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Financial Regulatory Reform: Consumer Financial Protection Proposals

David H. Carpenter
Legislative Attorney

Mark Jickling
Specialist in Financial Economics

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Summary

In the wake of what many believe is the worst U.S. financial crisis since the Great Depression, the Obama Administration has proposed sweeping reforms of the financial services regulatory system, the broad outline of which has been encompassed in a nearly 90-page document called the Administration's White Paper (the White Paper). The White Paper seeks to meet five objectives:

(1) "Promote robust supervision and regulation of financial firms";

(2) "Establish comprehensive supervision and regulation of financial markets";

(3) "Protect consumers and investors from financial abuse";

(4) "Improve tools for managing financial crises"; and

(5) "Raise international regulatory standards and improve international cooperation."

The Administration subsequently offered specific legislative proposals that would implement each of the five objectives of the White Paper, including the Consumer Financial Protection Agency Act of 2009 (the CFPA Act or the Act). The Act would establish a new executive agency, the Consumer Financial Protection Agency (the CFPA or the Agency), to protect consumers of financial products and services. On July 8, 2009, Representative Barney Frank, Chairman of the House Financial Services Committee, introduced similar legislation, H.R. 3126, which also is entitled the CFPA Act of 2009. H.R. 3126 was marked up and ordered to be reported by both the House Financial Services Committee and the House Energy and Commerce Committee. H.R. 3126 was incorporated as Title IV of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, which passed the House by a vote of 223-202 on December 11, 2009. On May 20, 2010, the Senate also approved a comprehensive financial reform bill, S. 3217, the Restoring American Financial Stability Act of 2010 (RAFSA). (The Senate actually passed H.R. 4173 in lieu of S. 3217 for procedural purposes; however, this report will refer to the Senate-passed bill as S. 3217 in order to differentiate between the two bills.) Title X of RAFSA (the Consumer Financial Protection Act of 2010) would create a Bureau of Consumer Financial Protection within the Federal Reserve System, which would be provided similar authorities over consumer financial products and services as proposed for the CFPA by H.R. 4173, with some significant differences.

This report provides a brief summary of the Administration's CFPA Act and delineates some of the substantive differences between it and H.R. 4173, Title IV, as it passed the House, and S. 3217, Title X, as it passed the Senate. It then analyzes some of the policy implications of the proposal, focusing on the separation of safety and soundness regulation from consumer protection, financial innovation, and the scope of regulation. The report then raises some questions regarding state law preemption, sources of funding, and rulemaking procedures that the Act does not fully answer.

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Introduction

In the wake of what many believe is the worst U.S. financial crisis since the Great Depression, the Obama Administration has proposed sweeping reforms of the financial services regulatory system, the broad outline of which has been encompassed in a nearly 90-page document called the Administration's White Paper (the White Paper).[1] The White Paper seeks to meet five objectives:

> (1) "Promote robust supervision and regulation of financial firms" through the creation of an oversight council of the primary federal financial regulators; the provision of systemic risk oversight powers for the Federal Reserve; heightened prudential standards for financial firms; and increased federal oversight of institutions that are unregulated or only lightly regulated under current law;
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> (2) "Establish comprehensive supervision and regulation of financial markets" by enhancing regulation over credit rating agencies; requiring originators and issuers to retain a long-term interest in securitized loans; regulating over-the-counter (OTC) derivatives; and providing the Federal Reserve with new oversight authority of payment, settlement, and clearing systems;
>
> (3) "Protect consumers and investors from financial abuse" through the creation of a new executive agency devoted exclusively to consumer protection of financial products and services;
>
> (4) "Improve tools for managing financial crises" by establishing an insolvency regime for systemically significant financial institutions and improving the Federal Reserve's emergency lending powers; and
>
> (5) "Raise international regulatory standards and improve international cooperation" by coordinating oversight of international financial firms and other regulatory changes.[2]

The Administration subsequently offered specific legislative proposals that would implement each of the five objectives of the White Paper, including the Consumer Financial Protection Agency Act of 2009 (the CFPA Act or the Act).[3] The Act would establish a new executive agency, the Consumer Financial Protection Agency (the CFPA or the Agency), to protect consumers of financial products and services. On July 8, 2009, Representative Barney Frank, Chairman of the House Financial Services Committee, introduced similar legislation, H.R. 3126, which also is entitled the CFPA Act of 2009. H.R. 3126 was marked up and ordered to be reported by both the House Financial Services Committee and the House Energy and Commerce Committee. H.R. 3126 was incorporated as Title IV of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009, which passed the House by a vote of 223-202 on December 11, 2009. On May 20, 2010, the Senate, by a vote of 59 to 39, also approved a comprehensive financial reform bill, S. 3217, the Restoring American Financial Stability Act of 2010 (RAFSA). (The Senate actually passed H.R. 4173 in lieu of S. 3217 for procedural purposes; however, this report will refer to the

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[1] Financial Regulatory Reform, Obama Administration White Paper, June 19, 2009, available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (hereinafter, White Paper).

[2] White Paper at 3-4.

[3] Consumer Financial Protection Agency Act of 2009, June 30, 2009, available at http://www.financialstability.gov/docs/CFPA-Act.pdf (hereinafter, CFPA Act).

Senate-passed bill as S. 3217 in order to differentiate between the two bills.) Title X of RAFSA (the Consumer Financial Protection Act of 2010) would create a Bureau of Consumer Financial Protection within the Federal Reserve System, which would be provided similar authorities over consumer financial products and services as proposed for the CFPA by H.R. 4173, with some significant differences.

This report provides a brief summary of the Administration's CFPA Act and delineates some of the substantive differences between it and H.R. 4173, Title IV, as it passed the House, and S. 3217, Title X, as it passed the Senate. It then analyzes some of the policy implications of the proposal, focusing on the separation of safety and soundness regulation from consumer protection, financial innovation, and the scope of regulation. The report then raises some questions regarding state law preemption, sources of funding, and rulemaking procedures that the Act does not fully answer.

Summary of the Administration's CFPA Act

Under the Act, the CFPA would be headed by a board consisting of four members appointed by the President, subject to the advice and consent of the Senate, for five-year staggered terms and subject to removal only for cause. The board also would have one ex officio member, the Director of the National Bank Supervisor[4] (proposed in the White Paper to be a new government agency, which would be established through additional legislation, in charge of prudential regulation of all federally chartered insured depositories).[5] The Agency would be funded through appropriations and potentially through fees assessed by the CFPA against covered entities.[6]

The CFPA would be established to "seek to promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products and services" and to help ensure that consumers are able to make educated decisions regarding financial products and services; that they are "protected from abuse, unfairness, deception, and discrimination"; that markets operate efficiently and fairly; and that "traditionally underserved consumers and communities have access to financial services."[7]

To implement these goals, the CFPA would have authority over a vast array of financial activities, including deposit taking, mortgages, credit cards and other extensions of credit, investment advising to entities not subject to registration or regulation by the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC), loan servicing, check-guaranteeing, collection of consumer report data, debt collection, real estate settlement,

[4] The Administration's White Paper proposes eliminating the thrift charter and converting such entities into state or national banks, while also modifying the regulatory framework to which banks are subject. Under this proposal, the new bank regulator would be the National Bank Supervisor. Thrifts, like banks, offer federally insured consumer deposits, but thrifts, unlike banks, historically have been mission-oriented through a required focus on residential mortgages and related assets. In order to maintain this concentration, thrifts historically have been subject to limitations on the types of assets in which they can invest. *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure*, Dept. of Treasury, pp. 38-39, Mar. 2008, available at http://ustreas.gov/press/releases/reports/Blueprint.pdf.

[5] CFPA Act § 1012.

[6] CFPA Act § 1018.

[7] CFPA Act § 1021.

money transmitting, financial data processing, and others.[8] The CFPA would not have authority over most insurance activities.[9] The range of entities engaged in financial activities that would be subject to the CFPA also is expansive under the Act, including banks, credit unions, and mortgage brokers to name a few. The proposed legislation defines those covered by the Act to be

> any person who engages directly or indirectly in a financial activity, in connection with the provision of a consumer financial product or service [used primarily for personal, family, or household purposes]; or any[one who] provides a material service to, or processes a transaction on behalf of, [such] a person.[10]

The Act would establish the CFPA as the primary federal regulator for non-depository financial institutions, such as mortgage brokers, that under current law are primarily regulated at the state level and generally are not subject to the type of prudential and compliance regulation and oversight of their depository counterparts. This potentially would significantly increase the federal supervision of these entities.

The Act also would consolidate in the CFPA consumer protection regulatory and enforcement authority, which is currently shared by a number of federal agencies. The Act would transfer to the CFPA the "consumer financial protection functions"[11] and many of the employees performing those functions from the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission (FTC), and the National Credit Union Administration (NCUA).[12] However, according to the guidelines of the White Paper, these agencies, with the exception of the OTS,[13] would retain safety and soundness supervisory and examination powers outside the purview of consumer protection over certain regulated entities.[14]

The CFPA would be the primary federal regulator, examiner, and rulemaker[15] with enforcement authority under many of the federal consumer protection laws, including the Equal Credit Opportunity Act;[16] the Fair Credit Reporting Act[17] (except with respect to sections 615(e), 624, and 628[18]); the Home Mortgage Disclosure Act;[19] the Home Ownership and Equity Protection

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[8] See definition of "financial activity," CFPA Act § 1002(18).

[9] See definition of "financial activity," CFPA Act § 1002(18).

[10] CFPA Act § 1002(9).

[11] The CFPA Act defines "consumer financial protection functions" as "research, rulemaking, issuance of orders or guidance, supervision, examination, and enforcement activities, powers, and duties relating to the provision of consumer financial products or services, including the authority to assess and collect fees for these purposes." CFPA Act § 1061(d).

[12] CFPA Act §§ 1061-1066.

[13] See *supra* FN 4.

[14] White Paper at 19-42. The White Paper does propose changes with regards to who regulates whom and the scope of supervision. For a detailed discussion of the current regulatory system, see CRS Report R40249, *Who Regulates Whom? An Overview of U.S. Financial Supervision,* by Mark Jickling and Edward V. Murphy.

[15] CFPA Act § 1022.

[16] 15 U.S.C. §§ 1691 *et seq*.

[17] 15 U.S.C. §§ 1681 *et seq*.

[18] 15 U.S.C. §§ 1681m(e), 1681s-3, 1681w. These provisions primarily pertain to "red flag" identity theft prevention measures for federal financial institutions, the use of credit report information among affiliates to market and solicit consumers, and credit report record retention by federal financial institutions.

Act;[20] the Real Estate Settlement Procedures Act (RESPA);[21] the S.A.F.E. Mortgage Licensing Act;[22] the Truth in Lending Act (TILA);[23] and the Truth in Savings Act, among others.[24]

The CFPA would be required to monitor the market and the innovation of new products and services. In order to do so, the Act would provide the Agency the authority to examine covered persons, including national banks, federal credit unions, and federal thrifts.[25] Under current law, examination powers generally rest exclusively in the institutions' primary federal regulators, if the institutions have a federal prudential regulator.

Rather than explicitly imposing new substantive regulation on financial activities and products, the Act primarily (though, not exclusively[26]) leaves such decisions to be made by the CFPA through future rulemaking and guidance. The Agency would have the authority to promulgate rules and issue guidance and orders to meet the objectives of the CFPA Act.[27] The standard rulemaking procedures provided by the Act would require the Agency to weigh the costs and benefits to both consumers and industry, including the potential effect the rule would have on the availability of financial products and services.[28] The Agency also would have to "consult with the Federal banking agencies ... regarding the consistency of a proposed rule with prudential, market, or systemic objectives administered by such agencies."[29] Within three years[30] of any CFPA "significant rule or order" becoming effective and after a public comment period, the Agency must publish a report assessing the effectiveness of the rule or order.[31] The Act does not specify what would be considered "significant," presumably leaving these determinations to the Agency.

The Act imposes additional procedures upon specific types of rulemaking, including for disclosure requirements;[32] minimum standards for the prevention and detection of "unfair, deceptive, abusive, fraudulent, or illegal transactions";[33] provision of "standard consumer financial products or services" (a.k.a. "plain-vanilla" products and services) that may serve as a

(...continued)

[19] 12 U.S.C. §§ 2801 *et seq*.

[20] 15 U.S.C. § 1639.

[21] 12 U.S.C. §§ 2601-2610.

[22] 12 U.S.C. §§ 5101-5116.

[23] 15 U.S.C. §§ 1601 *et seq*.

[24] 12 U.S.C. §§ 4301 *et seq*.

[25] CFPA Act §§ 1022(c) and 1024.

[26] However, the Act would impose some substantive regulations. For example, the Act would require disclosure of new data points under the Home Mortgage Disclosure Act. CFPA Act § 1086(f).

[27] CFPA Act § 1022(a). The CFPA would be expressly prohibited from setting a usury cap without specific authorization by law. CFPA Act § 1022(g). The Act specifically provides the Agency the authority to prohibit or limit arbitration clauses. CFPA Act § 1025.

[28] CFPA Act § 1022(b).

[29] CFPA Act § 1022(b).

[30] The Agency may delay the report for up to five years after the effective date if it determines that three years is not enough time to adequately review the rule. CFPA Act § 1024.

[31] CFPA Act § 1024.

[32] CFPA Act §§ 1032 and 1034.

[33] CFPA Act § 1035.

comparison to similar, but less traditional products or services;[34] and imposition of duties, including compensation practices, on covered persons.[35]

All of these steps and restrictions exceed the normal notice and comment procedures of the Administrative Procedure Act, which generally apply to agency rulemaking.[36]

With regard to preemption of state laws, the preemption language of the "enumerated consumer laws" largely would remain unchanged by the CFPA Act.[37] However, for matters unrelated to enumerated consumer laws that include provisions explicitly delineating how such federal laws shall interact with state laws,[38] the Act would *not* preempt state consumer protection laws and regulations that provide greater protections to consumers, but would preempt otherwise conflicting state laws. The CFPA largely would decide whether or not particular state laws conflict with the Act,[39] with specific decisions subject to judicial review.[40] Any generally applicable state consumer law would apply to national banks and thrifts unless it discriminates against them (presumably to the benefit of state-chartered financial institutions) or conflicts with the Act.[41] Additionally, any state consumer law regulating state banks or thrifts that was enacted in compliance with federal law also would apply to national banks and thrifts unless it discriminates against the federally chartered institutions or conflicts with the CFPA Act.[42] Depending on how they are interpreted by the Agency and the courts, these provisions could result in a departure from current federal banking law, which the OCC and other banking regulators interpret as preempting many state consumer laws.[43]

The CFPA would be provided the authority to enforce the requirements of the CFPA Act and the enumerated consumer laws, as well as the rules and regulations promulgated under the authority of those laws.[44] State attorneys general also would be given authority to enforce the CFPA Act and its regulations on behalf of residents of their state; however, before doing so, state attorneys general, under most circumstances, would have to provide advance notice to the CFPA, and the

[34] CFPA Act § 1036.

[35] CFPA Act § 1037. The Agency would only be able to enforce violations of duties prescribed under the authority of § 1037 in accordance with an adjudicatory proceeding described in great detail in §§ 1051-1058 of the Act. CFPA Act § 1037.

[36] 5 U.S.C. § 553. See, also, CRS Report RL32240, *The Federal Rulemaking Process: An Overview*, by Curtis W. Copeland.

[37] CFPA Act § 1041(b) (The one exception is with regard to the preemption language of the Alternative Mortgage Transaction Parity Act).

[38] For example, 15 U.S.C. § 1610 of the Truth in Lending Act states in part: "Except as provided in subsection (e) of this section, this part and parts B and C of this subchapter, do not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency."

[39] CFPA Act § 1041.

[40] For a description of judicial review of statutory interpretation by agencies, see CRS Report R40595, *Cuomo v. The Clearing House Association, L.L.C: National Banks Are Subject to State Lawsuits to Enforce Non-Preempted State Laws*, by M. Maureen Murphy.

[41] CFPA Act §§ 1043(b)-(c) and 1046(b)-(c).

[42] CFPA Act §§ 1042(d) and 1046(d).

[43] See, e.g., 12 C.F.R. §§ 7.4000 *et seq.* and Part 34. See, also, CRS Report RL32197, *Preemption of State Law for National Banks and Their Subsidiaries by the Office of the Comptroller of the Currency*, by M. Maureen Murphy.

[44] CFPA Act § 1022.

Agency would have the authority to intervene in the civil action. The Act would not alter the authority (or lack thereof) of state attorneys general to enforce the enumerated consumer laws.[45]

H.R. 4173, as It Passed the House

There are a number of substantive differences between the Obama Administration Proposal and H.R. 4173, as it passed the House on December 11, 2009.

Organizational Structure

H.R. 4173 would establish an agency structure wholly different from that of the Obama Administration Proposal. Under H.R. 4173 virtually all of the CFPA's powers initially would be held by a director. However, the director's powers would be transferred to a five-member commission three and one-half years after the bill's enactment (called the "Agency conversion date"[46]). The initial director would be a Presidential appointee, subject to the advice and consent of the Senate, who would serve until the Agency conversion date, during which time s/he could only be removed for cause.[47] Prior to confirmation by the Senate, the President's nominee to become director would hold all of the powers of the director.

After the Agency conversion date, the CFPA would be operated through a five-member commission. Each member would be appointed by the President, subject to the advice and consent of the Senate, for staggered terms, and could only be removed for "inefficiency, neglect of duty, or malfeasance in office." The bill also would prohibit more than three of the five members from being affiliated with the same political party.[48]

The bill also would create a Consumer Financial Protection Oversight Board, composed of most of the other federal financial regulators, the Secretary of Housing and Urban Development, and a representative of state financial regulators, to offer the CFPA director advice. This oversight board would not have any substantive authority over the Agency.[49]

Covered Entities and Activities

H.R. 4173, as it passed the House, would exempt, to a certain degree, a number of entities from the Agency's "rulemaking, supervisory, enforcement or other authority, including authority to order assessments." These exempted entities include retailers, merchants, and sellers of non-financial goods when extending credit (or collecting a debt from such extension of credit) for the purchase of a good or service directly to a consumer but only to the extent "in which the good or service being provided is not itself a consumer financial product or service." The CFPA would have the authority to implement rulemaking affecting these extensions of credit or debt collection

[45] CFPA Act § 1042.

[46] H.R. 4173 § 4002(38) defines "Agency conversion date" as "the date that is 2 years after the designated transfer date." H.R. 4173 § 4602 states that "the designated transfer date shall be 180 days after the date of enactment of this title."

[47] H.R. 4173 § 4101.

[48] H.R. 4173 § 4103.

[49] H.R. 4173 § 4104.

practices as provided by existing powers that the bill would transfer from another regulator to the CFPA or an enumerated consumer law, such as the Truth in Lending Act or the Debt Collection Practices Act. The bill would provide other limitations to these exemptions, for instance if the seller, merchant, or retailer provides an extension of credit that "significantly exceeds the fair market value of the product or service provided."[50]

H.R. 4173 also would provide certain exceptions from the CFPA's reach for state-regulated insurers; companies registered with the SEC and CFTC; entities regulated by the Farm Credit Administration; the Federal Home Loan Banks;[51] accountants; tax preparers; real estate brokers and agents; automobile dealers; manufactured and mobile home retailers; attorneys; pawnbrokers; and others.[52]

Examination and Enforcement Powers

The primary examination and enforcement powers for consumer compliance issues over banks and credit unions with $10 billion or less in assets would remain with those institutions' safety and soundness regulator, rather than being transferred to the CFPA. However, the bill would provide a procedure by which the CFPA could (1) participate in the examination process conducted by the primary regulator and (2) assume the enforcement and examination powers over any smaller depository institutions that have not been adequately supervised by a prudential regulator. The CFPA generally would not have the authority to impose assessments on these smaller banks and credit unions to cover *examination* costs.[53] The Agency may have the authority to order assessments on these smaller institutions to cover other supervisory costs. The bill also would provide an avenue by which the CFPA could delegate its examination (but not its enforcement) authority over larger depository institutions to those institutions' prudential regulator.[54]

For those covered entities that the CFPA does have primary examination and enforcement powers for consumer compliance issues, the Agency generally would have to coordinate its compliance examinations to occur along with the safety and soundness examinations of the prudential regulators.[55]

[50] H.R. 4173 § 4205.

[51] This exemption is actually for "a person regulated by the Federal Housing Finance Agency," which the bill defines as "any Federal home loan banks, and any joint office of 1 or more Federal home loan banks." This exemption language does not seem to cover the government sponsored enterprises Fannie Mae and Freddie Mac, which also are primarily regulated by the Federal Housing Finance Agency. However, it is unclear to what extent Fannie Mae and Freddie Mac engage in consumer financial products and services that generally fall under the CFPA's jurisdiction. Additionally, Fannie Mae and Freddie Mac may meet an exemption from the CFPA based on the fact that they each register with and are, to some extent, regulated by the SEC.

[52] H.R. 4173 § 4205.

[53] The bill would not prohibit a *prudential* regulator from assessing a smaller depository institution for examination costs.

[54] H.R. 4173 §§ 4202-4203.

[55] H.R. 4173 § 4202.

Funding and Assessments

H.R. 4173 would require 10% of the Federal Reserve System's total expenses to be transferred to the CFPA to implement the authorities provided by the bill. This percentage would roughly account for the compliance and supervisory costs of implementing the authorities transferred from the Federal Reserve to the CFPA. The CFPA also would have the authority to assess fees on covered entities "to meet the Agency's expenses for carrying out the duties and responsibilities of the Agency," subject to the limitations on assessing banks and credit unions holding $10 billion or less in assets (as described above in the "Examination and Enforcement Powers" subsection). However, the Agency would have to keep the fees brought in from depository institutions (i.e., banks, thrifts, and credit unions) and non-depositories separate, and ensure that the fees assessed against depositories are not used for the examination and compliance of non-depositories. The bill also would provide protections for smaller institutions, including that they would not be assessed disproportionately as compared to larger institutions. Finally, H.R. 4173 authorizes $200 million in appropriations for each of the next five fiscal years.[56]

Specific Authorities

Under H.R. 4173, as it passed the House, the CFPA would not have the authority to promulgate regulations concerning the provision of "standard consumer financial products or services" that may serve as a comparison to similar, but less traditional products or services (a.k.a. "plain-vanilla" products and services), as would have been allowed under the Obama Administration's Proposal.[57]

Preemption

H.R. 4173, as it passed the House, also would impose a different preemption standard from the Obama Administration's proposal. From a general standpoint, H.R. 4173 would only preempt state consumer financial protection laws to the extent of their inconsistency, where state laws providing greater consumer protection are not to be considered inconsistent with federal law. Aside from changes the bill would make to the Alternative Mortgage Transaction Parity Act of 1982, H.R. 4173 would not alter the preemption provisions of the existing enumerated consumer protection laws.[58]

In addition to these more general preemption principles, H.R. 4173 would establish preemption standards specific to depository institutions. Under H.R. 4173, as it passed the House, consumer financial protection laws as they apply to national banks and thrifts would be preempted only if:

> (1) the state laws would have a discriminatory effect on national depositories as compared to state depositories;

[56] H.R. 4173 § 4111.

[57] H.R. 4173 § 4311.

[58] H.R. 4173 § 4401. Changes that would be made to the Alternative Mortgage Transaction Parity Act of 1982 can be found at H.R. 4173 § 4803.

(2) the OCC, OTS, or a court determines by regulation or order that the state law "prevents, significantly interferes with, or materially impairs the ability of [such] an institution to engage in the business of banking"; or

(3) the state law is preempted by another federal law.[59]

The bill would establish standards that the OCC, OTS, and courts would have to follow when making case-by-case preemption decisions. H.R. 4173 would not effect the applicability of state laws as they apply to the non-depository subsidiaries or affiliates of federally chartered banks or thrifts.[60]

S. 3217, as It passed the Senate

S. 3217 would create a Bureau of Consumer Financial Protection (Bureau), which would have similar authorities as H.R. 4173's CFPA; however, there are a number of notable differences between the two proposals.

For one, the Bureau would be headed by a director that is appointed by the President, subject to the advice and consent of the Senate.[61] S. 3217 would not eventually transfer the powers of the director to a commission, like H.R. 4173 provides.

Also, rather than creating a new, free-standing regulatory agency like in H.R. 4173, the Bureau would be established within the Federal Reserve System. As such, the Bureau would be somewhat less autonomous than H.R. 4173's CFPA. For instance, S. 3217 allows, but does not require, the Federal Reserve Board to "delegate to the Bureau the authorities to examine persons subject to the jurisdiction of the [Board] for compliance with the Federal consumer financial laws." However, the Federal Reserve Board would not have the formal authority to stop, delay, or disapprove of a Bureau regulation, nor could it

> (A) intervene in any matter or proceeding before the Director, including examinations or enforcement actions, unless otherwise specifically provided by law;
> (B) appoint, direct, or remove any officer or employee of the Bureau; or
> (C) merge or consolidate the Bureau, or any of the functions or responsibilities of the Bureau, with any division or office of the Board of Governors or the Federal reserve banks.[62]

The Bureau would be funded "from the combined earnings of the Federal Reserve System [in an] amount determined by the Director to be reasonably necessary to carry out the authorities of the Bureau" subject to a specified cap.[63] However, the Bureau would not have the authority to order assessments on covered entities for general funding purposes, as proposed by H.R. 4173's CFPA.

[59] H.R. 4173 §§ 4404 [regarding national banks] and 4407 [regarding federal thrifts].

[60] H.R. 4173 §§ 4406 [regarding national banks] and 4409 [regarding federal thrifts].

[61] S. 3217 § 1012.

[62] S. 3217 § 1012.

[63] S. 3217 § 1017. The cap would be 10% for FY2011, 11% for FY2012, and 12% thereafter. The cap also would be adjusted for inflation.

Another distinction between S. 3217's Bureau and H.R. 4173's CFPA is that the Financial Stability Oversight Council, which would be established by the Senate bill and mainly composed of the federal financial regulators, would have the ability to set aside or stay a regulation prescribed by the Bureau if the regulation "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." These powers would be in addition to the Financial Stability Oversight Council's authority to settle jurisdictional disputes among the federal financial regulators.[64]

The Senate bill also would impose limitations on the ability of the Bureau to examine and supervise non-depository institutions. The Bureau would only have authority to directly examine and supervise non-depository institutions that are engaged in consumer mortgage related activities (i.e., mortgage origination, brokerage, or servicing activities, mortgage modification or foreclosure relief activities) and non-mortgage related consumer financial entities that are "larger participant[s] in a market" as determined by the Bureau in regulations and after consultation with the FTC. Even for a company that falls into one of these categories (a "covered non-depository"), the Bureau would have to rely on existing reports required by prudential regulators "to the fullest extent possible" and would have to coordinate examinations with the company's (state or federal) primary regulator.[65] These conditions could significantly limit the Bureau's ability to effectively supervise even covered non-depositories, but especially those not covered by § 1024. Supervisory and enforcement actions over non-depositories that are not covered under § 1024 largely would be limited to the Bureau's civil investigative powers as proposed under Subtitle E of the bill.

The Senate bill, much like the House bill, treats larger depository institutions differently than smaller depository institutions. Under the Senate bill, the Bureau would have the authority to examine depository institutions holding more than $10 billion in assets and would serve as the primary enforcer of consumer protection laws over such institutions.[66] The enforcement powers over banks and credit unions with $10 billion or less in assets (smaller depository institutions) would remain in those institutions' primary prudential regulators. The Senate bill does not provide a process by which the Bureau could acquire enforcement powers over these institutions, like the House bill proposes. However, the Bureau, "on a sampling basis," could participate in examinations of these smaller depository institutions that are conducted by the prudential regulator. The bill would establish a procedure by which the Bureau could refer potential enforcement actions against smaller depository institutions to their prudential regulators. The Bureau generally would have access to examination reports prepared by prudential regulators of these smaller depository institutions and would have the authority to require reports directly from these depositories, although the Bureau would have to rely on existing reports "to the fullest extent possible."[67]

In a related matter, the Senate bill generally would allow state attorneys general to enforce S. 3217 Title X and any regulations prescribed by the Bureau under the title. However, the bill would provide special provisions regarding the ability of state attorneys general to bring enforcement actions against national banks and federal thrifts. State attorneys general would be permitted to raise claims against national banks and federal thrifts "*to enforce a regulation prescribed by the Bureau under a provision of this title* and to secure remedies under provisions

[64] S. 3217 § 1023.

[65] S. 3217 § 1024.

[66] S. 3217 § 1025.

[67] S. 3217 § 1026.

of this title or remedies otherwise provided under other law." The bill would prohibit state attorneys general from "bring[ing] a civil action in the name of such State against a national bank or Federal savings association *with respect to an act or omission that would be a violation of a provision of this title*."[68] These limitations do not explicitly apply to state chartered depository institutions.

The boundaries of these provisions (i.e., the lines between "an act or omission ... of this title" and enforcement of "a regulation prescribed by the Bureau under a provision of this title") are unclear. It also is unclear how a court would interpret these provisions in connection with restrictions on the Bureau's ability to enforce consumer financial laws and regulations against smaller depository institutions. S. 3217 § 1026 states: "Except for requiring reports under subsection (b), the prudential regulator shall have exclusive authority to enforce compliance with respect to [such a smaller depository institution.]" Section 1026 could be interpreted as an additional restriction on the ability of state attorneys general to bring enforcement actions, in this case, against all (state or federally chartered) depositories that hold $10 billion or less in assets.

S. 3217 would not alter the authority (or lack thereof) of state attorneys general to enforce the enumerated consumer laws.[69]

While the Senate bill provides various levels of exemptions from the Bureau's jurisdiction for many of the same entities as those proposed by H.R. 4173 (e.g., insurance companies and entities regulated by the SEC), the language that would establish some of those exemptions is not the same in both bills. For instance, S. 3217's language that would exempt merchants, retailers, and sellers of nonfinancial consumer goods is markedly different from that of the House bill. Also, S. 3217 does not provide a specific exemption for auto dealers;[70] however, the Senate did approve, by a vote of 60-30, a non-binding Vote to Instruct Conferees to include the House-passed exemption for auto dealers in the final conference report.[71]

Would the CFPA Be an Improvement?

The Administration's White Paper argues that the CFPA is necessary because recent events in financial markets have exposed the inadequacy of the current regulatory framework. As an example, the White Paper cites overly complicated, nontraditional mortgages that were unsuitable for the many borrowers who lost their homes to foreclosure.[72] By creating an agency dedicated exclusively to consumer protection, supporters hope to raise standards for financial intermediaries and ultimately foster a culture of consumer protection within financial firms. In the White Paper's analysis, the imperative to protect consumers was simply overwhelmed by profit considerations—by its very existence, the CFPA is intended to right the balance.[73]

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[68] S. 3217 § 1042 (emphasis added).

[69] S. 3217 § 1042.

[70] S. 3217 § 1027.

[71] Cong. Record, Vote No. 163, pp. S4130-36, 38, May, 24, 2010.

[72] White Paper at 55.

[73] White Paper at 57.

There are benefits to having a single agency in charge of virtually all consumer financial products and services and consumer protection laws. But there are also costs, which may fall either on regulated financial institutions or on consumers. These costs may have been the driving force for some of the changes to the Obama Administration's proposal that were made by the House and Senate bills. Still, these CFPA proposals raise a number of possible issues about the structure and purposes of regulation.

Redundancy

The powers that the CFPA would be provided over banks, thrifts, and credit unions, are primarily derived from federal banking statutes. This raises the objection that the existing federal bank regulators already have full authority to do what the new agency would do. What would prevent failures in regulation from being addressed within the existing structure?

One can argue that there is a conflict between safety and soundness regulation and consumer protection. When a banking activity is profitable, regulators tend to look upon it favorably, since it enables the bank to meet capital requirements and withstand financial shocks. According to the White Paper, professional bank examiners are trained "to see the world through the lenses of institutions and markets, not consumers."[74] This conflict may be especially sharp in consumer lending.

Over the past several decades, banks and other financial institutions have expanded the scale and scope of their consumer lending programs. Partly driven by competition from the securities industry (which has largely supplanted banks as a source of funds for large corporations) and other non-depository financial institutions that are primarily regulated by the states, and partly by the availability of computerized credit scoring models (which dramatically reduce the cost of evaluating borrowers' creditworthiness), mainstream lenders have made credit available to consumers who not long ago would have been viewed as too risky and unqualified.[75]

Credit card and subprime mortgage lending are perhaps the most visible results of this trend. On the one hand, they represent a great expansion in the availability of credit and have allowed many consumers to raise their standard of living. On the other hand, both have been criticized for high costs to borrowers, hidden fees, and/or excessive complexity, to the extent that lending practices have been described as unscrupulous and abusive.

Have the traditional bank regulators been too slow to detect potentially harmful features of new sources of banking profits? Could a consumer agency, that potentially would not have the same level of oversight of, or expertise in bank finances as that of the bank examiners, do a better job of identifying emerging problems in new consumer finance markets?

While the federal banking regulators already have many of the same enforcement, oversight, and rulemaking authority over banks, thrifts, and their affiliates, financial institutions that are not affiliated with depository institutions are not subject to the same degree of regulatory oversight at the federal level. Would providing the CFPA broad regulatory authority over these primarily state-regulated non-depositories reduce abuses by these institutions? Would reducing the disparity in

[74] White Paper at 56.

[75] Darryl E. Getter, "Consumer Credit Risk and Pricing," *Journal of Consumer Affairs*, vol. 40, Summer 2006, p. 41.

the regulatory burdens between depositories and non-depository financial institutions, as proposed by the CFPA Acts, improve both safety and soundness standards and consumer protection compliance for depositories and non-depositories alike?

Financial Innovation

An argument against the CFPA is that it could stifle financial innovation. Innovative practices are by definition less well understood than traditional ones,[76] and financial institutions tend to earn higher margins on successful new products, at least until their competitors enter the market and compete away excess profits. Both factors might appear problematic to a consumer protection regulator, though not necessarily to a safety and soundness regulator. Opponents of the CFPA might argue that this attitude could lead to the creation of barriers and hurdles—perhaps in the form of slow approval of disclosure forms—to the introduction of new products.

The debate over strengthened consumer protection, in other words, involves the age-old question of how much government intervention into markets is warranted: should consumers be protected from their mistakes, or trusted to make decisions that will enhance individual and common welfare? The issue of financial innovation can be framed similarly: is development of new and/or exotic financial products to be encouraged, or are they potentially troublesome if they gain wide currency before the risks are fully understood by regulators and market participants?

Jurisdiction

Under the Obama Administration's Proposal and H.R. 4173, the SEC and CFTC generally would retain their consumer protection role in securities and derivatives markets.[77] This could be viewed as a flaw, which would preserve the existing fragmented federal regulatory structure. The banking and securities industries have for years offered products that compete with each other—money market funds, brokerage checking accounts, investment advice through bank trust departments, etc.—and issues of overly complex products, inadequate disclosure, conflicts of interest, and the extent of fiduciary duties are common to both.

Since the onset of the financial crisis, households' losses in real estate have been exceeded by their losses in securities investments.[78] Not all those losses resulted from fraud or regulatory failure, but the SEC's recent record is not notably better than the bank regulators'. The logic of creating a single agency exclusively concerned with consumer financial protection, and excluding securities (and futures[79]) may not be apparent to some market participants.

For comparison, the Financial Services Authority in the United Kingdom has consumer protection powers over all financial industries, including banking, securities, derivatives, and insurance. Its objectives, as posted on its website, appear to mirror those of the proposed CFPA. The Financial Services and Markets Act gives the FSA four statutory objectives:

[76] This is the case for all financial products, not just those designed for consumers.

[77] The White Paper does recommend certain enhancements to the SEC's authority: see, e.g., p. 70.

[78] Between the end of 2006 and the first quarter of 2009, households lost $4.01 trillion of the value of their real estate holdings, while the value of corporate stock and mutual funds held by households (and non-profits) fell by $5.10 trillion. Federal Reserve, Flow of Funds Accounts, Table B. 100.

[79] Although relatively few individuals trade in derivatives markets.

- Market confidence: maintaining confidence in the financial system;
- Public awareness: promoting public understanding of the financial system;
- Consumer protection: securing the appropriate degree of protection for consumers; and
- The reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.[80]

Is there a different regulatory structure, where jurisdiction is split differently among multiple regulators, that could lead to a greater balance of the regulatory costs and benefits? Are there other products and services that should be excepted from or added to the CFPA's jurisdiction?

Questions Left Unanswered

Preemption

Both H.R. 4173 and S. 3217 would provide the CFPA a fair amount of flexibility in deciding whether or not federal laws preempt state consumer financial protection laws, especially as they apply to non-depositories. The bill provides similar flexibility to the OCC to make preemption decisions as they apply to federally chartered banks and thrifts. If a bill is enacted, how well will the CFPA and the banking regulators work together? How narrowly or broadly would these agencies and the courts interpret potential conflicts between state and federal law? If interpreted narrowly, then the bill's preemption language could have a detrimental effect on institutions that provide consumer financial products and services in multiple states because they could be working within multiple regulatory regimes, increasing administrative costs that, in part, likely would be passed on to consumers.[81] If these agencies interpret conflicts broadly, then interstate actors may only have a single set of rules to follow, but consumers may not be as fully protected from predatory products, services, and practices as they would be otherwise.

Rulemaking

Are the Act's rulemaking procedures appropriately drawn? As previously mentioned, agency rulemaking generally requires public notice of proposed rulemaking and a period for public comment on the matter. The Act would require steps in addition to notice and comment. For instance, the CFPA would have to make findings regarding the costs of potential rules on both industry and consumers. Additionally, the Agency would have to review any significant rule within three to five years after its effective date. The Act would impose other restrictions on rulemaking, as well. If rulemaking procedures are too easily met, then the Agency could go too far, promulgating rules that have a deleterious effect on consumers' access to credit and on industry's profitability. If procedures are so restrictive that the Agency is unable to promulgate rules in a timely fashion, consumers could be harmed by otherwise preventable predatory products and practices, which also could lead to long-term harm to industry.

[80] http://www.fsa.gov.uk/Pages/about/aims/statutory/index.shtml.

[81] This potentially could put entities acting only within a single state at a competitive advantage over interstate actors.

Author Contact Information

David H. Carpenter
Legislative Attorney
dcarpenter@crs.loc.gov, 7-9118

Mark Jickling
Specialist in Financial Economics
mjickling@crs.loc.gov, 7-7784