VENABLE LLP financial services alert

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July 20, 2009

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Consumer Financial Protection Agency: A Jack of All Trades But Master of None

On July 8, 2009, Chairman of the House Financial Services Committee Barney Frank (D-MA) introduced H.R. 3126, "*The Consumer Financial Protection Agency Act of 2009*" ("CFPAA"). For the most part, the bill reflects the Obama Administration's published proposal to create a new consumer protection agency, the primary focus of which is the protection of consumer interests related to financial products and services. And, although the bill adds numerous pages of text to the Administration's proposal, it remains surprisingly short on key details regarding how the newly formed Consumer Financial Protection Agency (the "Agency") would work from a practical perspective.

Where the bill is specific, however, demonstrates that Congress' ire at banks and mortgage companies as a result of the economic crisis has not yet cooled. More specifically, the bill requires the new Agency to create an integrated Truth in Lending Act/Real Estate Settlement Procedures Act disclosure within one year from the time of enactment (a project that the Federal Reserve Board and the Department of Housing and Urban Development started at least ten years ago). Notwithstanding that the clear target of Congress' displeasure is the mortgage lending industry, the bill drags within the ambit of this new Agency every entity that offers a consumer financial product or service – from retail sellers to credit counselors to small dollar lenders – irrespective of their role in precipitating the collapse of the housing and credit markets.

Congress is creating a "jack of all trades" agency – one that will regulate every financial product and service that exists in the marketplace today and those that have yet to be created. The Agency also will regulate every entity that offers such a product or service – whether that entity has a federal charter or a state charter, or a state license or no license at all. The Agency must (quickly) become a master at all of this to ensure that the confidence the public is gaining in the financial marketplace is not lost again.

This Alert focuses on answering key questions related to the creation of the new consumer financial protection agency and examines the implications of certain "improvements" to the Federal Trade Commission Act, which "improvements" will affect all marketers including those not covered by the new Agency.

I. Creation of the Consumer Financial Protection Agency

A. Who Will Make Up the Agency?

As contemplated in the bill, Congress is knitting the Agency together with patches of personnel from various existing federal banking agencies – including the Federal Reserve Board (the "Board"), the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), the Federal Deposit Insurance Corporation ("FDIC") and the National Credit Union Administration ("NCUA").

Heading the independent Agency will be a five-member Board comprised of four individuals appointed by the President and confirmed by the Senate. The fifth member is the head of the agency responsible for chartering and regulating national banks. Curiously, there exists no limitation in this draft of the bill on the political composition of the board. This is a departure from the rule for entities like the FTC, where no more than three of the agency's board members may be from one political party.

B. What Can the Agency Do?

The Agency will have in its quiver nearly every regulatory arrow needed to regulate consumer financial products or services and the entities that offer them. However, before we review these, we need to review the scope of the Agency's reach, which we can presently determine only from the definitions provided.

1. Key Definitions

The definitions contained in the bill are, in their effort to be broad in reach, ambiguous and in need of more specific interpretation so that their outer bounds may be more clearly discerned. As currently written (and set forth below) the Agency will have power over "covered persons" who offer "consumer financial products or services:"

- **Covered Person.** A "covered person" is: (i) any person who engages directly or indirectly in a financial activity, in connection with the provision of a consumer financial product or service; or (ii) any person who, in connection with the provision of a consumer financial product or service, provides a material service to, or processes a transaction on behalf of, a person described in (i), above.

- **Consumer Financial Product or Service.** A "consumer financial product or service" is any "financial product or service to be used by a consumer primarily for personal, family or household purposes."

For purposes of the above, the term "financial activity" includes, among other things, taking deposits, extending "credit," servicing loans, providing consumer report information, collecting debt, and providing credit counseling activities. The goal here appears to be to encompass the entire life cycle of a financial product or service – from counseling - to origination - to servicing - to collecting on defaulted debt. Also, for purposes of the above, providing a consumer financial product or service includes advertising, marketing, soliciting, selling, disclosing, delivering, or maintaining an account or servicing a financial product or service.

Note that the definition of "credit" as contained in the bill is far simpler than that provided for under the federal TILA. Entities that defer the payment of a debt but that do not provide TILA disclosures because they do not offer "credit" as that term is defined under TILA should be aware that, for purposes of this bill, they probably are offering credit. "Credit" is simply "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purpose." Arguably, this definition is sufficiently broad to reach entities as remote as infomercial marketers who offer multi-payments through debit/credit cards.

The Agency will be given authority over the following specific laws, which for purposes of this Alert are called the "Transferred Consumer Protection Laws:" (i) Alternative Mortgage Transaction Parity Act ("Parity Act"); (ii) Electronic Funds Transfer Act ("EFTA"); (iii) Equal Credit Opportunity Act ("ECOA"); (iv) portions of the Fair Credit Reporting Act ("FCRA"); (v) Fair Debt Collection Practices Act ("FDCPA"); (vi) Home Mortgage Disclosure Act ("HMDA"); (vii) Real Estate Settlement Procedures Act ("RESPA"); (viii) Truth in Lending Act ("TILA"); and (ix) Truth in Savings Act ("TISA"). The Consumer Reinvestment Act ("CRA") is not a transferred law.

2. General Mandate

The Agency's overarching mandate is to "seek to promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products or services." To effect this mandate, the Agency will have the following powers at its disposal:

- **Rulemaking.** The Agency may prescribe those rules and issue orders and guidance necessary and appropriate to administer and carry out the purposes and objectives of the bill, the Transferred Consumer Protection Laws and to prevent evasion of any of those laws. When engaging in such a rulemaking the Agency must bear in mind any potential reduction of consumers' access to financial products and the consistency of the rule with prudential, market or systemic objectives administered by the existing federal banking agencies. The Agency has the authority to carve entities out of compliance with any such rules provided the Agency considers, among other things, the entity's assets, volume of transactions, and the extent to which it engages in one or more financial activity. Although rumors persist that banks will obtain a general carve out from the Agency, this seems unlikely given that it would destroy the purpose of the Agency to be able to examine both depository and non-depository entities. If the Agency were to use this authority at all, arguably it will be for entities involved in the process of offering financial products to consumers but whose business involves little risk of harm to the consumer or for entities who are not really "financial" in nature.

- **Examinations and Reports.** The Agency is permitted to examine covered persons and require reports. To the extent possible, the Agency will use reports that the covered person already submits to federal or state regulators (such as HMDA reporting for mortgage lenders and Call Reports for banks). Reporting requirements are imposed on both depository and non-depository institutions.

- **Enforcement.** To the extent that the Agency and another federal agency (with the exception of the Department of Justice) have the authority under federal law to enforce that law, the Agency has primary authority to enforce it. Such other federal agencies (like the Federal Trade Commission) may recommend in writing that the Agency take a particular action. If, after 120 days, the Agency does not act on such a recommendation, then the other agency may initiate action. This 120-day cooling off period came under significant criticism from the Federal Trade Commission's Chairman in a recent hearing before the House Energy and Commerce Committee.

The Agency's above rulemaking and examination authorities are exclusive with respect to the Transferred Consumer Protection Laws.

3. Specific Powers

In addition to the above overarching mandate, the Agency is given the following specific powers:

- **Unfair Regulations.** The Agency is authorized to take action to prevent a person from "committing or engaging in an unfair, deceptive, or abusive act or practice under federal law in connection with any transaction with a consumer for a consumer financial product or service." In effecting this specific goal, the Agency is permitted to prescribe regulations identifying any such unlawful, unfair, deceptive or abusive acts or practices. In determining what constitutes "unfairness," the Agency must follow the current standard imposed on the FTC and have a reasonable basis to conclude that the act or practice causes or is likely to cause substantial injury to consumers and such substantial injury is not outweighed by benefits to consumers or competition. Although not expressly stated in the bill, the Agency does not appear to be required to undergo a Magnuson-Moss rulemaking process, which process is more time-consuming and burdensome because a hearing is required prior to issuing a regulation.

- **Appropriate and Effective Disclosures.** The Agency may prescribe regulations to ensure the appropriate and effective disclosure or communication to consumers of the costs, benefits, and risks associated with any consumer financial product or service. These disclosures should: (i) balance the communication of the benefits with the risks and costs; (ii) prominently disclose the significant risks and costs in reasonable proportion to the benefits; and (iii) communicate significant risks and costs in a clear, concise and timely manner.

- **Combined TILA/RESPA Disclosure.** Within one year from the effective date, the Agency must propose regulations and model disclosures to combine the TILA and RESPA disclosures into a single, integrated disclosure.

- **Standard Product or Service.** The Agency may not require that any covered person offer a "standard" consumer financial product or service until it promulgates regulations defining such a product. A "standard" consumer product or service is one that is or can be readily offered to consumers, is transparent to consumers in its terms and features, poses lower risks to consumers and facilitates comparisons with the benefits and costs of alternative consumer financial products or services. Critics of this requirement read this to mean that Congress will be, essentially, determining what financial products may enter the marketplace. Chairman Frank dismisses such a reading, instead stating that this standard is meant only to be a disclosure/transparency standard.

- **Fair Dealing.** The Agency is tasked with prescribing regulations imposing duties on a covered person, its employees, its agents or independent contractors who deal or communicate directly with consumers in the provision of a consumer financial product or service as the Agency deems appropriate or necessary to ensure fair dealing with consumers.

C. What Can't the Agency Do?

Although the draft bill puts few limits on the Agency's reach, it does impose two notable limitations. First, the Agency is prohibited from establishing a usury ceiling applicable to an extension of credit offered or made by a covered person to a consumer "unless explicitly authorized by law." This is consistent with Professor Elizabeth Warren's (who is often characterized as the architect of this Agency) description of the Agency before the House Financial Services Committee as not having rate-setting abilities. Warren professed that rate-setting should be done by Congress if it is to be done at all. Second, the Agency, when prescribing regulations relating to an employee, agent or independent contractor's "fair dealing" with a consumer, cannot prescribe a limit on the total dollar amount of compensation paid to any person.

D. How is State Law Affected?

Notwithstanding that the purpose of the Agency is to provide uniformity to the fragmented patchwork of state and federal laws that regulate the provision of consumer financial products and services, the bill provides only for "conflict" preemption of state laws. Conflict preemption means that a state law is preempted to the extent that it is "inconsistent" with a federal law or regulation issued by the Agency. A state law, however, is deemed to be not inconsistent with an Agency regulation if the law provides greater consumer protection. Thus, the bill creates a federal regulatory "floor" upon which the states can build.

In response to some pointed questions directed to Assistant Secretary of the Treasury Michael Barr by Members of the House Committee on Energy and Commerce regarding whether this standard will require covered persons to adhere to 51 different laws, Barr responded with the belief that he anticipated that any federal standard would be set sufficiently high that state law would be unnecessary. Industry insiders are concerned that such an approach means that the Agency will survey state laws, find the state with the highest compliance standard and adopt that as the federal "floor" for various credit products and services.

E. What Happens with Overlapping Jurisdictions?

Arguably, depository institutions have the most to "lose" in terms of finding themselves beholden to a new regulator. As noted above, the Agency retains primary regulatory and examination and enforcement authority over depository institutions when offering a consumer financial product or service related to a Transferred Consumer Protection Law. And, by way of clarification, the bill makes clear that state unfair and deceptive practices law applies to national banks and federally chartered savings associations and all of their operating subsidiaries, other subsidiaries and affiliates.

Additionally, States Attorneys General have concurrent authority to bring action in a representative capacity in the name of the state for the violation of any law under this bill. However, before commencing action, the Attorney General generally must provide the Agency with prior notice and an opportunity to intervene.

II. Expansion of the Federal Trade Commission Authority

The bill would transfer some of the Federal Trade Commission's existing authority to the new Agency. Not surprisingly, the Commission's testimony on the Administration's original legislative proposal questioned whether subdividing its current regulatory turf would serve consumers. But FTC Chairman Jon Leibowitz was all smiles when he discussed the provisions of the bill that would expand his agency's already expansive authority over unfair and deceptive practices generally – whether or not such practices involve consumer financial products or services.

First, the bill would give the FTC the authority to collect civil penalties for any violations of Section 5 of the FTC Act. The Commission's current civil penalty authority is generally limited to cases involving violations of regulations or administrative orders. But if the bill becomes law, any garden-variety Section 5 case could result in the assessment of civil penalties if the defendant had actual knowledge or "knowledge fairly implied" that its actions were unfair or deceptive. One question not answered by the proposed legislation is whether such knowledge could be implied from the existence of consent agreements or FTC guides relating to similar conduct.

In deceptive advertising cases, the FTC often seeks consumer redress equal to the total net sales of the advertised product -- which amount usually exceeds the maximum civil penalty award it could expect to obtain. But in certain types of cases (e.g., those involving data security or spyware), the harm to consumers is hard to put a dollar figure on, and a civil penalty approach may result in a larger monetary award for the government (because civil penalties are usually not tax-deductible while consumer redress payments usually are, a civil penalty takes a considerably bigger bite out of a defendant than a redress award).

Although the Commission's testimony expressed gratitude for the proposed augmentation of its civil penalty authority, there was a bit of "may-I-have-some-more" from the FTC Chairman. Currently, the FTC must first present civil penalty cases to the Department of Justice for filing. The Commission would prefer to have unfettered authority to file civil penalty cases instead of having them reviewed first by DOJ.

The bill also authorizes the FTC to take action against those who assist others in engaging in unfair or deceptive acts or practices. While the Commission recently has cast its net wider and wider in an attempt to punish additional defendants who were not primarily responsible for an allegedly unfair or deceptive practice, this amendment would no doubt embolden the staff to be even more aggressive and imaginative in targeting parties who supplied goods or services to a law violator, but whose connection to the alleged Section 5 violation was only tangential. For example, the Agency could use this authority to make newspapers, TV networks or other advertising media defendants in deceptive advertising cases.

Finally, the CFPAA would strip away some unique procedural requirements that apply to FTC rulemaking, and allow the Commission to follow the bare-bones, notice-and-comment procedures that constitute the lowest common denominator of the Administrative Procedure Act ("APA").

Back in the 1970's, the FTC went on a rulemaking spree that was truly breathtaking in breadth, fully justifying the sobriquet of "The National Nanny" given to it by *The Washington Post*. Since then, what the FTC Chairman called "cumbersome and time-consuming" rulemaking procedures have discouraged some regulatory excesses. But the new proposal would allow the agency to put the rulemaking pedal to the metal.

Former FTC Chairman William Kovacic, who still serves as one of the agency's five commissioners, dissented from the Commission's endorsement of the greatly streamlined rulemaking procedures that the bill would permit if it became law, arguing that the FTC's rulemaking jurisdiction is so broad in terms of subject matter and sectors of the economy that it would be "prudent" to retain procedures beyond the APA minimums. Kovacic also dissented from the majority endorsement of across-the-board civil penalty authority. And, Commissioner Thomas Rosch did not vote in favor of the Commission's testimony because he does not endorse the proposal to create the Agency in the first place.

III. Conclusion

As noted above, Congress is creating a "jack of all trades" agency – one that must regulate every financial product and service that exists in the marketplace today and those that have yet to be created for every entity that offers such a product or service – whether that entity has a federal charter or a state charter, or a state license or no license at all. Industry reaction has been negative but relatively muted thus far, likely waiting the result of hearings in the Senate regarding the creation of this new Agency.

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