

Financial Institutions Advisory & Financial Regulatory Group | July 15, 2009

The Consumer Financial Protection Agency Act of 2009

On July 8, 2009, Congressman Barney Frank, Chairman of the House Financial Services Committee, introduced H.R. 3126, entitled the Consumer Financial Protection Agency Act of 2009 (“the Act”).¹ The Act is based on the legislative language proposed by the Obama Administration and represents the first step in implementing the U.S. Department of the Treasury’s financial reform plan. If enacted, the Act would establish a new independent federal agency that is responsible for the oversight of financial products or services used by consumers and would signify a dramatic shift in consumer regulatory protection.

Overview

The Act provides for the creation of the Consumer Financial Protection Agency (“CFPA”), a new federal agency that would serve as an independent regulator with broad authority over “any financial product or service” used by consumers. The principal objectives of the CFPA are to ensure that consumers of financial products and services have access to, and can utilize, the information that is necessary to make responsible financial decisions, while simultaneously protecting them from abusive, deceptive, and discriminatory practices. The goal of the new agency is to guarantee that markets for such products “operate [both] fairly and efficiently with ample room for sustainable growth and innovation.”²

Under the Act, the CFPA would have sole authority to promulgate and interpret existing and future consumer financial regulations. The new agency would assume all responsibilities regarding the supervision of banking institutions for consumer regulatory compliance,

regardless of whether the institution is federally chartered or state chartered. The CFPA would also have similar supervisory and enforcement authority over non-banking institutions that engage in other consumer-related “financial activities;” however, such authority would be used merely as a second-line defense behind the protections currently provided by state consumer protection laws.

The CFPA would be granted primary enforcement authority to enforce federal law with respect to any person covered under the CFPA. However, Section 122 (f) of the Act would explicitly exempt all financial products and services that are regulated by the Securities and Exchange Commission (“SEC”) or the Commodity Futures Trading Commission (“CFTC”) from the purview of the CFPA. This broad exemption was hard fought for by the SEC Chair Mary Schapiro, who publicly championed her agency’s jurisdiction in the face of a

¹ The Act is available at http://www.house.gov/apps/list/press/financialsvcs_dem/21frank_011_xml.pdf

² Section 121 (b) of the Act.

potentially messy power sharing arrangement with the CFPA.³

Governance and Funding of the CFPA

The CFPA would be governed by a five member Board that would include the Director of the National Bank Supervisor and four members appointed by the President and required to be confirmed by the Senate. The President would be responsible for designating one of the five Board members to serve as Director and Chief Executive of the CFPA. The Board would be responsible for all of the executive and administrative functions of the new agency. Additionally, the Board would be required to establish a Consumer Advisory Board, whose members would include experts in financial services, community development, and consumer financial products. The Consumer Advisory Board would provide additional advice and consultation with regard to emerging practices in the consumer financial products and services industry.

The CFPA would be required to establish a self sustaining funding structure based on fees and assessments. Such fees would be assessed on entities and transactions across the financial sector; this would include banking and non-banking institutions, as well as other providers of financial products and services that are covered under the Act.

Range of Financial Activity Overseen

The CFPA would have jurisdiction over any consumer related financial activity or service. The Act outlines a broad range of activities that fall under the definition of “financial activity” under the statute, including:

- Deposit-taking activities;
- Extending credit and serving loans;

- Check-guaranty services;
- Credit reporting services;
- Debt collection services;
- Real estate settlement services;
- Leasing of personal or real property, or acting as an agent, broker, or advisor in such an activity;
- Investment advice not subject to SEC or CFTC regulation;
- Financial advisory services;
- Financial custodial services; and
- Any other financial activity that is later defined by the CFPA.

Consolidation of Federal Oversight

As a result of the Act, many consumer financial regulations that are currently divided among several agencies would be consolidated within the CFPA. This represents an effort to centralize consumer financial protection in order to standardize regulatory oversight, which in turn would minimize opportunities for regulatory arbitrage (where firms choose the least restrictive regulator possible). Subtitle F of the Act entitled “Transfer of Functions and Personnel,” would transfer all consumer financial protection functions, and the powers and duties related thereto, to the CFPA from the following federal agencies:

- Board of Governors of the Federal Reserve System;
- Comptroller of the Currency;
- Director of the Office of Thrift Supervision;
- Federal Deposit Insurance Corporation;
- Federal Trade Commission; and
- National Credit Union Administration.

³ Perhaps representing a compromise with the Administration, the SEC recently formed the Investor Advisory Committee in order to provide investors with a greater voice in the Commission's activities. Similarly, the CFTC recently formed the Risk Management Advisory Committee in order to conduct public meetings and develop reports and recommendations on risk-management issues.

Subtitle H of the Act entitled “Conforming Amendments,” would effectuate these changes to reflect the transfer of authority to the CFPA by amending the following statutes:

- Inspector General Act of 1978;
- Privacy Act of 1974;
- Alternative Mortgage Transaction Parity Act of 1982;
- The Consumer Credit Protection Act;
- Expedited Funds Availability Act;
- Federal Deposit Insurance Act;
- Gramm-Leach-Bliley Act;
- Home Mortgage Disclosure Act;
- Division D of the Omnibus Appropriations Act, 2009;
- Real Estate Settlement Procedures Act of 1974;
- Right to Financial Privacy Act of 1978;
- Secure and Fair Enforcement for Mortgage Licensing Act of 2008; and
- Truth in Savings Act.⁴

The Act would require the Secretary of the CFPA to designate a transfer of authority no later than 60 days after the date of the enactment of the Act. The actual transfer of authority from the abovementioned agencies to the CFPA would be required to take place no earlier than 180 days and no later than 18 months after the enactment of the Act.

⁴ One notable difference between the draft legislation originally proposed by the Administration and the bill recently introduced by Congressman Frank is the removal of the following statutes from the Act: the Consumer Leasing Act of 1976, the Community Reinvestment Act of 1977, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act, the Fair Debt Collection Practices Act, and the Home Ownership and Equity Protection Act of 1994.

A copy of the Administration's originally proposed draft is available at <http://financialstability.gov/docs/CFPA-Act.pdf>

Risk Monitoring

One of the responsibilities of the CFPA would be to identify and monitor the risks that financial products and services pose to consumers. Through the examination of consumer reports and the assessment of consumer complaints, surveys, and interviews, the CFPA would be required to publish an annual report that outlines existing and future risks associated with buying or using financial products and services. In order to effectively accomplish this goal, the Act authorizes the CFPA to require reports from providers of consumer financial products that not only identify product risks, but determine whether consumers fully understand what those risks represent.

Development of a Simpler Market with Standardized Products

A second undertaking for the CFPA would be the development of a simpler market for consumers. Specifically, the Act provides that the CFPA would create standardized consumer financial products. These “plain vanilla” products would be more “transparent to consumers” and facilitate comparisons between the benefits and costs of alternative consumer financial products. Such products would be required to contain the features and terms defined by the Agency for that particular class of product or service. Additionally, the Act would authorize the CFPA to require that the seller of the mortgage offer the prospective mortgagor the agency-created mortgage, prior to offering its own alternative financial product.⁵

Some respected commentators have been highly critical of the potential level of intrusion into the market that is represented by a requirement to offer standard government approved products ahead of other products.

⁵ Section 136 (b)(1)(b) of the Act provides that “the agency may adopt rules or issue guidance regarding the offer of a standard consumer financial product or service at or before the time an alternative consumer financial product or service is offered to a consumer, including ... providing the consumer with a meaningful opportunity to decline to obtain the standard consumer financial product or service.”

For example, according to Judge Richard Posner, the literal application of this language would provide the CFPA with unfettered discretion in developing a standard product. It would essentially allow the CFPA to “draft a mortgage loan contract that provided for a 30-year non-recourse 100 percent (that is, zero equity) fixed rate mortgage loan.” Judge Posner believes that the proposed legislation is “another example of an emerging regulatory philosophy that is an understandable, but inexcusable, reaction against the recent history of lax, ineffectual financial regulation that can be summed up as too much, too soon, too costly.”⁶

Prevention of Unfair, Deceptive, and Discriminatory Practices

The CFPA would further be responsible for the prevention of “unfair, deceptive, or abusive acts or discriminatory practices in connection with any transaction with a consumer for a consumer financial product or service.” Through regulations and administrative enforcement, the CFPA would be explicitly authorized to ban unfair terms and practices or place tailored restrictions on product terms and provider practices. It would have the authority to impose heightened duties of care on financial intermediaries that reflect reasonable consumer expectations, and prevent compensation practices from creating conflicts of interest between intermediaries and consumers.⁷

Transparency of Risks and Costs

In order to promote greater transparency for consumers, the CFPA would develop disclosure requirements that are designed to promote a consumer’s awareness and

understanding of both risks and costs associated with a particular product or service. Through a new proactive approach to the disclosure process, the CFPA would require that all communications directed toward consumers are reasonable, in that they are balanced in their presentation of benefits, and clear in their identification of costs, penalties, and risks. This would provide for concise financial product disclosures and assist in providing “consumers the necessary information needed to make effective financial decisions.”

Rollback of Federal Preemption

In addition to creating the CFPA, the Act would change the balance between state and federal authority with regard to consumer financial protection. The rules promulgated by the CFPA would “serve as a floor, not a ceiling” to state consumer protection laws, thereby allowing states to enact and enforce stricter consumer protection laws. This would be expressly permitted in Subtitle D of the Act, entitled “Preservation of State Law.”

Under the Act, federally chartered institutions would be subject to nondiscriminatory state consumer protection and civil rights laws to the same extent as other financial institutions. States would be able to enforce these laws, as well as the regulations published by the CFPA, with respect to federally chartered institutions and their subsidiaries.⁸

The Act would also affirm the recent Supreme Court decision of Cuomo v. Clearing House Association⁹ by redefining “visitorial powers” of the national bank regulator. In Cuomo, the Court held that the Office of Comptroller of the Currency’s regulation interpreting “visitorial powers” to prohibit states from enforcing state

⁶ See Richard Posner, A Failure of Capitalism: The Proposed Consumer Financial Protection Agency Act of 2009, *The Atlantic*, Jul. 4, 2009, available at http://correspondents.theatlantic.com/richard_posner.

⁷ Section 131(c) of the Act provides that when determining whether a practice is “unfair,” the agency must determine that it “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers and such substantial injury is not outweighed by countervailing benefits to consumers or to competition.”

⁸ Section 141(a)(2) of the Act would overrule the 2007 Supreme Court decision Watters v. Wachovia Bank, 550 U.S. 1 (2007). In Watters, the Court held that Michigan’s bank regulator had no authority over a mortgage subsidiary of Wachovia, a national bank, even though the mortgage subsidiary itself was chartered by the state. By making state consumer protection laws applicable to national banks, such laws will no longer be deemed to be inconsistent with federal law.

⁹ Cuomo v. Clearing House Ass’n, 2009 U.S. LEXIS 4944 (2009).

laws against national banks was inconsistent with the National Bank Act. The Court deemed that a state's "visitorial powers" and "its power to enforce the law are two different things," and the National Bank Act "pre-empts only the former." Under the Act, state attorneys general would be expressly authorized to bring lawsuits requiring national banks to produce records for investigations into violations of state consumer laws and to enforce any applicable federal or state law.

Going Forward

The Consumer Financial Protection Agency Act of 2009 will undoubtedly be the subject of contentious congressional debate over the upcoming months. Many of the significant details pertaining to the authority and powers of the CFPA will certainly change as the legislative process continues to progress.

Yet, if enacted, it is clear that the creation of the CFPA would mark a significant change the landscape of consumer regulatory protection. We will provide further alerts as the legislation continues to develop.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this memorandum, you may contact your regular Shearman & Sterling contact person or any of the following:

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