

**THE IMPACT OF THE  
CONSUMER FINANCIAL PROTECTION  
AGENCY ACT OF 2009  
ON  
EFFECTIVE BANK SUPERVISION**

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**by**

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## I. Executive Summary

This paper assesses the impact of the proposed Consumer Financial Protection Agency Act of 2009 (CFPA Act) on effective bank supervision.<sup>1 2</sup> In particular it focuses on the effects of separating consumer protection from safety and soundness supervision and regulation. This Executive Summary presents a summary of the key findings and recommendations that are developed in greater detail in the following sections of the paper.

Separation of consumer protection from safety and soundness supervision and regulation of depository institutions through the proposed Consumer Financial Protection Agency (CFPA) would weaken both efforts, as is discussed in Sections II and III.

- Consumer protection and safety and soundness supervision are mutually reinforcing within each of the agencies.
- In consumer protection rulemaking and supervision, the new CFPA – divorced from the other elements of prudential supervision – would at best have a learning period and at worst might never be able to overcome its lack of experience in safety and soundness supervision.
- Effective examination of certain compliance regulations requires examiners who can evaluate the underwriting of loans and the provision of other financial services from a safety and soundness point of view, a capability that the CFPA would have difficulty in retaining with regard to transferred examiners and developing with regard to new examination staff.

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<sup>1</sup> This paper presents the positions of its authors and does not necessarily reflect the views of LECG, LLC. Moreover, while the authors received support for this paper from the American Bankers Association, the views expressed do not necessarily reflect the views of the ABA.

<sup>2</sup> The paper addresses the Act as proposed by the Obama Administration. It does not address the changes that have been proposed by the House Committee on Financial Services, or changes that have been proposed or may be proposed by individual Congressmen and Senators.

- In ongoing examination and supervision, many depository institutions are likely to be subjected to conflicting restrictions and requirements from two agencies with quite different objectives and no mechanisms in place for resolving differences at any level.
- Some of the important tools the current banking regulators use to correct violations and practices that could develop into violations would not be available to the new CFPA as a separate agency with responsibility for consumer protection only.

The incomplete separation of consumer protection regulation from safety and soundness regulation in many areas in the Administration's proposal demonstrates that the two types of regulation are integrally related and cannot be separated cleanly (Section IV).

There is no example from among independent agencies or the executive branch of the federal government where an agency currently has as much power over such a broad range of activities, and with so little oversight, as is proposed for the CFPA (discussed in Section V).

- The CFPA would have the power to regulate virtually any service and the providers of that service (other than insurance, futures, stock brokerage, and mutual fund products that are specifically excluded from its jurisdiction).
- The CFPA would have the power to expand upon existing consumer statutes and even to create rules in areas where Congress has chosen to not act, that is, in effect, to write legislation where none exists.
- The influence of the safety and soundness concerns of the current depository regulatory agencies on the actions of the CFPA would likely be minimal, given that the requirement for consultation with the depository agencies carries no requirement for the CFPA to pay attention to those concerns.

- The agency wielding all this power would be a new agency with no track record and a singular focus devoid of perspective.

Several aspects of the proposed structure of the CFPA would compound the problems created by separating consumer protection and safety and soundness responsibilities (Section VI).

- The requirement that four of the five directors have “strong competencies and experiences related to consumer financial products or services” poses the possibility that nearly the entire board would be blind to other relevant considerations.
- The lack of a required political balance on the board of the CFPA, in contrast to the requirements for political balance on the boards of many agencies, adds to these concerns.
- It is also troubling that the proposed legislation does not place any limits on the costs of the new agency, or on the manner to be used by the CFPA in recovering its expenditures from regulated entities.

It is likely that little or nothing of significance would be done by the CFPA with regard to non-depository providers of consumer financial services for at least two to three years after its creation (Section VII).

- The worst abuses have occurred at non-depository providers – in areas such as debt consolidation, debt collection, and mortgage originations – that are generally not subject to effective and proactive regulation, if any regulation at all.
- One of the desirable goals of the CFPA proposal is to subject all providers of the same financial services to the same standards and comparable enforcement,

regardless of whether they are currently regulated depository institutions or other providers.

- Enhancements within the existing regulatory agencies are more likely than the CFPA proposal to bring about effective improvements on a timely basis in the detection and resolution of violations and abuses by non-depositories.

The proposed separation of consumer protection regulation from safety and soundness regulation would likely impose substantial costs and uncertainty on depository institutions, as is developed in Section VIII.

- The higher costs would be in the form of one-time and higher ongoing costs to comply with increasingly burdensome consumer compliance regulations, conflicting demands and prohibitions issued by two different agencies with different objectives, and higher assessments from all regulatory agencies combined.
- The higher costs would be passed on to consumers in some combination of higher fees, higher interest rates charged for loans, and lower interest rates paid on deposits.
- The creation of the CFPA would add substantial uncertainty to providers of financial products and services, which would result in less money being available for consumer loans at a time when the economy needs more lenders to make more loans to consumers.

The proposal to create a new CFPA with unprecedented and isolated power over depository institutions and other providers of financial services should be rejected. The attempt to separate consumer protection from safety and soundness supervision and regulation of depository institutions would result in less effective consumer protection and safety and soundness regulation, and would impose substantial unproductive burdens on depository

institutions. The CFPA proposal would do little or nothing of significance for at least two to three years to provide for improved detection and resolution of abuses and violations of consumer protection laws at non-depository providers of consumer financial services, where the great majority of abuses have occurred. The proposal would also have a number of side effects that would be harmful to consumers.

## **II. Current Federal and State Consumer Regulatory Structure and How Consumer Protection and Safety and Soundness Considerations Are United**

This section provides a brief description of how the four federal banking agencies and the credit union regulator (hereafter referred to as the five depository regulatory agencies) carry out their responsibilities with respect to consumer financial protections and how consumer protection and safety and soundness supervision are mutually reinforcing within each of the agencies. It is presented to provide helpful background for understanding and analyzing the proposed legislation that would replace the current system with a new CFPA, which is the subject of Sections III through VIII of this paper.

The federal depository agencies are responsible for rulemaking to implement the federal financial consumer protection laws applicable to insured depository institutions and have been since enactment of The Truth-in-Lending Act in 1968. For some laws – such as The Truth-in-Lending Act, the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act – the Federal Reserve (Fed) has sole rulemaking authority. For other laws where the Congress believed that other agencies had specific expertise that would be helpful in rulemaking – such as the privacy protection portions of the Gramm-Leach-Bliley Act of 1999 (GLB) – the Fed and other depository agencies (plus the Securities and Exchange Commission (SEC), Federal Trade Commission (FTC), and the Secretary of the Treasury in the case of GLB) have responsibility to write rules which are then applied to all federally insured depository institutions. For other acts, such as the Real Estate Settlement Procedures Act, the regulations are written by another agency (Department of Housing and Urban Development (HUD) in that case) and implemented by the depository agencies.

At present, the depository regulatory agencies consider consumer concerns together with safety and soundness and other relevant concerns in their regulatory programs. Their safety and soundness and consumer protection roles are usually mutually re-enforcing.

For example, consider prepayment penalties in loan agreements. Recognizing that prepayment penalties that are properly disclosed can benefit some borrowers by lowering interest rates, can be delivered safely by responsible lenders, and can have important safety and soundness effects by enabling banks to better manage interest rate risk, the Federal Reserve Board limited, but did not ban, the use of prepayment penalties. The result preserved advantageous options for consumers and important risk management tools for banks, while regulating for potential abuses. The Administration stated, in introducing the CFPA Act, that “the CFPA could determine that prepayment penalties should be banned for certain types of products, such as subprime or nontraditional mortgages, or for all products, because the penalties make loans too complex for the least sophisticated consumers or those least able to shop effectively.”<sup>3</sup> If the CFPA were to take a narrow approach in reconsidering restrictions or prohibition of prepayment penalties, it could unwittingly eliminate benefits to some borrowers and the safety and soundness effects that the Fed preserved.

There are times when the safety and soundness and consumer protection objectives of the agencies could conflict if not managed together and coordinated. For example, an agency focused solely on consumer interests narrowly considered might promulgate regulations requiring banks to make automated teller machines (ATMs) available to depositors of other banks at the same fees as their own depositors (who may pay no fees). Such a ban on ATM surcharges would not allow banks to recoup a portion of their substantial ATM hardware and

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<sup>3</sup> United States Department of the Treasury, “Financial Regulatory Reform: A New Foundation,” June 17, 2009, 68.

network costs from non-customers, forcing their own depositors to subsidize users from other banks, and would likely result in fewer ATMs or ATMs becoming unavailable to anyone not having a deposit at that bank. A bank would have to take such a defensive action, because from a safety and soundness perspective it cannot long maintain a losing line of business. Bringing all of these considerations together at the outset would avoid a proposal that in its longer term effects would harm both the bank and consumers.

Another conflict that needs to be managed carefully by responsible regulatory agencies is the timing of funds availability on deposited checks. Consumers would like the shortest possible hold times on checks they deposit in their banks. An agency focused solely on consumers might require shorter hold times on a deposited check than the time period required for the bank to verify the availability of sufficient funds in the payer's account at another bank, and perhaps more importantly to identify check frauds that could harm both the depositor and the bank. Thus, such a requirement would result in increased fraud losses to the banks, at least part of the costs of which would ultimately be passed on to customers in the form of higher fees on deposit accounts.

Under the current system, proposed regulations go through a vetting process at the depository regulatory agencies that coordinate and integrate the competing concerns. Under the proposed CFPA, this built-in coordinating mechanism would be lost.

The depository agencies conduct on-site consumer compliance and safety and soundness examinations of depository institutions subject to their respective jurisdictions. The agencies have thousands of examiners who inspect and supervise depository institutions, and thereby uncover violations of their rules and even discover and address practices that could lead to future violations. Each of the federal depository agencies has professional consumer examiners who

conduct the consumer compliance examinations. At the Office of Thrift Supervision (OTS), consumer and safety and soundness examinations are conducted jointly, and the agency issues joint examination reports that include both consumer and safety and soundness issues. At the other agencies, the consumer and safety and soundness examiners have coordinated their efforts to an increasing extent in recent years, but the two types of examinations are generally conducted separately. In all cases, potentially conflicting guidance to depository institutions from consumer examiners and safety and soundness examiners is addressed within the agency, and the depository institutions are provided with restrictions and guidance that are coordinated parts of an overall supervisory program.

In all of the agencies, the consumer compliance and safety and soundness examinations can be and are mutually reinforcing. The safety and soundness examiners do not want institutions to make loans that cannot be collected in accordance with their terms, and the consumer compliance examiners have the same objective. Effective examination of compliance with the Equal Credit Opportunity Act and certain other laws requires examiners who can evaluate the underwriting of each loan from a safety and soundness point of view. Without those skills, the agency would get false positives (findings of discrimination where there are none), miss patterns of discrimination that may be developing, or both. Consumer examiners' findings of inadequate underwriting standards and policies are communicated to safety and soundness examiners. Similarly, a safety and soundness examiner may find violations of consumer protection laws or regulations in the course of conducting an examination, and in that event information is transmitted for appropriate consumer protection action.

Regulators of depository institutions have a variety of means at their disposal to correct violations or practices that could develop into violations, which they do not hesitate to use.

These include lowering examination ratings, requiring special reporting, removing officers and directors, refusing to act on corporate applications unless and until the firm complies with the standards of its regulator, assessing civil money penalties, and instituting memoranda of understanding, formal agreements, and cease and desist orders on multiple grounds of safety and soundness and consumer compliance concerns. Some of the most powerful of these tools — for example, refusing to act on a corporate application until the depository institution satisfies the regulator on a specific consumer protection issue — would not be available to the new CFPA if it were to become a separate agency with responsibility for consumer protection only, severed from safety and soundness supervision.

Moreover, for an industry so dependent upon public confidence, it is very important that enforcement actions against a depository institution be coordinated within a single agency, in order to assure that a consumer enforcement action does not severely weaken a depository institution's health or even drive it out of business, unless the violation is serious enough to merit such a penalty. How a penalty is applied can often be more important than the nature of the penalty itself. This is particularly important in uncertain economic times like the present. For that reason, the confidentiality of bank examination information is protected by law. An agency removed from concern for safety and soundness consequences could take actions that would unwittingly undermine public confidence in a bank, thereby creating funding problems or even promoting a run on the bank.

It is also noteworthy that the regulatory agencies have extensive programs to inform themselves of bank consumer practices and to gather information on consumer concerns. The agencies require depository institutions to submit reports to the regulators, such as the geographic distribution of applications and originations of home mortgages and of ethnicity,

race, gender, and income of applicants and borrowers, as is required by the Home Mortgage Disclosure Act of 1975.

The regulatory agencies also operate complaint hotlines through which consumers may lodge complaints about the practices of banks and savings associations. The agencies investigate consumer complaints submitted to both the regulatory agencies and the depository institutions. The agencies also publish educational material for the benefit of consumers of financial services. These educational materials are informed by consumer protection and safety and soundness considerations.

The depository agencies' consumer financial rulemaking and ongoing supervision efforts are supported by economic research and data analysis performed by their respective research divisions. The research divisions also perform consumer surveys and testing, to help develop effective disclosures. Similar support is provided by the extensive legal staffs of the agencies.

Moreover, the existing agencies have reached out extensively to consumer advocacy groups to help the agencies carry out their consumer financial regulatory responsibilities. The Fed has been advised by its Consumer Advisory Council since 1976. This group consists of representatives of consumer groups, community groups, and lenders. It meets with the Fed Chairman and other governors three times per year. While the other agencies do not have formal consumer advisory groups, they do meet and consult with consumers often, including representatives of consumer advocacy groups. The leaders of the agencies gain information and helpful perspectives from these contacts, which are incorporated into the decisions and policies of the agencies.

The FTC has an important role in consumer financial protection at the federal level. It enforces Section 5 of the Federal Trade Commission Act, which prohibits "unfair or deceptive

acts and practices in or affecting commerce” (UDAP). The FTC’s UDAP authority, however, extends only to the acts and practices of non-depository financial service providers and the non-depository affiliates of depository institutions. The Fed and the OTS promulgate UDAP regulations for depository institutions based on the FTC’s regulations and have expanded on them in some areas. All of the federal depository regulatory agencies implement and enforce UDAP regulations at depository institutions.

The states charter banks and savings associations, and supervise those institutions, in conjunction with the Fed in the case of Fed member banks, the Federal Deposit Insurance Corporation (FDIC) in the case of federally insured banks that are not members of the Fed, and the OTS in the case of federally insured savings associations.

Federally chartered banks and savings associations operate under national standards for consumer protection that are enforced by their respective federal regulators, with consumer privacy notice laws being a notable exception where federally chartered depository institutions are subject to additional state laws and enforcement. Significant portions of privacy notices provided to consumers are made up of the various additional or different information requirements of the states.

In sum, the five federal depository agencies have devoted substantial resources to developing integrated and mutually reinforcing consumer protection and safety and soundness supervision of depository institutions under their respective jurisdictions. While the results have not been perfect, the general effectiveness of the integrated approaches of the agencies is demonstrated by the fact that the great majority of the consumer abuses have been at providers of financial services other than depository institutions.

### **III. Proposed CFPA Would Result in Separation of Consumer Protection from Safety and Soundness Supervision and Regulation**

The CFPA would take over the consumer protection regulation of federally insured depository institutions from the depository agencies, have greatly expanded powers in comparison with the depository agencies, and have the same powers over non-depository institution providers of consumer financial services. For reasons not made clear by the Administration, the CFPA would not have authority over consumer financial products and services classified as insurance, futures, stock brokerage, and mutual funds, even though many of these products and services compete directly with those offered by banks and credit unions and are marketed to the same consumers.

One of the Administration's stated reasons for proposing creation of the CFPA is that "Banking regulators at the state and federal level had a potentially conflicting mission [to protecting consumers] to promote safe and sound banking practices."<sup>4</sup> The Administration also states that "the systems, expertise, and culture necessary for the federal depository agencies to perform their core missions and functions are not conducive to sustaining over the long term a federal consumer protection program that is vigorous, balanced, and creative. These agencies are designed, and their professional staff is trained, to see the world through the lenses of institutions and markets, not consumers."<sup>5</sup>

The Administration has not provided either evidence or arguments to support those views. That is understandable, because the assertions are not supported by fact or regulatory experience. To the contrary, protecting consumers through administration and enforcement of consumer banking laws and regulations is a core mission of those agencies, embedded in every

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<sup>4</sup> Ibid, 7.

<sup>5</sup> Ibid, 56.

depository regulator, and is complementary to their other missions. The current system of combining safety and soundness supervision and consumer protection supervision within each of the five depository regulatory agencies results in a supervisory program in which safety and soundness and consumer protection concerns are mutually supporting.

It is desirable and important to retain that unity. As indicated in Section II above, consumer compliance examiners and safety and soundness examiners often find and communicate concerns relevant to the other's areas of responsibility. Consumer compliance examiners benefit from credit review experience to evaluate loan files to determine whether a depository institution has applied underwriting criteria consistently and priced for risk adequately. Coordination of enforcement actions against a depository institution within a single agency can and does assure that safety and soundness concerns are taken into account in determining appropriate enforcement actions for violations of consumer protection laws and regulations.

The Administration expressed concern that the current system of consumer regulation is "fragmented among the four agencies," thereby making "coordination of supervisory policies difficult" and slowing "responses to emerging consumer protection threats."<sup>6</sup> In fact, consumer protection regulation is embedded in the regulatory programs of each of the federal depository agencies. Implementation of the consumer protection laws and regulations is assigned to each of the depository regulatory agencies, with each agency responsible for those depository institutions under its jurisdiction. Each agency has been equipped with particular legislative authority and has developed specialized resources and expertise born of long experience in supervising the institutions within its jurisdiction. There would be, at the very least, a learning problem for the

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<sup>6</sup> Ibid.

new CFPA in taking over the responsibilities of the depository regulatory agencies, a problem that the CFPA – divorced from the other elements of prudential supervision – might never overcome.

The Administration also expressed concern that the current system of multiple banking regulatory agencies having responsibilities for consumer regulations creates “opportunities for regulatory arbitrage, where firms choose their regulator according to which entity will be least restrictive.”<sup>7</sup> In fact, while taking into account the differences among the various banking charters, the regulators exhibit minimal differences in the effective administration of the consumer regulations. Banking regulators, as a matter of practice and reinforced by recent joint guidance, do not allow a firm to switch charters if that firm has material unresolved matters outstanding with its primary regulator. In short, there is little opportunity for “regulatory arbitrage” with respect to consumer compliance regulations.

The Community Reinvestment Act (CRA) has important and essential safety and soundness considerations, written into the statute since its enactment in 1977, and needs to be administered by federal agencies responsible for safety and soundness, not the CFPA as proposed by the Obama Administration. In fact, the CRA is not a consumer protection statute. Applying the demands of consumer activists to CRA would be dangerous. Depository institutions and regulators that were praised earlier for their roles in making credit available to the “traditionally underserved” were later criticized for allowing unsophisticated consumers to take out loans. The trade-offs by individual depository institutions between the objectives of making credit more available and sound underwriting are difficult to make in the best of times

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<sup>7</sup> Ibid.

and should be overseen by depository agencies that understand and oversee the credit decisions of those institutions within a complete context involving all relevant considerations.

One of the benefits cited by the Obama Administration in proposing the CFPA is that consumer regulators would have a separate and independent “seat at the table.” In fact, the consumer regulators already have important and separate seats at the tables of each of the depository regulatory agencies, seats that the proposed reorganization would take away. If the Administration’s proposal were enacted, consumer compliance and safety and soundness examiners would no longer sit together and develop an integrated set of criticisms, guidance, restrictions, and requirements for each depository institution. In place of this coordinated program, many depository institutions would be subjected to conflicting restrictions and requirements from at least two agencies with quite different objectives and no mechanisms in place for resolving differences at any level, and each agency would have to look outside of its organization to find perspective and expertise that is now an integral part of the regulatory program residing within each agency.

Based on the above, separation of safety and soundness and consumer protection supervision and regulation of depository institutions, such as through the proposed CFPA, would result in a weakening of both the safety and soundness and the consumer protection efforts of the federal government.

#### **IV. Proposed Separation of Safety and Soundness and Consumer Protection Regulation Would Not Be Complete**

Almost every consumer banking product or service presents both consumer protection and safety and soundness issues. Creating an artificial separation between the two and placing them in separate agencies presents very serious difficulties. For example, loan underwriting standards are both a consumer protection and a safety and soundness issue, and separating their supervision presents the likelihood of conflicting mandates on what is the same function within a bank. This difficulty is reflected in the CFPA proposal, since the Administration plan announces that it places consumer protection responsibilities (at least of the banking regulators) in the CFPA, but in fact refrains from a complete transfer of consumer protection.

There are a number of specific areas where the creation of the CFPA as proposed would result from the outset in an incomplete division of responsibilities between the CFPA and the depository regulatory agencies. Rather than avoiding problems, this structure creates supervisory problems that do not currently exist. Those splits would result in unnecessary and at best time-consuming negotiations and coordination between the CFPA and the depository agencies, perhaps over protracted periods of time, before they were resolved. A few of those areas include:

- Truth-in-Lending Act supervision over mortgages would be assigned to the CFPA, but flood insurance coverage and private mortgage insurance laws that protect consumers would remain with the depository agencies.
- The Electronic Funds Transfer Act (EFTA) and the implementing Federal Reserve Regulation E include both consumer protections and safety and soundness elements to protect banks against fraud. The EFTA would be assigned to the CFPA, but the

rules for clearing electronic check images would remain with the Fed. Having both of these responsibilities within the Fed has been helpful in trying to resolve certain fraud schemes, and separating them would make it far more difficult to address present and future scams.

- Bank information security will remain the purview of safety and soundness agencies, while responsibility for protecting consumer privacy would shift to the CFPA.
- Banks have extensive duties under customer identification or “know your customer” regulations that have been designed to fight money laundering and terrorism, which would remain in the purview of the safety and soundness agencies. Customer identification, however, is also a significant consumer protection principle.
- Identity theft, which is related to customer identification, is another crucial consumer concern that would not be assigned to the CFPA. In fact, for many consumers the risk of identity theft is a major preoccupation. Yet, responsibility for identity theft supervision would remain with the FTC and the depository regulatory agencies.

We are not suggesting that the lines be drawn in different places on these issues to provide for a “better” separation between consumer protection and safety and soundness regulation. Rather, the incomplete separation of consumer protection regulation from safety and soundness regulation in the Administration’s proposal – from the outset in some areas and potentially in other areas – demonstrates that the two types of regulation are integrally related and cannot and should not be separated.

## **V. Proposed Powers of the CFPA**

The CFPA would have nearly unlimited power to carry out its responsibilities, including powers traditionally wielded by the legislative branch of government. The CFPA could provide itself with power to regulate virtually any service and the providers of that service, by virtue of the inclusion in the proposed legislation of the term “any other activity that the Agency defines, by rule, as a financial activity for purposes of this title”<sup>8</sup> (other than insurance, futures, stock brokerage, and mutual fund products that are specifically excluded from its jurisdiction, although arguably the CFPA would itself define the boundaries separating its reach from such products). Similarly, the CFPA would have broad power to create regulations as it sees fit in areas not covered by current laws, that is, in effect, to write legislation where none exists, as is discussed below. Combining these powers with the proposed exclusivity of its jurisdiction, its data collection powers, and its primary enforcement powers, the CFPA would decide what rules are needed over what services and providers, write the rules, conduct field examinations, require the submission of reports, and enforce the rules. Such enforcement authorities include tools such as cease and desist orders, money penalties, disgorgements, and modifications of contracts.

The influence of the safety and soundness concerns of the depository regulatory agencies on the actions of the CFPA would likely be minimal, given that the requirements for consultation and exchanges of examination reports with the safety and soundness agencies carry no requirement for the CFPA to pay attention to those concerns. In effect, the CFPA would become legislator, regulation writer, field examiner, judge, jury, and executioner with virtually no checks on those powers by any branch of the government short of removal of its board members by the

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<sup>8</sup> CFPA Act, Section 1002(9).

President or new legislation to limit its powers. The fact that the legislation provides no guidance on the expenses of the CFPA or the manner in which it would make assessments to pay for those expenses, as discussed in Section VI below, would further insulate the new agency from effective oversight of its operations.

The proposal to provide the CFPA with exclusive authority to issue rules “to enable it to administer and carry out the purposes and objectives of this title” goes far beyond the broad discretionary power typically granted by Congress to implement legislation, in that there are virtually no boundaries on what the CFPA might consider to come within the “purposes and objectives of this title.”<sup>9</sup> Such a proposal to bypass the existing legislative process is dangerous and unnecessary. The Congress plays an important and ongoing role in consumer financial protection. It responds to specific problems that are not covered by existing laws and regulations. Elected Congressmen and Senators introduce bills to address those issues. Congress then debates the merits of those proposals – with participation by the press, consumer advocacy groups, and other interested parties – and new legislation may be enacted. This is what happened most recently when the Congress enacted the Credit Card Act of 2009, and it is the process followed throughout the federal government. Delegating this power to the new CFPA, which has no track record and a singular objective, would have the effect of putting in play for change, by a narrow group of five unelected Washington officials, over 40 years of serious analysis and deliberations by Congress on the issues of consumer financial protection.

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<sup>9</sup> Ibid, Section 1022(b)(1). Those objectives, stated at Ibid Section 1021(b), are “ensuring that – (1) consumers have, understand, and can use the information they need to make responsible decisions about consumer financial products or services; (2) consumers are protected from abuse, unfairness, deception, and discrimination; (3) markets for consumer financial products or services operate fairly and efficiently with ample room for sustainable growth and innovation; and (4) traditionally underserved consumers and communities have access to financial services.”

Under the proposed legislation, the new agency would take over rulemaking responsibility from existing agencies for sixteen federal statutes. Some of those statutes are:

- The Truth-in-Lending Act (requires a uniform method for computing the cost of credit and for disclosing credit terms and gives borrowers the right to cancel certain mortgage loans within three days);
- Fair Credit Reporting Act (provides rules for the handling and use of information in the credit files of credit reporting agencies);
- Equal Credit Opportunity Act (prohibits discrimination in credit transactions on the bases of race, gender, marital status, religion, and age);
- Real Estate Settlement Procedures Act of 1974 (regulates the disclosure to borrowers of the nature and cost of settlements and prevents certain abusive practices);
- Home Mortgage Disclosure Act of 1975 (requires annual disclosure of the geographic distribution of applications and originations of home mortgages and of the ethnicity, race, gender, and income of applicants and borrowers);
- Community Reinvestment Act of 1977 (requires banks to meet the credit needs of their communities);
- Electronic Fund Transfer Act (establishes rights and responsibilities of consumers who use electronic funds transfer services and of financial institutions that offer them); and
- Truth-in-Savings Act (requires financial institutions to disclose to depositors certain data about their accounts including annual percentage yield, prohibits certain methods of calculating interest, and regulates advertising).

It can be expected that the new CFPA, with a singular focus on protecting consumers, would want to demonstrate its impact early. Given this focus in comparison to the broader focus on integrated supervision of the Fed and other agencies with current rulemaking authority, the new agency would likely engage in an initial round of amendments to the regulations, adopt new rules, and continue to tinker with the regulations, even in the absence of any changes in the industry of the type that typically trigger rule changes or legislation. Further, the lack of oversight over the CFPA discussed above plus a number of elements discussed below in Section VI raise the concern that the CFPA would not be sensitive to the costs that would be incurred by depository institutions in adapting their operations, computer systems, training, forms, customer communications, and other aspects of an ongoing business organization to new regulations, costs that would either be passed on to consumers or affect the quality and availability of services provided.

The proposed broad authorization of the CFPA to exempt any covered person or product or service from any or all of its requirements is potentially troublesome.<sup>10</sup> Besides raising the possibility of inconsistent treatment among regulated entities, such power offers the possibility that the CFPA could use this exemption power selectively as a *quid pro quo* in order to gain even greater power in other areas. For example, the CFPA could use this exemption power in approving a new product for a depository institution, by requiring that the product be accompanied by a free checking account or that the institution also offer small dollar amount loans at interest rates that do not cover its costs.

There is no example from among independent agencies or the executive branch of our federal government where an agency currently has so much power – with so little oversight –

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<sup>10</sup> Ibid, Section 1022(b)(3).

over such a broad range of activities. It is particularly troubling that so much power would be vested in a new agency with no track record and a singular focus, and would be used to replace an integrated system of consumer protection and safety and soundness banking regulation that works reasonably well with a new separated system that has built in conflicts that are very likely to weaken both consumer protection and safety and soundness regulation.

## VI. Proposed Structure of the CFPA

The proposed structure of the CFPA is troubling in several ways. The requirement that four of the five directors have “strong competencies and experiences related to consumer financial products or services”<sup>11</sup> poses the possibility that nearly the entire board would be blind to other relevant considerations, compounding the problems created by separating consumer protection and safety and soundness responsibilities. The board of the new agency would be unable to lead it to an effective program benefiting consumers without a deep appreciation for safety and soundness supervision and regulation, the need for strong and competitive depository institutions, and the importance of these institutions and their services to the economy. The fifth director, the Director of the National Bank Supervisor, could be outvoted on every issue and therefore rendered effectively powerless.<sup>12</sup> In fact, the stated criteria for board members in the proposed legislation fail to embody the Administration’s June 17 statement introducing the legislation, which states “The Board should represent a diverse set of viewpoints and experiences.”<sup>13</sup> That the limited viewpoint of the Board as proposed is not accidental is suggested by the lack of understanding of and the hostility to bank lending, banking, and bank regulation evidenced in the writings of the supporters of the CFPA.<sup>14</sup>

The lack of a required political balance on the board of the proposed CFPA, in contrast to the requirements for political balance on the boards of the FDIC, SEC, NCUA, FTC, and other

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<sup>11</sup> Ibid, Section 1012(a)(1)(B).

<sup>12</sup> The Director of the National Bank Supervisor is a position that does not currently exist, but would be created through legislation introduced the same day as the CFPA Act that, among other things, would eliminate the federal thrift charter and create the National Bank Supervisor through a merger of the Office of the Comptroller of the Currency (OCC) with the OTS.

<sup>13</sup> “Financial Regulatory Reform: A New Perspective,” 58.

<sup>14</sup> See, for example, Oren Bar-Gill & Elizabeth Warren, “Making Credit Safer,” 157 U. PA. L. REV. 1, 39 (2008), and Adam J. Levitin, “The Consumer Financial Protection Agency,” Pew Financial Reform Project, 2009.

regulators, adds to these concerns.<sup>15</sup> This lack of political balance raises the possibility that the CFPA will be politicized rather than being an independent regulatory agency like these other agencies. That danger is reinforced by the proposal to allow the President to fire any of the board members “for inefficiency, neglect of duty, or malfeasance in office,”<sup>16</sup> rather than allowing them to serve their full terms, subject to impeachment by Congress, as is the case with the depository agencies. Such opportunity for politicizing the regulation of financial services is alarming, especially in light of the broad and unchecked authority that would be wielded by the agency.

The single-minded exclusive perspective of the proposed CFPA, as opposed to the broader perspectives of the existing depository agencies, adds to the possibility of serious conflicts between the CFPA and the safety and soundness regulators, both in the establishment of rules and regulations and in day-to-day examination and enforcement actions (see Section III above). The requirement for the CFPA to “consult” with the depository regulatory agencies in rulemaking<sup>17</sup> would not be a meaningful constraint on the CFPA’s actions.

These concerns are greatly increased by the proposed powers of the CFPA discussed in Section V above, including the broad power to determine what providers and products it will regulate and to create regulations as it sees fit in areas not covered by current laws.

The Administration claims that the costs of the proposed CFPA will be the same as the current combined expenses of consumer regulatory functions of the depository regulatory agencies, excluding start-up costs. However, the proposed legislation places no limits on the costs of the new agency, or on the manner to be used by the CFPA in recovering its expenditures

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<sup>15</sup> For example, Section 2(a)(2) of the Federal Deposit Insurance Act states that “not more than 3 of the (5) members of the Board of Directors may be members of the same political party.”

<sup>16</sup> CFPA Act, Section 1012 (c)(2).

<sup>17</sup> Ibid, Section 1022(b)(2)(B).

from regulated entities.<sup>18</sup> This lack of oversight on costs is of particular concern, given not only the typical mission creep in government agencies but also the proposed broad powers of the agency to decide what products and providers it will regulate and to, in effect, write legislation where none exists (see Section V above). It seems likely that the start-up costs will be substantial. We believe the ongoing depository institution regulatory costs of the agency will be significantly higher than those incurred currently by the consumer divisions of the depository agencies, given the loss of the current synergies between the consumer divisions and the other parts of those agencies such as economic research, legal, data processing, human resources, training, and accounting.

In addition, the new agency will quite appropriately incur substantial start-up costs and ongoing operating costs for examining and carrying out enforcement actions against financial service providers not currently being supervised effectively at the federal level, the area most in need of additional attention from the federal level as discussed in Section VII below.

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<sup>18</sup> Ibid, Section 1018(b). The bill provides no standards for fairness or equity in the design of the agency's funding program. The CPFA would not be prohibited from incorporating into its fee schedule its view on the cooperation it receives from regulated entities.

## **VII. Delays in Regulating Non-Depository Providers of Consumer Financial Services**

One of the desirable goals of the CFPA proposal is to subject all providers of the same financial services to the same standards and comparable enforcement, regardless of whether they are currently regulated depository institutions or other providers. The CFPA could be expected to do little or nothing of significance with regard to non-depositaries, where most of the chronic abuses have occurred, for at least two to three years following enactment of the legislation. It is ironic that the stated purpose of the legislation – the uniting of all consumer financial protection within one federal agency – is abandoned from the outset in the Administration’s proposal. The CFPA would not have authority over consumer financial products and services classified as insurance, futures, stock brokerage, and mutual funds, even though many of these products are substitutes for and compete directly with products and services that would be subject to the CFPA’s authority.<sup>19</sup>

The CFPA is to be staffed initially through the transfers of the consumer regulatory staffs and functions of the five depository regulatory agencies, plus the financial services staff and regulatory functions of the FTC. This transition is to take place 6 to 18 months after enactment of the proposed legislation, or later if deemed necessary by the Secretary of the Treasury.<sup>20</sup> It appears likely that the initial efforts of the CFPA following such transfers will be to take over the existing duties of these regulatory agencies with respect to insured depository institutions described in Section II above, processes that are working reasonably well at present. The effectiveness of those processes is likely to be disrupted during the transition, as the CFPA

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<sup>19</sup> Ibid, Sections 1002((18)(O), 1021(f)(2)(B), and 1021(f)(2)(C). The CFPA would not have authority over nearly all insurance products and products supervised by the SEC and the Commodity Futures Trading Commission.

<sup>20</sup> Ibid, Section 1062(c).

develops its own economic research, legal, data processing, human resources, training, and accounting capabilities to try to replace those capabilities that will necessarily remain with the depository regulatory agencies. In addition, it is inevitable that many of the employees transferred from the depository agencies will be as much or more occupied with job status as with mission status during this transition, with regard to both their roles in the new agency and their situations *vis-à-vis* new colleagues from other depository agencies.

It is difficult to predict exactly when the CFPA would begin providing effective administration and enforcement of the consumer protection rules at non-depositories. Given built in delays to enact the legislation, plan for a transition, transfer existing personnel and responsibilities, and then absorb the existing duties of the depository agencies, it is likely that little or nothing would be done by the CFPA with regard to non-depositories for at least two to three years.

Yet it is at those non-bank providers that the chronic abuses have occurred. The great bulk of the wrong-doing that led to financial suffering by many individuals and families, particularly the unsophisticated and elderly, was in sectors of the financial services industry not subject to the federal depository regulatory agencies – non-banking firms that offered sub-standard services in areas such as financial advice, debt consolidation, debt collection, and mortgage originations.<sup>21</sup>

The states charter or license many non-depository providers of financial products and services, including mortgage companies, finance companies, providers of check guarantee services, debt collectors, providers of real estate settlement services, financial counselors of

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<sup>21</sup> In “Financial Regulatory Reform: A New Perspective,” 69-70, the Treasury cited a Federal Reserve study that “reported that only six percent of the higher-priced loans were extended by the CRA-covered lenders to lower income borrowers or neighborhoods in the local areas that are the focus of CRA evaluations.” CRA-covered lenders are insured depository institutions and their subsidiaries.

various types, etc. Consumer compliance rulemaking for non-depository institutions is largely the responsibility of the FTC and various state agencies. The FTC and the states, usually the state attorneys general, are responsible for enforcing consumer protection laws against non-depository providers of financial products and services.

Unfortunately, the consumer financial regulatory system for non-depository institutions is at best uneven, and large segments of the financial services industry are not subject to effective consumer regulation, if any consumer regulation at all. One of the challenges faced by the FTC and the states is limited staffing and funding. Another challenge is the difficulty of detecting abuses in businesses where entry is very quick and easy, particularly given the lack of proactive bank-like examination of non-depository providers to detect abuses and violations of consumer protection laws in their early stages. As a result of these challenges, enforcement actions are generally taken in response to complaints.

It is important to focus efforts on filling the current gaps in consumer regulation now when they are most needed and apparent. Delaying federal action while a new agency is set up and trying to become operational would be poor policy. It would be far more timely and effective to address these gaps immediately within the existing federal regulatory structure. Responsibilities for non-depository providers could be given to one or more of the depository regulatory agencies, or the funding and other resources available to the FTC could be increased substantially. In either case, greater coordination of efforts and resources between the federal government and the states would enhance the monitoring and enforcement of laws and regulations with regard to providers not currently supervised by the depository regulatory agencies.

## **VIII. Impacts of the Proposed CFPA on Depository Institutions and Consumers**

Separation of consumer protection regulation from safety and soundness regulation as proposed by the Obama Administration would likely impose substantial unproductive costs and other burdens on depository institutions, which would be passed on to consumers or diminish the loans and other services made available to consumers.

The existing safety and soundness agencies and the new CFPA would likely impose conflicting restrictions and requirements on many depository institutions, as discussed in Section III above. The new agency, wanting to show some early impact and with a singular focus that is different from the integrated focus of the depository agencies, would be very likely to amend existing consumer protection regulations and adopt new rules, both of which would result in substantial expenses for depository institutions to adapt to the new rules, as discussed in Section V above.

In addition, as discussed in Section VI above, the new agency would have substantial one-time operating costs and increased operating expenses in comparison to the current combined consumer compliance expenses of the depository regulatory agencies. It can be expected that the higher regulatory costs would result in higher assessments and fees on the depository institutions.

These higher costs of complying with consumer regulations and the higher assessments would be passed on to consumers in some combination of higher fees, higher interest rates charged for loans, and lower interest rates paid on deposits. This result of a program intended to be pro-consumer is ironic, but predictable.

Another result of the Administration's proposal to separate consumer protection regulation from safety and soundness regulation would be to add substantial uncertainty to providers of financial products and services. Such uncertainty is likely to make the provision of consumer loans and other consumer services less attractive to many financial firms and their investors, and thereby lead to less money being available for consumer loans, at a time when the economy needs more lenders to make more loans and consumers to buy more goods and services with the proceeds of those loans.

Many but not all of the areas in which the CFPA would create uncertainty for providers of consumer financial products and services are discussed throughout Sections III – VI of this paper. Some of the more important causes of uncertainty include:

- the virtually unlimited power of the new agency over consumer financial products and their providers (Section V);
- the possibility of a future anti-lender direction of a new CFPA having nearly unlimited powers, particularly to the extent its board is narrow in focus and reflective of the anti-lending perspective of many of its advocates (Section VI);
- the possibility of future conflicts, that might not be resolved quickly or easily, between the directives of safety and soundness examiners and consumer examiners (Section III);
- the potential for substantial fines being levied by an agency with no safety and soundness knowledge, interest, or responsibility (Section III);
- the possibility for changes in the CFPA's attitude toward certain categories of loans – *i.e.*, initial encouragement to expand credit availability, later transformed into

- criticism for having made what are subsequently considered to be inappropriately risky loans (Section III);
- possible effects of required replacement of certain disclosures with simplified disclosure language that misses important nuances in product descriptions and that creates vulnerabilities to lawsuits or to criticisms from safety and soundness or other regulators such as the SEC and the Internal Revenue Service (not addressed in this paper but widely criticized by other commentators);
  - possible impacts of the proposal that the CFPB have the power to require providers of financial products and services to offer “plain vanilla” products if they offer alternative products of the same type (not addressed in this paper but widely criticized by other commentators); and
  - effects of removal of current federal pre-emption of state laws and regulations for federally chartered banks and savings associations (not addressed in this paper but the subject of criticism by many other commentators).

## **IX. Conclusion**

Based on the above analysis, the proposal to create a new CFPA with unprecedented power over depository institutions and other providers of financial services should be rejected.

The attempt to separate consumer protection from safety and soundness supervision and regulation of depository institutions would result in less effective consumer protection and safety and soundness regulation. Consumer protection and safety and soundness supervision are mutually reinforcing within each of the agencies. In consumer protection supervision, the new CFPA – divorced from the other elements of prudential supervision – would at best have a learning period and at worst might never be able to overcome its lack of experience in safety and soundness supervision. Effective examination of certain compliance regulations requires examiners who can evaluate the underwriting of each loan from a safety and soundness point of view, a capability that the CFPA would have difficulty in developing and retaining. Some critical tools the depository agencies use to correct violations and practices that could develop into violations would not be available to the new CFPA as a separate agency.

There is no example in the federal government where an agency currently has as much power over such a broad range of activities, and with so little oversight, as is proposed for the CFPA. The CFPA would have the power to regulate virtually any service and the providers of that service (other than insurance, futures, stock brokerage, and mutual fund products that are specifically excluded from its jurisdiction). The CFPA would have the power to expand upon existing consumer statutes and even to create rules in areas where Congress has chosen to not act, that is, in effect, to write legislation where none exists. The agency wielding all this power would be a new agency with no track record and a singular focus devoid of perspective.

Several aspects of the proposed structure of the CFPA compound the problems created by separating consumer protection and safety and soundness responsibilities. Those aspects include the narrow focus on expertise in consumer financial products in the criteria for board members, the lack of a required political balance on the board, and the lack in the proposed legislation of limitations on the costs of the new agency or guidance on the manner of charging fees to regulated entities.

The CFPA proposal would do little or nothing of significance for at least two to three years to provide for improved detection and resolution of abuses and violations of consumer protection laws at non-depository providers of consumer financial services, where the great majority of abuses have occurred. Enhancements within the existing regulatory agencies are more likely than the CFPA proposal to bring about effective improvements on a timely basis in the detection and resolution of violations and abuses by non-depositories.

The CFPA proposal would likely impose substantial unproductive costs and uncertainty on depository institutions. The higher costs would be in the form of one-time and higher ongoing costs to comply with increasingly burdensome consumer compliance regulations, conflicting demands and prohibitions issued by two different agencies with different objectives, and higher assessments from all regulatory agencies combined. The higher costs would be passed on to consumers in some combination of higher fees, higher interest rates charged for loans, and lower interest rates paid on deposits. The creation of the CFPA would add substantial uncertainty to providers of financial products and services, which would result in higher costs to consumers and in less money being available for consumer loans at a time when the economy needs more lenders to make more loans to consumers.