

Summary

Obama Administration Financial Services Industry Restructuring Proposal

Consumer Protection Agency

A very controversial aspect of the proposal from the perspective of the financial services industry is that it would create a new super consumer regulatory agency with authority over insured depository institutions as well as institutions that are not now subject to federal supervision.

The new entity, the Consumer Financial Protection Agency (the “Agency”) would have sweeping rulemaking, supervision, and enforcement authority over virtually all consumer credit activities, except investment products and services regulated by the SEC and the CFTC. Rather than working with the existing regulatory structure to fill gaps in consumer protection, such as state regulated mortgage brokers, the proposal would create an entirely new federal bureaucracy to take over the consumer protection functions of several federal agencies.

The intent of the proposal is to provide greater protection for consumers by placing control over the way consumer products and services are developed, marketed, and delivered into the hands of one centralized authority. While this might have some surface appeal, it would have unintended and potentially adverse consequences for both consumers and the financial services industry.

Single New Consumer Protection Agency. The new Agency would be an independent federal agency that will have sole supervisory, examination, and enforcement authority for protecting consumers of financial products. Its jurisdiction would cover financial services and credit, savings and payment products and related services, all institutions that issue, provide, or service these products and services, and all entities that provide services to the institutions that provide these products.

- The Agency would have a Director and Board (one seat reserved for a “prudential” regulator). The proposal provides no details on how the Director and Board are selected or appointed, although the Board should represent a “diverse” set of viewpoints and experiences and at least one seat should be reserved for the head of a “prudential regulator.”
- The Agency would have a “stable” funding stream, which could come from fees assessed on financial services entities and transactions “across the financial sector.”

Supervision and Regulation. The new Agency would have sole authority to promulgate and interpret regulations under existing consumer laws such as TILA, HOEPA, RESPA, CRA, ECOA, HMDA, and FDCPA, and any future consumer financial services or fair lending laws. To address any “gaps” in these laws, the Agency would have broad authority to “adopt tailored protections” such as disclosures or restrictions in contract terms to prevent unfair, deceptive, or abusive practices.

- The Agency would be required to study and report on the effectiveness of new consumer protection regulations at least every year and must do the same for existing regulations as time and priorities allow. The Agency should create an advisory panel to provide it with information on emerging industry practices and it should coordinate with other federal and state agencies to provide consistent and gap-free coverage of consumer and investor products and services.

- The Agency can collect data “through the supervisory process” as well as specific data collection laws such as HMDA. It has the responsibility of collecting consumer complaints and helping to resolve them. It also is supposed to play a leading role in financial education efforts and to promote community development and investment.
- The Agency would be specifically required to review and potentially ban or restrict mandatory arbitration clauses.
- The Federal Trade Commission’s (FTC) primary authority for financial services protections would be transferred to the new Agency. However, the FTC retains backup authority for institutions currently within its jurisdiction. It specifically retains primary authority over data security, but privacy will be handled by the Agency.

New Consumer Protections. The Agency would be responsible for reform of consumer protection disclosures – mandatory forms must be clear, simple, and tested regularly in the field.

- The proposal targets mortgage disclosures for “significant reform.” The Agency would have authority over both TILA and RESPA and will have the authority to issue a single, integrated federal mortgage disclosure form.
- All disclosures and communications with consumers must be “reasonable” - balanced with respect to the presentation of the risks and benefits. Lenders will be required to “share” the burden of updating mandatory disclosures when they introduce new products. In that regard, the Agency would be authorized to issue “no action” letters for new product disclosures or communications.
- Technology should be used to improve disclosures. Internet calculators allowing consumers to compare products could be mandatory. In addition, point of sale (POS) warnings on ATMs could be mandated when the use of a debit card could overdraw the account.

“Plain Vanilla” Consumer Products. The Agency would have authority to define standards for “plain vanilla” products for consumers that are easy to understand and compare. Specifically, the Agency would be authorized to define the standards for what is “plain vanilla” and require covered entities to offer such products alongside other product offerings. Oversight of mortgage lending would be a primary focus of the Agency.

- “Plain vanilla” mortgages would not include prepayment penalties, would fully document income, collect escrow for taxes and insurance, and have predictable payments.
- The Agency would have regulatory authority over high cost mortgages presently under the authority of the Federal Reserve. It would have authority to determine whether other types of mortgages should be added to the regulatory framework requiring additional scrutiny.
- The Agency would also be authorized to use a variety of measures to ensure that alternative mortgage products are provided only to those consumers who fully understand the products and the risks. This could be in the form of warning labels, required consumer application questionnaires, or written consumer opt-in provisions.

There would be a strong presumption that “plain vanilla” mortgage products are suitable for consumers. Conversely, alternative products are not presumed to be suitable and violations could trigger costly penalties.

Restrictions on Terms and Practices. The Agency would be authorized to place restrictions on product terms and provider practices when “the benefits outweigh the costs.” It would have the authority to regulate unfair, deceptive, and abusive acts or practices for all credit, savings, and payment products.

- For example, the agency would be authorized to determine when and if prepayment penalties are appropriate for mortgages, including subprime mortgages and other products, under the belief that such penalties make loans complex for the least sophisticated consumers or those unable to shop effectively.
- The Agency would also be able to adopt consumer protections covering the life of the loan, through servicing and loss mitigation stages.
- The Agency would have the authority to ban yield spread premiums, and it could require that mortgage originators receive compensation over time, as the loan performs, rather than a lump sum.

Duty of Care. The agency would further be authorized to impose a duty of care on intermediaries. Specifically, it would have authority to counteract a mortgage originator’s conflict of interest regarding the consumer. It would also be authorized to require that mortgage originators inform consumers when they could qualify for a lower interest rate based on borrowers’ risk profiles. This would also place on the originator a duty to determine whether the loan is affordable for the borrower.

The Agency would also be required to identify products in the market that are similar to those it is authorized to regulate and apply consistent regulations. For example, the Agency is given authority to regulate credit plans, and would therefore have authority to similarly regulate overdraft protection, payday loans, and cash advances. As to overdraft coverage and credit card over the limit fees, the Administration would require the consumer to opt-in.

Community Reinvestment Act (CRA). Oversight and enforcement of CRA would be a core function of the Agency. It would have sole authority to evaluate CRA compliance. However, decisions on merger applications would remain with the prudential regulators.

Enforcement. The proposal states specifically that existing consumer protection statutes that contain private rights of action are not “disturbed.” In fact, statutory damages may be increased through legislation.

- The Agency itself would have administrative enforcement authority over anyone covered by the laws it implements, including insured depository institutions and other firms not now subject to “comprehensive federal supervision.”
- The Agency would also have enforcement authority over nonbanking institutions, although “the states should be the first line of defense.” The Agency could intervene in any state actions against an institution within its jurisdiction for all purposes including appeals.
- The Agency would cooperate closely with the Department of Justice (DOJ) and the Department would have independent authority to enforce all statutes administered by the Agency.
- Federal rules promulgated by the Agency would override “weaker” state laws, but the states are free to adopt “stricter” laws. States would also have concurrent authority to enforce the Agency’s regulations. Federally chartered institutions would also be subject to “nondiscriminatory” state consumer protection and civil rights laws.