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## Meet the new boss: the Bureau of Consumer Financial Protection

### **Foley & Lardner LLP**

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With the passage and signing of the omnibus Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), a new era of financial regulation has been born. The 2,300 plus pages of new legislation will forever change the way financial services companies do business in the United States (and elsewhere). With that in mind, the CFSL Bulletin will publish a series of articles reviewing the 429 pages of Title X of the Dodd-Frank Act, also known as the Consumer Financial Protection Act of 2010 (CFPA). The series begins with a detailed overview of the Bureau of Consumer Financial Protection (Bureau), the new primary regulator with authority over consumer financial products and virtually every federal consumer financial protection statute. Specifically, this installment will address:

1. The CFPA's Effective Date;
2. The Bureau's Limitations;
3. The Structure of the Bureau;
4. The Bureau's Rulemaking Authority; and
5. The Bureau's Supervisory Authority.

Subsequent articles will focus on the CFPA's provisions addressing preemption, enforcement, regulatory improvements, and federal consumer financial protection statutory amendments.

### **Effective Date**

There are two important effective dates for the CFPA. First is the "effective date," which is July 21, 2010 -- the date President Obama signed the Dodd-Frank Act. On the effective date, the provisions of the CFPA that establish the Bureau and grant it general rulemaking and supervisory authority take effect. Most other provisions in the CFPA become effective on the "designated transfer date," which, based on the effective date, is no sooner than January 17, 2011 and no later than January 21, 2012. The designated transfer date will be selected by the Secretary of the Treasury (currently, Tim Geithner) no later than September 19, 2010. In setting the designated transfer date, the Secretary is required to consult with the chairs of the Federal Reserve, the FDIC, the FTC, and a host of other financial regulatory agencies.

## **The Bureau's Limitations**

Before delving into the breadth of coverage of the statute and the powers the Bureau will have under the CFPA, as a prefatory matter, it is important to understand the Bureau's limitations. First, the CFPA specifically excludes from the Bureau's coverage certain parties, including:

- Merchants, retailers, and other sellers of nonfinancial goods or services
- Real estate brokerage activities
- Manufactured home retailers and modular home retailers
- Accountants and tax preparers
- Legal practitioners
- Employee benefit and compensation plans
- Persons regulated by the SEC, the CFTC, a state securities commission, a state insurance regulator, or the Farm Credit Administration
- Motor vehicle dealers, unless they provide mortgages or extend consumer retail credit without assigning it to third parties
- Tax-exempt organizations

Second, the Bureau will not have any power under the CFPA to impose usury limits. Third, the CFPA does not change the authority already granted to the Attorney General or Secretary of Treasury under other laws, the FDIC under the Federal Deposit Insurance Act, or the National Credit Union Administration Board under the Federal Credit Union Act. Fourth, the CFPA does not affect any authority arising under the Fair Housing Act.

Importantly, the Bureau will have the power to pass regulations that will exempt from the CFPA any class of persons covered by the CFPA, services providers, or any consumer financial product or service. In doing so, the Bureau must take into account the total assets of the class of covered persons, the volume of transactions involving consumer financial products or services in which the class of covered persons engages, and existing laws applicable to the product or service and the extent to which such provisions provide consumers with adequate protections.

## **The Structure of the Bureau**

The CFPA refers to the Bureau as a "independent bureau" that "shall be considered an Executive agency" as defined by 5 U.S.C. 105. Whatever the moniker, make no mistake about it, the Bureau will be an important and potent federal agency in the decades to come.

The Bureau will be headed by a Director, appointed for a five year term by the President and confirmed by the Senate. Currently, there is much speculation over who President Obama will appoint for the job. Needless to say, the first Director of the Bureau will have a lasting impact on the direction of the organization for years to come. Until a Director is appointed and affirmed, the Secretary of the Treasury (i.e., Tim Geithner) is authorized to provide the Bureau's administrative services in advance of the designated transfer date.

The Federal Reserve Board is required to fund the Bureau each year from the combined earnings of the Federal Reserve System. The funding is capped by a percentage of the Federal Reserve System's total operating expenses as reported in the 2009 Annual Report of the Board of Governors. For 2011, the cap is 10 percent; for 2012, 11 percent; and for 2013 and each year thereafter, it is 12 percent. This means an initial budget of half-a-billion dollars for the Bureau. In addition, for 2010 through 2014, the Director may seek an additional \$200,000,000 appropriation when "the sums available to the Bureau . . . will not be sufficient to carry out the authorities of the Bureau under Federal consumer financial law for the upcoming year."

### Rulemaking Authority

The Bureau will have expansive authority to adopt and enforce new regulations that will apply to "covered persons" offering any "consumer financial product or service." Congress set forth a specific rulemaking standard for the Bureau under the CFPA. Specifically, when prescribing any rule, the Bureau must consider: (a) the potential benefits and costs to consumers and "covered persons" (including the potential reduction of access by consumers to "consumer financial products or services" resulting from a rule), and (b) the impact of proposed rules on covered persons and the impact on consumers in rural areas.

Congress put an important check in place against the Bureau's rulemaking authority. Specifically, the new Financial Stability Oversight Council (Council) born out of the Dodd-Frank Act has the power to set aside any final regulation prescribed by the Bureau if it "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." A two-thirds vote of the Council is required.

### **Definitional Interlude**

As may be evident at this point, the CFPA is thick with important defined terms, three of which require definition here. First, the CFPA defines a "**covered person**" as "any person that engages in offering or providing a consumer financial product or service" and "any affiliate of [such person] if such affiliate acts as a service provider to such person."

Second, the CFPA very broadly defines "**financial product or service**" as including, among other things:

- Extending credit and servicing loans
- Extending or brokering leases of personal or real property that are the functional equivalent of purchase finance arrangements (subject to certain requirements)
- Providing real estate settlement services (subject to certain exceptions)
- Engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a customer
- Selling, providing, or issuing stored value or payment instruments (subject to certain exceptions)
- Providing check cashing, check collection, or check guaranty services
- Providing payments or other financial data processing products or services to a consumer by any technological means, or through any payments systems or network used for processing payments data (subject to certain exceptions)
- Providing financial advisory services to consumers to consumers on individual financial matters or

relating to proprietary financial products or services (subject to significant exceptions)

- Collecting, analyzing, maintaining, or providing consumer report information or other account information used or expected to be used in connection with any decision regarding the offering or provision of a consumer financial product or service (subject to certain exceptions)
- Collecting debt related to any consumer financial product or service

In addition, the Bureau can, by regulation, add to this list of financial products or services any other product or service if the Bureau finds that such product or service is: (1) "entered into or conducted as a subterfuge or with a purpose to evade any Federal consumer financial law;" or (2) "permissible for a bank or for a financial holding company to offer or to provide under any provision of a Federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers."

Third, the CFPA defines "**service provider**" as any person that provides a "material service" to a covered person in connection with the offering or provision of a consumer product or service. Excluded from the definition of service provider are persons who, solely by virtue of offering or providing to a covered person either: (a) support or ministerial services "of a type provided to businesses generally," or (b) time or space for the advertising of a consumer financial product or service. However, the CFPA expressly provides that "[a] person that is a service provider shall be deemed to be a covered person to the extent such person engages in the offering or provision of its own consumer financial product or service."

### **Three Key Areas of Bureau Rulemaking**

The Bureau has three important areas of rulemaking authority: (1) the federal consumer financial laws; (2) unfair, deceptive, or abusive acts or practices; and (3) restrictions on pre-dispute arbitration clauses.

#### **1. Federal Consumer Financial Law**

The Bureau will have complete rulemaking authority over "Federal consumer financial law." The CFPA defines that term as including the CFPA itself, "enumerated consumer laws," laws for which authorities are transferred under certain specific provisions of the CFPA (these will be discussed in detail in a subsequent posting), and any rule prescribed by the Bureau under any of these laws.

The "enumerated consumer laws" include the familiar alphabet soup of consumer financial laws, as well as several other statutes. Specifically, the exhaustive list of enumerated consumer laws is as follows:

- Alternative Mortgage Transaction Parity Act
- Consumer Leasing Act
- Electronic Fund Transfer Act (with certain exceptions)
- Equal Credit Opportunity Act
- Fair Credit Billing Act
- Fair Credit Reporting Act (with certain exceptions)
- Home Owners Protection Act
- Fair Debt Collection Practices Act

- Federal Deposit Insurance Act (only section 43(b)-(f))
- Gramm-Leach-Bliley Act (only section 502 through 509, except section 505 as it applies to section 501(b))
- Home Mortgage Disclosure Act
- Home Ownership and Equity Protection Act
- Real Estate Settlement Procedures Act
- S.A.F.E. Mortgage Licensing Act of 2008
- Truth in Lending Act
- Truth in Savings Act
- Omnibus Appropriations Act of 2009 (only section 626)
- Interstate Land Sales Full Disclosure Act

Thus, with the passage of the CFPA, the rulemaking authority of the federal agencies under the enumerated consumer laws -- e.g., the Fed, the OCC, the OTS (actually abolished under the Dodd-Frank Act), the NCUA, the FDIC, HUD -- has been transferred to the Bureau.

## 2. **Unfair, Deceptive, or Abusive Acts or Practices**

The CFPA specifically authorizes the Bureau to take any enforcement action (the Bureau's enforcement powers will be discussed in a subsequent posting) to prevent a covered person or service provider from "committing or engaging in an unfair, deceptive, or abusive act or practice" in any transaction with, or offering to, a consumer for a consumer financial product or service. In order to declare an act or practice "**unfair**," the Bureau must have a reasonable basis to conclude that the consumer financial product or service is: (a) likely to cause or causes substantial injury which is not reasonably avoidable by consumers, and (b) "countervailing benefits to consumer or to competition" do not outweigh the substantial injury. The Bureau may also consider public policy, but public policy cannot serve as the primary basis for a finding of unfairness.

In order to reach a finding that an act or practice is "**abusive**," the Bureau must find that such act or practice either: (a) materially interferes with a consumer's ability to understand a term or condition of a consumer financial product or service, or (b) takes "unreasonable advantage" of a consumer's lack of understanding, inability to protect herself, or reasonable reliance on a covered person to act in the consumer's interests. The latter alternative seems to incorporate the notion advanced by academics that consumers are generally not capable of comprehending the terms of consumer financial products or services and the resulting consequences for various defaulting behaviors (e.g., late payments, account overdraws).

Interestingly, the CFPA does not define or set a standard for a "**deceptive**" act or practice.

## 3. **Ability to Restrict Mandatory Pre-Dispute Arbitration**

The Bureau is required to conduct a study of the use of pre-dispute arbitration agreements between covered persons and consumers in connection with the offering or provision of any consumer financial product or service. After the Bureau reports its findings to Congress, the Bureau may, by regulation, prohibit or

impose conditions or limitations on the use of such agreements if it is in the public interest and for the protection of consumers. The authority to prescribe these rules is limited to pre-dispute arbitration clauses; the Bureau may not prohibit or restrict a consumer from entering into a post-dispute arbitration agreement.

## **Supervisory Authority**

The Bureau will now have primary supervisory and examination authority over certain nondepository and depository institutions. For purposes of supervision, the CFPB separates "covered persons" into three categories: (1) nondepository institutions; (2) large depository institutions; and (3) smaller depository institutions. Additionally, service providers are subject to the authority of the Bureau to the same extent it would be covered if it was engaged in a service relationship with a bank and the Bureau were a federal banking agency under Section 7(c) the Bank Service Company Act.

### **1. Nondepository Institutions**

A nondepository covered person includes:

- Mortgage originators, brokers, and servicers
- "Larger" participants of a market for other consumer financial products or services
- Persons the Bureau determines to be engaging in conduct that poses risks to consumers
- Private education loan providers
- Payday lenders

The CFPB does not define "larger participants," but it is reasonably foreseeable that this category would include large captive finance companies and the like.

Under the CFPB, the Bureau has the power to require any nondepository covered person to file reports addressing whether it is a covered person subject to supervision and examination, and, in consultation with state agencies, prescribe registration requirements. Additionally, the Bureau has exclusive authority to enforce the Federal consumer financial laws (other than where the FTC retains enforcement authority). A federal agency that is authorized to enforce any Federal consumer financial law may make a referral by recommending that the Bureau begin enforcement proceedings.

### **2. Large Depository Institutions**

This category is for insured depository institutions and credit unions (and their affiliates) with total assets of more than \$10 billion. For these large depository institutions, the Bureau has the primary authority to enforce the Federal consumer financial laws. As with nondepository entities, a federal agency that is authorized to enforce any Federal consumer financial law may make a referral by recommending that the Bureau begin enforcement proceedings. There are two important differences, however. First, the FTC may not make a referral for large depository institutions. Second, if the Bureau does not institute an enforcement proceeding within 120 days of the referral, the referring agency may initiate the proceeding.

### **3. Smaller Depository Institutions**

A smaller depository institution is a covered person that is either an insured depository institution or credit union with total assets of less than \$10 billion. The smaller depository institution's prudential regulator has the exclusive authority to enforce the Federal consumer financial laws. The Bureau must notify the

prudential regulator when the Bureau believes that a smaller depository institution has materially violated the Federal consumer financial laws.

### **Conclusion**

With a broad mission of regulating consumer financial products and services, the Bureau will soon be shaping the future direction of the retail financial industry. Check back frequently to read more about preemption and enforcement under the CFPB, developments of the Bureau, and the appointment of the CFPB's first Director.

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