

# The New Cop Sets Up Shop

## The New Consumer Financial Protection Bureau

by  
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The Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA or the Act), all 2,300+ pages of it, is the most sweeping change to the financial services industry since the Great Depression. Almost 500 pages in Title X of the DFA creates the Consumer Financial Protection Bureau, (CFPB or Bureau), the first independent federal agency established in over 30 years to oversee the consumer financial services industry. The CFPB, after much debate, is housed as an independent agency within the Federal Reserve, itself an independent federal agency. This “agency within an agency” has the potential to become one of the most powerful governmental forces in the United States, with authority to radically transform how the consumer financial service industry will be regulated and supervised. It has a single director with no oversight by a board of directors like the Federal Reserve or the FDIC, and most importantly is not subject to the Congressional appropriations process getting all of its funding, estimated to be in excess of \$500 million, from the Federal Reserve budget, itself not subject to the appropriations process.

The DFA gives the CFPB the authority to make and enforce regulations to ensure that all consumers have access to markets for consumer financial products and services, and that these markets are “fair, transparent and competitive.” Set to assume its authority on July 21, 2011, the “designated transfer date,”



the CFPB is starting to take form with initial staff being hired and a organization chart beginning to take shape.

In September 2010, President Obama named Harvard Law School professor and noted Wall Street critic Elizabeth Warren as his special assistant and to assist Treasury Secretary Timothy Geithner in setting up the CFPB. While lobbying forcefully to become the first director of the CFPB, concern about her “confirmability” led the President to defer naming Warren as the initial director, but instead to have her play a “pivotal role” in selecting the first director and making personnel decisions as the Bureau takes shape and begins to fulfill its statutory responsibilities. Warren has been outspoken in saying she views the CFPB as the “tough cop on the beat” in supervising the consumer offerings of financial institutions, and undoubtedly will recommend to the President a nominee who shares her views. That nomination will require the consent of the U.S. Senate.

Recently named to the Bureau’s implementation team are:

- Steve Anantakas, former Massachusetts Commissioner of Banking, to head up the Bureau’s responsibilities regarding regulated depository institutions
- Peggy Twohig, a former Federal Trade Commission

official, who will head up the Bureau's nondepository institutions regulation

- Richard Cordray, former attorney general of Ohio, to become head of enforcement at the Bureau
- Leonard Chanin, deputy director of the Consumer Affairs Division of the Federal Reserve Board, to head up the regulations drafting section of the legal division
- David Silberman, former general counsel of Kessler Financial Services and former deputy general counsel of the AFL-CIO, to lead the Bureau's credit cards market division
- Holly Petraeus, wife of Army Gen. David H. Petraeus and director of the Better Business Bureau's Military Line, to lead the CFPB's Office for Service Member Affairs.

The industries and practices that the new CFPB focuses on will also reflect how it will take advantage of the significant powers it has been granted by Congress. For example, in an interview shortly after she was selected to supervise the CFPB's creation, Warren said one of her first targets will be credit card agreements, which she said are "still long and they are still hard to read and they are still chock full of 'tricks and traps.'"

In addition to hiring staff, Warren and the Treasury Department are conducting research relating to consumer financial products and services, developing a nationwide consumer complaint response center, preparing to implement supervision of nondepository covered persons, and preparing for the opening of outreach offices.

"Development of the supervision program for certain nondepository covered persons is particularly significant because no federal agency previously has had the responsibility of supervising these entities, such as payday lenders, mortgage companies, debt collectors, and consumer reporting agencies," Treasury noted in a September news release.

The CFPB also will plan "the orderly integration of bank, thrift, and credit union examiners from five different Federal agencies and preparing for rulemakings" required by the Dodd-Frank Act, the notice stated.

### **Covered Activities**

The DFA defines consumer financial products and services broadly. They include the following if offered or provided for use by consumers for personal, family or household purposes:

- extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit
- extending or brokering certain leases of personal or real property that are the functional equivalent of purchase finance arrangements
- providing real estate settlement services or performing appraisals of real estate or personal property
- taking deposits or transmitting or exchanging funds for use by or on behalf of a consumer
- selling, providing, or issuing stored-value or payment instruments (except for merchants that sell stored-value products but do not actually enter into the contract with the consumer for the product)
- providing check cashing, check collection, or check guaranty services

- providing credit counseling, debt management or debt settlement services
- collecting, analyzing, maintaining, or providing consumer credit reports, or
- collecting debt related to any consumer financial product or service.

The CFPB will have authority to promulgate regulations applicable to all banks and non-banks with respect to 18 federal consumer financial laws, including the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Equal Opportunity Act and the Electronic Fund Transfers Act. However, it will only have examination and enforcement powers over banks and credit unions with more than \$10 billion in assets, all mortgage lenders, servicers and brokers (and related businesses), and certain nonbank financial companies such as payday lenders, debt collectors and consumer reporting agencies. Banks and credit unions with assets of \$10 billion or less will continue to be examined by their current regulators, although the CFPB may require such regulators to provide it with examination reports. The Act generally excludes certain persons from the CFPB's reach, including merchants, retailers and other sellers of non-financial goods and services, real estate brokers, sellers of manufactured and modular homes, tax preparers, accountants, and attorneys and auto dealers subject to certain exceptions.

### **UDAP Authority and Consumer Disclosures**

In addition to promulgating regulations, the CFPB also is authorized by the DFA to prevent any person from committing or engaging in unfair, deceptive or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service. The CFPB has wide authority to issue regulations identifying unfair, deceptive or abusive practices.

To declare a practice "unfair," the CFPB must have "a reasonable basis to conclude that the act or practice causes or is likely to cause substantial injury to consumers" and is not outweighed by benefits. To declare a practice "abusive," the CFPB must find that it materially interferes with a consumer's ability to understand a term or condition of a product or service, or takes "unreasonable advantage" of a consumer's lack of understanding or reasonable reliance on a covered person to act in the consumer's interests. No standard is set under the DFA for what a "deceptive" act or practice is although the FTC under Section 5 has had this authority for many years, and the banking industry has some experience in how that standard has been used by the federal banking agencies in recent years.

The CFPB also has broad authority to regulate communications and disclosures to consumers about the costs, benefits and risks associated with financial services products and services. Covered persons must provide consumer disclosures that balance descriptions of benefits with descriptions of significant risks and costs of any consumer financial product or service. The CFPB may develop model disclosure forms, and using those would provide a safe harbor to be deemed in compliance with the disclosure requirements.

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### Preemption of State Law

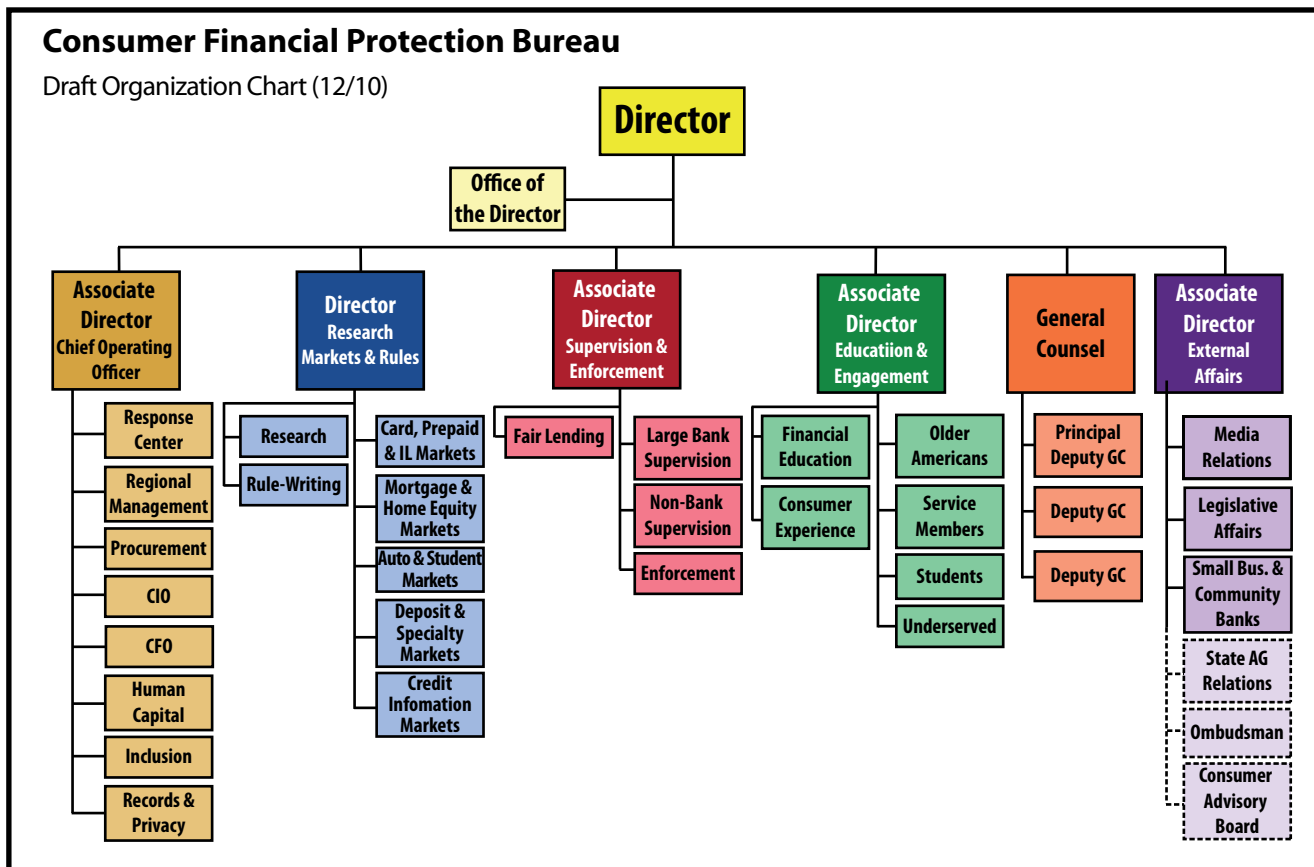
The DFA changes, some argue substantially, the preemption authority of state consumer financial laws for national banks and federal thrifts. For federal thrifts, which enjoyed so called “field preemption” for almost all of its activities, the DFA represents a radical change. Federal thrifts lose their strong preemption authority and are now subject to the same preemption authority as national banks.

For federal thrifts and national banks, the DFA provides that where state law conflicts with federal law, the appropriate standard to determine preemption is set forth in the U.S. Supreme Court decision of *Barnett v. Nelson*, 517 U.S. 25 (1996), where the Court held that state law is only preempted as applied to a national bank if the state law “prevents or significantly interferes with” the exercise of the national bank’s powers. The standard articulated in *Barnett* represents an arguably stricter standard than contained in the Office of the Comptroller of the Currency (OCC)’s extensive preemption regulation promulgated in 2004, which purports to preempt any state law that “obstructs, impairs, or conditions” the exercise of a national bank’s powers. 12 C.F.R. § 7.4009. A state consumer financial law also will be preempted if it discriminates against national banks, or if it is otherwise preempted by some other provision of federal law such as the Alternative Mortgage Parity Act (AMTPA).

The OCC will still have the ability to issue preemption determinations, but only on a case-by-case basis. In the exercise of this authority, the Comptroller must personally determine that the state consumer financial law at issue is preempted, i.e., he may not delegate the determination duty to another agency official. Additionally, the OCC must consult the CFPB and must take the views of the CFPB into account in making the preemption determination. In addition, the Comptroller’s determination will no longer enjoy “Chevron” deference, that the agencies reasonable regulation issued by it is given “substantial deference,” but is now only granted so called “Skidmore” deference, a lesser deferential standard recognized by the courts.

The DFA codifies the limitations of a state’s ability to exercise visitorial powers as interpreted by the U.S. Supreme Court in *Cuomo v. Clearing House Ass’n*, 129 S.Ct. 2710 (2009). In *Cuomo*, the Court confirmed that the ability to exercise supervisory authority over a federally chartered institution, such as the routine examination of the books and records of the institution, resides in the primary banking regulator and not in state attorneys general. The Court also held, however, that this visitorial exclusivity does not displace the traditional law enforcement authority of state attorneys general to enforce compliance with non-preempted laws. The ability to conduct such law enforcement activities, however, is limited to civil litigation and may not be accomplished through state administrative enforcement actions.

Beyond the powers of federally chartered institutions themselves, the DFA also eliminates the preemption enjoyed by operating



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subsidiaries of these institutions. Under the Supreme Court's decision in *Watters v. Wachovia*, 550 U.S. 1 (2007), the Court held that operating subsidiaries of national banks are entitled to the same preemption from state law as their national bank parents. The Act provides that operating subsidiaries are subject to the same laws as any other entity subject to state law with no preemption authority of its national bank parent.

It remains to be seen whether the Act's preemption and visitorial powers provisions will have any significant consequences for federally chartered financial institutions. The Barnett standard for preemption of state consumer financial laws is different from the OCC standard only in degree, and the practical effect may be negligible, particularly given that reviewing courts are often more heavily influenced by pronouncements of the Supreme Court and not the OCC. Litigation will no doubt answer the question of whether the changes included in the DFA will in fact subject national banks and federal thrifts to state laws that they were previously preempted.

In eliminating the operating subsidiary preemption under *Watters*, we are likely to see operating subsidiaries with significant consumer interaction converted to divisions of their parent financial institutions so as to retain as much of the benefits of preemption as possible, although such changes will no doubt have a substantial impact of how such subsidiaries are managed within the bank's corporate structure. In addition, if the subsidiary has existing joint ventures with third parties, collapsing them into the national bank may prove to be problematic.

## Arbitration Clauses

The DFA requires the CFPB to conduct a study and report to Congress concerning the use of arbitration agreements in connection with consumer financial products or services. It also provides that the CFPB may by regulation "prohibit or impose conditions or limitations on the use of" arbitration agreements "if the [CFPB] finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers." The findings in the regulations must be consistent with the study.

Congress has given the CFPB the authority to abrogate the 85-year-old Federal Arbitration Act, but only with respect to arbitration agreements entered into by consumer financial services companies. Although the DFA does not identify any particular concerns with arbitration agreements, consumer advocates and plaintiffs' class action lawyers have expressed the view that arbitration agreements can be used to defeat class action lawsuits, and prevent consumers from vindicating their rights when small amounts of money are involved. How the CFPB conducts its study, what findings it makes, and how much deference it gives to the substantial body of legal precedent that already exists on the enforceability of arbitration agreements will determine the future of arbitration agreements in consumer financial contracts.

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(continued from p. 13)

### The "Speed Bump" Amendment

Section 1100G of the DFA looks to ensure fairness and transparency for small businesses by designating the CFPB as a "covered agency" under the Regulatory Flexibility Act (RFA) and the special rules that previously applied to only two federal agencies, the Environmental Protection Agency (EPA) and the Occupational, Safety and Health Administration (OSHA). As a covered agency, CFPB rulemaking that would have a "significant economic impact on a substantial number of small entities" would be subject to small business review panel provisions, called a SBREFA panel. Additionally, the CFPB will have to give special consideration to the impact that such rules would have on the cost of credit for small businesses and consider specific alternatives to minimize increases in the cost of such credit. The SBREFA panel process, in the event the Bureau determines that proposed rules will have a substantial impact on a significant number of small entities, can increase the time it takes to pass new rules from many months to years, particularly if the Bureau fails to follow the RFA and SBREFA rules, or the rule-making process is challenged in court, which has occurred in many instances with respect to EPA and OSHA rule-making.

Deemed the "speed bump" provision, Section 1100G appears to have been intended by Congress to slow down the CFPB rulemaking process so that any intended or unintended effects of CFPB rules on small businesses can be fully evaluated and revised

to minimize their impact. The SBA rules designate a bank that has less than \$175 million in assets, or some 1,800 banks out of the 7,500 in the United States, or \$7 million in gross revenues for other entities, as a "small business" for purposes of the RFA and the SBREFA process.

These small entities will be given a "seat at the table" and have a 60 day dialogue with the Bureau on how to minimize the impact of proposed rules on small business entities. Given the substantial body of case law that reflects the difficulty EPA and OSHA have had in carrying out this process correctly, it will be interesting to see how a new federal agency with no rules, no history and no staff familiar with the process will be able to meet its statutory requirements relating to the RFA and the SBREFA process.



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48

141



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