

**Funding and Staffing**  
**the New Consumer Financial Protection Agency**

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## **Funding and Staffing the New Consumer Financial Protection Agency**

The Obama Administration's proposal for the creation of the Consumer Financial Protection Agency (CFPA) recommends a funding strategy that would include appropriations, new fees, and the movement of staff involved in consumer protection from the four federal bank regulatory agencies to the new agency. To understand how this funding mechanism may fit into the current and existing bank oversight structure, it is useful to consider how federal agencies are currently funded and staffed and how states may manage new burdens associated with the addition of a separate consumer protection regulatory structure.

Such an analysis also reveals that activities at the agencies are interlinked. Unwinding and splitting the task of consumer regulation – both financially and physically – is not as simple as moving some staff to new offices and transferring the funding that supports them. First, the intertwined relationships between safety and soundness and consumer protection means that few, if any, agency staff dedicate 100 percent of their time to consumer protection (or vice versa). Second, any staff that can be identified as fully focused on consumer protection is supported by myriad additional staff that provide support and are also not 100 percent focused on consumer protection – research, human resources, executive staff, legal, information technology, etc. – but must be recreated in a new agency.

In addition, the Agency will face many operational challenges. The examination of *all providers* of consumer financial products for compliance purposes would be labor-intensive as it would require site visits. It is unlikely that the transfer of staff from various federal agencies would be sufficient to ensure compliance with consumer laws, particularly for non-banks, which have had no on-site exams and little formal regulation. Therefore, this agency will have to significantly expand its staffing resources beyond that of the current agencies as it oversees the many products currently under state jurisdiction.

The financial resources needed by the proposed CFPA are significant. This recreation and doubling of efforts must be funded, as current funding sources cannot cover the additional staffing that will be required. The Administration's proposal envisions funding these efforts through fees, which will impose additional costs on state chartered banks and thrifts. However, since staff must be increased to accomplish the goals of the new agency that is envisioned, and since neither the FDIC nor the Federal Reserve funds their examinations through assessments, the costs will be greater. This paper details how the funding needs for a new federal agency may be met and the implications for banks of all sizes.

### **I. Structure of the U.S. Banking System**

The hallmark of the U.S. banking system is its dual chartering, with parallel state and federal systems in coexistence. In place since 1819, the dual banking system provides a layer of federal oversight to all banking institutions, even those which are state chartered. Funding of this oversight is

complicated and costly already, but promises to become more so with the addition of a new agency that separates out consumer protection and brings additional examinations.

The burden of this funding will likely fall on the smaller, state chartered institutions, particularly community banks. These banks currently receive primary oversight from their state regulator and pay for this oversight with fees and/or assessments to this state regulator. In addition, the FDIC or the Federal Reserve have a duty to ascertain the health of the state chartered institution, and do so by reviewing the state exams and by conducting their own on-site exam on a biannual basis. ***State chartered institutions do not pay any exam fees or assessments to these Federal agencies for this oversight.*** These federal agencies, who oversee the state chartered banks, are funded by other means, discussed later in this paper. Since the new consumer regulator is to be funded by fees and assessments, and since the proposal envisions a new Federal agency that does on-site examinations on its own – rather than use the existing exam structure – it is inevitable that state chartered institutions will pay more fees. Moreover, the Administration’s proposal will permit states to create more stringent regulation which would require even more regulatory oversight, including longer and more costly examinations. Further fees could be required by states to cover the cost of carrying out this responsibility.

## **II. Funding for Federal Banking Agencies**

Unlike most government agencies, the four federal bank regulatory agencies do not receive an annual appropriation from Congress; instead they generate their operating budgets from program-driven revenues. The federal banking agencies are fully funded by the banking industry – ***not by taxpayer revenues.*** The tasks these agencies carry out – many of them behind-the-scenes in support of the examination process – are focused on the effective supervision of traditional banks. As Comptroller of the Currency John Dugan pointed out in a recent letter, this supervision necessarily involves the analysis and understanding of consumer protection issues:

Effective supervision of retail banking activities today requires a sophisticated assessment of the bank’s policies, operations, and controls, and of the long-term effect of those policies, operations, and controls on the bank’s reputation, customer relationships, legal exposure, and earnings. Our examiners evaluate consumer protection as a part of that ongoing supervisory process, since it is an integral part of the bank’s condition.

Consumer protection will still be an integral part of the bank’s condition if a separate consumer regulator is put in place.

***Federal Reserve:*** The Federal Reserve regulates all state-chartered banks that are members of the Federal Reserve. It does not earn revenue from assessments, but receives income from its exercise of monetary policy and from payment system services provided to banks. The purchasing, holding

and selling of government securities represents over two-thirds of the agency's revenue, while other traditional Federal Reserve activities, such as holding foreign currencies and payment systems administration, are roughly seven percent of revenue. The remaining quarter of current revenues come from the new lending and liquidity facilities that the Federal Reserve has implemented.

These resources cover all of the examination and supervisory responsibilities of the Federal Reserve, including the supervision of state chartered institutions, thus state chartered member institutions are not charged additional fees for the supervision provided by the Federal Reserve. The supervisory functions include the analysis of any issue which could affect the bank, including consumer protection, which is not split out as a separate part of the supervisory process.

***Office of the Comptroller of the Currency:*** The OCC regulates all national banks. This agency generates over 90 percent of its revenue through assessments, fees and other income generated from the supervision of its regulated banks. The remainder – less than 5 percent – comes from interest earned on investments. These funds support a holistic supervisory process and, as Comptroller Dugan said, “if Congress were to enact legislation transferring the OCC’s supervision, examination, and enforcement functions with respect to consumer protection to the CFPA, there would be only a limited number of OCC staff who could be identified solely with consumer protection functions that would be transferred to the CFPA.”

***Office of Thrift Supervision:*** The OTS regulates all federal and state chartered thrifts. Like the OCC, the OTS generates over 90 percent of its revenue through assessments, fees and other income. State and federally chartered thrifts do pay an examination fee to the OTS.

***Federal Deposit Insurance Corporation:*** The primary source of revenue for the FDIC is from insurance premium assessments paid by all banks. As these balances are invested in Treasury securities, the FDIC also earns significant interest income on accumulated funds. Over the last two decades, 61 percent of the FDIC’s revenues have come from assessments and the rest has come from the Treasury portfolio. The FDIC does not assess examination fees.

The revenues from premiums support the entire regulatory and supervisory activities of the FDIC, including the examination of state chartered banks who are not members of the Federal Reserve. The FDIC evaluates and provides back-up supervision to all banks as a part of its provision of deposit insurance.

### **III. State Banking Agencies as the First Line of Defense**

The state banking agencies derive much of their revenue from depository institutions. Of the 50 state banking departments, 30 generate more than half of their revenue from assessments on insured depository institutions. Eight states earned more than half their revenue from state-licensed mortgage brokers or securities brokers.

The Administration's proposal envisions that states will become much more active in consumer protection issues. Indeed, the administration's white paper calls states a "first line of defense" for consumer protection. As such, the Administration proposes to eliminate federal preemption of state consumer protection laws. Instead, federal rules issued by the Agency would override "weaker" state laws, although states are free to adopt "stricter" laws. If a state adopts stricter laws, the state would also have concurrent authority to enforce the Agency's regulations. In order to enforce stricter state and federal law, states likely will need more staff with a greater amount of expertise in federal and state law. This comes at a time when states are facing severe financial challenges.

#### **IV. Proposed Funding of the CFPA**

Although the Administration proposes to initially fund the new Agency through appropriations, any such funds ***must be repaid through fees or assessments on entities regulated by the Agency.*** The proposal gives the Agency liberty to set the amount and frequency of the fees and assessments. In addition to fees and appropriations, the new proposal would move some portion of the bank agencies' current budgets to the new consumer protection agency.

However, since the work of the existing agencies must encompass some level of consumer protection, even with a new agency focused on consumer protection, the portion of the budget and staff that could be moved is relatively small. Much additional funding will be required to recreate the agency environment that is necessary to support the examination process. At a minimum, a number of departments that might be considered overhead must be replicated at the new agency – executive staff, human resources, finance, research, legal, information technology, etc. These will also have to be funded through fees. An independent analysis suggests this cost could reach \$5 billion.

The analysis looked at two ways of estimating the cost of a new agency. The first reviewed the budgets of three existing federal agencies that have an examination function, as this function is very costly. These agencies have budgets that range from \$1.2 billion (the Food Safety and Inspection Service) to \$5.5 billion (the Centers for Disease Control and Prevention).

A more organic budget construction yielded similar results. In the second analysis, a budget was constructed from estimates of the cost of the examination function of the new agency. By reviewing the average cost per FDIC compliance exam and estimating the total number of institutions that would need to be examined, a base examination cost would be almost \$3 billion. The base examination cost, however, is only a part of the cost. The examination team, as discussed above, is supported by myriad functions. At the OCC, FDIC, and OTS the examination staff represents 40 to over 60 percent of the staff. Combining the base exam estimate with the ratio of staff focused on examinations at these agencies would push that number toward the \$5 billion range. Clearly, this will be a big, expensive agency.

## **V. Staffing of the Consumer Financial Protection Agency**

The Treasury Department proposes that the new Agency be staffed by transferring employees from the consumer protection divisions of the Federal Reserve, FDIC, Federal Trade Commission (FTC), National Credit Union Association (NCUA), OCC and OTS into the new agency. This is not a simple nor straightforward task. Most bank agency employees do not spend 100 percent of their time on either consumer protection or safety and soundness regulation. Moreover, a significant amount of money and resources are devoted to staff an independent agency, such as finance, operations, research, information technology, human resources, etc. All of these functions would have to be duplicated in a new agency – at a huge cost to taxpayers.

### ***Challenges of Transferring Staff***

The staff from the current regulatory agencies would help start the new CFPA, but this new organization would face many challenges which could linger. Work that was subdivided over six organizations and numerous departments would now be handled under one roof. These newly-combined departments would have to overcome the challenge of working with new information systems, new hierarchies and new paths of internal and external communication. Additionally, there would likely be organizational culture clashes as individuals from competing agencies are melded into the new CFPA. As with any merging of any organization – or in this case the merging of several organizations into one – there will likely be new inefficiencies introduced.

Moreover, the proposed CFPA would eliminate many synergies that exist between prudential and consumer supervision. FDIC Chairman Sheila Bair stated in testimony, “[w]e typically cross-train our examiners...[A]busive mortgages that are abusive to consumers are also unsafe and unsound, and frequently we will find those consumer affairs problems.”<sup>1</sup>

## **VI. Conclusion**

The creation of a large, new federal agency to oversee consumer financial products would be a complicated and expensive undertaking. Current funding sources will not begin to cover the costs of creating and maintaining the new agency, even taking into account the transfer of some staff. There are few synergies to be obtained from the creation of a new agency; rather the move will be duplicative, since two agencies will be performing the functions currently done by one. As has been clearly presented, this new agency would require increased fees on banks. Regulated institutions will incur added costs, which will be passed on through increased prices and restrictions on product availability to consumers.

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<sup>1</sup> [http://www.banklawyersblog.com/3\\_bank\\_lawyers/2009/07/bair-turns-the-corner.html](http://www.banklawyersblog.com/3_bank_lawyers/2009/07/bair-turns-the-corner.html)

