



Learning from the Mistakes of Others— CFPB’s Summer 2021 Supervisory Highlights

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Most creditors find 100% regulatory compliance to be an elusive goal, and auto-secured creditors are no exception. My clients often say to me, “Gee, I would have fixed that compliance gap if I had only known it was there!” Are examiners sympathetic to this response? Or do they give the creditor an icy stare and say, “Well, your compliance management system is supposed to uncover those gaps”? An even worse compliance strategy is waiting for your customers to complain. Sometimes a client tells me, “I know we are not perfect, but when a consumer complains to us, we make it right.” When I hear that statement, I hope the client has a checkbook handy.

In fairness, no CMS will prevent or even catch every mistake, and the Consumer Financial Protection Bureau understands this. What distinguishes a creditor that gets a warning from one that gets an enforcement action is often the CFPB’s perspective on how hard the creditor worked to avoid mistakes. With this in mind, let’s look at some recent gaffes the CFPB has uncovered in auto finance servicing, as noted in its Summer 2021 *Supervisory Highlights*, and see what we can learn.

Unfair Charges for Collateral Protection Insurance

Creditors “force place” collateral protection insurance when a consumer fails to maintain required property insurance on the financed car. CPI is expensive, so the CFPB takes an especially dim view of charging a consumer for it when it is not needed. Every auto-secured creditor I know has a system to monitor for lapsed property insurance and retains the contractual right to buy CPI and bill the consumer for it if the consumer’s comprehensive and collision insurance lapses. Creditors typically send a warning notice to the consumer and give the consumer time to respond before force placing property insurance. They may even notify the consumer again when they buy the CPI. And, if they still make a mistake, they remove the charges. With controls like this, how do things go wrong?

It appears that there is more than one way to make a mistake, according to the CFPB’s most recent *Supervisory Highlights*. Most creditors use electronic databases to monitor whether customers are maintaining adequate insurance coverage. A database alert prompts the creditor to ask the customer to provide proof of insurance. The consumer’s failure to do so will cause the creditor to purchase a CPI policy to protect its collateral. If the consumer later proves she had coverage, the creditor will generally remove the charge.

The first mistake, according to the CFPB, is not sending the request for proof of insurance to the right address. We assume that the creditor sent the notice to the address on file, and, after all, it is the customer’s obligation to provide updated contact information. Although the CFPB doesn’t say

what its expectations are in these instances, it seems like sending the notice to the address on record and hoping for the best may not cut it. Here are some additional steps a creditor might take:

- Check the National Change of Address database maintained by the U.S. Postal Service before sending the request for proof of insurance;
- Use customer service representatives to call, text, and/or email the customer, rather than relying only on mailed correspondence; and/or
- If the correspondence requesting proof of insurance is returned as undeliverable, consider skip-tracing the customer before buying CPI.

“But hold on a minute!” a creditor might exclaim. “How can sending mail to the wrong address be an unfair practice if the customer did not tell us of the address change?” That’s an excellent question. Readers who are scholars of the law of unfairness will recall the second prong of an unfairness claim—the consumer cannot reasonably avoid the injury the challenged practice causes. Creditors require customers to notify them of an address change precisely because the creditor may need to reach the customer on an important issue, such as a suspected lapse in insurance coverage. All the customer must do is provide a current address to avoid this injury. Is that too much to ask?

The CFPB doesn’t say. The *Supervisory Highlights* glide over this point by simply saying that the consumer cannot avoid the injury if she did not have notice of the creditor’s plan to place CPI because the notice was sent to an “inaccurate” address. There is no explanation of whether the inaccurate address was the creditor’s error or the consumer’s, but this should matter. Unless the creditor experienced a major problem in processing address updates that customers provided, it seems more likely that the inaccurate address was the consumer’s fault. But I’m sorry to inform you that the CFPB does not limit its concern to instances where the inaccurate address was the creditor’s fault.

The second mistake cited by the CFPB was not having adequate procedures for processing insurance cards that customers sent to the creditor to prove that insurance was in place. Once again, more details would have been helpful here. All I can advise is this: At least one creditor did not correctly note proof of insurance coverage when the consumer submitted a copy of her insurance card. If this happened with one creditor, it might happen with you, too. It is worth checking out. This is a situation in which those complaint logs the CFPB wants companies to maintain as part of their CMS can come in handy.

Finally, the CFPB cites a servicer’s failure to “process insurance documentation from consumers.” This sounds a lot like the second mistake, but the CFPB doesn’t say how. Any complaint that a consumer submitted proof of insurance but was nonetheless charged for CPI should prompt a thorough internal investigation, often called a root-cause analysis, to see if procedures need to be improved. If you are short of ideas for your internal audit team, consider suggesting this topic.

There is more to worry about with CPI than correctly notifying customers and correctly processing proof of insurance in order to avoid buying it needlessly (and charging customers for it). We must also think about cancelling the insurance when it is no longer needed. You probably have procedures to cancel force-placed insurance when the customer reinstates her own insurance. But have you thought about repossessions of cars with CPI? Apparently, some auto-secured creditors did not.

Once a creditor takes back a financed car, either through involuntary repossession or voluntary

surrender, the customer's obligation to maintain insurance coverage arguably ends. The creditor, not the customer, now has the right to possession. The creditor should be sure that its repo checklist includes cancelling any CPI as of the date of repossession. In the case of a voluntary surrender to a dealer, the cancellation (or at least the CPI credit to the customer) should be as of the date the creditor learned of the surrender, regardless of when it actually picked up the car from the dealership.

Inaccurate Payment Posting

I have had clients contact me for advice when they find that a payment has been posted to the wrong account and the consumer who made the payment calls to complain of late fees and negative credit reports. This mistake usually happens when the customer doesn't use the usual method of linking the payment to the account number, forcing the creditor to guess which customer with a common name made the payment. But in this latest issue of *Supervisory Highlights*, the CFPB said that the payment was posted to the wrong account "despite the consumer providing their account information." It's hard to understand how this might have happened, and it would have been helpful if the CFPB had told us a bit more. Was it a payment that required manual data entry, and the employee simply made a typo?

The second type of payment posting error the CFPB discussed is more interesting. The CFPB said that the creditor applied the payment to principal instead of to the periodic payment. Again, the CFPB doesn't say much more, but here's what I am guessing happened. Could it happen to you, too?

Imagine a customer's payment of \$400 is due on the 5th of each month. The customer's payment arrives and is posted on the 3rd, and all is fine. Then the creditor receives another payment on the 15th of the month for \$400. The creditor thinks it is an extra payment and applies the entire amount to principal. But the customer was simply intending to make the next payment early. When a payment due on the 5th of the following month does not arrive, the creditor marks the payment as late, charges late fees and extra interest, and reports the account as delinquent.

Creditors clearly need to have a system to handle this situation. What is yours? Does it still work if the early payment is not in the exact amount of the periodic payment? If a consumer sent a check for enough to cover three payments, along with a note saying the check was for the next three payments, could you handle that? If not, what do you do? These situations may not arise often, but they definitely occur. A good compliance team will think through every way advance payments might arise. Be sure you have good systems to detect them and ensure they are applied properly.

Failure to Follow Disclosed Payment Application Order

Most creditors have a rule for the order in which to apply a payment, such as to interest first, then to principal, then to any past-due payments, and then to late fees and other charges. Sometimes the payment order is in the contract, and sometimes not. Following a specific payment order is necessary to avoid violations of the Federal Trade Commission's Credit Practices Rule, which includes a ban on pyramiding late fees.

One unfortunate creditor used a contract that gave it total flexibility on the order for applying payments, but its website addressed its payment application order. The problem occurred when it failed to follow its stated order for partial payments. In those cases, it applied the payment first to late fees. In some cases, this practice caused vehicle repossessions. The CFPB jumped on this

creditor. The fact that the CFPB traced through the consequences of the payment application order and identified “some” repossessions suggests to me that the CFPB took this problem pretty seriously.

Inaccurate Payoff Amounts

Here is a set of facts that I fear may be common, and many auto finance servicers would not even think of it. Requests for payoffs are routine, and every creditor provides them. What if the contract includes amounts for optional products that the consumer can cancel and receive a refund? This is likely common, too. Does your system identify optional products, tell whether they are the type that can be canceled, and, if so, deduct the refunds from the payoff quote? That’s asking a lot from a payoff quote system, and I will bet many auto-secured creditors cannot do this.

“But, wait!” you may protest. After all, state laws control the rules for giving refunds for GAP and other voluntary protection products cancelled early. Sometimes the holder of the contract must provide the refund promptly after the account is paid. Other states require the consumer to seek the refund from the dealer. Some states are silent. The CFPB did not limit its discussion of this alleged violation to situations where the creditor/servicer was required by state law to make the refund. It appears the CFPB believes it is unfair to quote a payoff amount that does not assume the creditor is required to terminate the product and make a refund without being asked.

But it gets worse. Voluntary protection products that can be canceled often require that the refund be made on a pro-rata basis. At least one creditor/servicer used a program that computed the refund on an actuarial basis, which probably yields a smaller refund than the pro-rata calculation. If you find this problem, the CFPB strongly implies that this is an unfair practice and that you must reprogram your systems (or replace them) to perform appropriate calculations—and then make refunds to affected consumers.

This interpretation will strike many readers as creating a new “rule” through enforcement and supervision. If my read of the *Supervisory Highlights* is on point, the CFPB wants you to: (a) give a refund to every consumer who has a product that can be cancelled, even if state law places that duty on someone else; (b) give the refund at the time of payoff, even if state law provides a different time; and (c) ensure your payoff quotes compute the refund using the applicable method. It would have been helpful if the industry had been given an opportunity to raise concerns with such a rule as part of a notice-and-comment rulemaking, but no such luck. If you are reading about this interpretation for the first time in this article, time’s a wastin’. This may not be a quick fix or an inexpensive one.

Conclusion

What do many of these servicing concerns have in common? Creditors may have what appear to be completely appropriate account servicing policies and procedures—and mistakenly take comfort in that knowledge. For example, they may have strong policies and procedures on force-placed insurance, including a requirement to send an advance notice and to cancel it promptly when the consumer later provides proof of insurance. But do they know whether their front-line employees are having some problems with the responses they receive to these notices, such as a customer document the employee can’t read or a piece of returned mail? Do they know whether their checklist for repossessions and voluntary surrenders requires checking for CPI and canceling it on the correct date? Do they have a backup system to detect human-error mistakes?

Even more troubling is that some of these problems will be uncovered only through transaction testing, which is no doubt exactly how the CFPB examiners found them. If your internal audit team is asking for suggestions of things to audit (or even if it isn't), this article contains several fine ideas. If you don't have an internal audit function, it might be wise to think about hiring an outside auditor or figuring out how to test your systems yourself, including creating well-documented and thorough reports to management.

You definitely want to find these problems before the CFPB does. And if your different way of doing things costs your customers some money, you should consider a restitution plan as part of your remedial action. Whatever it costs, I can assure you that the cost will be less than enduring a bad exam, an investigation, and an enforcement action. Cold comfort, I know, but when your company successfully dodges these bullets, I promise you will be glad you did!

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