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Some Basic Concerns about the CFPA Legislation and a Partial Response to Professor Bar-Gill's "The Consumer Financial Protection Agency: Sorting the Critiques"

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The fluency of Professor Bar-Gill's September 14, 2009 article in *Lombard Street* entitled "The Consumer Financial Protection Agency: Sorting the Critiques"[1] masks the paucity of evidence he has to justify creating a Consumer Financial Protection Agency across the spectrum of providers of consumer financial products (CFPs). Rather, he makes a wonderful case for splitting the consumer protection examination and supervision functions from the two primary bank regulators, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS), or, my personal preference, for giving more power and resources to the Federal Trade Commission.

This response looks at the justifications Professor Bar-Gill uses to support the creation of the CFPA. But first, I offer some general concerns about the CFPA.

Some Basic Concerns about the CFPA Legislation

Before proceeding to Professor Bar-Gill's argument, let me share my own perspective on the CFPA.[2] This will allow readers to compare my ideas with Professor Bar-Gill's approach.

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[1] Oren Bar-Gill, "The Consumer Financial Protection Agency: Sorting the Critiques," *FinReg21*, Sept.14, 2009, available at http://www.finreg21.com/lombard-street/the-consumer-financial-protection-agency-sorting-critiques

[2] Some of these ideas first circulated in an op-ed I wrote that appeared regionally in this fall, e.g., "Ensure Consumers Get Solid Financial Protection," *Northwest Indiana Times*, Oct. 7, 2009; "Congress Should Redo Obama's Plan to Ensure Consumers Get Quality Financial Protection," *Hawaii Reporter*, Sept. 24, 2009; "Improve It: Try Fixing Only What's Broken," *Portland (Maine) Press Herald,* Sept. 18, 2009; "U.S. Consumers Deserve Protection," *Augusta (Georgia) Chronicle,* Sept. 18, 2009; "Congress Should Ensure Consumers Get Quality Financial Protection," *Lexington (Ky) Herald-Leader,* Sept. 17, 2009; "Congress Should Ensure Consumers Get Quality Financial Protection," *Sacramento Bee,* Sept. 17, 2009. As readers will notice, copy editors at the newspapers added their own spin to the title of the op-ed. Its original title was "Getting Consumer Protection that Works."

- *Don't fix what's not broken*. The bank regulators – the OCC and the OTS – fell down on their consumer protection responsibilities. Congress could create stronger consumer protection powers for the customers of banks and thrifts and possibly of other providers that were not subject to regulation by the States. However, there is no need to take power away from the Federal Trade Commission, the National Credit Union Administration, or the Federal Deposit Insurance Corporation, which have worked hard to protect consumers, or the States, which have worked effectively to enforce their own consumer protection laws.

- *Don't reward failure with more power.* The Department of the Treasury had jurisdiction over the OCC and OTS for the past 20 years. The Secretary of the Treasury will get additional interim powers under the CFPA legislation over all other providers of CFP's while the new Agency's Director is confirmed and staffing-up occurs, a process the legislation suggests may take from six to 24 months. The CFPA legislation remains very bank-centric in its orientation. Don't let Treasury direct this new bigger consumer protection mission – temporarily or permanently – at the expense of credit unions and those non-depositary providers under its jurisdiction whose actions had nothing to do with the current economic woes.

- *Don't fall for the "A New Agency Will Fix Everything" rhetoric.* People who need help understanding credit options or finding an appropriate refinancing should not have to wait for a new agency to get up and running. The CFPA legislation proposes to transfer employees from five agencies with different cultures, *viz*., from all of the bank regulatory agencies, the NCUA, and the FTC. The last experience with a new federal agency was the Department of Homeland Security, which has taken years to become fully operational while going through at least two rounds of publicly announced reorganizations.

- *Don't buy the "One Agency is Better" argument.* Providers of consumer financial products vary in size, lines of commerce, corporate structure or chartering, and how and where they operate. The CFPA is about to have jurisdiction over 200 huge commercial banks and thrifts, and more than one million smaller creditors such as auto dealers, furniture stores, check cashers, remittance companies, and issuers and sellers of stored-value cards. It will have some rulemaking jurisdiction over 8,000 community banks and the nation's credit unions under the marked-up House bill. This is a huge mandate for one agency – one that could slow real supervision.

It also might be a job too big, placing too much responsibility in one agency's hands. It is not clear that one agency can perform better than many, given the stratified nature of the current CFP marketplace.

Bigger agencies also tend to organize by specialties. In this case, that might mean that there would be one division for banks, one for thrifts, one for credit unions, and one for everyone else. Given the employee transfers contemplated, one can assume that the bank people are likely to continue to examine and supervise banks (they have the expertise, right?) and the credit union people will work with the credit unions, etc. How will the new Agency impose the change that the promoters of the CFPA believe is needed if the CFPA is roughly the sum of parts of other agencies, some of which paid little apparent attention to consumer protection?

Indeed, the CFPA plan sacrifices the best aspects of our current system – the diversity of perspectives and enforcement priorities that different agencies at the federal and state levels contribute. Instead, it risks everything on one big regulator that might get "it" catastrophically wrong from either end of the regulatory spectrum.

The designers of the CFPA have assumed that the CFPA's leaders will always share the same perspectives and goals that its proponents do today. That is unlikely to be the case. Looking at the past 45 years, we have experienced swings of regulation and de-regulation, of law & economics and laissez-faire as the prevailing approaches, and of budget issues that engender intense debates about how to achieve goals with small allocations of resources.[3]

We have seen what happens when the one and only regulator gets something wrong. More accurately, we have recent evidence from several federal regulators – the OTS, the OCC, and the SEC.[4] How much worse a position would our banking sector and economy be in if the OTS had been the only bank regulator and had been able to wink at financial statement deadlines for more thrifts? How much more damage could the OTS' and OCC's ultra-aggressive preemption policies[5] and litigation strategies have caused if the

[3] For example, a more pro-business or pro-bank director of the CFPA nominated and confirmed by the Republican party would likely hold very different views on priorities and solutions than a director such as Professor Elizabeth Warren or Eric Stein (of the Treasury and formerly of the Center for Responsible Lending). Agency Directors will only get one five-year term at a time. So, while Directors' terms will last longer than one presidential term, a director appointed towards the end of one presidency could hold views for the next four years radically at odds with the President's view or with those prevailing in Congress. Thus, a de-regulator could remain in control of the Agency for a period well into the first term of a new pro-regulation president depending on the precise timing of the confirmation of the director.

[4] Gretchen Morgenson, "But Who Is Watching the Regulators?" N.Y. Times, Sept. 13, 2009, at BU1.

[5] *See, e.g.,* Bank Activities and Operations: Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1917 (Dep't of Treasury, Jan. 13, 2004) (amending 12 C.F.R. pts. 7 & 34). In particular, as to operating subsidiaries, new 12 C.F.R. § 7.4006 (2007) provided: "Unless otherwise provided by Federal law or OCC regulation, State laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank." One commentator observed that this new regulation "broadly denied states any role in regulating the activities of national banks or their operating subsidiaries." Sarah Jane Hughes, Stephen T. Middlebrook, and Broox W. Peterson, *Developments in the Law Concerning Stored-Value Cards and Other Electronic Payment Products,* 63 BUS. LAW. 237, 247 (2007). This preemption analysis was written by Mr. Peterson, a former Senior Vice President and Assistant General Counsel for Visa. For additional discussion of the progress of the OCC's preemption of state authority over national banks and their subsidiaries, see *id.* at 245-254. For a discussion of a similar exercise of preemption over state regulations by the Office of Thrift Supervision, see SPGGC, LLC v. Ayotte, No. 06-2326 (1st Cir. May 30, 2007).

OTS or OCC had control over banks, credit unions, <u>and</u> every other non-bank provider of consumer financial products and services?[6]

Responses to Professor Bar-Gill's Arguments Favoring the CFPA

Professor Bar-Gill makes three primary arguments in favor of the CFPA: (1) that the sloppy regulation and supervision of banks resulted from regulatory arbitrage and that the CFPA is the way to resolve this type of regulatory failure; (2) the failure of capital markets and customers to appreciate the risks inherent in certain financial products – or, put Bar-Gill's way, *that market forces "failed to maximize welfare in important CFP markets,"* and that the CFPA can resolve this market failure; and (3) that support for capital markets reform necessarily constitutes support for reform of consumer protection agencies.[7] Let me discuss each in turn.

<u>Regulatory Failure and Arbitrage</u>

There is evidence that regulatory arbitrage between the OCC and the OTS in the past 20 years cost us in terms of regulation and supervision. Although this regulatory arbitrage problem affected providers who were subsidiaries of depositary institutions as well as their parent banks, Professor Bar-Gill does not explain that regulatory arbitrage *did not affect the non-depositary providers* of consumer financial products that must have state licenses to operate in each state in which they offer products. Thus, because the fall-out from regulatory arbitrage was confined to <u>banks and their subsidiaries</u>, regulatory arbitrage is not sufficient reason to support the entirety of the CFPA plans.

Bar-Gill's argument also overlooks the favorable regulatory perspectives and laboratory-like innovation environments that the States can offer, when they are given the chance, in regulating CFPs. Instead, depending on which version of the CFPA legislation one examines, the plans would centralize in the CFPA all or most of the regulation and supervision that others including the Federal Trade Commission, National Credit Union Administration, and the States have performed well in the past into the CFPA. So, instead of more than 50 sources of innovation in regulatory and enforcement strategies, particularly for non-depositary providers' products, the CFPA would be the only one or the primary one exercising such regulatory powers.

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[6] See generally Watters v. Wachovia Bank, N.A., 550 U.S. 1 (2007) (holding that the OCC has exclusive "visitorial" rights over operating subsidiaries of national banks such that the State of Michigan could not investigate possible violations of or enforce its mortgage lending laws). Of course, the OCC also helped sellers of stored-value cards (also know as gift or prepaid cards) that were issued by national banks to avoid compliance with state laws. *See, e.g.,* SPGGC, LLC v. Ayotte, No. 06-2326 (1st Cir. May 30, 2007); SPGGC, LLC v. Blumenthal, 408 F. 2d 87 (D. Conn. 2006), *aff'd in part, vacated in part*, No. 05-4711 (2d. Cir. Oct. 19, 2007).

[7] Bar-Gill, *supra* note 1.

Rather than consolidating all consumer protection authority in the CFPA, let's preserve the best of the status quo. For example, the FTC and the NCUA should maintain significant regulatory as well as enforcement roles for consumer financial products. The consumer protection records of either of these federal agencies have not been criticized in more than 40 years.

The States appear to have performed admirably in protecting or trying to protect their residents. Congress also should not alter the States' historic roles as regulators of many financial providers without a more robust record of problems with state regulation and enforcement. This is particularly true for products that are offered in face-to-face transactions by community-based and -oriented providers. For these products there is no opportunity for regulatory arbitrage because each provider must be licensed to act in the particular state in which it offers products and services and is subject to examination and supervision by the State(s) from which it obtains such a license. These depositary and non-depositary providers generally cannot "export" the terms and conditions of the CFPs they offer to consumers from one state to another, or fail to comply with state disclosure requirements. The principal exceptions to that rule are operating subsidiaries of national banks that have been protected from some state oversight by the aggressive preemption positions taken by the OCC and OTS.[8]

Moreover, regulatory consolidation is not necessarily a cure for regulatory arbitrage. Fannie Mae and Freddie Mac, currently under federal control, exercised vast powers as arbiters of which mortgages could be securitized or even discounted. Failure of mortgage instruments to meet Fannie or Freddie requirements, or failure of the deal to meet one of their conditions, meant that the deal fell through and the borrower either succumbed to the GSE's demands or went without credit. Did this type of consolidated power protect us? Apparently not.

A final concern about regulatory consolidation in the proposed CFPA focuses on its funding sources. The CFPA will get several sources of funding, including assessments in addition to funds from the Federal Reserve System and appropriations from Congress. Agency funds will be segregated into a "bank fund" and a "non-bank fund" under the September 2009 discussion draft. The demise of the single-fund approach in the original legislation reintroduces the spectrum of regulatory coziness if not of regulatory capture.

Market Failure or Lack of Appreciation of the Risks in Particular Consumer Financial Products

[8] *E.g.,* Cuomo v. The Clearing House Ass'n. L.L.C., 129 S. Ct. 2710 (Jun. 29, 2009)(affirming injunction against enforcement of administrative subpoena issued by the Attorney General of New York under N.Y. Exec. Ann. §63(12) (2002) because 12 U.S.C.A. §484A (2007) allocated "visitorial powers" over banks and their subsidiaries to the OCC and "enforcement" powers to the courts; Watters v. Wachovia Bank, N.A., *supra* note 6.

Bar-Gill cites the proposed CFPA as a solution to a problem of market failure that he describes as either excessively risky consumer financial products or as products that impose underappreciated risks on consumers.

It's hard not to agree that some financial products were excessively risky or that some market participants did not appreciate their risks. But the important question is: how much new regulation does the available "evidence" support?

The majority of the evidence that Bar-Gill cites relates to two types of products – 1) subprime or exotic residential mortgages and 2) bank products such as over-limit or late credit card fees, and over-draft fees on debit cards, prepaid cards, and checking accounts that no regulator supervises. Evidence suggests that some mortgage brokers or originators placed consumers into mortgage financing that was more expensive than they qualified for and that others paid fees to often-unregulated mortgage modification intermediaries that gave them poor advice.

In response, I would argue that consumers do make rational choices among products in many cases based on information already disclosed to them and on other factors such as the types of financial product and providers available to them, the time frame in which they have to select a product, and the relative costs of products.

We should not re-regulate every product or the entire marketplace because *some products* were too risky. Moreover, we should not assume that every market participant lacked sufficient information about the CFPs they chose. There is no evidence that *everything* was wrong.

What consumers may need is better information, the most prominent choice for addressing some forms of market failure since the enactment of the Truth in Lending Act forty years ago, or more formal financial literacy education about some types of products. Congress would need to assign these tasks a sufficiently high priority and appropriate sufficient funds to sustain the effort. The Federal Trade Commission can handle this task separately, or Congress might assign the task jointly to agencies with good track records such as the FDIC, NCUA, and FTC with a deadline to come back with a report to Congress.

<u>Capital Markets Reform Is Not the Same as Consumer Protection Reform</u>

Bar-Gill argues, but does not support, the notion that support for structural reforms of our capital markets necessarily includes broad support for the proposed consumer protection agency. Structural reform of capital markets – ranging from regulating derivatives or executive compensation to more aggressive re-regulation of the businesses of commercial and investment banking – is a subject entirely different from creating a new agency to regulate how consumer financial products are marketed and sold. As evidence of their separateness, proposals for regulatory reform of the capital markets also are moving on a track separate from the CFPA reforms of the consumer protection functions of federal and state agencies.

Thus, although it seems hard to predict, we might end up with the CFPA but without the structural re-regulation that recent economic risk-taking and turmoil call for.

At most, Bar-Gill's arguments suggest that some additional independent thinking should be applied to the regulation and supervision of the largest banks that are under the visitation powers of the OCC and OTS, and of their non-depositary subsidiaries that were protected by agency preemption policies from complying with state consumer protection laws. This can include moving the 1974 authority to regulate *banks* that commit unfair or deceptive practices, which the OCC has exercised in only a few cases in those 35 years,[9] as proposed, to a new bank-centered agency. The House Financial Services Committee gets this point: it recently voted to leave consumer protection examination of community banks with their safety and soundness supervisor.

One way to achieve many of the goals that Professor Bar-Gill espouses is to create a separate consumer regulatory agency for national banks and federal savings and loans. Congress should provide the separate bank consumer protection agency with more funding (particularly funding not tied to assessments imposed on the entities being regulated and supervised), clearer instructions from Congress on how to use its regulatory and enforcement authority, and a mandate for more detailed and frequent reports to Congress to enable some serious Congressional oversight of its performance. Chairman Frank's 2007 admonition to the Federal Reserve Board to "use it or lose it"[10] – "it" being the Board's unfair or deceptive acts or practices authority under section 5(a) of the FTC Act[11]– caused the Board to promulgate the credit card regulations[12] that Congress ratified in the Credit CARD Act of 2009.[13] The Board also proposed

[9] Press Release, Fed. Deposit Ins. Corp., FDIC Seeks in Excess of $200 Million against Credit Card Company and Two Banks for Deceptive Credit Card Marketing (June 10, 2008) (PR-47-2008), *available at* http://www.fdic.gov/news/press/2008/pr08047.html. The complaint charged that Compucredit and two banks had engaged in deceptive marketing of Visa and MasterCard branded credit cards to consumers with low credit scores. The FDIC singled out for special attention failure to disclose significant upfront fees. *Id.* For additional discussion of this enforcement action, see Patricia J. Allouise, Sarah Jane Hughes, and Stephen T. Middlebrook, 64 BUS. LAW. 219, 244-246 (2008).

[10] *See* Jesse Westbrook &Craig Torres, *U.S. Regulators Tell Lenders to Toughen Standards,* BLOOMBERG.COM, June 29, 2007, http://www.bloomberg.com/apps/news?pid=20601103&rsid=aM7SRhUR34Sg (commenting on how Chairman Frank and others thought that regulators were shirking their rulemaking authority with regard to subprime mortgage loans).

[11] Federal Trade Commission Act § 5(a), 15 U.S. C. § 45(a) (2006).

[12] Unfair or Deceptive Acts or Practices, 73 Fed. Reg. 28904 (proposed May 19, 2008) (to be codified at 12 C.F.R. pts. 227, 535 & 706) (joint proposal of the Federal Reserve System, Office of Thrift Supervision, and the National Credit Union Administration).

[13] Credit Card Accountability, Responsibility and Disclosure Act of 2009, Pub. L. No.111-24, 123 Stat. 1734 (to be codified in scattered sections of 15 U.S.C.) (hereinafter the CARD Act)..

companion revisions to Regulation Z[14] and Regulation DD.[15] Agencies are not likely to ignore mandates from Congress that threaten their budgets or their authority.

Specific Roles for the New CFPA

Bar-Gill gives an example of a solid policy role that the proposed agency could play – provisions related to enhanced consumer disclosures across the spectrum of providers of substitutable products. Although artfully written, this argument proves too little when compared with the expense and complexity of the CFPA proposal. Congress could assign the task of designing enhanced consumer disclosures to the Federal Trade Commission without the breadth of authority that the CFPA would have, and far faster and cheaper than creating a new agency and waiting for its work.

Professor Bar-Gill does not see the downside of the electronically enhanced consumer disclosures that the CFPA legislation would mandate. These disclosures will contain personally identifiable information about the consumer and their retention by the provider can later be accessed by public agencies or their private contractors to use for purposes beyond the original uses. Indeed, these disclosures readily can become a kind of federal database of consumer financial transactions. As a proponent of strong personal financial privacy, this strikes me as a scary scenario.

Conclusion

Professor Bar-Gill offered *Fin Reg21* readers an elegant argument favoring the creation of a single, nearly omnipotent regulator of consumer financial products. Despite the demonstrated need for more consumer protection enforcement, particularly for products issued or marketed by banks and their subsidiaries, the rest of the credit and financial products have not produced much evidence of the regulatory or market failures of which he so eloquently writes.

There is little to prevent Congress from directing the Federal Trade Commission to promulgate standards in coordination with whatever agency or agencies may still hold supervisory authority over depositary institutions after Congress has finalized the more general supervisory and capital markets reforms under consideration. A practical barrier to what the proponents of the CFPA want is the fact that the FTC's organic authority to promulgate industry regulations is bound to the elaborate Magnuson-Moss rulemaking procedures.[16] However, it would be possible to adjust the FTC's rulemaking authority to reduce the procedural requirements for rulemaking while maintaining the substantive requirements that the Agency may adopt a regulation only if it can demonstrate either a history of problems with a particular

[14] Truth in Lending, 73 Fed. Reg. 28866 (proposed May 19, 2008) (to be codified at 12 C.F.R. pt. 226).

[15] Truth in Savings, 73 Fed. Reg. 28739 (proposed May 19, 2008) (to be codified at 12 C.F.R. pt. 230).

[16] 15 U.S.C. § 57a (2006).

act or practice or the prevalence of problems such as current Magnuson-Moss rulemaking under section 57a of the FTC Act requires[17] The House Financial Services Committee rejected a similar idea for the CFPA during its recent mark-up of H.R. 3126, but I hope that this idea will get more attention as the bill moves to the House floor and the Senate.

Professor Bar-Gill has made only a partial case for the new CFPA, and for the reasons offered above, I am not persuaded that the new Agency should have the totality of the powers that it unfortunately may get.

[17] *Id.*