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July 15, 2009

Memorandum

To: Interested Parties

From: Wright Andrews

Re: Major Pro & Con Arguments on Establishing A Federal Consumer Financial Protection Agency

Numerous arguments have been put forth by proponents and critics of the proposed new federal Consumer Financial Protection Agency (CFPA), proposed earlier by the Obama Administration and now embodied in H.R. 3126, sponsored by House Financial Services Committee Chairman Barney Frank. This background memorandum is intended to help facilitate understanding of the key issues by highlighting major arguments that have been raised for and against this proposal.

PRO - CFPA Proponents' Contentions

- **Caused Economic Crisis** - Failure to protect consumers from risky and abusive products and practices was a primary cause of the current economic crisis, and the associated systemic risk, and it is essential that dramatic changes be made to protect consumers and to prevent such a crisis from reoccurring
- **Abusive Business Model & Broken Market** – Many financial services providers now operate using an abusive business model that essentially is based on offering extremely complex products that consumers' generally cannot understand; lenders profit by “tricks and traps” taking unfair advantage of consumers' lack of knowledge and confusion to charge them excessive fees and to offer unsuitable products using abusive lending practices; simply put, the current financial services market is broken; consumers cannot possibly understand many of the products being offered; therefore, they cannot make informed economic decisions; enhancing disclosures in such a complex and confusing market clearly would not be adequate
- **Federal Agencies' Consumer Protection Programs Are Structurally Flawed**
 - *Focus on Prudential Regulation Instead of Consumer Protection* - Banking agencies have given “safety and soundness” concerns top priority and have repeatedly failed to give proper weight to protecting consumers
 - *Failure to Act* - Part of the problem has been agencies have often failed to make timely use of the authority to protect consumers that they have under current law (e.g., Federal Reserve's failure for years to use mortgage regulation powers; also, failure to act in a timely and effective manner to rein in credit card abuses); experience has shown that

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- current agencies simply cannot be trusted to properly enforce consumer protection laws even if statutes were changed to give consumer protection a much higher priority within the agencies
- *Inadequate Powers & Staff Expertise* – Another problem has been that there are gaps in regulation and federal officials have not always had the enforcement powers they needed (e.g., have lacked supervisory and examination powers over non-bank lenders; also have lacked power to ensure “fair dealing” with consumers and product “suitability”), or the ability to take proactive “early intervention” actions to prevent abusive products and practices from being offered; moreover, consumer protection staff have not always had the needed level of expertise or dedication to protect consumers
 - *Lack of Data* – In many cases, regulators have lacked information they needed to recognize problems were arising and to take appropriate actions
 - *Inefficiencies, Conflicts, Lack of Transparency, Etc.* – Dividing consumer protection responsibilities among different agencies has resulted in: inefficiencies; lack of proper coordination; confusion; conflicting and/or overlapping policies; treating similar products differently resulting in an “unlevel playing field” for many lenders (especially smaller banks who often lack the compliance and advertising resources needed to compete effectively with larger institutions); additional compliance burdens; “regulatory capture” of regulator by the regulated institutions; “regulatory arbitrage” and a “race to the bottom” with some regulators essentially competing with others over who has the weaker consumer protections; and banking agencies’ supervisory activities have frequently lacked transparency on consumer protection issues
 - *Inadequate Funding* – Federal agencies’ consumer protection programs have often been underfunded so they have been unable to have robust programs
 - *FTC Not Adequate Alternative* – While the FTC has been relatively “pro-consumer” it simply is not an adequate alternative to a new CFPA; and the FTC frequently has funding limitations, and it has responsibilities and focus on more than consumer protection
 - **CFPA Will Provide Dramatically Better Consumer Protections**
 - CFPA will make consumer financial protection its top and only priority
 - CFPA will have very broad powers---including a full array of regulatory tools (e.g., rulemaking; examination; supervision; enforcement) so that it can address effectively essentially any consumer protection related issue regarding financial products and services; it also will have new powers (e.g., to ensure “fair dealing”) and ample regulatory rulemaking discretion to fill any regulatory gaps
 - CFPA will be staffed with dedicated experts who are committed to consumer protection
 - CFPA will have solid research and analysis capabilities and be empowered to gather necessary data from financial providers so it will have the information and deep understanding of the market and products needed to make better decisions

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- CFPA will have market-wide responsibility so it will have a broader perspective than current agencies, thereby enabling it to intervene more rapidly when it sees problems or trends developing and to reduce risks to consumers and will enhance safety and soundness for financial institutions and the entire financial system; moreover, CFPA will treat comparable products the same and will level the playing field between different types of providers, and make non-bank lenders subject to supervision and examination; it also will have authority to regulate salesmen and middlemen to ensure they are dealing fairly with consumers
- CFPA will be more accountable as it will have all the consumer protection responsibilities---i.e., “the buck stops” at CFPA
- CFPA will reduce and simplify lenders’ regulatory burdens by consolidating various rules and requirements, saving lenders costs and compliance problems
- CFPA will foster simple, “plain vanilla” products that will not be unduly risky or unsuitable for most consumers and that consumers will be able to understand; this will enable consumers to make informed choices and will help fix the currently broken market; it will also foster market innovation in that it will facilitate the development of such products (instead of complex ones that no one understands and that are filled with “tricks and traps”)
- CFPA’s decision making and enforcement processes will be much more transparent than what we currently experience via the banking agencies
- CFPA will have a centralized complaint handling process thereby making it much easier for consumers to have their concerns quickly channeled to the appropriate party and addressed promptly
- CFPA will help ensure more uniform national standards because it will set a high “floor” of consumer protections and states will be empowered to enforce the federal law so states will be less inclined to pass many different requirements
- CFPA will be adequately funded (with several different funding sources, including user fees) so it can aggressively pursue its consumer protection mission
- CFPA will restore public confidence and trust in our financial system
- Other agencies will still have “backup enforcement authority” so they can help enforce the law
- Consumers will still be able to buy more complex products if they want them
- CFPA will take various considerations, including consumers’ need for credit availability, into account and balance its actions; moreover, having the national banking supervisor on the CFPA Board will ensure adequate coordination with prudential regulators
- **States Will Still Be Able To Pass Tougher Consumer Protections When Needed**
 - States will continue to have a vital role both in enforcing the federal consumer protection rules and in promptly acting to fill gaps or add new tougher protections when needed

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- States have an important role serving as laboratories for developing cutting edge government policies and by being closer to the consumers they learn quickly what is occurring and can act when needed in their local areas
- **Consumers Also Should Be Given A Private Right Of Action To Enforce CFPA's Rules -** Given the broad scope of the financial services market, and the fact that neither CFPA nor state officials will in many cases be able to act to ensure individuals receive proper redress when they are injured by abusive financial services products and practices, individuals should also have the right to bring suit to enforce federal statutory and regulatory requirements

CON - CFPA Critics' Contentions

- **Consumer Protection And "Safety & Soundness" Regulation Are Integrally Related And Cannot Be Separated** – Consumer protection is inextricably bound to safety and soundness; these are really “two sides of the same coin”
 - Banks can only operate successfully if they treat customers fairly
 - CFPA would not give proper consideration to safety and soundness considerations
 - The prudential regulator is best positioned to properly balance competing concerns and resolve the inevitable conflicts that will arise
 - Training employees would be a nightmare if the two functions were separated
 - Experience with the separation of prudential and consumer protection functions with regard to Fannie/Freddie regulation showed this is bad idea
 - Requiring that CFPA “consult” with prudential regulators still allows CFPA to disregard their concerns and override their recommendations
 - CRA should not be taken away from the prudential regulators as the Administration initially proposed because CRA duties have to be balanced against safety and soundness and some aspects, like supporting community development are not consumer protection functions
- **Lenders Do NOT Favor Keeping The "Status Quo;" They Favor "Fixing" It** – There have clearly been regulatory shortcomings and gaps and these can and should be fixed, but consumer protection authority should not---and need not--- be taken away from current agencies and placed in a new CFPA
 - Congress should amend current laws to raise the priority of consumer protection within the missions of existing federal agencies and should add new powers where gaps exist
 - Although agency critics claim that experience has proved that current regulators will not provide proper consumer protections and the only way to do so is to have a totally new, independent, all-powerful consumer protection agency, they simply have not proven----nor can they----that agencies would not provide adequate protections if Congress gave them appropriate powers and raised their consumer protection missions and ordered them to fulfill them

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- If CFPA is created, its focus should be narrowed to unsupervised non-depository financial services providers (like state licensed mortgage lenders), who really caused most of the problems and who have not been properly regulated; CFPA should have a focus on such state licensed firms because it is unrealistic, given state budget limitations, to expect that state agencies will adequately regulate non-depository institutions in many cases
- Alternatively, the FTC could be given greater powers and responsibilities for regulating such non-bank lenders
- Alternatively, some argue that many state licensed and regulated lenders, like those who offer small, short-term loans, who were not responsible for the financial crisis and who have not had to be bailed out, are being adequately regulated at the state level and should not be subjected to a new federal regulatory scheme
- CFPA might possibly be structured so that it would be given backup enforcement authority if other federal agencies failed to take appropriate consumer protection actions
- Disclosures do help, and should be improved; consumers are not too dumb to make sound decisions if they have proper disclosures
- A centralized call center could be established for receiving and directing complaints
- The systemic risk regulator could be given power to look at consumer issues that posed systemic risks and to require other regulatory agencies to address them
- More enforcement generally is called for
- **CFPA Would Be A Massive, Highly Intrusive, Costly, Burdensome New Federal Bureaucracy** – Clearly, as proposed, CFPA would be a very large agency with a mission of regulating almost all types of financial services providers, and even many firms that provide related services; inevitably, they would impose costly and burdensome requirements and regulations; in particular, smaller community banks, who caused little of the economic problems, would be disproportionately hurt by such new regulations; would also prevent small niche players from competing as they would be required to offer “plain vanilla” products as well as their special niche products, etc.; small businesses also would be hurt because many owners use their personal consumer credit for business purposes and they would no longer be able to get many of the special, tailored products they need
- **CFPA Would Have Incredibly Broad, Largely Undefined And Unlimited Powers And Could Impose Very Arbitrary Requirements On Lenders And Many Related Service Providers** – CFPA would be given an unprecedented level of power to superimpose its judgments and policies on almost any business involved in the financial services marketplace
 - CFPA’s sweeping powers appear to allow it to dictate what types of financial products and services could and should be offered and to impose whatever restrictions, requirements, and prohibitions it wanted on such products; this would be more about product regulation than consumer protection

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- CFPB bureaucrats would be designing and mandating many products instead of lenders, and would be able to arbitrarily conclude what is “reasonable” and whether lenders were meeting “fair dealing” requirements in any case
- CFPB requirements would often add significant costs, limit consumer choices and stifle innovation as lenders would be afraid of costly litigation if they offered much beyond the agency mandated “plain vanilla” products
- CFPB would also impose intrusive and costly information gathering requirements on lenders
- Congress should set specific rules and not abdicate its legislative responsibilities by giving CFPB a “blank check” to totally control what and how financial services can be offered
- Only elites would be able to get more sophisticated products and many consumers who need other products tailored to their particular needs would not be able to obtain them as lenders would be afraid of being subjected to lawsuits and huge fines for offering what later were held to be “unsuitable” products
- Risk-based pricing, which is designed to ensure consumers pay fairly based on the risk they pose, would be largely destroyed under a CFPB regime
- CFPB would make it much more difficult to attract new capital to the financial services industry
- **Allowing States To Pass Different, More Onerous Laws Applicable To Federal Banking Institutions Would “Balkanize” Financial Services Regulation, Imposing Costly Compliance Burdens And Causing A Lack of Uniform Regulation** – If given the authority, states inevitably will pass numerous different and more restrictive laws that will cause inefficiencies, conflicts and costly compliance nightmares and this will make products less available and/or more expensive for consumers; no limits are proposed on states taking totally unbalanced, very restrictive positions that disregard federal policies; uniform national standards are needed, not more conflicting state laws
- **A Private Right of Action Would Generate A Massive Amount of Litigation** – Individuals should not be given the right to sue on the basis of CFPB’s regulations and requirements as some consumer groups propose as this would guarantee countless unmerited and costly lawsuits
- **No Protection Against CFPB Partisanship** – As structured, there is no requirement that CFPB membership be balanced between political parties; this would allow the President to make totally partisan appointments who then run the agency in a partisan manner
- **Unintended & Unknown Consequences** – Congress should not rush to judgment and try to pass the CFPB proposal quickly; the proposal’s implications are far too complex and too important to push it through without careful consideration and refinement; if CFPB in some form is to be passed, it should be developed as a part of overall regulatory reform, not separately