Consumer Financial Issues In the Dodd-Frank Era

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Consumer Financial Issues In the Dodd-Frank Era

- On July 21, 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law.
- The Act is the largest financial regulation in decades.

Today's Discussion

1. Bureau of Consumer Financial Protection (Bureau)
2. Mortgage Lending
3. Preemption

1. Creation of the Bureau of Consumer Financial Protection

- The Bureau is an independent entity within the Federal Reserve System whose central mission is to ensure that consumer financial markets are fair, transparent, and competitive and to protect consumers from discrimination and unfair, deceptive, or abusive acts and practices.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- The Bureau consolidates consumer financial law currently handled by:
  - The Office of the Comptroller of the Currency (OCC)
  - The former Office of Thrift Supervision (OTS)
  - The Federal Deposit Insurance Corporation (FDIC)
  - The Federal Reserve
  - The National Credit Union Administration
  - The Department of Housing and Urban Development
  - Federal Trade Commission

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- The Bureau will have rulemaking and enforcement authority over all consumer finance activities except insurance and CFTC/SEC regulated services.
- The Bureau will be vested with enforcing TILA, ECOA, FDCPA, FCRA/FACTA, and GLBA.
  - Cannot set usury limits.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- It is presumed that the Bureau will streamline the process of highlighting potential consumer financial issues, create and issue rules, and then enforce those rules. For example, enforcement of the Credit Card, Accountability, Responsibility and Disclosure Act (Card Act) is consolidated with the Bureau.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- The Bureau will be largely independent but the Federal Reserve will have limited ability to restrict the rulemaking and enforcement of the Bureau if such rules and enforcement endanger the safety and soundness of the financial system.
- Staffing from FTC Consumer Protection Division.
- FTC retains enforcement of non-bank lenders.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- New rulemaking:
  - The Bureau is authorized to write new rules to curtail deceptive, unfair, or abusive practices related to consumer financial products, but it is not required to re-examine inherited rules.
  - In making such rules, the Bureau is required to consider the potential benefits and costs to consumers <u>and</u> providers. The Bureau must take into consideration whether a new rule could reduce access to financial products and guard against that possibility.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Bureau must conduct three large studies.
  A. Impact of Mandatory Arbitration:
    - The act specifically calls for the Bureau to study mandatory, pre-dispute arbitration and, after reporting back to Congress, will be authorized to either ban or regulate pre-dispute arbitration clauses, provided it "finds that such prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers" and such findings are consistent with its study.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Bureau must conduct three large studies. *(cont.)*
  - B. Reverse Mortgages:
    - The Bureau must conduct a study on reverse mortgages and evaluate their disclosures and limitations to determine if any practice is "unfair, deceptive, or abusive." After such study, the Bureau is directed to provide an "integrated disclosure standard and model disclosures for reverse mortgage transactions."

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Bureau must conduct three large studies. *(cont.)*

  C. Credit Reports/Scores:

  - The Bureau must evaluate “the nature, range, and size of variations” between the credit score information sold to consumers in the credit reports and to creditors in marketing information and determine whether these studies disadvantage consumers. Like the other studies, this study will likely result in new disclosure standards and rules.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Exclusions and limitations of the Bureau:
  - Retailers, merchants, and sellers of non-financial goods or services that provide credit for the sale of retail products are not regulated by the Bureau.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Exclusions and limitations of the Bureau: *(cont.)*
  - Specific entities were excluded from Bureau regulations even though they provide some type of financial products, notably:
    - Auto dealers
    - Accountants and tax preparers
    - Manufactured and modular home retailers
    - Real estate brokerage activities
    - Attorneys (practicing law)

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Exclusions and limitations of the Bureau: *(cont.)*
  - The Bureau has limited examination authority over banks, thrifts, and credit unions with $10 billion or less in assets because their primary regulators will be responsible for examining and enforcing compliance with federal consumer financial laws.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Impact on litigation:
  - More effective and quicker enforcement in civil and criminal regulatory actions.
  - Studies will likely lead to new litigation. New rules regarding mandatory arbitration could spur class action filings. The reverse mortgage and credit score studies could bring to light industry patterns of lending that could form the basis of potential claims.

1. Creation of the Bureau of Consumer Financial Protection *(cont.)*

- Impact on litigation: *(cont.)*
  - Bureau enforcement decisions could be used by parties as a basis for potential claims, especially those involving "abusive" trade practices.

2. Mortgage Reform and Predatory Lending

- The Act sets minimum underwriting standards for mortgages and requires lenders to verify that consumers have a reasonable ability to repay at the time the mortgage is made. Certain high-quality, low-cost loans are presumed to meet this standard.

2. Mortgage Reform and Predatory Lending *(cont.)*

- Down-the-chain registration requirements (lead providers, brokers, debt counselors).
- Mirrors many state-based regulations passed in reaction to foreclosure crisis.

2. Mortgage Reform and Predatory Lending *(cont.)*

- The Act prohibits lenders from making higher-cost mortgages without first obtaining a written appraisal.
- The Act also establishes federal appraisal independence standards prohibiting parties involved in a real estate transaction from influencing the independent judgment of an appraiser through collusion, coercion, or bribery.

2. Mortgage Reform and Predatory Lending *(cont.)*

- In order to prevent predatory lending, certain practices have been prohibited. For example, the Act bans the payment of “yield spread premiums” to brokers or any other type of origination compensation based upon interest rates or other loan terms. Pre-payment penalties are also banned.

2. Mortgage Reform and Predatory Lending *(cont.)*

- The Act expands protections for high-cost loans (loans secured by a principal dwelling that is 6.5% more than the prime rate for comparable transactions or 8.5% more for second mortgages) by prohibiting the financing of points and fees, excessive fees for payoff information, modifications, or late payments, and other practices viewed as increasing the risk of foreclosure (e.g., balloon payments, call provisions).

2. Mortgage Reform and Predatory Lending *(cont.)*

- Mandatory pre-dispute arbitration in residential mortgages and home equity loans are banned (though parties may agree to arbitrate their claims).

2. Mortgage Reform and Predatory Lending *(cont.)*

- Additional information must be placed on periodic statements including: (1) the amount of loan principal; (2) the current interest rate; (3) the date which the interest rate may reset or adjust; (4) any late fee; (5) a phone number and an email address the borrower can contact for loan information; and (6) information on credit counseling agencies.
- The Act establishes an office of Housing Counseling within HUD to boost home ownership and provide rental housing counseling.

3. Preemption Under the Act

- Preemption trend is reversed by the Act.
- Operating subsidiary preemption is eliminated, thus non-bank operating subsidiary lenders need to be brought into the parent bank or thrift to receive any type of preemption protection.
  - Tax consequences.

3. Preemption Under the Act *(cont.)*

- State visitorial and enforcement powers were expanded to:
  - Allow authorized state law enforcement authorities to bring lawsuits under state law against national banks.
  - Authorize suits by state attorneys general against national banks and thrifts to enforce rules issued by the Bureau (but not to enforce the Act).

3. Preemption Under the Act *(cont.)*

- For non-bank institutions, state attorneys general can sue to enforce the Act and Bureau rules and state regulators can bring administrative proceedings to enforce the Act and Bureau rules.

3. Preemption Under the Act *(cont.)*

- The Act establishes when "state consumer finance laws" can be preempted. A "state consumer finance law" is a law that directly and specifically regulates any financial transaction or account.
- So, arguably, pre-Act preemption standards for laws that do not fall into that category survive.

3. Preemption Under the Act *(cont.)*

- "State consumer finance laws" are only preempted if:
  - The law discriminates against national banks;
  - The law "prevents or significantly interferes with the exercise by the national bank of its powers," per the standard set forth by the U.S. Supreme Court in its 1996 *Barnett Bank* decision, determined by the OCC on a case-by-case basis or by a court; or
  - If the law is preempted by another federal law.

3. Preemption Under the Act *(cont.)*

- In doing its case-by-case determination, the Comptroller shall consider the impact of a particular state consumer finance law on any national bank subject to that law, or the law of any other state with substantially equivalent terms.

3. Preemption Under the Act *(cont.)*

- The Comptroller cannot delegate this determination to other officials, and his/her decision must be supported by "substantial evidence" made on the record supporting the specific findings under the *Barnett Bank* standard.
- Also charged with looking at costs of compliance.
- Automatic "interference" argument will not be an option.

3. Preemption Under the Act *(cont.)*

- A court reviewing the Comptroller’s decision shall consider such determinations based upon, among other things, the thoroughness of the OCC’s consideration, validity of reasoning, and consistency with other determinations.
- Periodically the OCC must review its preemption determinations and report the result of the review to Congress.

3. Preemption Under the Act *(cont.)*

- The Act allows states to impact federal law by requiring the Bureau to issue a notice of proposed rulemaking when a majority of states enact a resolution in support of the establishment or modification of a consumer protection regulation. The Bureau does not have to adopt any proposal, but if it does not rule based upon the state resolutions, it must provide an explanation.

3. Preemption Under the Act *(cont.)*

- The Act does not affect preemption provisions in other federal laws.
- The Act preserves the provision of the National Bank Act that allow for the “exportation” of interest rates from the bank’s home state (fees, etc., follow that).

3. Preemption Under the Act *(cont.)*

- The preemption and applicability of state law provisions do not take effect until the designated “transfer date” – when the powers of certain federal regulators are transferred to the Bureau. This must occur between six to 12 months after enactment with a potential extension of up to 18 months after enactment.

3. Preemption Under the Act *(cont.)*

- The preemption provisions do not alter the applicability of OCC or OTS preemption regulations, orders, or guidance to any "contracts" entered by banks or thrifts prior to the enactment of the Act.

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