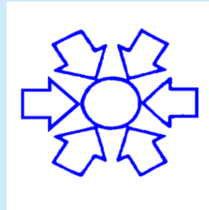

Financial Services Management

Consumer Financial Protection Bureau

Retail Finance	Strategic Action Item

Cite

Dodd-Frank Act
Title X

Recommended Distribution

Retail Finance, Retail Payments, Mortgage Banking, Corporate Planning, Marketing, Risk Management, Compliance, Legal, Government Relations

Website

http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/conference_report_FINAL.pdf

Overview

In this report, FedFin analyzes the strategic implications of the new Bureau of Consumer Financial Protection (CFPB) established in Title X of the Dodd-Frank Act. Although strongly opposed by the financial-services industry, this new, independent, and powerful agency is given broad authority with which to work its will in new product design, pricing (other than anything that could be characterized as a usury ceiling), disclosure and other standards for all retail financial products outside the insurance sector. Mortgages will come in for a significant rewrite not only due to the new CFPB, but also to provisions in Title XIV of Dodd-Frank that define new origination standards and Title IX, which establishes the parameters for "qualified residential mortgages" exempt from risk retention. An in-depth report on mortgage finance will be sent shortly to clients on these and other sections in Dodd-Frank that restructure U.S. residential-housing finance. A follow-up FedFin decision-point memo will highlight key strategic issues that immediately confront financial-services firms, including the degree to which new consumer standards could force wholesale fee and product rewrites with adverse profit implications. This will be of particular concern in the remittance-transfer and payment arena.

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In general, virtually all consumer-related duties are transferred from the bank regulators to the CFPB upon its establishment, with full operations possible as soon as six months after enactment. CFPB is nominally housed in the FRB, which the Board privately believes will lead it to be held accountable for CFPB actions even though it is not responsible for them due to express barriers on Board intervention. The Financial Stability Oversight Council[1] could overturn a CFPB rule, but only through a difficult process that makes this unlikely. The law does, however, subject CFPB rulemakings to additional scrutiny regarding impact on small business, a requirement that may well slow down action, if not necessarily temper it. All covered consumer-finance activities will be judged by the CFPB on criteria that include not only whether they are confusing, unfair or deceptive, but now also if they are “abusive.” Dodd-Frank also rolls back the ability of the OCC to preempt state law for national banks, although the extent to which this is in fact done will depend on the new Comptroller, pressure from the CFPB and, ultimately, court rulings. However, state attorneys general have been granted clear authority to enforce federal consumer regulations, opening the way for more state-dictated sanctions against federally-chartered depositories.

Analysis

A. Start-Up

As noted, the CFPB may begin work as soon as a director is nominated and confirmed. It could even start more quickly, as the Treasury Secretary is authorized to conduct his or her duties until a director is named. However, CFPB official duties do not start until the “transfer date,” which will be set by the director in consultation with the FRB, Office of Management and Budget and other agencies. The transfer date needs to be no sooner than six months after enactment and no later than a year thereafter (although Treasury could permit an extension until eighteen months in a process detailed in the law).

During the start-up period, the CFPB can acquire staff transferred from other regulators and otherwise generally organize itself. It could also determine which rules it wishes to govern beyond those expressly named in the statute (see below).

B. Structure

1. *Organization*

The Bureau must have a director nominated by the President and confirmed by the Senate and a deputy director appointed by the director. Within 180 days of the transfer date, CFPB would also have to have an

[1] See Client Report SYSTEMIC29, *Financial Services Management*, July 13, 2010.

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ombudsman for general purposes and a special one, named by Treasury, for private educational loans. Specific units would need to be established for:

- research;
- community affairs (although CFPB does not have jurisdiction over the Community Reinvestment Act);
- complaint tracking, including a single toll-free number. CFPB would then address these complaints or route them to the FTC, prudential regulators or states (if these meet numerous conditions);
- an office of fair lending and equal opportunity (although the Fair Housing Act remains under the jurisdiction of the Department of Housing and Urban Development). An assistant director for fair lending is mandated;
- an office of financial education. Various studies and reports in this area are mandated;
- an office of servicemember affairs; and
- an office of financial protection for older Americans, which would need to be established within 180 days of the transfer date and be run by an assistant director. A study of whether certifications should be provided for those who advise older persons is mandated.

The law also mandates a Consumer Advisory Board.

2. Funding

The FRB would need to transfer funds determined by the CFPB director, with this limited to ten percent of Board operating expenses in FY2011 and moving up to no more than twelve percent in FY2013 and the years thereafter. Before the transfer date, the FRB will transfer to the CFPB the amount determined necessary by Treasury to start its operations. Should FRB funds not prove sufficient, the law provides limited authority for requests for additional appropriations. In addition, the law establishes a CFPB Civil Penalty Fund which would then be used for victim relief and, if excess funding is received, for financial literacy.

C. Coverage

Although the scope of the law is very broad, as discussed below, the CFPB is also given wide authority to exempt any covered persons or activity from its regulations. In providing any such exemptions, CFPB would need to consider the size of the institution or volume of the activity and the rules that would otherwise govern it.

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1. *Covered Products*

These exclude insurance (and related activities and reinsurance), but otherwise include:

- providing credit and servicing loans;
- extending or brokering certain leases;
- providing real estate settlement services or appraisals;
- deposit-taking and funds or financial-instrument gathering, exchanging and related custody services;
- selling and issuing stored-value cards or payment instruments (but only if the seller exercises "substantial control" over applicable conditions and the card is not a traditional gift card redeemable for goods at the issuing store);
- check-cashing and related services;
- payment or related financial-processing services for consumers (with various exceptions for merchants and providers of technological services); and
- financial-advisory services (other than those regulated by the SEC and/or the states or to the degree advice is provided in media services). However, the Bureau and SEC can work together on rules to protect consumers in securities services. The SEC is to consult with the Bureau if promulgating rules for securities services that are comparable to those governed by the CFPB or compete with them. A similar process excludes activities regulated by the CFTC.

Although general merchant activities (including debt collection) are expressly excluded from Bureau jurisdiction, the CFPB may add other products to the list of those it regulates if they are structured as a "subterfuge" to CFPB regulation or if the product is permissible for a bank. The law in fact then goes on to redefine permissible FHC activities to exclude various information-retrieval services not just for CFPB purposes but, apparently, as a total ban to future FHC activities in them.

Although the law generally excludes services related to employee retirement plans from CFPB jurisdiction, the Bureau could issue rules for them if requested do so by Treasury and the Department of Labor in a process detailed in the measure. This could bring CFPB into the governance of 401(k) plans and other arrangements which have been subject to considerable criticism in Congress.[2]

2. *"Covered Persons"*

This is defined to cover any person providing a consumer financial product or service and any affiliated provider. Consultants and similar advisers are covered if they play a material role in consumer financial activity and independent contracts (e.g., attorneys, accountants, appraisers and

[2] See Client Reports in the 401k series.

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others) may be subject to the CFPB if they engage in knowing or reckless violation of its rules or breach a fiduciary duty. The law includes a rule of construction covering persons if the financial service they provide is "their own," clarifying the other definitions designed to exclude merchants, advertisers, telecommunications firms and similar entities.

D. Authority

The Bureau will take over responsibility from the banking agencies for consumer statutes including:

- Consumer Leasing Act;
- Electronic Funds Transfer Act provisions as cited;
- Equal Credit Opportunity Act;
- Fair Credit Reporting Act other than designated provisions;
- The general body of federal mortgage consumer-protection law as detailed in the measure;
- Consumer-protection provisions in the FDIC Act and Gramm-Leach-Bliley Act;
- Truth-in-Lending Act; and
- Truth-in-Savings Act.

In addition, the Bureau may issue rules and take other actions (other than as provided in the FTC Act) it believes are applicable to protect consumers related to financial products.

E. Powers

1. Purposes

As dictated in the law, these are:

- to promote consumer understanding of financial products;
- to protect consumers from unfair, deceptive or discriminatory practices;
- to end outdated or burdensome rules;
- to enforce federal consumer law consistently, regardless of any status as an insured depository; and
- to promote efficient and transparent markets for consumer financial products.

2. Functions

Primary CFPB functions are:

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- financial education;
- addressing consumer complaints;
- research on consumer financial-product markets to identify risk. An annual report resulting from this monitoring is required, with the report to include data on various factors (although information sent by individual institutions for these reports may be held in confidence, with rules to come on how this will be done);
- supervision of covered persons and enforcement actions; and
- issuance of rules and related actions. The law details CFPB's authority here, noting that it must indicate any dissents from prudential regulators but need not change any rules in response to them. CFPB would also need to assess all its "significant" rules every five years and seek public comment on them while doing so.

F. Regulatory Framework

In general, CFPB has exclusive authority over all the rules implementing the statutes noted above even if another agency is charged with them in advance of the transfer date or thereafter.

1. *Repeal*

The Financial Stability Oversight Council[3] could overturn any CFPB rule if it finds that a rule would put the U.S. financial system at risk. An agency on the FSOC could petition the Council to do so through a public process detailed in the law that would have to be detailed in FSOC regulations.

2. *Registration*

The CFBP could require covered persons that are not insured depositories or credit unions to register with it under terms detailed in the law. Registration and related information may be made public.

3. *Non-Bank Covered-Person Examination*

The law includes a structure for supervision of all persons engaged in residential-mortgage activity that will be assessed in a subsequent FedFin analysis focused on mortgage finance. These provisions also affect any "larger" entity involved in consumer finance if CFPB determines risk is present or if the entity offers private education or payday loans, with rules mandated to define these activities. This new examination process must be risk-based and be coordinated with federal and state prudential regulators to minimize burden.

4. *Large Institutions*

Insured depositories with assets over $10 billion and their affiliates are under the exclusive jurisdiction of CFPB for consumer-finance regulation and enforcement. However, if another federal agency recommends enforcement action and CFPB does not take it within 120 days, the other agency may

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begin action. The law includes a process in which institutions could appeal different decisions by different agencies to force a common agreement through a "governing panel" set up in the measure.

5. Smaller Entities

Although CFBP could demand reports from insured depositories with less than $10 billion in assets, the primary regulator would generally examine for compliance with CFPB regulation. CFPB could also sample examinations done by other agencies to assess them. Prudential regulators would also enforce CFPB directives for smaller entities, with the Bureau authorized to refer complaints.

G. Regulation

As noted, CFPB rules are subject to additional "regulatory flexibility" review, which focuses on small-business impact. This will require participation by the Small Business Administration in Bureau rulemakings, although the SBA has no power to block actions it opposes.

1. Mandatory Dispute Arbitration

The law mandates a study of this and gives CFPB authority to ban these contractual clauses. There is no deadline for the study, although rules could not be effective until 180 days after they are issued and they could not ban voluntary agreements for dispute arbitration.

2. UDAP

The CFPB is given authority to prescribe rules barring acts and practices that are not only unfair and deceptive – usually called UDAP – but also any that are abusive. "Unfair" may only be found if the Bureau has a reasonable basis to believe that the action could cause substantial injury that is not otherwise preventable and that this substantial injury is not outweighed by consumer or competitive benefit, taking "public policy" into consideration. The Bureau is also limited in its ability to call a product or activity "abusive," with this allowed only in cases in which a consumer's ability to understand the product has been "materially interfered" with or when "unreasonable advantage" is taken of a consumer's inability to understand a product or expect a provider to act on his or her behalf. In setting these UDAP-plus rules, the Bureau will need to consult with prudential regulators.

The law also makes it unlawful to act against these standards. Any person providing "substantial assistance" to a covered person who engages in knowing or reckless unlawful consumer-financial practices is liable to the same extent as if it were covered by the CFPB.

The FTC could enforce any of these rules against persons it regulates if desired.

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3. *Disclosures*

The Bureau may also set rules for disclosures related to consumer-financial products and services, including model forms which would need to be validated through consumer testing. Use of a model form would afford a regulatory safe harbor. Trial disclosure programs by service providers in which variations on the model form are also permitted, with a safe harbor possible in such cases and public disclosure mandated for them. Included in this section is a mandate for model forms within one year of enactment that combine TILA and RESPA requirements.

4. *Access*

Rules are required so that consumers may access information held on them in connection with consumer finance (excluding proprietary or confidential information and that related to law enforcement). The Bureau would need to consult prudential regulators and the FTC, but no deadline is set for these rules.

5. *Educational Loans*

The private-educational loan ombudsman noted above would need to consider rules for this area, provide public information on it and report to Congress.

H. Preemption

1. *General Standard*

CFPB determinations will not preempt state law unless that law is "inconsistent," and then only to the extent of that inconsistency. More stringent state laws may not be considered "inconsistent." The CFPB would make these determinations on its own or following a "non-frivolous" petition from a state attorney general (AG). A proposed rule is required when a majority of state AGs petition for preemption of a specific set of state laws, with the law prescribing considerations that generally press for preemption and require the CFPB to make clear why it upholds any preemption determinations and to make sure Congress is aware of its findings.

2. *State Enforcement Power*

Following consultation with the Bureau and applicable prudential regulators, state attorneys general could enforce its rules through civil actions on all covered persons but national banks and federal savings associations. For the latter institutions, state AGs cannot generally enforce federal consumer law, but they could do so for CFPB regulations. The Bureau must issue rules detailing this process.

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3. *National Banks*

In addition, Title X limits the ability of the OCC to preempt state law, essentially codifying the "*Barnett*" standard.[4] However, the statute includes the "significantly interfere" standard to preempt state law that, along with a mandate for case-by-case determinations on individual state laws and a requirement for a record showing "substantial evidence" supporting preemption, may well limit broad preemption decisions going forward. The OCC will also need to consult with the Bureau going forward for any preemption determinations and periodically to seek public comment on all of its preemption determinations (which are not delegable). This periodic review must be done every five years, with a public notice then made of each decision following it on all outstanding preemption determinations. A report to Congress at these times is also required. A quarterly list of all preemption decisions is also required.

While the law protects any preemption decisions on interest rates, it expressly overturns another Supreme Court case. In the *Waters* decision,[5] the Court found that OCC preemption decisions could reach to a national bank's operating subsidiaries. The law reverses this, clarifying law with particular regard to mortgages so that, going forward, state law will prevail for national bank mortgage activities conducted in op-subs or activities conducted by an agent even if upheld for the national bank itself. An additional Supreme Court case (*Cuomo*) is also reversed, giving state AGs the authority to bring suit against national banks to enforce any applicable law. Similar provisions also now apply to federal savings associations.

In a colloquy on the Senate floor as the measure was passed, Sen. Carper (D-DE) sought to emphasize that the language goes no farther than the Supreme Court in *Barnett*, but this will remain to be seen from both how the OCC acts in future and what the courts may uphold.

I. Interchange Fees

1. *Fee Limits*

The FRB must now set fees for payment cards (i.e., debit cards) that are "reasonable and proportional." Although the final language permits fraud considerations in this calculation, a colloquy on the Senate floor by the amendment's sponsor, Sen. Richard Durbin (D-IL) sought to require that this be done on a fee-by-fee basis, not across all transactions. The FRB is charged with issuing and enforcing these interchange-fee rules, with final ones due nine months after enactment that must be effective one year after

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[4] See Financial Services Regulation & Legislation, April 15, 1996.

[5] See Client Report PREEMPT25, *Financial Services Management*, April 27, 2007.

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enactment. All of the rules and power in this area would transfer to the CFPB when it is established at the transfer date (see above).

To exclude fraud-prevention costs, an issuer would need to comply with standards to come from the FRB. The FRB may also issue rules related to network fees to ensure that they do not circumvent the fee limits on debit cards.

These restrictions will not necessarily apply to cards from issuers with less than $10 billion in assets or to government-issued cards (although Sen. Durbin insisted that the latter exemption is only for government cards with no other purposes). Certain prepaid, reloadable cards are also exempt. An annual report to Congress on fees of exempted cards is required from the FRB.

2. ***Card-Use Restrictions***

The language also limits the ability of issuers and payment networks to block merchants from offering discounts or other incentives to encourage use of lower-cost payment devices or to route payments to specific providers. Rules here are due in one year from the FRB (although again CFPB takes over if it is established). Merchants could also set minimums for the acceptance of credit cards, as long as this does not differentiate between issuers or cards and the minimum does not exceed $10 (with this amount subject to increase).

3. ***Remittance Transfers***

These transactions are now subject to new disclosures on facts such as the amount of currency to be received issued by the FRB. The jurisdiction of these rules and others related to remittance transfers would, however, appear to transfer to the CFPB upon its establishment. In addition, a receipt and error-resolution statement are required. These rules would apply only to insured depositories and credit unions offering remittance services and could cease after five years. Various exceptions to the new disclosures are authorized. The Board could also issue a model disclosure form showing facts such as currency receipts for remittance transfers, but this form would be required for on-line transfers. Various studies to determine the value of these rules are required, although it does not appear that the FRB could not issue final disclosure standards if studies do not validate them. Within eighteen months of enactment, the Board could also issue rules addressing countries that do not allow reliable currency-receipt reporting, allowing transferring institutions to provide alternative disclosures.

If the sender of the transfer reports an error, then the law mandates resolution within ninety days, including return of the transferred amount. The error-resolution rules are due eighteen months after enactment. Cancellation and refund rules are also due eighteen months after enactment. These rules would apply only to electronic remittances, with transferring banks liable for failures by their agents. The FRB will need also to issue rules on agent liability.

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The FRB is also required to work with Treasury to expand the automated clearing house (ACH) and other payment systems to handle remittances and report on this to Congress one year after enactment and for ten years thereafter. The drafting here suggests that the FRB is requires to expand the ACH system to handle remittances. Bank regulatory agencies must also issue guidelines to low-cost remittances, with a study from CFPB due one year after enactment on whether remittance transfers could be favorably used in credit histories.

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