

# The CFPA Controversy: Asking the Tough Questions



Obama Administration announced its intention to revamp the regulatory framework.<sup>4</sup> In a white paper, wistfully titled Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation<sup>5</sup> (Plan), the Administration suggested new regulatory schemes to prevent a recurrence of another financial crisis. Admitting that the “government could have done more” to prevent the crises that ensued throughout the financial system, the Plan declares:

*“We must build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.”<sup>6</sup>*

By Jonathan Foxx

Some believe that any improvement is better than no improvement at all. Given the dismal enforcement of existing regulatory mandates, there seems to be some systemic dysfunction. Indeed, a “report card,” issued by the House Financial Services Committee, demonstrated “the poor record of the Federal Reserve in using the tools provided by Congress to protect consumers from abusive financial industry practices,” and asserting that “consumer protection has long been overlooked by federal regulators, and their motivation to protect consumers has been driven more by congressional pressure rather than a sense of duty to protect the American public.”<sup>7</sup>

The basis for creating the CFPA rests on the assertion that “as abusive practices spread, particularly in the market for sub-prime and non-traditional mortgages, our regulatory framework proved inadequate in important ways.”<sup>8</sup> Systemic risk is supposed to be remedied through the CFPA by consolidating into it certain authorities from other regulatory bodies, as well as by having it raise the standards between and among financial intermediaries.

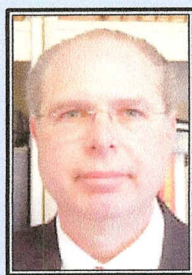
## Will regulatory consolidation lead to greater consumer financial protections?

It should be noted that there are three areas of divergence between the Act and the Plan. First, the Act does not transfer oversight and enforcement authority over the Community Reinvestment Act to the CFPA;<sup>9</sup> second, the Act does not eliminate the thrift charter, and, by extension, the Office of Thrift Supervision (OTS); and third, the Act makes reference to “the head of the agency responsible for chartering and regulating national banks,”<sup>10</sup> but not an oversight supervisor. However, the Plan calls for the transfer of CRA enforcement authority to the CFPA, eliminates the thrift charter (converting thrifts to state or national banks),<sup>11</sup> and suggests the establishment of a National Bank Supervisor.

Consolidation of regulatory authorities will be considerable. The Plan is actually proposing to transfer and consolidate within the CFPA primary enforcement authority over the consumer financial protection functions currently performed by the Federal Reserve’s Board of Governors, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA) and the Federal Trade Commission (FTC). This includes exclusive authority over all related research, rule-making, guidance, supervision, examination and enforcement activities.

At least 16 existing consumer protection laws will be included in the transfer, giving new exclusive rule-making and examination authority to the CFPA. These laws include:

- ❖ Alternative Mortgage Transaction Parity Act (AMTPA)<sup>12</sup>
- ❖ Community Reinvestment Act (CRA)<sup>13</sup>



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The Consumer Financial Protection Agency (CFPA) is on the way and its gestation stage will not be as long as many expect.<sup>1</sup> Although its nascence will endure the inevitable crucible of politics churned out by the Congress, federal and state regulatory bodies, bank and non-bank industry lobbyists, and eminent legal scholars,<sup>2</sup> the actors in this drama seem to argue, at one extreme, for a CFPA with robust oversight and regulatory enforcement authorities, and, at the other extreme, some kind of oversight agency that reviews financial products and consumer protection statutes, but without the authority to create new guidelines or enforce such protections. What is coming could be a witches’ brew of regulatory authorities migrated from various existing regulatory venues, along with a red hot dash of new authorities especially aimed at regulating the non-bank industry. The Consumer Financial Protection Agency Act of 2009 (Act), HR 3126, is viewed by politicians and many in the mainstream media as the antidote to preventing another toxic “mortgage meltdown.”<sup>3</sup>

Whatever newly legislated agency we are eventually confronted with, it is important to understand the implications of the many features being suggested for

the CFPA. There are cogent arguments on both sides of this issue, given industry orientation and political bias. More deliberative, though, would be to ask some tough (and perhaps disturbing) questions, the answers to which will help us to evaluate the proposed and even final legislative results. It’s time to ask those tough questions now, however impolitic they may seem, in order to be able to evaluate the import of the legislation. What follows is a set of probing questions, along with some tentative answers, that should help us to manage our expectations for the CFPA.

## Will the CFPA improve the current regulatory framework?

Recent events have demonstrated that the existing regulatory framework is either dysfunctional or in need of a complete overhaul. In many cases, just enforcing current regulations might have stemmed or slackened the mortgage crisis; however, there were challenges for which the regulations were not adequately responsive. The



- ❖ Consumer Leasing Act (CLA)<sup>14</sup>
- ❖ Electronic Funds Transfer Act (EFTA)<sup>15</sup>
- ❖ Equal Credit Opportunity Act (ECOA)<sup>16</sup>
- ❖ Fair Credit Billing Act (FCBA)<sup>17</sup>
- ❖ Fair Credit Reporting Act (except with respect to sections 615(e), 624 and 628) (FCRA)<sup>18</sup>
- ❖ Fair Debt Collection Practices Act (FDCPA)<sup>19</sup>
- ❖ Federal Deposit Insurance Act, subsections 43(c) through 43(f)(12) (FDIA)<sup>20</sup>
- ❖ Gramm-Leach-Bliley Act, sections 502 through 509 (GLBA)<sup>21</sup>
- ❖ Home Mortgage Disclosure Act (HMDA)<sup>22</sup>
- ❖ Homeownership and Equity Protection Act (HOEPA)<sup>23</sup>
- ❖ Real Estate Settlement Procedures Act (RESPA)<sup>24</sup>
- ❖ SAFE Mortgage Licensing Act (SAFE Act)<sup>25</sup>
- ❖ Truth-in-Lending Act (TILA)<sup>26</sup>
- ❖ Truth-in-Savings Act (TISA)<sup>27</sup>

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Although the CFPA would be assigned primary authority to enforce these laws, other federal regulators, including the banking agencies and the FTC, would retain overlapping, secondary enforcement authority over certain requirements. And state attorneys general would be empowered to enforce federal laws under the CFPA (subject to any existing limitations in the laws to be transferred to the CFPA’s authority). State consumer financial protection laws would not be preempted, except to the extent that they are inconsistent with federal law (although such state laws could be stricter than the federal laws, in which case they would not be preempted by federal law).

A quick look at the list of affected laws indicates that the CFPA’s authorities will be coming for the most part from federal banking statutes. Therefore, this begs the question: how does it benefit the consumer by transferring these existing authorities from their current regulators, who already are or should be enforcing these laws, to a new primary regulator to do the very same enforcement measures? Two views are generally held in response. The first maintains that there is an inherent conflict between encouraging institutional profitability and availability of credit, but also offering risky, complex, and high-cost loans to borrowers which can, at times, lead to abuse. An opposing view would be that adding yet another layer of regulatory control does nothing really to alter the fact that broad and robust measures of consumer protection are already in place. Presumably, the CFPA’s mandate should be over time to eliminate bureaucratic waste and duplicative procedures, and bring about the further streamlining of authorities. The goal, apparently, would be to create an agency that has the capacity to proactively enforce existing and new powers as well as respond quickly and deliberately to critical financial conditions.

### **Does the CFPA thwart financial innovation?**

Winston Churchill wrote that “If you have ten thousand regulations you destroy all respect for the law.” One might also add, perhaps, that you could destroy all respect for innovation as well! At least that is the argument against allowing the CFPA to regulate consumer financial products. Both price discovery and innovation in financial products often come through the arbitrage created in a dynamic and open market. Although a regulator might have no immediate concerns with respect to the exercise of its prudential function, such exceptional, dynamic market activities as price discovery and innovation could be viewed with much apprehension by an agency whose specific mandate is to provide consumer protection.

The debacle is made even more clear when the Plan advocates for a “plain vanilla” financial product—whatever that is supposed to mean! Presumably, this is a financial product which offers the legislation’s motifs of transparency, simplicity, fairness, accountability, and access to all.<sup>28</sup> These types of products could be “standardized” fixed-term mortgages without pre-payment penalties, and would require financial institutions to offer them alongside the institution’s other products. Such standards are “simpler and have straightforward pricing,” and these products are to be disclosed “prominently, alongside whatever other lawful products” a provider chooses to offer.<sup>29</sup>

The premise, of course, is that there is no efficient market upon which to base a regulatory framework. To put it bluntly, the need to codify the “plain vanilla” product and promulgate its regulatory management through an oversight agency is a rejection of the consumer as a rational, informed actor in the marketplace. It is an embracing of the rule that consumers need to be protected from themselves and regulations provide that protection. However, it is often the case that regulations must necessarily exclude certain activities, even though it may include other activities. What may be excluded, though, could be the very kinds of innovations that allow a market to evolve, grow, and be responsive to public need. The damp-

ening effect of restrictive, consumer protection regulations might eventually leave the consumer with less financial options. Unexpected consequences, as we all should have learned recently, cannot be regulated away.

## Evaluating the CFPA: Key questions

There are other components to the CFPA legislation that could derivatively impact many aspects of the mortgage industry. The Plan is complex, nuanced, and far-reaching. For example, the preemption provisions in the Act itself, if narrowly interpreted, could have a detrimental effect on a bank's financial products and services on a multi-state basis, thereby increasing administrative costs. On the other hand, if the CFPA broadly interprets its authorities, the same provisions could lead to multi-state companies having a single set of rules, thereby depriving consumers of the kinds of full protection from predatory products that they otherwise would be receiving under a state's own statutory framework.

The complexity of this new legislation—especially because it creates a new government agency—is structured to provide the following five stated objectives:<sup>10</sup>

1. Promote robust supervision and regulation of financial firms.
2. Establish comprehensive supervision of financial markets.
3. Protect consumers and investors from financial abuse.
4. Provide the government with the tools it needs to manage financial crises.
5. Raise international regulatory standards and improve international cooperation.

The means by which the CFPA accomplishes the above-enumerated objectives will determine both its longevity and efficacy. Nevertheless, how will you evaluate the implications of the Consumer Financial Protection Agency Act of 2009, as it makes its way through committees, hearings, votes, and eventually to President Obama's desk? Your answers to the following five questions can guide your judgment. Will the CFPA:

1. Improve the transparency and fairness of financial products and services?
2. Provide transparent and uniform enforcement of regulations?
3. Focus on the safety of credit products, features, and practices?
4. Protect consumers from discriminatory, deceptive, or fraudulent loans?
5. Contribute to long-term sustainability of lenders and the economy as a whole?

Each member of the mortgage industry will need to research and answer these questions individually, and, as market participants, decide collectively how to prepare for the substantial and fundamental changes soon to become the law of the land.

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For more information on author Jonathan Foxx, visit Lenders Compliance Group on the Web at [www.lenderscompliancegroup.com](http://www.lenderscompliancegroup.com).

## Footnotes

1—Foxx, Jonathan: "The Birth of an Agency," *National Mortgage Professional Magazine*, Volume 1, Issue 5, September 2009, pp. 24-27.

2—On Sept. 29, 2009, more than 70 law scholars who teach in fields related to consumer law and banking law issued a detailed "Statement of Support" demonstrating their strong views in favor of passing HR 3126 and the creation of the CFPA. Hyperlink: [law.hofstra.edu/pdf/Media/consumer-law%209-28-09.pdf](http://law.hofstra.edu/pdf/Media/consumer-law%209-28-09.pdf).

3—Consumer Financial Protection Agency Act of 2009, House Bill 3126. The Financial Services Committee in the House, chaired by Rep. Barney Frank (D-MA), commenced hearings on the CFPA in September 2009.

4—U.S. Department of Treasury, June 17, 2009, TG-175: President Obama to Announce Comprehensive Plan for Regulatory Reform.

5—Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation, issued by the U.S. Department of Treasury on June 17, 2009, and updated Aug. 11, 2009.

6—Ibid. p. 2.

7—The Federal Reserve's Record on Consumer Protection, issued by House Financial Services Committee, Chairman Barney Frank (D-MA). Press Release: Sept. 23, 2009.

8—Op.cit. 5, p. 55.

9—HR 3126 § 101(16).

10—HR 3126 § 112(a).

11—Opt.cit. 3, pp. 30-31.

12—12 U.S.C. §§ 3801 et seq.

13—12 U.S.C. §§ 2901 et seq. Not included as an "Enumerated Consumer Law" in HR 3126, but enforcement authority over this Act is transferred to the CFPA. HR 3126 § 184(b)(2).

14—15 U.S.C. §§ 1667 et seq. Not specifically referenced in HR 3126's definition of "Enumerated Consumer Law, but enforcement authority over this Act is transferred to the CFPA. HR 3126 § 184(b)(2).

15—15 U.S.C. §§ 1693 et seq.

16—15 U.S.C. §§ 1691 et seq.

17—15 U.S.C. §§ 1666-1666j. Not specifically referenced in HR 3126's definition of "Enumerated Consumer Law," but enforcement authority over this Act is transferred to the CFPA. HR 3126 § 184(b)(2).

18—15 U.S.C. §§ 1681 et seq.; and, 15 U.S.C. §§ 1681m(e), 1681s-3, 1681w.

19—15 U.S.C. §§ 1692 et seq.

20—12 U.S.C. § 1831t(c)-(f).

21—15 U.S.C. §§ 6802-6809.

22—12 U.S.C. §§ 2801 et seq.

23—15 U.S.C. § 1639.

24—12 U.S.C. §§ 2601-2610.

25—12 U.S.C. §§ 5101-5116.

26—15 U.S.C. §§ 1601 et seq.

27—12 U.S.C. §§ 4301 et seq.

28—Op.cit. 5, pp. 63-67.

29—Op.cit. 5, p. 15.

30—Op.cit. 5, pp. 3-4.