We will follow up to ensure that the remaining recommendation is fully addressed.

Purpose

We conducted this evaluation to assess the extent to which the CFPB promotes a focus on independence and has policies, procedures, and controls to mitigate the risk of conflicts of interest among SEFL staff.

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes the CFPB to supervise depository institutions and their affiliates with more than $10 billion in total assets and certain nondepository institutions. SEFL is responsible for ensuring compliance with federal consumer financial laws by supervising market participants and initiating enforcement actions when appropriate.

To foster public confidence in the integrity of the agency's work, CFPB officials and staff must independently and objectively execute their financial institution supervision and oversight activities. CFPB employees must adhere to principles of ethical conduct and conflict of interest statutes, including recusal requirements.

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

Recommendations, 2024-SR-C-007, February 26, 2024

The CFPB Can Enhance Certain Practices to Mitigate the Risk of Conflicts of Interest for Division of Supervision, Enforcement and Fair Lending Employees

Finding: OSE Should Formally Adopt an Examiner Rotation Policy and Implement an Assignment Tracking Mechanism to Mitigate the Risk of Regulatory Capture

Number	Recommendation	Responsible office
1	Develop and implement a formal examiner rotation policy to clarify rotation requirements for key examination staff on recurring examinations and monitoring activities, and communicate these requirements to OSE staff.	Division of Supervision, Enforcement and Fair Lending
2	Implement a mechanism to track and document assignments for key examination staff, including the start and end dates, to ensure compliance with the examiner rotation policy.	Division of Supervision, Enforcement and Fair Lending

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

MEMORANDUM

DATE: February 26, 2024

TO: David Uejio
Acting Associate Director, Division of Supervision, Enforcement and Fair Lending
Consumer Financial Protection Bureau

FROM: Michael VanHuysen
Associate Inspector General for Audits and Evaluations

SUBJECT: OIG Report 2024-SR-C-007: *The CFPB Can Enhance Certain Practices to Mitigate the Risk of Conflicts of Interest for Division of Supervision, Enforcement and Fair Lending Employees*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the extent to which the Consumer Financial Protection Bureau promotes a focus on independence and has policies, procedures, and controls to mitigate the risk of conflicts of interest among Division of Supervision, Enforcement and Fair Lending (SEFL) staff.

We provided you with a draft of our report for review and comment. In your response, you concur with our recommendations and outline actions that have been or will be taken to address our recommendations. We have included your response as appendix B to our report.

We appreciate the cooperation from SEFL staff and the regional offices during our evaluation. Please contact me if you would like to discuss this report or any related issues.

cc: Jan Singelmann
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Contents

Introduction

Objective

Our objective was to assess the extent to which the Consumer Financial Protection Bureau promotes a focus on independence and has policies, procedures, and controls to mitigate the risk of conflicts of interest among Division of Supervision, Enforcement and Fair Lending (SEFL) staff.

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act established the CFPB to regulate the offering and provision of consumer financial products and services under federal consumer financial laws. The Dodd-Frank Act authorizes the CFPB to supervise depository institutions and their affiliates with more than $10 billion in total assets and certain nondepository institutions.[1] To foster public confidence in the integrity of the agency's work, CFPB officials and staff must independently and objectively execute their financial institution supervision and oversight activities. CFPB employees must adhere to principles of ethical conduct and conflict of interest statutes, including recusal requirements.

The Division of Supervision, Enforcement and Fair Lending

SEFL is responsible for ensuring compliance with federal consumer financial laws by supervising market participants and initiating enforcement actions when appropriate. SEFL comprises the Office of Supervision Examinations (OSE), the Office of Supervision Policy (OSP), and the Office of Enforcement.

- OSE supervises and examines entities to ensure compliance with federal consumer financial laws. OSE has four regional offices: New York (Northeast), Atlanta (Southeast), Chicago (Midwest), and San Francisco (West). Regional OSE staff conduct examinations and monitor supervised entities. Each region has a regional director and multiple assistant regional directors. Senior examination managers and field managers (FMs) oversee examination teams. Examiners-in-charge (EICs) lead examinations of supervised entities. In addition, OSE may assign an FM, an examiner, or an analyst as the central point of contact to monitor a supervised entity's compliance efforts and to manage communications with the entity.
- OSP develops supervision strategy and provides subject-matter expertise support to examination staff on legal and policy issues. OSP generally does not interact with supervised entities.
- Enforcement investigates potential violations of federal consumer financial laws and addresses violations as appropriate. Enforcement attorneys generally work on various cases involving supervised entities as well as persons outside the CFPB's supervisory authority.

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[1] Among nondepository institutions, the CFPB has the authority to supervise entities in the consumer mortgage lending, payday lending, and private education lending markets regardless of size; larger participants in markets for other consumer financial products or services as defined by the agency; and entities the CFPB has reasonable cause to determine, by order, are "engaging, or ha[ve] engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services."

Ethics Laws and Regulations That Apply to SEFL Employees

SEFL employees are subject to the *Standards of Ethical Conduct for Employees of the Executive Branch* and *Supplemental Standards of Ethical Conduct for Employees of the Bureau of Consumer Financial Protection*.[2] Additionally, federal statutes prohibit bribery of public officials, impose postemployment restrictions, and prohibit participation in matters in which an employee has a financial interest.

The *Standards of Ethical Conduct for Employees of the Executive Branch* requires employees to recuse themselves from matters in which they have a financial interest or if a reasonable person may question the employee's impartiality. Employees who become aware of the need to recuse themselves should notify the person who assigned them to the recused matter. Employees—not their employer or manager—are responsible for identifying potential conflicts of interest.

The *Supplemental Standards of Ethical Conduct for Employees of the Bureau of Consumer Financial Protection* establishes additional ethics rules for SEFL employees. SEFL employees, their spouses, and their minor children may not own or control any security in any supervised entity identified on the agency's prohibited holdings list, which is updated periodically. SEFL employees, their spouses, and their minor children are also prohibited from seeking, obtaining, or renegotiating credit or indebtedness with an entity that is a party to or represents a party to a specific matter while the employee is working on that matter. In addition, SEFL employees may not accept credit, become indebted to, or enter into a financial relationship with a supervised entity unless they are offered terms no more favorable than those offered to the general public.

SEFL relies on the expertise of the agency's ethics officials within the Office of General Law and Ethics (GLE) regarding ethics matters.

The Office of General Law and Ethics

GLE is an office within the CFPB's Legal Division that manages the agency's government ethics program, which includes monitoring compliance with financial disclosure requirements and providing ethics training. GLE maintains the agency's *Ethics Handbook*, which summarizes the ethics laws and regulations applicable to its employees. The handbook instructs employees to avoid the appearance of a lack of impartiality when performing official duties and outlines the circumstances in which an employee must recuse themselves under the *Standards of Ethical Conduct for Employees of the Executive Branch*. The deputy general counsel, an assistant general counsel, and three senior ethics counsel manage GLE's ethics-related functions, with occasional support from six staff attorneys.

As part of its functions, GLE reviews annual Office of Government Ethics (OGE) Form 278e financial disclosure forms for senior officials and OGE Form 450 financial disclosure forms for certain other SEFL employees to ensure compliance with ethics rules and to identify any potential conflicts of interest. OGE Form 278e and OGE Form 450 require disclosure of assets, income, liabilities, outside employment, and gifts.

GLE also conducts annual ethics training for SEFL employees to raise awareness of employees' ethical responsibilities. Among other topics, the training provides hypothetical scenarios that may pose a

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[2] These standards apply to all CFPB employees.

potential conflict of interest. While employees are not required to contact GLE regarding potential conflicts of interest, employees are encouraged to seek GLE's advice if they are unsure whether a situation constitutes a conflict. If an employee contacts GLE and GLE determines that a situation warrants a recusal, the employee should inform their manager of the recusal and no longer perform work involving that matter. In instances in which a recusal should be broadly disclosed, GLE may write a recusal memorandum to be shared with those who need to know. GLE retains these recusal memorandums on its internal SharePoint site.

Finding: OSE Should Formally Adopt an Examiner Rotation Policy and Implement an Assignment Tracking Mechanism to Mitigate the Risk of Regulatory Capture

We found that most OSE regions have informal practices for rotating examiners assigned to supervised entities and for tracking examiner assignments. We learned through benchmarking that other federal financial regulatory agencies have formal examiner rotation policies to promote independence and objectivity and track examiner assignments to ensure that examiners rotate consistent with those policies. However, OSE does not have a formal policy to ensure that examiners rotate to assignments at other supervised entities within a specified time frame. Additionally, OSE does not use a system, application, or monitoring tool to track examiner assignments to ensure that these rotations occur in a timely manner. By establishing a formal rotation policy and a tracking mechanism for examiner assignment data, OSE can ensure that rotations are monitored and implemented effectively. Periodically rotating examiners will also promote objectivity, cross-training, and broader expertise among examiners while reducing the risk of regulatory capture—the risk that sustained exposure to the same regulated entity increases a regulator's susceptibility to becoming less independent and objective.

OSE Has Informal Practices for Rotating and Tracking Examiners Assigned to Supervised Entities

OSE has some examiner rotation policies for three large supervised entities. For example, OSE's Northeast region has a written policy that requires supervision staff for two large supervised entities to rotate every 5 years. We learned from an official that OSE's West region also has a written policy for rotating EICs at least every 5 years for one large supervised entity. However, for the rest of the CFPB's supervised entities that have recurring examinations, the staff rotation practices are informal in all regions. One official stated that the rotation process occurs naturally; examiners can be rotated based on needs, availability, skill sets, and other factors. Officials from OSE's Southeast and Midwest regions stated that they follow the informal practice of rotating examiners when there is a change in structure within the region, such as when a new supervised entity becomes subject to the CFPB's supervision or through staff attrition.

Similarly, practices for tracking examiner assignments are informal across the regions. We learned from one region that supervisors rely on the FM and the examiner to notify them of the need to rotate when assigned to the same supervised entity for over 3 years. Some regions have created documents to record examiner assignments to supervised entities. For example, OSE's Southeast region uses a document that lists supervised entities and assigned examiners, but the document did not include assignment start dates until September 2023, after we inquired about them. An official stated that OSE's West region manually maintains a chart that shows prospective FM assignments 18 months in advance. The official also stated that OSE's West region tracks historical examiner assignment data.

OSE Does Not Have a Formal Rotation Policy or Tracking System for Examiner Assignments

OSE does not have a formal rotation policy for most supervised entities with recurring examinations. In addition, OSE does not have a tracking system to determine when examiners need to rotate. One official noted that OSE does not have a good tool for tracking how long an employee is assigned to an entity, and another official also indicated that the regions could be better at tracking examiner assignments. We learned that even the regions that document examiner assignments do not track the start and end dates of examiner assignments.

Other Federal Financial Regulators Have Rotation Policies and Track Examiner Assignments to Ensure Compliance With Policies

Our benchmarking efforts revealed that three other financial regulatory agencies have policies that formalize expectations for examiner rotation, as well as mechanisms to ensure compliance with these policies.

Specifically, we found that one federal financial regulatory agency established a formal rotation policy covering examiners for the largest and most complex financial institutions. The policy requires all EICs and lead experts that examine large banks to rotate at least every 5 years. According to this agency, the practice of periodically rotating examiners promotes objectivity, cross-training, and broader expertise among examiners. The agency uses a tracking tool to monitor compliance with its rotation policy and requires documentation of any exceptions.

Similarly, another federal financial regulatory agency has policies requiring the periodic rotation of onsite staff with lead responsibility for examining or monitoring insured depository institutions and other supervised entities. EICs assigned to a large institution's safety and soundness examinations may serve in the role for 5 years, after which they rotate off for at least 24 months. EICs assigned to small institutions may only serve in that role for two consecutive examinations. According to this agency's memorandum on examiner rotation, examiner independence is crucial, and rotating EIC assignments periodically ensures fair and objective treatment for all institutions.

Additionally, since 2002, another federal financial regulatory agency's policy has required EICs of large bank supervisory teams and central points of contact for large organizations to rotate every 3 to 5 years. This agency also tracks projected rotation dates.

A Formal Rotation Policy and a Mechanism for Tracking Examiner Assignments Could Help Promote Independence

Rotation of key examination staff promotes objectivity and independence by reducing the risk of regulatory capture. By establishing a formal rotation policy, OSE could clarify which key examination staff should rotate, establish a time frame for examiner rotation, and set clear expectations for examiner rotation across supervised entities with recurring examinations and monitoring activities.

In addition, implementing a system, an application, or a tool for tracking data on examiner assignments over time, including start and end dates for assignments, could reduce the risk of regulatory capture by ensuring that rotations occur within the time frames established by the formal policy.

Recommendations

We recommend that the director of SEFL

1. Develop and implement a formal examiner rotation policy to clarify rotation requirements for key examination staff on recurring examinations and monitoring activities, and communicate these requirements to OSE staff.
2. Implement a mechanism to track and document assignments for key examination staff, including the start and end dates, to ensure compliance with the examiner rotation policy.

Management Response

In response to our draft report, the acting associate director of SEFL concurs with our recommendations. Regarding recommendation 1, the response states that in September 2023, OSE finalized and published a directive that limits the time that a central point of contact or an FM may be assigned to an entity to no more than 5 years. Regarding recommendation 2, the response states that OSE plans to develop and implement a tool for the regional offices to track FM and central point of contact assignments by June 30, 2024.

OIG Comment

For recommendation 1, we reviewed documentation associated with the action taken by the CFPB, and we closed this recommendation based on the action taken. For recommendation 2, the planned action described by the CFPB appears to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Matter for Management Consideration: SEFL Should Consider Implementing a Process for Employees to Attest to Their Impartiality

We identified one matter for management consideration related to SEFL's recusal process. In February 2022, the CFPB director instructed agency staff to consider potential ethical issues every time they begin a new assignment and to never work on a matter in which their integrity or impartiality could be questioned. The director's guidance echoes the requirements of the *Standards of Ethical Conduct for Employees of the Executive Branch* and the CFPB's *Ethics Handbook*, which state it is an employee's responsibility to identify potential conflicts of interest and the need for recusal.

In 2023, a SEFL office was considering implementing a process, in consultation with GLE and OGE, to have employees sign a document at the start of an assignment affirming that the employee has no conflict of interest or potential appearance of impartiality regarding the assigned matter. While the process is not final and the office is still considering implementing the change, we believe that divisionwide adoption of such a process will help ensure that all SEFL employees self-assess potential conflicts of interest at the beginning of, and during, each assignment and attest to their impartiality to help further mitigate the risk of conflicts of interest.

Appendix A: Scope and Methodology

We initiated this evaluation to assess the extent to which the CFPB promotes a focus on independence and has policies, procedures, and controls to mitigate the risk of conflicts of interest among SEFL staff. We assessed OSE's practices for examiner rotation and for tracking examiner assignments at supervised institutions. OSP generally does not interact with supervised entities and therefore does not rotate staff among entities. Given the adversarial nature of the enforcement process, Enforcement does not rotate staff among supervised entities.

To accomplish our objective, we reviewed the *Standards of Ethical Conduct for Employees of the Executive Branch*, *Supplemental Standards of Ethical Conduct for Employees of the Bureau of Consumer Financial Protection*, and the CFPB's *Ethics Handbook*. We also reviewed recusal documentation, the Southeast region's documentation of examiner assignments, and the West and Northeast regions' rotation policies for select supervised entities.

We interviewed CFPB officials and staff involved in mitigating conflicts of interest among SEFL staff. Specifically, we interviewed officials in GLE, OSE, Enforcement, and OSP, as well as senior SEFL leadership. We also interviewed officials in all four OSE regions.

We conducted benchmarking with other federal financial regulators. These benchmarking efforts included reviewing relevant policies, guidance, and memorandums related to the rotation of examination staff.

We conducted our evaluation from February 2021 to December 2023. We conducted this evaluation in accordance with the *Quality Standards for Inspection and Evaluation* issued by the Council of the Inspectors General on Integrity and Efficiency in December 2020.

Appendix B: Management Response

cfpb Consumer Financial Protection Bureau

1700 G Street NW, Washington, D.C. 20552

February 1, 2024

Michael VanHuysen
Associate Inspector General for Audits & Evaluations
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Mr. VanHuysen,

Thank you for the opportunity to review and comment on the Office of Inspector General's report entitled *The CFPB Can Enhance Certain Practices to Mitigate the Risk of Conflicts of Interest for Division of Supervision, Enforcement and Fair Lending Employees.*

The Bureau appreciates the time and effort that the Office of Inspector General (OIG) put into its evaluation, observations, and recommendations it has provided for improving how the Division of Supervision, Enforcement, and Fair Lending can mitigate risks posed by potential conflicts of interest of our employees. We are committed both to preventing conflicts of interest in our work and to preserving the independence of our staff. We note your observations around implementing a formal examiner rotation policy and a mechanism to track and document assignments of key examination staff. We have also taken under advisement your suggestion for a division-wide process for employees to certify that there is no conflict of interest before being assigned to matters.

Thank you again for your review and the opportunity to provide comments on this report.

Sincerely,

David Uejio

David Uejio
Acting Associate Director
Division of Supervision, Enforcement and Fair Lending

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Responses to Specific Recommendations

Recommendation 1: Develop and implement a formal examiner rotation policy to clarify rotation requirements for key examination staff on recurring examinations and monitoring activities, and communicate these requirements to OSE staff.

The Bureau concurs with this recommendation. During the OIG engagement, Supervision finalized a Directive on Central Point of Contact (CPC) and Field Manager (FM) Rotation Cadence (the Directive), which limits the time that a CPC or FM may be assigned to an entity to no more than five years The Directive was finalized and published in Supervision's Repository of Internal Operations on September 10, 2023.

Recommendation 2: Implement a mechanism to track and document assignments for key examination staff, including the start and end dates, to ensure compliance with the examiner rotation policy.

The Bureau concurs with this recommendation. By June 30, 2024, the Office of Supervision Examinations plans to develop and implement a tool for the Regions to use to track FM and CPC assignments, to ensure that assignments are rotated in accordance with the Directive.

Abbreviations

EIC	examiner-in-charge
FM	field manager
GLE	Office of General Law and Ethics
OGE	Office of Government Ethics
OSE	Office of Supervision Examinations
OSP	Office of Supervision Policy
SEFL	Division of Supervision, Enforcement and Fair Lending

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