

# The Birth of an Agency

By Jonathan Foxx

We are about to get a new federal agency. Historically speaking, federal agencies come into existence infrequently. A recent agency, the Financial Crimes Enforcement Network (FinCEN), was founded in 1990. Yet, the Federal Aviation Administration (FAA) was founded in 1958, the Food and Drug Administration (FDA) came into existence in 1937, and the Federal Reserve in 1913. The Federal Deposit Insurance Corporation (FDIC) was founded 76 years ago. Often, federal agencies are founded as a reaction to, rather than in anticipation of, a crisis. Regulation follows where the supposedly unpredictable has happened. But there is a kind of arrogance about our ability to predict, given our proclivity to believe narratives, basing our actions on retrospective considerations, or relying solely on precedent to foresee the future. Regulation follows where the dangerously obvious has been obscured by the opacity of politics and power. We seek the comfort of a government protector, a means to be kept safe (or safer) when we take an airline flight, eat our food, ingest our medicine, bank our money or borrow money to buy a home. And when the protector fails to protect, as when the Securities and Exchange Commission (SEC), founded in 1934, fails to enforce existing regulations, resulting in the loss of billions of investors' dollars in a Ponzi Scheme, the government's response is still reactive—still not anticipatory—and thus likely to result in many more regulations.

We are about to get a new agency, called the Consumer Financial Protection Agency (CFPA),<sup>1</sup> yet another reactive response to the dangerously obvious. There will be turf wars between

the federal agencies to keep their respective, existing authorities away from the CFPA; there will be debates about what and who will be regulated; and politics and power will work very hard to obscure the facts and muddle the solutions. Though Congress will now debate when it will become law and how much authority it will have, the CFPA is on the way. As it makes its ascent on the regulatory horizon, let's take a close look at what we have been told about it.

The Treasury released a white paper, on June 17, 2009, in tandem with President Barack Obama's announcement of a comprehensive plan for regulatory reform. Entitled "Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation," the proposal outlines the Administration's requirements to reform the U.S. financial regulatory system. If adopted in its entirety, this robust and complicated document will become the blueprint for significant changes to the financial world.<sup>2</sup> The goal of the plan is to remediate the following four perceived, regulatory deficiencies that purportedly caused the recent financial crisis:

1. Regulators imposed insufficient capital and liquidity requirements (off-balance sheet and trading assets);
2. Regulators did not take into account the harm that the failure of a large,

complex financial institution could have on the economy;

3. Supervisory authority of large firms was granted among many agencies and amongst a number of bank charter types, causing industry fragmentation and uncoordinated oversight between the regulators; and,

4. Insufficient or no specific oversight of significant non-bank financial enterprises, such as investment banks, money market funds, hedge funds, lenders, mortgage originators, and other private pools of capital.

It is this fourth regulatory deficiency that meets the mortgage industry directly and unequivocally through the creation of the CFPA.<sup>4</sup>

## A new framework

The fourth aspect of the plan, indicated above, centers on building a consumer protection agency to oversee the kinds of financial products heretofore outside of the purview of banking regulations. Such products as non-traditional and sub-prime mortgages, it is alleged, were often unsuited for consumers' needs. Banks and thrifts offered these products, leading to widespread abuse. The plan, in effect, asserts that the mission of federal and state bank regulators to promote safety and soundness potentially conflicts with consumer protection goals. Thus, the remedy proposed is a new framework, consisting of

regulatory, legislative, and administrative reforms. Its goal will be to "reduce gaps in federal supervision and enforcement; improve coordination with the states; set higher standards for financial intermediaries; and promote consistent regulation of similar products."<sup>5</sup> This single, regulatory agency, to be known as the Consumer Financial Protection Agency, will be a federal consumer advocacy agency, focused on consumer protection with respect to financial products and services. By becoming the primary federal financial consumer protection supervisor, the new agency is expected to provide accountability. The plan seeks for the agency broad authorities to enable the fulfillment of its mission, such as by expanding jurisdictions and implementing new regulatory guidelines to eliminate abuse, extending even to providing new authorities to the Federal Trade Commission (FTC) and the Securities and Exchange Commission (SEC).

## The CFPA structure

The plan's recommendations to implement the CFPA are premised on granting "consolidated authority over the closely related functions of writing rules, supervising and examining institutions' compliance, and administratively enforcing violations," with the goal being to "reduce gaps in federal supervision; improve coordination among the states; set higher standards for financial intermediaries; and promote consistent regulation of similar products."<sup>6</sup>

There are eleven (11) features of the plan, which can be summarized in the following table.<sup>7</sup>



*"Often, federal agencies are founded as a reaction to, rather than in anticipation of, a crisis. Regulation follows where the supposedly unpredictable has happened."*



Proposal	Purpose	Authorities and Benefits
1. A single primary federal consumer protection supervisor to protect consumers of credit, savings, payment and other consumer financial products and services, and to regulate providers of such products and services.	Better promote accountability and help prevent regulatory arbitrage. Federally-supervised institution no longer able to choose its supervisor based on any consideration of real or perceived differences in agencies' approaches to consumer protection supervision and enforcement.	Supervisory, examination and enforcement authority. Should have the ability to act comprehensively to address emerging consumer protection concerns.
2. Broad jurisdiction to protect consumers in consumer financial products and services such as credit, savings and payment products.	Consumers have the information they need to make responsible financial decisions, and be protected from abuse, unfairness, deception or discrimination. Markets operate fairly and efficiently with room for sustainable growth and innovation, and traditionally underserved consumers have access to lending, investment and financial services.	Jurisdiction covers consumer financial services and products (i.e., credit, savings and payment products), as well as institutions that issue, provide, or service these products and provide services to the entities providing the financial products.
3. An independent agency with stable and robust funding.	Director and a board, with the board representing a diverse set of viewpoints and experiences. At least one seat on the board reserved for the head of a prudential regulator. <sup>8</sup> A stable funding stream could come in part from fees assessed on entities and transactions.	Appointments and compensation of officers and professional, financial, and technical staff on terms commensurate with those currently used by other independent financial regulatory agencies.
4. Sole rule-making authority for consumer financial protection statutes, as well as the ability to fill gaps through rule-making.	Sole authority extends to promulgating and interpreting regulations under existing consumer financial services and fair lending statutes (i.e., Truth-in-Lending Act [TILA], Home Ownership and Equity Protection Act [HOEPA], Real Estate Settlement and Procedures Act [RESPA], Community Reinvestment Act [CRA], Equal Credit Opportunity Act [ECOA], and Home Mortgage Disclosure Act [HMDA] and the Fair Debt Collection Practices Act [FDCPA]).	Rule-making authority under any future consumer protection laws addressing the consumer credit, savings, collection or payment markets. Broad authority to adopt tailored protections—such as disclosures or restrictions on contract terms or sales practices—against unfairness, abuse or deception, subject to the notice and comment procedures of the Administrative Procedure Act.
5. Supervisory and enforcement authority and jurisdiction over all persons covered by the statutes that it implements, including both insured depositories and the range of other firms not previously subject to comprehensive federal supervision. Work with the Department of Justice to enforce the statutes under its jurisdiction in federal court.	<ul style="list-style-type: none"> <li>Supervisory, examination and enforcement authority over all entities subject to its regulations, including regulations implementing consumer protection, fair lending, and community reinvestment laws (i.e., Community Reinvestment Act [CRA]), as well as entities subject to selected statutes for which existing rule-writing authority does not exist or is limited (i.e., Fair Housing Act to the extent it covers mortgages, the Credit Repair Organization Act, the Fair Debt Collection Practices Act, and provisions of the Fair Credit Reporting Act).</li> <li>Promote compliance by publishing supervisory guidance indicating how it intends to administer the laws it implements.</li> <li>Able to use other tools to promote compliance, such as publishing best and worst practices based on surveys, mystery shopping, and information collected from supervision and investigations.</li> </ul>	<ul style="list-style-type: none"> <li>Assumes all responsibilities from the federal prudential regulators for supervising banking institutions for compliance with consumer regulations (federal- or state-chartered). Jurisdiction extends to bank affiliates that are not currently supervised by a federal regulator.<sup>9</sup></li> <li>Interaction between itself and all prudential regulators of major matters and share confidential examination reports with them, with action taken by the CFPA or regulators.</li> <li>Supervisory and enforcement authority over non-banking institutions, including enforcement powers (with subpoena authority), over non-banking institutions within its jurisdiction.</li> <li>Able to request that the U.S. Attorney General bring any action necessary to enforce its subpoena authority or to bring any other enforcement action on its behalf in the appropriate court.</li> </ul>
6. Regulatory reviews: <ul style="list-style-type: none"> <li>Pursue measures to promote effective regulation, including conducting periodic reviews of regulations, an outside advisory council, and in coordination with the Council.<sup>10</sup></li> <li>Establish an outside advisory panel, akin to the Federal Reserve's Consumer Advisory Council, to promote the CFPA's accountability and provide useful information on emerging industry practices.</li> </ul>	Required to complete a regulatory study of each newly enacted and existing regulation at least every three years after the effective date, to assess the effectiveness of enacted regulation, and allowing public comment on recommendations for expanding, modifying or eliminating a regulation.	Interact with other agencies through the Council to promote consistent treatment of similar products and to assure no product goes unregulated merely because of uncertainty over jurisdiction. Through the Council, coordinate efforts with the SEC, the CFTC, and other state and federal regulators to promote consistent, gap-free coverage of consumer and investor products and services. Agencies required to report their work to Congress.
7. Strong rules promulgated to serve as a floor, not a ceiling. States have the ability to adopt and enforce stricter laws.	Federally-chartered institutions to be subject to non-discriminatory state consumer protection and civil rights laws to the same extent as other financial institutions. States to be able to enforce these laws, as well as regulations of the CFPA, with respect to federally-chartered institutions, subject to appropriate arrangements with prudential supervisors.	States to have concurrent authority enforce regulations of the CFPA. CFPA promulgated federal rules under a pre-existing statute or its own organic rulemaking authority should override weaker state laws, but states should be free to adopt stricter laws. With respect to state banks supervised by a federal prudential regulator, the CFPA to be the primary consumer compliance supervisor at the federal level.
8. Coordination of enforcement efforts with the states.	Maintain consistency among the 50 states' supervisory and enforcement efforts. The CFPA assumes responsibility for federal efforts to help the states unify and strengthen standards for registering and improving the quality of providers and intermediaries.	Authorized to establish or facilitate registration and licensing regimes for other financial service providers and intermediaries (i.e., debt collectors, debt counselors or mortgage modification companies). The CFPA and state enforcement agencies to use registration systems to help weed out bad actors.



Proposal	Purpose	Authorities and Benefits
<p>9. A wide variety of tools to enable it to perform its functions effectively:</p> <ul style="list-style-type: none"> <li>❖ Research and data</li> <li>❖ Complaints</li> <li>❖ Financial education</li> <li>❖ Community affairs</li> </ul>	<ul style="list-style-type: none"> <li>❖ Research and data: Information used to improve regulations, promote compliance and encourage community development.</li> <li>❖ Complaints: Responsible for collecting and tracking complaints about consumer financial services and facilitating complaint resolution with respect to federally-supervised institutions. States retain primary responsibility for tracking and facilitating resolution of complaints against other institutions.</li> <li>❖ Financial education: Streamline existing financial literacy, educate consumers about financial matters, improve their ability to manage their own financial affairs and make their own judgments about the appropriateness of certain financial products.</li> <li>❖ Community affairs: Promote community development investment, fair and impartial access to credit.</li> </ul>	Engage in a wide variety of activities to help financial institutions, community-based organizations, government entities and the public understand and address financial services issues that affect low- and middle-income people across various geographic regions.
10. Improve incentives for compliance by restricting or banning mandatory arbitration clauses.	Gather information and study mandatory arbitration clauses in consumer financial services and products contracts to determine to what extent, and in what contexts, they promote fair adjudication and effective redress. If CFPA determines that mandatory arbitration fails to achieve these goals, establish conditions for fair arbitration, or, if necessary, ban mandatory arbitration clauses in particular contexts, such as mortgage loans.	Authority to restrict or ban mandatory arbitration clauses, since consumers often waive their rights to trial when signing form contracts in taking out a loan, and that a private party dependent on large firms for their business will decide the case without offering the right to appeal or a public review of decisions.
11. The Federal Trade Commission (FTC) given better tools to protect consumers.	FTC retains authority for dealing with fraud and sale of services like advance fee loans, credit repair, debt negotiation and foreclosure rescue/loan modification fraud.	CFPA authority is in coordination with FTC, with FTC remaining the lead federal consumer protection agency on matters of data security. Front-end privacy protection on financial issues moved to the CFPA."

## Disclosures

The Plan suggests a "proactive" approach to consumer disclosures, with an emphasis on transparency, consisting of three dimensions:

1. Make mandatory disclosure forms clear, simple and concise, and test them regularly.
2. Require that disclosures and other communications with consumers be reasonable.
3. Use technology to make disclosures dynamic and relevant to the individual consumer.

The CFPA would be authorized to require that all disclosures and other communications with consumers be reasonable, balanced in their presentation of benefits and clear and conspicuous in their identification of costs, penalties and risks. Consequently, the plan calls for all mandatory disclosure forms to be clear, simple and concise. (The CFPA would determine which risks and costs should be highlighted.) The plan also recommends that the CFPA establish standards and procedures for testing disclosures (including immunity from liability) for providers of consumer financial products and services. A reasonable communication would balance the presentation of risks and benefits and have a clear and conspicuous description of significant product costs and risks. This standard would apply to communications with cus-

tomers, marketing materials, and all mandatory disclosures.

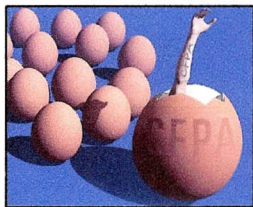
The CFPA would be authorized to implement a process under which a provider, "acting reasonably and in good faith," could obtain the equivalent of a "no-action" letter for disclosures and other communications for new products. For example, the CFPA could adopt a procedure under which a provider petitions the CFPA for a determination that its product's risks were adequately disclosed by the mandatory model disclosure or marketing materials. The CFPA could approve use of the mandatory model or marketing materials, or provide a waiver, admissible in court to defend against a claim, for varying the model disclosure. Violations would be subject only to administrative action, rather than civil liability.

Finally, the plan recommends utilizing technology to improve disclosures, such as requiring Internet (online) calculators to compare the overall cost of a mortgage. The CFPA is expected also to promote adoption of innovations in point-of-sale technology (i.e., allowing consumers who use a credit card to choose a payment plan for the purchase).

## Simplicity

The proposal recommends that the CFPA be authorized to define standards

for "plain vanilla" products, such as "standardized" fixed term mortgages without prepayment penalties and require financial institutions to offer such "plain vanilla" products alongside the institution's other products. Such standards are to be "simpler and have straightforward pricing," and these products are to be disclosed "prominently, alongside whatever other lawful products" a provider chooses to offer.



## Higher cost loans

The CFPA would assume responsibility for the Federal Reserve Board

regulations that impose extra protections and higher penalties on alternative or higher cost loans. For instance, the CFPA could be authorized to add other mortgage types to the class of products that receive additional scrutiny, leaving only products which meet the "plain vanilla" standards in the less scrutinized class. And the CFPA would be empowered to impose a strong warning label on alternative products, require applicants to fill out a financial experience questionnaire, or mandate that providers obtain a written opt-out to "plain vanilla" products.

## A new fairness doctrine

The CFPA would have the authority to regulate unfair and deceptive acts or

practices for all credit, savings and payment products. The proposal also calls for the CFPA to have the authority to address overly complex financial contracts. Perhaps this should be called the "New Fairness Doctrine." It consists of the following three authorities, in which the CFPA is authorized to:

1. Regulate unfair, deceptive or abusive acts or practices.
2. Impose empirically justified and appropriately tailored duties of care on financial intermediaries.
3. Apply consistent regulation to similar products.

The CFPA could ban certain practices, such as prepayment penalties, for certain types of contracts or payments to mortgage originators, including yield spread premiums, if disclosures were found to be an inadequate protection. The CFPA could also adopt a "life of loan" approach to mandate consumer protections through the servicing and loss mitigation stages of the loan. Indeed, the plan even suggests that the CFPA could consider requiring mortgage originators to receive a portion of their compensation over time, contingent on loan performance, rather than in a lump sum at the time of origination.

There are recommendations in the plan to grant CFPA the authority to impose "duties of care" on financial intermediaries (i.e., a duty of 'best exe-



cution' on mortgage brokers with respect to available mortgage loan types and pricing). The proposal also calls for CFPA to apply consistent regulation to similar products, taking into consideration "consumer perceptions" of such products.

## Community Reinvestment Act (CRA) and access

As described in the above-outlined table, a key feature of the CFPA would be the administration of the CRA, and the plan recommends that the CFPA should have sole authority to evaluate financial institutions for CRA compliance. This is in keeping with the claim that a critical part of the CFPA's mission is to promote access to financial services, especially households and communities that traditionally have had limited access.

The CFPA, therefore, would now determine if a financial institution had a record of meeting the lending, investment and services needs of its community under the CRA, and in connection with the approval of a merger application by the institution's prudential supervisor. Additionally, the plan calls for the CFPA to maintain a fair lending unit with attorneys, compliance specialists, economists and statisticians; and, importantly, it is to have primary fair lending jurisdiction over federally-supervised institutions and concurrent authority with the states over other institutions. To promote fair lending, the CFPA would have the authority to collect data on mortgage and small business lending, including expanding the required data to be reported under HMDA. Critical new fields would be added to HMDA data, such as a universal loan identifier that permits tying HMDA data to property databases and proprietary loan performance databases, or a flag for loans originated by mortgage brokers, or information about the type of interest rate (i.e., fixed vs. variable).

## Reinforcing consumer protection

By creating the CFPA, the Obama Administration hopes to bring new means to bear on consumer protection, allowing it broad authority to implement its initiatives through various enforcement mechanisms. There are five principles that guide its formation: transparency, simplicity, fairness, accountability and access.<sup>12</sup> To accomplish these principles, consumer protection mandates will be transferred to the CFPA from the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (FRB), Office of Thrift Supervision (OTS), Federal Trade Commission (FTC), and the National Credit Union Administration (NCUA). The regulations impacted by the CFPA's new authorities will include the Equal Credit Opportunity Act (ECOA), Fair Credit Reporting Act (FCRA) (except sections 615(e), 624, and 628), Alternative Mortgage Transaction Parity Act

(AMTPA), Electronic Funds Transfer Act (EFTA), Fair Debt Collection Practices Act (FDCPA), Federal Deposit Insurance Act (FDIA) (subsections 43[c] through [f]), the Gramm-Leach-Bliley Act (GLBA) (sections 502 through 509), Home Mortgage Disclosure Act (HMDA), Community Reinvestment Act (CRA), Real Estate Settlement Procedures Act (RESPA), Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), Truth-in-Lending Act (TILA), and the Truth-in-Savings Act (TISA). Given such broad and sweeping responsibilities and authorities, the new Consumer Financial Protection Agency will bring about new modalities of regulatory guidance and enforcement methodologies, fundamentally altering the financial products and services industries.

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## Footnotes

1—Consumer Financial Protection Agency Act of 2009, House Bill 3126.

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

3—Examples of substantial revisions, to name but two, include altering or eliminating the so-called "functional regulation" regime of the Gramm-Leach-Bliley Act (1999) and the interstate branching approval process of the Riegle-Neal Interstate Banking and Branching Efficiency Act (1994).

4—The discussion provided herein is based on a review of the 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 on August 11, 2009.

5—Ibid. Pg. 55.

6—Ibid. Pg. 56.

7—Ibid. Pp. 57-63.

8—Prudential regulation is regulation of deposit-taking institutions and supervision of the conduct of these institutions and set-down requirements that limit their risk-taking. The aim of prudential regulation is to ensure the safety of depositors' funds and keep the stability of the financial system.

9—In a departure from the current framework of federal bank charter preemption of state laws, the plan recommends that federally-chartered institutions be subject to nondiscriminatory state consumer protection and civil

rights laws to the same extent as other financial institutions. States would have the ability to enforce these state laws against federally-chartered institutions as well as state-chartered institutions and the ability to enforce the regulations of the CFPA against federally-chartered institutions.

10—To address the need for coordinated agency oversight and identification of emerging risks, the Plan would create a Financial Services Oversight Council (Council). The Secretary of Treasury would serve as the Council's Chairman, and membership would include representatives of a many agencies, including the SEC, the Commodity Futures Trading Commission (CFTC), the Federal Housing Finance Agency (FHFA), and the new fed-

eral banking and consumer protection agencies proposed in the plan itself.

11—It is asserted that the FTC has a clear mission to protect consumers, but generally lacks jurisdiction over the banking sector and has limited tools and resources to promote robust compliance of nonbank institutions. To quote the plan itself, "mortgage companies not owned by banks fall into a regulatory 'no man's land' where no regulator exercises leadership and state attorneys general are left to try to fill the gap." Op. Cit. Note 3, Pg. 56.

12—"Strengthening Consumer Protection," a synopsis of the five principles, is available on the FinancialStability.gov Web site. It is one of several additional resources to the plan.