

New Federal Initiatives Project

**The Obama Administration's Proposed
New Consumer Regulator (CFPA)**

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THE OBAMA ADMINISTRATION'S PROPOSED NEW CONSUMER REGULATOR (CFPA)

The Obama Administration has proposed creation of a new independent financial consumer regulator with the goal of increasing protection of consumer financial interests. The Administration's June 17, 2009, White Paper recommends that the new Consumer Financial Protection Agency (CFPA) "have broad jurisdiction to protect consumers in consumer financial products and services"¹ The breadth of that jurisdiction and the related powers of the agency are matters of serious debate, with government organization and even constitutional implications being raised in the debate.

Under the plan, all of the consumer protection responsibilities of the Federal Reserve, the Federal Deposit Insurance Corporation, the federal bank chartering agencies, and the Federal Trade Commission would be transferred to the new agency, together with full authority over 16 "enumerated consumer laws." The list of the enumerated laws would include the Truth in Lending Act, the Truth in Savings Act, the Home Ownership and Equity Protection Act, the Real Estate Settlement Procedures Act, the Electronic Funds Transfer Act, the Home Mortgage Disclosure Act, and others. The Community Reinvestment Act is also in the list of enumerated consumer laws.² The supervision of any entities or persons covered by the authorities of the Securities and Exchange Commission or the Commodity Futures Trading Commission would be excluded from the agency,³ as would most insurance products.⁴

In addition to the enumerated consumer laws, the new agency would be given wide new prerogatives in administering them, together with additional authorities not currently possessed by any federal agency. These new authorities, together with the independent nature of the agency (with few identifiable checks on the exercise of its authority), raise important government operation and even constitutional issues. Advocates of the agency assert that such broad and muscular authority is needed to ensure adequate consumer protection. Critics argue that they raise concerns about a rogue agency that could in the name of consumer protection exercise enormous control over the financial system.

What follows is a list of some of the more noteworthy powers proposed for the CFPA under the Administration Bill, particularly those that would appear to grant seemingly subjective authorities in the charter of the new consumer regulator.

Who and What Are Subject to the New Agency

- The jurisdiction of the agency extends to anyone who engages directly or indirectly in a financial activity as well as anyone who is involved "in connection with" providing a consumer financial product or service. The agency's jurisdiction reaches further to include anyone who in connection with the provision of a financial product or service provides a material service to someone so engaged. The agency would interpret what these terms mean.⁵
- The agency may determine what is meant by a deposit taking activity, including any activity related to the acceptance or receipt of money or its equivalent.⁶ Besides what one might normally consider a deposit in a bank, this authority could arguable include any step in the payments system or in the storage of wealth or handling of exchangeable things of value.
- The agency is given authority to define what activity is a "financial activity" (except for "the business of insurance") or a "financial product or service".⁷
- The agency defines what is a "standard consumer financial product or service". Later authorities (see below) give the agency power to require that financial firms offer these standard products.⁸

How is the New Agency Operated

- The agency has the full panoply of regulatory tools, including power to act by rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions.⁹
- The agency itself decides how large its staff is and how it is organized.¹⁰ The agency is not required to submit a budget to Congress or to any other agency for approval.

New Community Affairs Program

- The agency is required to maintain a community affairs unit to provide guidance and technical assistance regarding provision of consumer financial products to traditionally underserved consumers and communities, but no limits are placed on the size or budget of this operation and program.¹¹

How Is the New Agency Funded

- The bill would *appropriate* to the agency “such sums as are necessary”. No restriction is placed on the amount of the appropriation.¹² There are questions as to whether such an open-ended appropriation is allowed under the Constitution. A precedent would be the Terrorism Risk Insurance Act of 2002, which also had an unlimited appropriation.¹³
- The agency is directed to recover all of its costs through annual fees and assessments on those subject to the agency’s jurisdiction. The agency has authority to design the structure, amount, and frequency of the fees and assessments, by regulation.¹⁴ Given the open-ended appropriation, lack of outside control over the agency’s budget, the broad reach of the agency as to who is subject to its jurisdiction, and the very general authority with regard to design of its revenue collection, questions might be raised about whether this is a cession of taxation or excise authority to the agency, and whether that would be allowable under the Constitution.

New Consumer Financial Protection Agency Civil Penalty Fund

- The legislation creates a new Consumer Financial Protection Agency Civil Penalty Fund. Civil penalties collected by the agency are deposited into the Fund, and the agency determines terms, criteria, procedures, and so forth for distributing these funds to “victims”.¹⁵

Rules, Orders, Guidance, Policies, Exemptions

- The agency can prescribe rules, orders, and guidance to implement the purposes and objectives of the consumer protections and to “prevent evasions” of them. What might be intended by authority to “prevent evasions” is not articulated.¹⁶ In making rules, the agency is required only to “consult” with other Federal agencies “as appropriate” regarding the consistency of its rules with prudential, market, or systemic issues.¹⁷ This agency appears to be authorized to press on with its projects, even if they raise serious safety and soundness or systemic risks.
- The agency may exempt, by rule or order, any firm or product or service from any provision of this law or of any of the consumer laws the CFPA administers.¹⁸ The Securities and Exchange Commission (SEC), as an example, makes extensive use of its exemptive authority, often with significant conditions attached to the exemptions.

Exams, Reports, Information Requirements

- The agency can examine any firm subject to its jurisdiction and require reports; the nature and frequency of the exams and reports are to be defined by the agency.¹⁹

- The agency has “exclusive authority” for prescribing rules, issuing guidance, conducting examinations, requiring reports, or issuing exemptions under the financial consumer laws.²⁰ The new agency would seem to be able to trump any objection by any other agency of government to the form or substance of the exercise of these powers.
- The agency has authority to require from anyone subject to its jurisdiction information concerning business organization, conduct, and practices, annually, or in special reports, or seek answers to specific questions in writing. The agency may make the information public as it deems to be in the public interest.²¹ Considering the broad agency jurisdiction, this information authority raises privacy and business confidentiality concerns, among others.

Arbitration

- The agency may limit or prohibit the use of arbitration agreements however the agency believes to be in the public interest.²²

Unfair, Deceptive, or Abusive Acts or Practices

- The agency is given authority to take actions to “prevent” a person from engaging in an unfair, deceptive, or “abusive” act or practice in connection with a consumer financial product or service, as defined by the agency.²³ This provision would adjoin a new law to existing unfair and deceptive acts and practices (UDAP) statutes, and add the novel factor of “abusive” practices, not defined in the proposed legislation. Which “abusive” practices would be covered by the new standard that would not be caught by the terms “unfair or deceptive” must for now be left to speculation. What is meant by authority to “prevent” acts, or what the agency might do or require in that regard, is not defined.

Communications with Consumers

- The agency is given authority to set rules for how firms communicate with consumers, what kind of disclosures are made, how and when they are made, and how benefits and risks are described to consumers regarding “any” financial product or service. The agency is also directed to develop model mortgage disclosure documents.²⁴ Presumably, the recent RESPA disclosure by the Department of Housing and Urban Development, expanding a single-page disclosure form to a new three-page disclosure, would not be such a model.
- Similarly, the agency has broad authority to prescribe through rules, orders, and guidance the manner, setting, and circumstances for a firm to provide “any” consumer financial product or service.²⁵ That is to say, it appears that the agency could decide what could or could not be offered or sold over the Internet, or by phone, or in person, or prescribe how such business must be conducted. One observer asked whether the agency could require that businesses offer foreign language facilities for customers that might request them.

Standards for Non-Bank Firms

- The agency is given authority to prescribe minimum standards for firms not subject to banking regulation or comparable state regulation to “deter” and detect unfair, deceptive, abusive, fraudulent, or illegal transactions. The legislation does not elaborate on what the agency might do to “deter” these transactions.²⁶

Standard (“Plain Vanilla”) Consumer Financial Products

- The agency is given broad authority to design any standard (or, as described in the White Paper, “plain vanilla”²⁷) consumer financial products or services that any firm offering an alternative product or service of the same class must offer to consumers. The standard product must be offered before or at the time that the firm offers an alternative product. The agency can also prescribe the method by which the firm gives the consumer “a meaningful opportunity to decline” the standard product or service designed by the agency.²⁸ Although the legislation does not say so, there may be a presumption that a firm offering agency-designed products will be to some degree shielded from the broad prescriptive, investigative, and enforcement powers of the agency; any non-standard product would be fully exposed to the panoply of agency authorities and sanctions.

“Fair Dealing” Duties

- The agency is directed to prescribe rules imposing any duties the agency deems appropriate or necessary to ensure “fair dealing” with consumers, which duties are to reach to any firm under the jurisdiction of the agency, including any person, agent, or independent contractor who deals or communicates directly with consumers (except for attorneys, trustees, and the like).²⁹ The extent of these duties is not spelled out (other than that they include compensation practices), but it appears that they could extend to and beyond suitability requirements.

Preemption Determinations

- The proposed legislation would override the preemptions of the National Bank Act and the Home Owners’ Loan Act with regard to consumer protection laws. Federal laws would prevail over any state standards that do not afford consumers protection “greater than the protection” of the standards under the new agency, but states can impose additional “protections”. The agency decides whether any state statute, regulation, order, or interpretation is greater than the agency’s protections and therefore not preempted.³⁰

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¹ United States Department of the Treasury, “Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation,” June 17, 2009, (http://www.financialstability.gov/docs/regs/FinalReport_web.pdf), p.57.

² “Consumer Financial Protection Agency Act of 2009”, as drafted by the Obama Administration and submitted to Congress June 30, 2009, (<http://www.financialstability.gov/docs/CFPA-Act.pdf>), Section 1002 (16), hereafter referred to as “Administration Bill”.

³ Administration Bill, Section 1022(f).

⁴ Administration Bill, Section 1002 (18)(O).

⁵ Administration Bill, Section 1002 (9).

⁶ Administration Bill, Section 1002 (13).

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- ⁷ Administration Bill, Section 1002 (18)(19).
- ⁸ Administration Bill, Section 1002 (31).
- ⁹ Administration Bill, Section 1013(a)(8).
- ¹⁰ Administration Bill, Section 1013(a)(3)(4)(6).
- ¹¹ Administration Bill, Section 1014(c)(2).
- ¹² Administration Bill, Section 1018(a).
- ¹³ Terrorism Risk Insurance Act of 2002, Section 104(g).
- ¹⁴ Administration Bill, Section 1018(b).
- ¹⁵ Administration Bill, Section 1018(c).
- ¹⁶ Administration Bill, Section 1022(b)(1).
- ¹⁷ Administration Bill, Section 1022(b)(2).
- ¹⁸ Administration Bill, Section 1022(b)(3).
- ¹⁹ Administration Bill, Section 1022(c).
- ²⁰ Administration Bill, Section 1022(d).
- ²¹ Administration Bill, Section 1023.
- ²² Administration Bill, Section 1025.
- ²³ Administration Bill, Section 1031.
- ²⁴ Administration Bill, Section 1032.
- ²⁵ Administration Bill, Section 1033.
- ²⁶ Administration Bill, Section 1035.
- ²⁷ “Financial Regulatory Reform”, p.66.
- ²⁸ Administration Bill, Section 1036.
- ²⁹ Administration Bill, Section 1037.
- ³⁰ Administration Bill, Subtitle D.

Related Links:

“One Good Idea and a Number of Bad Ones” Testimony of Alex J. Pollock to the Committee on Financial Services Hearing on Restructuring Consumer Financial Products Regulation, June 24, 2009: http://www.house.gov/apps/list/hearing/financialsvcs_dem/pollock.pdf

Testimony of Todd Zywicki to the Committee on Financial Services Hearing on Banking Industry Perspectives on the Obama Administration’s Financial Regulatory Reform Proposals, July 15, 2009: <http://www.mercatus.org/uploadedFiles/Mercatus/Publications/CFPA%20Todd%20Zywicki%20Testimony%207-15-2009.pdf>

List of Prepared Testimony’s, Hearing on Banking Industry Perspectives on the Obama Administration’s Financial Regulatory Reform Proposals, July 15, 2009: http://www.house.gov/apps/list/hearing/financialsvcs_dem/fchr_071509.shtml

“Let’s Treat Borrowers Like Adults: The problems with a financial products safety panel.” by Todd Zywicki, *Wall Street Journal*, July 8, 2009: <http://online.wsj.com/article/SB124701284222009065.html>

“Do We Need a Consumer Financial Protection Agency?” by Peter J. Wallison and Alex J. Pollock, *AEI on the Issues*, August 2009: <http://www.aei.org/docLib/12-OTI-Wallison-Pollock-CFPA-g.pdf>

“A Conversation on Proposed Systemic Risk Regulation,” Podcast featuring Peter J. Wallison, Wayne A. Abernathy and John L. Douglas: http://www.fed-soc.org/publications/pubid.1546/pub_detail.asp