Asset Building Program

The Consumer Financial Protection Bureau

Tools, Transitions, and Choices

Tim Fernholz, New America Foundation

October 2010

The current financial reform process has been subject to inevitable comparisons with the sweeping overhaul of the 1930s, which created the bulk of America's financial bureaucracy as we know it today. With much of the Wall Street Reform and Consumer Protection Act, commonly called the Dodd-Frank bill, building on the framework established by the Roosevelt administration, the new law has suffered accusations of a poverty of ambition. However, in one area the act has succeeded in creating something unambiguously important and unique: The Consumer Financial Protection Bureau, an autonomous government agency dedicated to supervising the consumer financial markets.

Title X of the Dodd-Frank bill, the Consumer Protection Act, lays the foundation for this new agency. While the idea of a federal office specifically dedicated to consumer finance has been kicked around by policymakers for decades, experience with pernicious mortgage loans in the nineties and then through the housing bubble during the early years of the 21st century brought the idea back to the front of the public debate. Following the financial crisis, as Congress took up the task of reinforcing financial regulation, consumer advocates focused their efforts on making the agency a reality. After nearly a year of debate and negotiation, and despite objections from the industry, the CFPB has been established. This report will discuss exactly what Title X empowers the Bureau to do and what the Bureau's initial staff can do to begin using those tools to their fullest potential.*

Authorities

The CFPB's objective is straightforward: To create access for all types of consumers to financial markets, products, and services that are fair, transparent, and competitive. That entails—

1) Ensuring that consumers have timely and understandable information.
2) Prohibiting unfair, deceptive, abusive, or discriminatory business practices.
3) Identifying and addressing outdated or burdensome regulations.
4) Promoting transparent, efficient, and competitive markets for consumer financial products.

* This paper is based on an analysis of the law and two years of reporting on its development. In particular, thanks to Reid Cramer, Elizabeth Warren, Raj Date, Mike Konczal, Jonathan Mintz, Devin Fergus, Richard Carnell, Travis Plunkett, Ed Mierzwinski, and numerous congressional and executive staff for their insight.

The agency is empowered through a number of different authorities to pursue these objectives, including several aspects of the program that are broader than what we traditionally conceive of in a regulatory agency. Here is a description of the various responsibilities and powers identified by statute which will be the primary building blocks of the CFPB's agenda:

Conducting Financial Education Programs

The CFPB will be able to develop and implement financial education programs that give consumers a better understanding of their own choices. There are a number of existing models for this part of the Bureau's mission; the Treasury Department already runs several pilot programs providing financial education, and local consumer authorities from New York to San Francisco have seen success in providing the right information directly to consumers, especially those who did not obtain financial education from their schools or families. Financial education is a key part of the wealth-building—read, anti-poverty—mission of the CFPB.

Collecting, Investigating, and Responding to Complaints

The CFPB will administer a telephone hotline and web presence for collecting and addressing consumer complaints about financial products. Ideally, this will not only improve consumers' experience in the financial markets but also provide important data about business trends and practices. The CFPB is required to respond to consumer complaints with information about both the Bureau's response to the complaint and actions of the offending financial institution to redress the consumers' concern. All financial institutions that come under the CFPB's bailiwick are required by law to respond to both consumers and the regulator in a timely fashion during this process.

The CFPB's objective is straightforward: To create access for all types of consumers to financial markets, products, and services that are fair, transparent, and competitive.

Data Collection and Publication

The Research Office will be charged with identifying and collecting important data about consumer financial markets of interest to the public to inform decision making among businesses, consumers, and regulators. For instance, knowledge of how banks charged unfair or unnecessary service fees, such as those for overdrawn accounts, led to new rules about how banks inform their customers about overdraft protection programs and prohibitions on the kinds of fees banks can charge. Yet we know very little about similar service charges used by credit card companies to increase their revenue at the expense of consumers. With more information about those practices, businesses and consumers will be able to make smarter decisions and regulators will be able to respond with appropriate consumer protection measures similar to those on overdraft fees.

Toward this end, the CFPB is empowered to demand information from its supervisees, under oath if necessary, and other regulatory branches.

Rulemaking, Supervision, and Enforcement

The CFPB also wields authority to perform the traditional regulatory tasks of rulemaking and enforcement in the consumer financial markets. Previously, these functions were dispersed among other regulators but their consolidation at the CFPB creates opportunities, in theory, for more effective oversight that also may significantly change the landscape for the provision of financial services and products. Here are several factors to consider in understanding the potential impact of the CFBP.

The Bureau Supervises a Variety of Actors

The Dodd-Frank bill makes the CFPB the premiere regulator of all consumer financial markets and provides the agency with full power to employ subpoenas to obtain the information it needs; should covered institutions fail to comply, they face the possibility of being charged with contempt of court and corresponding penalties.

Perhaps most important in the wake of our last crisis, independent mortgage originators and brokers, which were not regulated because they were not, technically, banks, will now be supervised by the CFPB. Also joining the category of previously unregulated, non-bank entities are private education lenders and payday lenders. This will be the first time that all three of these sectors come under federal supervision.

The CFPB also supervises traditional banks that engage in consumer lending. While the CFPB has the unfettered ability to make rules about consumer finance, due to concerns about overly burdensome regulation affecting smaller institutions, Congress has limited direct enforcement authority to the Bureau for banks and credit unions with more than $10 billion in assets. Institutions below that size will still follow CFPB rules but will be directly supervised by their prudential regulator. The CFPB may elect to join in examinations performed by this regulator but may not supervise those institutions directly unless consumer complaints indicate that prudential supervision is inadequate.

Congress also exempted certain sectors from coverage by the CPFB, due to both political and policy concerns. Merchants, retailers, and other dealers in primarily non-financial goods are excluded from supervision by the CFPB even if they extend credit to their customers for certain purchases. That exemption can be invalidated, however, if the merchant in question sells or securitizes their customers debt, employs finance charges, or exploits the exemption to evade the law. A number of other pro forma exclusions are made (lawyers, accountants, etc.), but one additional and likely problematic exemption deserves attention: Congress elected to exempt completely auto dealerships that lend money directly to consumers to purchase cars. Given the size of these loans, and the fact that the auto-lending market is larger than the credit card market, this decision presents a great risk of pernicious practices, including rampant securitization, migrating into the auto sector. One potential saving grace, however, is that when auto dealers act as brokers rather than lenders, their contracts still fall under the oversight of the CFPB.

Previously, these functions were dispersed among other regulators but their consolidation at the CFPB creates opportunities, in theory, for more effective oversight that also may significantly change the landscape for the provision of financial services and products.

The CFPB has Broad Rule-Making Powers

Monitoring the actions of financial firms is an important way to achieve CFPB objectives, but effective supervision requires enforcing and writing rules for lender behavior. The Bureau is charged with interpreting federal law on consumer finance, both the new additions in the Dodd-Frank bill and a broad array of previously-enacted laws, ranging from the Truth in Lending Act to the Equal Credit Opportunity Act. Typically, the CFPB will make a rule by interpreting these statutes and taking into account the costs and benefits of the new regulation, its affect on existing institutions and customers, and the opinions of other regulators. Where the prudential regulators disagree with the CFPB, their dissents must be included in the publication of the rule. The CFPB can also exempt sectors of the market from their rules under a similar rubric.

Once the CFPB issues a rule, it must be enforced unless another regulator challenges the law. Under the Dodd-Frank bill, a new organ called the Systemic Risk Council now oversees the financial landscape. The Council is made up of the heads of the various regulatory agencies, the Chairman of the Federal Reserve and is Chaired by the Secretary of the Treasury. Should one of these bodies disagree with a CFPB ruling, they can make their case before the council—and the public—that the rule should be negated. However, they must meet a high standard by making the case that a proposed rule "would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk." The Council has up to ninety days to review the objection and requires a two-thirds majority to over-turn the rule. That decision is in turn subject to judicial review.

Many have noted that this veto power is one of the most direct limits on the CFPB and worry that it may eliminate the agency's founding purpose—to create a single, accountable home for consumer financial protection. However, the high standard for over-turning a rule, the public process, and the requirement for a two-thirds majority all suggest the costs of vetoing a rule—both in publicity, time, and resources—are high enough to make it an infrequent occurrence. The Dodd-Frank bill clearly lays out the CFPB's exclusive jurisdiction (except a few instances where work with the Federal Trade Commission will be required), so the process should not be an active venue for turf wars. However, prudential regulators may see value in slowing the CFPB's implementation of new rules if they perceive a conflict with their safety and soundness responsibilities, which could pit regulators against each other in an argument over the costs and benefits of a given rule.

There is one other very specific exemption in the CFPB's rulemaking authority. The Bureau is forbidden from imposing a "usury limit," that is, it cannot put in place a maximum interest rate for lenders. Usury caps, once common in the U.S., prevented outrageously high interest rates until the 1970s, when various regulatory loopholes allowed lenders to evade them after critics argued that the prohibition reduced credit availability. The CFPB's inability to limit interest rates will make enforcement actions against certain pernicious actors, especially pay-day lenders, more challenging, but other tools exist to limit predatory business practices.

> As well as enforcing rules, the CFPB has the power to ban activities that it rules unfair or abusive.

The CFPB can Enforce its Rules

The Bureau has the ability to enforce its rules on institutions it supervises through civil and criminal actions in court; the Dodd-Frank bill also makes committing fraud or acting to otherwise abet the violation of consumer finance rules a crime.

As well as enforcing rules, the CFPB has the power to ban activities that it rules unfair or abusive. Unfair practices are those that create injury to consumers that financial institutions cannot reasonably avoid, while failing to bring any broader benefit to the market. Abusive practices are those that materially interfere with consumers' ability to understand the terms and conditions of financial contracts, or take advantage of a consumer's misunderstanding of risk or reliance on their financial institutions.

The Bureau also has the ability to affect financial disclosures used to market products ranging from mortgages to credit cards. One powerful tool it can deploy is the model disclosure: The CFPB can design a clear, informative model for a financial product disclosure. While it cannot mandate that banks use that model as their own rubric, the Dodd-Frank bill provides a legal safe-harbor to any firm that does adopt the CFPB's model as its own. That's a large incentive for firms worried about regulatory burden to adopt government-certified disclosure forms.

Again due to the focus on home loans, the CFPB is required to produce a model mortgage disclosure within one year of its establishment.

Organization

Though the CFPB will be housed in the Federal Reserve Bank, Fed officials are prohibited from interfering in its activities. It is by law an Executive agency, which may surprise those legislators who saw the decision to name it a "bureau" as a compromise—opponents of the new agency attempted to reduce its profile as much as possible by housing it within another regulator, while its proponents tried to maintain its influence behind cosmetic changes. It will be headed by an independent director appointed by the President with the advice and consent of the Senate. Its budget will be obtained from the earnings of the Federal Reserve and is fixed at 10 percent of the central bank's total operating expenses for 2011, increasing to 12 percent by 2013 and going forward into the future. For comparison, in 2008 the agency's maximum budget would have amounted to $26 million.

The Director has latitude in organizing the CFPB, but at least some of its offices are mandated by law:

Research Office

This office is designed to gather important data, much of it now unavailable, on: markets for consumer financial products; access to credit in traditionally underserved communities; consumer understanding of both disclosures relating to their financial products and the real costs and benefits of those financial products; consumer behavior; and the experiences of underserved customers. The office will also have the ability to aid in academic research by providing more data publicly and by working to resolve issues of data interoperability, so that all of the agency's information—from the public, research, and private sector—can mesh together and provide a full picture of the marketplace.

This kind of data is critical to regulatory function. Accurate information on the incidence of high overdraft fees led the Federal Reserve to make new rules prohibiting banks from automatically enrolling their customers in overdraft plans and forcing customers to opt-in if they want that kind of protection. Gathering more data on financial products will allow for smarter rules.

> It will be headed by an independent director appointed by the President with the advice and consent of the Senate.

The office won't just look at products. Expect the Research Office to seek information on consumer financial behavior, especially among low-income and underserved communities where data on personal assets, participation in fringe financial services, and savings patterns remains sketchy. Understanding how people actually move in the financial marketplace will allow the agency to ensure that its actions complement consumer needs—for example, if research reveals a reliance on pay-day lenders for basic credit needs, the CFPB will know to focus its efforts on both protecting consumers from predatory loans and emphasizing the availability of safe short-term credit. Moreover, creating effective disclosure for financial contracts requires understanding the information that consumers actually need to make effective decisions.

While much of the focus on the CFPB has targeted its potential to change the consumer marketplace through rulemaking and enforcement, many consumer advocates believe that the data coming from this office will play a major role in shaping the way we think about consumer financial products.

Complaints

Another key development in the CFPB will be the creation of a single, toll-free telephone number, a website, and a database to facilitate the collection and monitoring of consumer complaints, in coordination with state authorities and the Federal Trade Commission. This office will also play a large role in contributing market information to the research office, allowing the latest developments in consumer finance, especially pernicious products, to come quickly to the attention of regulators. It will also provide, ideally, a real advocate for consumers that will hold financial institutions accountable for their business practices. The Complaints Office will be the site of most citizens' principle interaction with the CFPB and thus will demand strong execution.

Office of Financial Education

Another "sleeper" section of the bill that nonetheless has a good deal of potential to improve the consumer financial markets, the OFE is charged with educating and empowering consumers to make better informed decisions about their financial lives. It will develop national programs in financial counseling; evaluate credit products for ease of understanding; develop access to savings and borrowing for the unbanked; and create long-term wealth-building strategies for consumers.

Community Affairs

This office is charged with gathering information on and acting as a liaison to traditionally underserved communities, including minorities, low-income families, immigrants, and the unbanked. Federal Deposit Insurance Corporation studies find almost 8 percent of Americans are unbanked, including nearly one-fifth of black and Hispanic households. Evidence shows that transitioning from fringe financial services to the mainstream helps build assets and reduce poverty, which makes this an area where concentrated attention could pay real benefits not just for people who stand to gain from access to conventional banking, but for the economy at large as well. Outreach efforts to help identify products and practices that are obstacles to access by underserved communities could give the CFPB an opportunity to target its rulemaking and supervision while setting the agenda for broader access promotion policies.

Fair Lending and Equal Opportunity

This office will coordinate the enforcement of fair lending efforts under the authority of Title X and the Fair Lending Act, designed to prevent discrimination in lending practices and create equal opportunity for access to credit. The group has the potential to drive actions against predatory lenders in a variety of sectors, especially if it is able to work closely with the Department of Justice on prosecutions. Centralizing civil fair lending enforcement at the CFPB, with its ability to gather information from markets, stakeholders, and consumers, could seriously increase the ability of federal officials to identify and restrict redlining and price discrimination. A CFPB Assistant Director is required by law to head this office, emphasizing its importance to Congress.

Evidence shows that transitioning from fringe financial services to the mainstream helps build assets and reduce poverty, which makes this an area where concentrated attention could pay real benefits not just for people who stand to gain from access to conventional banking, but for the economy at large as well.

Office of Service Member Affairs

This is an office dedicated to bringing the various services of the CFPB to bear for those currently serving in the military and veterans. For a variety of reasons—access to the population on bases, the relative youth of service members, the strains of deployment, health challenges due to service—military families have been a particular target of predatory lenders. Due to their special status in American life, service members have already received some unique legal protection from these abuses, including limits on interest rates. The Department of Defense was a key institutional supporter of the Bureau for this reason. The CFPB may be able to glean lessons from the strategies used to protect service members in recent years and thus benefit the greater population.

Office of Financial Protection for Older Americans

A similar office is being created to focus on the problems faced by seniors, who have a higher incidence of being victimized by financial fraudsters. Dodd-Frank also requires that this office be led by an Assistant Director, once again suggesting the priorities of Congress.

Consumer Advisory Board

The Director will appoint a board of outside advisers, drawn from stakeholders in the consumer finance community, to advise and consult the CFPB on its various responsibilities. At least six of the members will be appointed by regional Fed bank presidents; the organ is analogous to the Federal Reserve's current Consumer Advisory Council.

Potential Additional Offices

It is likely as well that the CFPB will include an economics office and a chief economist, a general counsel's office, a legislative affairs office to facilitate effective relationships with the legislature, and an active public affairs office to promote the CFPB and provide information to journalists.

Though the organization of a federal agency may seem like a mundane topic, it's important to notice the increase in influence and accountability that comes from consolidating all these organs in one institution, rather than spreading them among half-a-dozen offices.

Choices and Transition

The CFPB will not simply appear over night. Implementation duties have been temporarily granted to the Secretary of the Treasury and a team of Treasury officials working under him to assemble the agency from the component parts of seven other existing regulators and whatever new staff must be hired to establish the agency's initial policies and strategy based on the authority of Title X and twenty other existing laws. Picking that staff isn't just a matter of filling slots in an organization chart: for a regulator to succeed, inculcating a culture of excellence and mission is key, which in turn means seeking out employees who are both qualified and dedicated.

The Secretary has announced that July 21, 2011 will be the "transfer date" when the agency will officially stand up under the auspices of a Senate-confirmed director. Until that time, the Treasury will manage the bureau, although legal confusion still reigns over the authority of the Treasury Secretary to make or enforce new rules, as the Secretary and his delegates may have only statutory authority to create the agency but not run it. Still, much important work can be done to lay the ground-work for the agency's practices before it gets under way.

Right now, Elizabeth Warren, a Harvard Law Professor whose 2007 journal article advocating a consumer regulator set the tone for public debate on the matter, is the key official charged with moving the agency into adulthood. An advisor to both the White House and the Treasury Department, Warren has been deputized to implement the transition of employees and authorities from other regulators into the CFPB, organize and staff new departments, and set the initial public tone and regulatory strategy for the agency.

After the transfer, the first permanent director will face some initial choices about priorities. The CFPB's first push will likely be on mortgage disclosure, simply because it is one of the first tasks required under the law, given its connection to the recent crisis. Generally, however, we can hope that the first director will emphasize metrics and deliverables right out of the gate. To establish the CFPB's legitimacy, it needs to take immediate action investigating complaints, opening up debates over rules and examining financial firms, and promoting those actions. The agency's reputation will define how effective it can be when engaged with consumers, business, and other regulators, and establishing an early pattern of action is important to the CFPB's future clout.

Because of its relative novelty, the CFPB will also have the advantage of starting from scratch, or rather, starting from today, in putting technology at the center of its operations. The agency's relationship with consumers, especially through the Complaints Office, demands leveraging the internet and other communications technology to make the end-user experience more rewarding and data gathering more effective. This also has implications for the agency's support of transparency; creating comprehensible and publicly accessible records of the agency's rulemaking process, its interactions with outside agencies, firms and interest groups, and the data it collects should be a priority. An open and understandable public comment process will also help build public respect and investment in the CFPB.

The first director will also set the tone for the CFPB's relationship with other agencies. This will be a delicate task given the CFPB's status as the only stand-alone, non-prudential regulator and the false conflict between prudential and consumer regulation that has been nurtured by the industry. The CFPB will need to find a balance between being a champion of consumers while interacting with other regulators, especially at meetings of the new Financial Stability Oversight Council, and creating effective working partnerships. This especially applies to the Federal Trade Commission, which still retains jurisdiction over some areas of consumer complaints and will need to work hand-in-glove with the CFPB.

Another Wrinkle: The New Federal Preemption Standard

There has been an extensive debate over the relationship between state and federal level financial services regulators; many a post-mortem of the financial crisis observed the prescience of many local regulators in recognizing the predatory practices that contributed to the housing bubble, but were prohibited from acting because of rules for "blanket preemption" that gave precedence to national regulators whose laxity led to little enforcement action.

At least in the consumer protection arena, this will see some change: There is an effort to create a 'floor, not a ceiling' mentality, and the law allows for state regulators to enforce laws that provide greater protection for consumers than mandated in federal law. State regulators may also use civil actions to enforce rules made by the CFPB to state chartered banks.

More broadly, while existing banking contracts will be grandfathered in under the old standard, going forward, state consumer financial laws will be preempted only if they are discriminatory towards national banks compared to locally chartered banks, or if they fail to meet the Barnett standard. Named for a 1996 Supreme Court case, the Barnett standard preempts state laws that significantly interfere with the business of banking.

Because of its relative novelty, the CFPB will also have the advantage of starting from scratch, or rather, starting from today, in putting technology at the center of its operations.

Under the standard, banks will have to appeal for preemption from state law on a case-by-case basis and will be forced to state their concerns publicly; depending on how a bank petitions for an exemption, the courts, the CFPB, and/or the Office of Comptroller of Currency, which will monitor national banks, make the judgment of whether a given state law is preempted under this standard. New transparency provisions should make these agreements more widely known and subject to broader discussion.

Conclusion

The CFPB represents a rarity in recent U.S. political history: an entirely new bureaucracy, created swiftly in response to a crisis, empowered by a president and with unique advantages in technology, data, and public reception. Making that potential a reality is a monumental management challenge, not only because of a fractious political environment in Washington, but also an industry unused to the priorities of a consumer-driven regulator, but it must be clear now how deeply important consumer credit markets are to both our broad economic stability and every family's hope to build wealth and leave their children with more advantages than they had. Policing this largely un- or under-regulated field is a big undertaking, but the CFPB's authority creates the tools for the job. Now it's time for someone to put them to work.

Appendix: The CFPB's Reports

The CFPB is required to submit a number of important reports and studies to Congress, the public, and other agencies.

Annual Report to Congress

Every year, the Director must submit a report to Congress that provides a 30,000-foot view of the American consumer finance markets. It must discuss significant problems for consumers; justify the CFPB's budget request; provide a list of rules and orders issued by the Bureau in the previous year; include an analysis of complaints about consumer financial products; assess the work of state consumer finance regulators; the effect of fair lending laws; and the inclusion of minorities and women in the financial markets.

Report on Mandatory Pre-Dispute Arbitration

Many credit card agreements require disputes to be resolved through third-party arbitration, providing an advantage to companies—and their attorneys—who are familiar with the administrative process and eliminating the potential for a trial where a consumer might have the advantage. The CFPB will study this practice and can impose conditions and limitations on arbitration agreements to level the playing field between card companies and consumers if they find it in the public interest.

Report on Financial Literacy Strategy

Yearly, the CFPB's Office of Financial Education will submit a report to Congress on financial literacy in the United States and the Bureau's efforts to promote it. This report will draw heavily on the Research Office's studies of consumer behavior.

Report on Reverse Mortgage Transactions

Reverse mortgages are loans taken out by seniors against their homes; consumers receive payments in exchange for equity in their homes, in effect cashing out their homes without having to move. While this may be useful for some seniors, it is also a practice rife with predation, and the Bureau must conduct a study on these transactions and if necessary, impose conditions or limits on them through rulemaking.

Study and Report on Credit Scores

The Bureau must conduct a study on consumer credit scores and the firms that compile them. Credit scores are now used in job and rent applications, as well as defining one's ability to borrow money, but the opaque scoring process denies consumers an information advantage. While the Dodd-Frank bill contains a provision that guarantees consumers access to their numerical score for free for the first time, this report will analyze the ratings system for weakness.

Report on Exchange Facilitators (Pawn Shops)

Among other kinds of fringe financial services, pawn shops as a source of temporary credit is suspected to be asset-stripping and predatory. The Bureau must conduct a study on consumers who use exchange facilitators for transactions primarily for personal, family, or household purposes to analyze the effect of these firms on consumer credit.

MAIN OFFICE
1899 L Street, NW
Suite 400
Washington, DC 20036
Phone 202 986 2700
Fax 202 986 3696

CALIFORNIA OFFICE
921 11th Street
Suite 901
Sacramento, CA 95814
Phone 916 448 5189

NEW AMERICA FOUNDATION
WWW.NEWAMERICA.NET