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REGULATORY REFORM

Consumer Financial Protection: It's A Smaller World After All


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Few of the reforms of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''**Dodd-Frank''**) have been as controversial[1] as the creation of the Consumer Financial Protection Bureau.[2] On the one hand, proponents envisioned the Bureau as ''a single, highly motivated federal regulator, [that would apply] the same regulation . . . to all similar products, regardless of the identity of the lender.''[3] On the other hand, critics have called the Bureau ''fatally flawed'' and suggested that it has the potential to ''stifle innovation and leave some market participants worse off.''[4]

As it turns out, the authority of the Bureau is not as monolithic as one might think after reading the headlines of the last several months. Beginning with the Obama Administration's issuance of its white paper on financial regulatory reform,[5] through the Administration's subsequent legislative proposal, and ending with the House and Senate's legislative efforts, the Bureau's jurisdiction has been steadily eroded. To be sure, the authority of the Bureau should not be underestimated, for it is considerable. Still, it is useful to understand pre-

[1] *See*, *e.g.*, Speech by James Bullard, President, Federal Reserve Bank of St. Louis, *The Consumer Financial Protection Bureau: The Direction and Implications*, Nov. 29, 2010.

[2] The agency assumed several different names and forms before Dodd-Frank finally settled on the ''Bureau of Consumer Financial Protection,'' a bureau housed within the Federal Reserve (previous names include the ''Consumer Financial Protection Agency''). Notwithstanding the terminology in Dodd-Frank, the agency has decided to refer to itself as the ''Consumer Financial Protection Bureau'' (see the Bureau's website at http://www.consumerfinance.gov/). We use ''**Bureau**'' to refer to all these iterations.

[3] Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer* 157 U. Pa. L. Rev. 1 (2008) at page 98.

[4] Letter from Rep. Randy Neugebauer, Subcommittee Chairman, House Oversight and Investigations Committee, to Elizabeth Warren, Assistant to the President, dated January 18, 2011.

[5] Department of Treasury, *Financial Regulatory Reform: A New Foundation*, (June 17, 2009) (''**White Paper**'').

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cisely what that authority encompasses and what has not changed since the issuance of the White Paper.

There are several state and federal laws in the United States that relate to consumer financial protection. Prior to the enactment of Dodd-Frank, rule-making, examination, and enforcement authority for these laws generally lay with federal bank regulators, but their enforcement efforts were generally considered unenthusiastic.[6] Even before the recent financial crisis, some complained that federal bank regulators had focused on their traditional mission of overseeing the safety and soundness of banks at the expense of their responsibility to pursue consumer protection.[7] In the aftermath of the crisis, much attention has centered on the Community Reinvestment Act of 1977 (''**CRA**'') and whether the CRA drove down mortgage underwriting standards, fuelling the housing and mortgage bubbles that caused the crisis.[8] While this debate is ongoing, the majority of the Financial Crisis Inquiry Commission concluded that ''the CRA was not a significant factor in subprime lending or the crisis.''[9]

At the state level, certain mortgage companies and other providers of consumer credit products (which were not regulated by federal banking agencies) were alleged to have made unsuitable loans to consumers with low teaser rates and other misleading terms.[10] As competition with these unregulated entities rose during the housing boom, banks reputedly lowered standards and made similarly unsuitable loans, but federal banking regulators allegedly did little to stop these practices.[11]

Warren Proposal

Against this background, Prof. Elizabeth Warren of Harvard Law School proposed the creation of a single, independent agency to serve as the focus of consumer financial protection, with ''broad rulemaking and enforcement authority over consumer credit products.'' The proposal itself, less than three pages long, was centered on the premise that a single agency should regulate all consumer credit products, irrespective of the type of entity that serves as supplier. If federal jurisdiction over consumer financial protection laws remained divided, then misleading and abusive treatment of consumers would continue, as financial service providers evade the jurisdiction of the most aggressive agencies.[12] The concept of a single agency regulating the provision of all consumer credit products held substantial intellectual and popular appeal, and Warren's proposal gained traction in the aftermath of the financial crisis.

Obama Legislative Proposal

In June 2009, the Treasury Department released its White Paper, the basis for the Administration's proposed financial reform legislation, Part III of which addressed consumer protection. The Administration found that abusive lending practices by both banks and non-banks fuelled the subprime mortgage boom, with ''disastrous results for consumers and the financial system.''[13] Consistent with Prof. Warren's proposal, the Administration sought to curtail abusive lending (and, presumably, future crises) by promoting a single agency with rulemaking, examination, and enforcement authority for all federal consumer financial protection laws, including the CRA.[14]

The White Paper marked the zenith of the single agency model for consumer financial protection oversight, but even at this point one can see cracks beginning to develop. For example, the White Paper carves from the jurisdiction of the Bureau any product or service already regulated by the Securities and Exchange Commission (''**SEC**'') and the Commodity Futures Trading Commission (''**CFTC**'').[15] This seems to be the

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[6] Several federal agencies have jurisdiction over U.S. banks (collectively, the ''**banking agencies**''): the Office of the Comptroller of the Currency (''**OCC**'') for national banks, the Board of Governors of the Federal Reserve System (''**Board**'') for bank and financial holding companies, and state chartered banks that are members of the Federal Reserve System, the Federal Deposit Insurance Corporation (''**FDIC**'') for state chartered banks that are not members of the Federal Reserve System, the Office of Thrift Supervision (''**OTS**'') for savings and loan companies (which will be merged with the OCC under a separate provision of Dodd-Frank), and the National Credit Union Administration (''**NCUA**'') for credit unions. State banks are also regulated by the chartering state. The Federal Trade Commission (''**FTC**'') also has jurisdiction over certain bank activities.

[7] The White Paper at 55.

[8] The White Paper also identified the Home Ownership and Equity Protection Act of 1994 (''**HOEPA**''), the Equal Credit Opportunity Act (''**ECOA**''), the Home Mortgage Disclosure Act of 1975 (''**HMDA**''), the Real Estate Settlement Procedures Act of 1974 (''**RESPA**''), the Truth in Lending Act (''**TILA**''), and the Fair Debt Collection Practices Act as important consumer financial protection laws.

[9] *See* Financial Crisis Inquiry Report (Jan. 27, 2011) (compare with dissent of Peter Wallison).

[10] Title X of Dodd-Frank sets a federal floor with respect to consumer protection standards. After years of observing preemptive federal standards, states now may apply more stringent standards than federal law. A bank with multistate operations must comply with the laws of each state in which it operates. State attorneys general may enforce federal consumer financial protection regulations against any entity doing business in their state. National banks and thrifts are different: state attorneys general may bring actions against those entities to remedy violations of a regulation promulgated by the *Bureau*, not the State. *See* Sections 1041 and 1042(a)(2) of Dodd Frank.

[11] *See, e.g.,* Patricia A. McCoy, Andrey D. Pavlov and Susan M. Wachter, *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure* 41 Conn. Law Review 1327 (2009) at 1334. Under HOEPA, bank regulators may police high-cost loan refinancings, but only with respect to a narrow subset of loans. HOEPA directed the Board to adopt regulations prohibiting unfair and deceptive conduct with respect to mortgages generally (*see* 15 U.S.C. § 1639(l)(2)), but the Board did not act until January 2008, well into the crisis.

[12] Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer* 157 U. Pa. L. Rev. 1 (2008) at 98, 99.

[13] The White Paper at 55.

[14] Rather than discuss why the jurisdiction over the CRA should repose with the Bureau, the White Paper disputed the argument that the CRA prompted the financial crisis. *See* The White Paper at 55, 69, and 70.

[15] The White Paper does not address the point, but there are logical reasons to create such an exception, notwithstanding complaints in the aftermath of the Madoff scandal that the SEC had failed in its mission of investor protection. Most sig-

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first of several significant departures from the proposal for a single agency that were made during the legislative process.[16]

The Obama Administration next proposed draft legislation to implement its White Paper.[17] Title X of the draft defined the consumer financial protection world in terms of relevant products and applicable statutes and established the Bureau as an independent, nonappropriated agency. Title X largely reflected the contents of the White Paper, and gave the Bureau expansive jurisdiction over consumer financial products.[18]

Dodd-Frank: Shrinking the Universe

At first blush, the final Dodd-Frank legislation seems to grant expansive authority to the Bureau to regulate all providers of ''consumer financial products or services'' and all ''federal consumer financial laws.'' Dodd-Frank follows the Administration model of defining the consumer financial protection world in terms of relevant products and applicable statutes and establishes the Bureau as an independent entity.[19] Both the House and the Senate bills, and the final Dodd-Frank legislation, departed from the Warren and Obama Administration proposals, however, by shrinking the universe of consumer financial laws and financial products and services over which the Bureau had jurisdiction.[20] Thus, the Bureau's initial status as a repository of authority over *all* consumer financial products has morphed into something less than what Prof. Warren and the White Paper envisaged.

Consumer Financial Product Or Service

''Consumer financial product or service'' is a very broad term and includes any financial product or service that is offered to or provided for use by consumers primarily for personal, family or household purposes.[21]

Traditional bank products and services like loans, deposits, custodial services and transmitting funds come within the term.[22] Products and services that both banks and nonbanks provide, *e.g.*, check cashing, certain financial advisory services, payment and data processing, lease financing arrangements, stored value payment cards, and debt collection also are covered. The jurisdiction of the Bureau therefore extends to the world of payday lenders, credit counselors and pawn shops.[23] Finally, in a nod to the notion that shoddy mortgage origination caused the crisis, Dodd-Frank adds real estate settlement and appraisal services to the list. What looks like a comprehensive list of covered financial products and services, however, is notable for its exceptions.

Legislators found two ways to carve-out important portions of consumer financial products industry from the Bureau's ambit that the Administration clearly had sought to cover. The ''business of insurance'' was simply removed from the list of covered products and services and thus placed outside of the Bureau's jurisdiction.[24] The regulatory status quo for auto dealers is preserved through a stand-alone exclusion, which affirms that the Bureau lacks jurisdiction over dealers predominately engaged in selling, leasing, and servicing motor vehicles.[25]

Dodd-Frank also puts limits (which vary by activity) on the Bureau's rulemaking, supervisory and enforcement authority over the following industry participants, although these limits are not as strong or as clear-cut as the limits on the Bureau's authority over insurance business and the auto industry:[26]

- Merchants, retailers and other sellers of non-financial goods and services;
- Real estate agents and brokers;
- Retailers of manufactured and model homes;
- Accountants, tax preparers and lawyers; and
- Qualified retirement or eligible deferred compensation plans.

Notwithstanding these limitations, the Bureau may adopt rules to cover other financial products and services provided by banks and financial holding companies that are likely to have ''a material impact on consumers.''[27] Further, the Bureau may adopt rules regulating any product or services ''entered into or conducted as a subterfuge or with a purpose to evade any Federal consumer financial law.''[28] It remains to be seen whether the Bureau will interpret these provisions to increase its jurisdiction over financial services and products, notwithstanding the statute's clear limitations concerning excluded products and services.[29]

Federal Consumer Financial Law

The Bureau holds sway over ''federal consumer financial law,'' comprised of 18 enumerated consumer

nificantly, the new Bureau would be charged with administering consumer financial laws that are based on the provision of traditional credit products. The SEC and the CFTC, in contrast, oversee completely different bodies of law. It would be a far simpler exercise to preserve jurisdiction over consumer issues in the commodity and securities law rather than transfer that authority to the Bureau.

[16] Warren's proposal was highly conceptual, with no discussion of her willingness to compromise or tolerate the creation of exceptions for products currently regulated by the SEC or the CFTC from the basic one-agency regulatory model.

[17] Obama Administration's combined draft legislation for Financial Regulatory Reform (available at http://www.llsdc.org/attachments/files/252/Dodd-Frank-Act_Admn-Reg-Reform-Bill.pdf) (''**Obama Legislative Proposal**'').

[18] Obama Legislative Proposal, Section 1002(16).

[19] The Bureau is located within the Federal Reserve, but any appearance of subordinate status as a ''bureau'' is misleading. To fund operations, the Bureau is entitled to a fixed percentage of the Board's total operating expenses. The Board may not: intervene in examinations or enforcement actions conducted by the Bureau unless specifically authorized by law; oversee the issuance of rules by the Bureau; hire or fire any employee of the Bureau; or merge or consolidate the Bureau with any other Board division. *See* Sections 1012(c) and 1017 of Dodd-Frank.

[20] This is not to say that the process was purely straightline. Indeed, there were some instances where individual legislators attempted to expand upon the Obama Legislative Proposal, but those were few and usually unsuccessful.

[21] Section 1002(5) of Dodd-Frank.

[22] Section 1002(15) of Dodd-Frank.

[23] *See*, *e.g.*, Speech by James Bullard, President, Federal Reserve Bank of St. Louis, *The Consumer Financial Protection Bureau: The Direction and Implications*, Nov. 29, 2010.

[24] Section 1002(15)(C) of Dodd-Frank.

[25] Section 1029(c) of Dodd-Frank: in particular, the Board and the FTC retain their authority over auto dealers.

[26] Section 1027 of Dodd-Frank.

[27] Section 1002(15)(A)(xi)(II) of Dodd-Frank.

[28] Section 1002(15)(A)(xi)(I) of Dodd-Frank.

[29] For example, Section 1027(m) of Dodd-Frank.

statutes.[30] Notwithstanding the recommendations of the Administration,[31] however, there are two major exceptions to this list: the CRA and the Federal Trade Commission Act.[32] Administration of these statutes will remain with the banking agencies and the FTC, respectively. This preserves the problem of fragmented authority over consumer financial products and services. There is also a concern that if the Bureau does not have CRA responsibilities, it will not give appropriate weighting to preserving access to financial services when exercising its consumer protection rulemaking powers.

Bureau of Consumer Financial Protection: Master of Its Universe?

Even within its smaller universe of jurisdiction, the authority that the Bureau may exert has been constrained following the push and pull of legislative compromise.

Rulemaking

In a relatively clean design, Dodd-Frank shifted rulemaking authority under the Federal consumer financial laws to the Bureau from the banking agencies, the FTC, and the Department of Housing and Urban Development,[33] but there are exceptions. For example, the Bureau has no power to adopt regulations under the Federal Trade Commission Act.

The Bureau may not act unilaterally but must consult with other federal agencies, as appropriate, when adopting rules regarding unfair, deceptive or abusive acts or practices, some of the most potent provisions of consumer protection law, ostensibly to ensure that such rules do not harm the safety of the financial system and markets. Other agencies adopting consumer rules, including the SEC and CFTC, similarly must consult with the Bureau to better achieve the Warren ideal of ''promoting consistent regulatory treatment of consumer financial and investment products and services.''[34] Like other Dodd-Frank provisions involving inter-agency coordination, these provisions raise a host of questions as to which there are no ready answers. For example, what exactly do inter-agency consultation and coordination entail? How will the agencies work together? What remedies are there for the general public if the agencies fail to cooperate and coordinate?[35]

There are other restrictions on the Bureau's rulemaking authority. For example, the Financial Stability Oversight Council may stay or set aside a Bureau rule, upon a determination that the rule would ''put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk.''[36] The FSOC may make that determination only upon the petition of another agency that has made a good faith effort to resolve the issue with the Bureau. Given these hurdles, one may question the circumstances under which this authority would ever be used.

Examination and Enforcement

The authority to promulgate rules is effectively weakened if the Bureau lacks the companion authority to examine regulated entities for compliance with those rules. While the Bureau's rulemaking authority is broad, its examination and enforcement authority varies depending on the type of entity being regulated.

Dodd-Frank departs from the Obama Administration proposal by dividing providers of consumer financial products and services into three categories:

- Depository institutions and credit unions with total assets of $10 billion or less (''**Smaller Banks**'');
- Depository institutions and credit unions with total assets of more than $10 billion, including affiliates (''**Large Banks**'');[37] and
- Certain non-depository institutions (''**Non-Depository Institutions**'').[38]

The Bureau's examination powers were significantly curtailed during the legislative process, especially in the case of Smaller Banks. The banking agencies retain complete examination authority over Smaller Banks, and Bureau examiners may participate only in a sample of the agencies' examinations.[39] The bank agencies, and not the Bureau, similarly have exclusive enforcement authority with respect to Smaller Banks.[40] The Bureau may only recommend that a bank regulator commence enforcement proceedings against a Smaller Bank.

The Bureau's examination powers over Large Banks and Non-Depository Institutions are more robust. The Bureau has exclusive authority to examine Large Banks for compliance with the Federal consumer financial laws (although it must coordinate its examinations with the Large Banks' prudential regulators).[41] The Bureau has examination authority over Non-Depository Institutions, but Dodd-Frank does not specify whether this authority is exclusive.[42]

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[30] The enumerated laws include the ECOA, the HMDA, the HOEPA, the RESPA, and the TILA. *See* Sections 1002(12) and 1002(14) of Dodd-Frank. ''Federal consumer financial law'' includes Title X of Dodd-Frank itself, certain savings provisions set out in Subtitle F, and miscellaneous authorities set out in Subtitle H.

[31] The White Paper at page 63, 69.

[32] Section 1002(14) of Dodd-Frank.

[33] Section 1061(b) of Dodd-Frank.

[34] Section 1015 of Dodd-Frank.

[35] See Donald N. Lamson and Hilary Allen, *SEC and CFTC Joint Rulemakings Under Dodd-Frank – A Regulatory Odd Couple?*, 43 SRLR 497, 03/07/2011, for a discussion of similar questions arising under Dodd-Frank's grant of joint rulemaking authority to the CFTC and SEC.

[36] Section 1023 of Dodd-Frank.

[37] As of the end of the third quarter of 2010, Large Banks held approximately 78% of the nation's banking assets. *See* 2010 FDIC Quarterly Banking Profile (Vol. 4, No. 4), Table III-A, p. 7.

[38] Non-Depository Institutions include providers of certain education and payday loans, mortgage originators, brokers and servicers, and any other ''larger participant of a market for other consumer financial products or rules'' designated in a Bureau rulemaking. Section 1024(a) of Dodd-Frank. Through such rulemakings and subject to consultation with the FTC, the Bureau may extend regulation to previously unregulated non-depository institutions.

[39] Section 1026(c) of Dodd-Frank.

[40] Section 1026(d) of Dodd-Frank.

[41] Section 1025(b) of Dodd-Frank.

[42] Section 1024(b) of Dodd-Frank. Presumably, the FTC may also supervise Non-Depository Institutions with respect to matters under its jurisdiction, but there is no provision in Dodd-Frank that requires the Bureau and the FTC to coordinate on supervisory matters (although the two agencies must coordinate on enforcement matters).

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The Bureau has primary enforcement authority with respect to consumer laws over Large Banks,[43] but prudential regulators have backup authority: they can act if they first request that the Bureau bring an enforcement proceeding and it fails to do so. The Bureau has exclusive enforcement authority over Non-Depository Institutions[44] – however, the Bureau and the FTC must negotiate an agreement for the coordination of enforcement actions over these entities. As with interagency rule-making, supervisory success will depend on how well the various agencies coordinate their enforcement powers over Large Banks and Non-Depository Institutions. Poor coordination could lead to confusion and inconsistent treatment for the regulated entities.

[43] Section 1025(c) of Dodd-Frank. Section 1061(c)(1)(A) of Dodd-Frank adds that prudential regulators can require reports and conduct examinations of Large Banks that are incidental to the exercise of this backup enforcement authority.

[44] Section 1024(c) of Dodd-Frank.

Conclusion

The Bureau was initially envisaged as a ''one stop shop'' for consumer financial protection, with sweeping rulemaking, supervision, and enforcement jurisdiction. Following the legislative process, the universe of products, services and laws covered by the Bureau was significantly narrowed from what had been proposed by Prof. Warren and the Obama Administration. Even within that universe, the Bureau does not have the monolithic authority that was originally proposed: the Bureau often has to share jurisdiction with other agencies, and its jurisdiction over Smaller Banks is particularly limited. The combined effect of these limitations is that many of the industries that most vehemently opposed regulation by the Bureau have largely avoided it. It remains to be seen whether this more limited jurisdiction and the requirement to coordinate with other regulatory agencies hobbles the efficacy of the Bureau, or whether the narrow parameters will cause the Bureau to better focus its efforts where they are most needed.