# FIRST DO NO HARM

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**An analysis of the broad powers of the Bureau of Consumer Financial Protection, otherwise known as the Consumer Financial Protection Bureau.**

In his remarks at the signing ceremony for the Dodd-Frank Wall Street Reform and Consumer Protection Act, President Obama promised that the arsenal of consumer protections included in the new law would be "enforced by a new consumer watchdog with just one job: looking out for people—not big banks, not lenders, not investment houses—looking out for people as they interact with the financial system." ■ The establishment of the Bureau of Consumer Financial Protection (more commonly known as the Consumer Financial Protection Bureau—or CFPB) has been a central and fiercely debated pillar of the administration's financial reform strategy. Although political compromise, practicality and even in-court challenges to the scope of the CFPB's authority could diminish its influence, the CFPB's current structure and powers point to an agency likely to profoundly impact the financial services industry. This article discusses that impact and the aspects of the CFPB likely to produce it.

**_Quis custodiet ipsos custodies?_ Who will guard the guardians themselves?**

After a lengthy legislative and public debate, a sole director will head the CFPB, distinguishing it from most other financial regulatory agencies run by commissions or boards. The director should enjoy relative autonomy, including independence from appropriations and minimal oversight from other agencies and Congress. Absent legislative change to the CFPB's structure and governance, the CFPB and its director are likely to wield considerable influence.

*The single-director model*

Under Dodd-Frank, the director must be appointed by the president and confirmed by the Senate to a five-year term, removable only for cause by the president. In its original formulation, however, the provision submitted by President Obama's Treasury Department called for a board of directors headed by a chairperson, a structure employed by nearly every other federal financial regulator.

In a paper accompanying its proposed legislative language, the Treasury noted that the board/director structure would promote "independence and accountability" and that the board "should represent a diverse set of viewpoints and experiences."

Nonetheless, after significant legislative debate, a single-director model for the CFPB was adopted despite the concerns—largely of congressional Republicans—that the model vests too much power in the director.

The fear has been that a CFPB director whose regulatory authority is not counterbalanced could—whether by abuse, misuse or underinformed use of power—make poor decisions with long-lasting and devastating consequences for the economy. Critics of a single-director model believe a bipartisan board or commission structure, with its inherent checks and balances, would better safeguard against such risks.

Opposition to a single-director model remains strident, and President Obama remains unable to confirm a director. Forty-four Republican senators—enough to defeat a motion for cloture—have signed a letter vowing to block any nominee for director until the CFPB is restructured. This promise, if kept, could significantly undercut the CFPB's mandate, as many of its powers do not become effective until a director is confirmed. To date, there is good reason to think Senate Republicans will hold their ground. During the Senate Banking Committee's Sept. 6 confirmation hearing for Richard Cordray, Obama's nominee for the directorship, several Republican members reiterated concerns about the CFPB's structure. As of press time, Cordray's nomination had not been approved out of the committee.

*An agency with limited oversight*

Beyond its single-director structure, the CFPB has a high degree of financial independence from Congress or the appropriations process. The CFPB is guaranteed a fixed percentage of the Federal Reserve Board's budget for the next three years, and has the ability to seek up to $200 million more in any year from the president.

Although the CFPB must submit annual financial reports to Congress, report on its budget, provide financial documentation to the Office of Management and Budget (OMB), and submit to annual Government Accountability Office (GAO) audits, these restraints—without congressional control of the purse—are unlikely to dissuade the CFPB, if it so chooses, from politicizing its approach to sensitive regulatory and enforcement matters.

Further, the limits on CFPB authority that purportedly are in place lack teeth. For example, the ability of the Financial Stability Oversight Counsel (FSOC) to review CFPB regulations is illusory. The FSOC may only overrule a CFPB rulemaking if two-thirds of the FSOC's voting membership finds that the rule endangers the entire financial system.

In addition, despite the fact that the CFPB is created as a "bureau" within the Fed, the Fed has no authority to intervene in CFPB matters, appoint or remove any CFPB personnel, merge or consolidate the CFPB or its functions, subject CFPB rules to review by the Fed, or even require legislative recommendations or testimony.

### *Et dominabitur a mari usque ad mare, et a flumine usque ad terminos terrae*—And he shall have dominion from sea to sea, and from the river unto the ends of the earth.

Exacerbating concerns over the CFPB's leadership is the scope of the agency's oversight. Under the Dodd-Frank Act, the CPFB will oversee nearly every actor in the financial system—regardless of size, prudential regulator or status as federal or state-chartered entity.

By statute, the CFPB is tasked with implementing and enforcing most federal consumer financial law. This includes the "enumerated" consumer-protection laws, including the Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA), Home Ownership and Equity Protection Act (HOEPA), Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), and a host of others (but notably excluding the Federal Trade Commission Act [FTC Act] and the Fair Housing Act).

CFPB power includes not only 1) issuing rules, orders and guidance; and 2) investigating consumer complaints; but also 3) supervising any "covered person" and 4) taking appropriate enforcement actions to address violations of federal consumer financial law.

The power to enforce federal consumer financial law against any "covered person" grants the CFPB at least some authority to oversee nearly the entire financial sector.

The most comprehensive CFPB authority is over "non-depository" financial institutions. This includes anyone engaged in mortgage origination, servicing and foreclosure; anyone who "is a larger participant of a market for other consumer financial products or services"; and anyone else the CFPB determines is engaging "in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services." Here, once the CFPB has a director in place and finalizes a rule, it will have exclusive supervisory, rulemaking and examination authority over all issues related to consumer financial services law.

The CFPB holds nearly as broad a grant of power over the most substantial category of regulated entities—the "large banks." This category includes any insured depository institution or credit union with more than $10 billion in assets, including affiliates.

To put this in perspective, this category currently covers 111 depository institutions, holding more than 80 percent of the banking industry's assets. The CFPB has exclusive authority to require reports and conduct examinations of these large banks with respect to compliance with federal consumer financial laws and primary enforcement authority over large banks for violations of these laws.

Although "small banks" should receive less scrutiny than their larger counterparts, the CFPB retains some oversight of them.

For example, the CFPB can have its examiners participate in the prudential regulator's examination and require reports from small banks, even though the prudential regulator retains primary supervisory authority. And, although the CFPB lacks enforcement authority, it can recommend enforcement actions to the prudential regulator that must be addressed within 60 days.

This statutory structure renders the CFPB essentially omnipresent when examining and enforcing compliance with federal consumer financial laws. That alone will mark a huge departure from the status quo for financial services companies. A new "cop" on the beat will mean that past experience with supervision will not necessarily be prologue; thus, prior examinations cannot be relied upon as either predictive tools or a defense against future actions.

Of particular significance for depository institutions is the fact that, unlike the historic practice of a prudential regulator always examining consumer compliance in tandem with institutional safety-and-soundness concerns, the CFPB can examine consumer compliance in isolation.

The departure from past practice will be stark even in comparison to the recent heightened frequency and intensity with which regulators have examined institutions for compliance, which—despite the increased scrutiny—has still been tethered to institutional safety-and-soundness considerations.

For non-depository institutions, the scope, depth and intensity of the examinations will likely be far more acute than in past compliance examinations by state regulators.

### *Abusus non tollit usum*—The abuse of a thing does not invalidate its proper use.

The concerns over who will govern the CFPB and what the CFPB will govern pale in comparison to concerns about how the CFPB will govern. Such concerns stem from the CFPB's authority to prohibit unfair, deceptive, or abusive acts or practices in connection with consumer financial products or services.

For nearly a century, the FTC Act gave the FTC the power to prevent unfair or deceptive acts or practices (UDAP) on the federal level, and over decades, the FTC and courts have built a reasonably stable common law for businesses to assess their own practices. Federal banking agencies, in turn, have generally followed the FTC's lead when enforcing Section 5 of the FTC Act against financial institutions.

However, the Dodd-Frank Act changes UDAP in two critical ways. First, it adds the CFPB as a principal arbiter of UDAP rulemaking and enforcement. Although the FTC will retain some role in rulemaking and enforcement under the FTC Act, the Dodd-Frank Act consolidates UDAP rulemaking for financial institutions in the CFPB and, along with the FTC, grants the CFPB authority to enforce those FTC rules with respect to covered people.

Second, the Dodd-Frank Act expands UDAP to include "unfair, deceptive and abusive acts and practices" (UDAAP), a definitional expansion the CFPB appears keen to leverage. However, there is little guidance as to the meaning of "abusive" or how it augments what was already covered by unfair and deceptive.

The Dodd-Frank Act merely provides that an abusive act or practice must "materially interfere" with the consumer's ability to understand a consumer financial product or service or take advantage of a consumer's lack of understanding, inability to protect his own interests or reasonable reliance. A more thorough definition is to be determined by future CFPB rulemaking.

In the absence of rulemaking, it is unclear how the CFPB will interpret its new authority to prevent abusive acts. It is also unclear whether courts will grant the same level of deference to the CFPB's interpretation of "abusive" as they tend to do with other examiners' recitations of "safety and soundness."

With its broad mandate, broad powers and vague definition of "abusive," the CFPB will have significant leeway to examine and enforce restrictions or prohibitions on certain practices, such as yield-spread premiums and "punitive" loan provisions.

The CFPB has already shown it does not intend to sit on the sidelines. Even before its July 21, 2011, launch, the CFPB had already consummated an unprecedented relationship with the state attorneys general (AGs) to coordinate federal and state enforcement of consumer financial protection laws.

On April 11, 2011, it released a "Joint Statement of Principles" with the National Association of Attorneys General that outlined a new degree of coordination between state and federal agencies with respect to oversight and enforcement of financial institutions. The principles include everything from sharing information to coordinating enforcement priorities, to enforcement itself "across state lines and without regard to corporate forms or charter choice." Because the Dodd-Frank Act centralizes consumer-complaint intake in the CFPB, this partnership ensures that institutions will confront coordinated federal and state enforcement.

In addition, because the CFPB's ability to regulate all institutions through rulemaking and its ability to use enforcement authority against non-depository institutions is constrained until the administration can confirm a director, the CFPB will look to influence depository institutions through its oversight, examination and enforcement powers. Such institutions should anticipate lengthy and comprehensive examinations by the CFPB.

They should also expect the CFPB to use its enforcement authority to impose remedial actions on alleged bad actors, thereby creating *de facto* law. This will likely deprive institutions of a meaningful opportunity to challenge enforcement positions of the CFPB, as nearly all would fear similar agency scrutiny.

Finally, the CFPB's role in ongoing settlement negotiations shows it will be a powerful regulator with significant influence on other federal and state enforcement authorities. For example, through Elizabeth Warren—then a special adviser to the secretary of the Treasury for the CFPB and widely regarded as the driving force behind its creation—the CFPB has been a critical player in settlement negotiations between the Department of Justice (DOJ), the state attorneys general and the nation's largest mortgage servicers over certain foreclosure practices.

In a presentation, the CFPB recommended a settlement value of $20 billion, which has since been reported as the baseline settlement value for the state AGs. Unsurprisingly, in a draft settlement proposal, the CFPB was given an ongoing oversight role that would have included 1) the receipt of audit reports and compliance data; 2) the review of loss-mitigation formulas and denials; and 3) the coordination of procedures to resolve borrower complaints.

### ***Qui non est hodie cras minus aptus erit*—He who is not prepared today will be less prepared tomorrow.**

Under the Dodd-Frank Act, the CFPB shall ensure that "markets for consumer financial products and services are fair, transparent and competitive." However, as things stand, it is not certain the CFPB's own actions will be fair, transparent or encourage competition.

Given the new regulatory and enforcement reality, what should institutions do? The best response is a familiar one: prepare, prepare, prepare.

Institutions should prepare for the CFPB to conduct more frequent, more intense consumer-compliance examinations that will not be refracted through the prism of safety and soundness. That means reviewing compliance programs, recordkeeping and documentation procedures, and implementing training programs, if needed. In addition, institutions should assess all consumer-facing products, focusing on risks to consumers as well as predatory and fair lending concerns.

Institutions should also consider the degree to which they will defer to the CFPB. From the economic cost of extensive, continual, comprehensive examinations, to the demands for information and records, to the restriction or elimination of products and practices, there are many context-specific reasons that could arise in which institutions may prefer to challenge the CFPB's reach. In this regard, the CFPB's lack of a safety-and-soundness mandate—though a cause of concern—may also provide a means to launch such a challenge insofar as courts may be less deferential to the CFPB than they historically have been to prudential regulators.

Although the hope is that the CFPB improves the financial services markets by establishing clear priorities and positions from which institutions can identify, learn and adapt their policies and practices, the CFPB's framework gives it the power to erode the very markets it was designed to protect. In the end, the collective weight of the single-director model, the agency's relatively unchecked power, its broad reach to nearly all actors in the financial industry, its unprecedented ability to govern "abusive" acts and practices, and its freedom from considering safety-and-soundness concerns will usher in a new and challenging era of regulation and enforcement for the financial services industry. **MB**

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