Financial Regulatory Reform: Analysis of the Consumer Financial Protection Agency (CFPA) as Proposed by the Obama Administration and H.R. 3126

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Summary

In the wake of what many believe is the worst U.S. financial crisis since the Great Depression, the Obama Administration has proposed sweeping reforms of the financial services regulatory system, the broad outline of which has been encompassed in a nearly 90-page document called the Administration's White Paper (the White Paper or the Proposal). The Proposal seeks to meet five objectives:

(1) "Promote robust supervision and regulation of financial firms";

(2) "Establish comprehensive supervision and regulation of financial markets";

(3) "Protect consumers and investors from financial abuse";

(4) "Improve tools for managing financial crises"; and

(5) "Raise international regulatory standards and improve international cooperation."

The Administration subsequently offered specific legislative proposals that would implement each of the five objectives of the White Paper, including the Consumer Financial Protection Agency Act of 2009 (the CFPA Act or the Act). The Act would establish a new executive agency, the Consumer Financial Protection Agency (the CFPA or the Agency), to protect consumers of financial products and services. On July 8, 2009, Representative Barney Frank, Chairman of the House Financial Services Committee, introduced similar legislation, H.R. 3126, which also is entitled the CFPA Act of 2009. H.R. 3126 was marked up and ordered to be reported by both the House Financial Services Committee and the House Energy and Commerce Committee.

This report provides a brief summary of the Administration's CFPA Act and delineates some of the substantive differences between it and H.R. 3126, as ordered to be reported by the House Financial Services Committee, as well as the version that was ordered to be reported by the House Energy and Commerce Committee. It then analyzes some of the policy implications of the proposal, focusing on the separation of safety and soundness regulation from consumer protection, financial innovation, and the scope of regulation. The report then raises some questions regarding state law preemption, sources of funding, and rulemaking procedures that the Act does not fully answer.

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Introduction

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> (1) "Promote robust supervision and regulation of financial firms" through the creation of an oversight council of the primary federal financial regulators; the provision of systemic risk oversight powers for the Federal Reserve; heightened prudential standards for financial firms; and increased federal oversight of institutions that are unregulated or only lightly regulated under current law;
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> (2) "Establish comprehensive supervision and regulation of financial markets" by enhancing regulation over credit rating agencies; requiring originators and issuers to retain a long-term interest in securitized loans; regulating over-the-counter (OTC) derivatives; and providing the Federal Reserve with new oversight authority of payment, settlement, and clearing systems;
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> (3) "Protect consumers and investors from financial abuse" through the creation of a new executive agency devoted exclusively to consumer protection of financial products and services;
>
> (4) "Improve tools for managing financial crises" by establishing an insolvency regime for systemically significant financial institutions and improving the Federal Reserve's emergency lending powers; and
>
> (5) "Raise international regulatory standards and improve international cooperation" by coordinating oversight of international financial firms and other regulatory changes.[2]

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This report provides a brief summary of the Administration's CFPA Act and delineates some of the substantive differences between it and H.R. 3126, as ordered to be reported by the House Financial Services Committee, as well as a modified version that was ordered to be reported by the House Energy and Commerce Committee. It then analyzes some of the policy implications of

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[1] Financial Regulatory Reform, Obama Administration White Paper, June 19, 2009, available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf (hereinafter, White Paper).

[2] White Paper at 3-4.

[3] Consumer Financial Protection Agency Act of 2009, June 30, 2009, available at http://www.financialstability.gov/docs/CFPA-Act.pdf (hereinafter, CFPA Act).

the proposal, focusing on the separation of safety and soundness regulation from consumer protection, financial innovation, and the scope of regulation. The report then raises some questions regarding state law preemption, sources of funding, and rulemaking procedures that the Act does not fully answer.

Summary of the Administration's CFPA Act

Under the Act, the CFPA would be headed by a board consisting of four members appointed by the President, subject to the advice and consent of the Senate, for five-year staggered terms and subject to removal only for cause. The board also would have one ex officio member, the Director of the National Bank Supervisor[4] (proposed in the White Paper to be a new government agency, which would be established under subsequent legislation, in charge of prudential regulation of all federally chartered insured depositories).[5] The Agency would be funded through appropriations and potentially through fees assessed by the CFPA against covered entities.[6]

The CFPA would be established to "seek to promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products and services" and to help ensure that consumers are able to make educated decisions regarding financial products and services; that they are "protected from abuse, unfairness, deception, and discrimination"; that markets operate efficiently and fairly; and that "traditionally underserved consumers and communities have access to financial services."[7]

To implement these goals, the CFPA would have authority over a vast array of financial activities, including deposit taking, mortgages, credit cards and other extensions of credit, investment advising to entities not subject to registration or regulation by the Securities and Exchange Commission or the Commodity Futures Trading Commission, loan servicing, check-guaranteeing, collection of consumer report data, debt collection, real estate settlement, money transmitting, financial data processing, and others.[8] The CFPA would not have authority over insurance activities other than mortgage, title, and credit insurance.[9] The range of entities engaged in financial activities that would be subject to the CFPA also is expansive under the Act, including banks, credit unions, and mortgage brokers to name a few. The proposed legislation defines those covered by the Act to be

> any person who engages directly or indirectly in a financial activity, in connection with the provision of a consumer financial product or service [used primarily for personal, family, or household purposes]; or any[one who] provides a material service to, or processes a transaction on behalf of, [such] a person.[10]

[4] The Administration's White Paper proposes eliminating the thrift charter and converting such entities into state or national banks, while also modifying the regulatory framework to which banks are subject. Under this proposal, the new bank regulator is the National Bank Supervisor.

[5] CFPA Act § 1012.

[6] CFPA Act § 1018.

[7] CFPA Act § 1021.

[8] See definition of "financial activity," CFPA Act § 1002(18).

[9] See definition of "financial activity," CFPA Act § 1002(18).

[10] CFPA Act § 1002(9).

Additionally, the Act would consolidate in the CFPA consumer protection regulatory and enforcement authority, which is currently shared by a number of federal agencies. The Act would transfer to the CFPA the "consumer financial protection functions"[11] and many of the employees performing those functions from the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission (FTC), and the National Credit Union Administration (NCUA).[12] However, according to the guidelines of the White Paper, these agencies, with the exception of the OTS,[13] would retain safety and soundness supervisory and examination powers outside the purview of consumer protection over certain regulated entities.[14]

The CFPA also would be the primary federal regulator, examiner, and rulemaker[15] with enforcement authority under many of the federal consumer protection laws, including

(A) the Alternative Mortgage Transaction Parity Act[16];

(B) the Community Reinvestment Act[17];

(C) the Consumer Leasing Act[18];

(D) the Electronic Funds Transfer Act[19];

(E) the Equal Credit Opportunity Act[20];

(F) the Fair Credit Billing Act[21];

(G) the Fair Credit Reporting Act[22] (except with respect to sections 615(e), 624, and 628[23]);

(H) the Fair Debt Collection Practices Act[24];

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[11] The CFPA Act defines "consumer financial protection functions" as "research, rulemaking, issuance of orders or guidance, supervision, examination, and enforcement activities, powers, and duties relating to the provision of consumer financial products or services, including the authority to assess and collect fees for these purposes." CFPA Act § 1061(d).

[12] CFPA Act §§ 1061-1066.

[13] The White Paper proposes the elimination of the thrift charter. White Paper at 32-34.

[14] White Paper at 19-42. The White Paper does propose changes with regards to who regulates whom and the scope of supervision. For a detailed discussion of the current regulatory system, see CRS Report R40249, *Who Regulates Whom? An Overview of U.S. Financial Supervision*, by Mark Jickling and Edward V. Murphy.

[15] CFPA Act § 1022.

[16] 12 U.S.C. §§ 3801 *et seq.*

[17] 12 U.S.C. §§ 2901 *et seq.*

[18] 15 U.S.C. §§ 1667 *et seq.*

[19] 15 U.S.C. §§ 1693 *et seq.*

[20] 15 U.S.C. §§ 1691 *et seq.*

[21] 15 U.S.C. §§ 1666-1666j.

[22] 15 U.S.C. §§ 1681 *et seq.*

[23] 15 U.S.C. §§ 1681m(e), 1681s-3, 1681w. These provisions primarily pertain to "red flag" identity theft prevention measures for federal financial institutions, the use of credit report information among affiliates to market and solicit consumers, and credit report record retention by federal financial institutions.

(I) the Federal Deposit Insurance Act, subsections 43(c) through (f)[25];

(J) the Gramm-Leach-Bliley Act, sections 502 through 509[26];

(K) the Home Mortgage Disclosure Act[27];

(L) the Home Ownership and Equity Protection Act[28];

(M) the Real Estate Settlement Procedures Act (RESPA)[29];

(N) the S.A.F.E. Mortgage Licensing Act[30];

(O) the Truth in Lending Act (TILA)[31]; and

(P) the Truth in Savings Act.[32]

The CFPA would be required to monitor the market and the innovation of new products and services. In order to do so, the Act would provide the Agency the authority to examine covered persons, including national banks, federal credit unions, and federal savings and loan associations.[33] Under current law, examination powers generally rest exclusively in the institutions' primary regulators.

Rather than explicitly imposing new substantive regulation on financial activities and products, the Act primarily (though, not exclusively[34]) leaves such decisions to be made by the CFPA through future rulemaking and guidance. The Agency would have the authority to promulgate rules and issue guidance and orders to meet the objectives of the CFPA Act.[35] The standard rulemaking procedures provided by the Act would require the Agency to weigh the costs and benefits to both consumers and industry, including the potential effect the rule would have on the availability of financial products and services.[36] The Agency also would have to "consult with the Federal banking agencies ... regarding the consistency of a proposed rule with prudential, market,

(...continued)

[24] 15 U.S.C. §§ 1692 *et seq*.

[25] 12 U.S.C. § 1831t(c)-(f). These provisions pertain to disclosure requirements for depository institutions that do not hold federal deposit insurance.

[26] 15 U.S.C. §§ 6802-6809. These provisions deal with financial institutions' use and protection of non-public consumer information.

[27] 12 U.S.C. §§ 2801 *et seq*.

[28] 15 U.S.C. § 1639.

[29] 12 U.S.C. §§ 2601-2610.

[30] 12 U.S.C. §§ 5101-5116.

[31] 15 U.S.C. §§ 1601 *et seq*.

[32] 12 U.S.C. §§ 4301 *et seq*.

[33] CFPA Act §§ 1022(c) and 1024.

[34] However, the Act would impose some substantive regulations. For example, the Act would require disclosure of new data points under the Home Mortgage Disclosure Act. CFPA Act § 1086(f).

[35] CFPA Act § 1022(a). The CFPA would be expressly prohibited from setting a usury cap without specific authorization by law. CFPA Act § 1022(g). The Act specifically provides the Agency the authority to prohibit or limit arbitration clauses. CFPA Act § 1025.

[36] CFPA Act § 1022(b).

or systemic objectives administered by such agencies."[37] Within three years[38] of any CFPA "significant rule or order" becoming effective and after a public comment period, the Agency must publish a report assessing the effectiveness of the rule or order.[39] The Act does not specify what would be considered "significant," presumably leaving these determinations to the Agency.

The Act imposes additional procedures upon specific types of rulemaking. For instance, the Agency would be authorized to promulgate rules on unfair or deceptive practices in connection with consumer financial services and products. However, the Agency could only promulgate a rule deeming an act unlawfully *unfair* if

> the Agency has a reasonable basis to conclude that the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers and such substantial injury is not outweighed by countervailing benefits to consumers or to competition.[40]

Other examples of specific rulemaking authority for which the CFPA Act would impose requirements in addition to the Act's standard rulemaking procedures outlined above include disclosure requirements;[41] minimum standards for the prevention and detection of "unfair, deceptive, abusive, fraudulent, or illegal transactions";[42] provision of "standard consumer financial products or services" (a.k.a. "plain-vanilla" products and services) that may serve as a comparison to similar, but less traditional products or services;[43] and imposition of duties, including compensation practices, on covered persons.[44]

All of these steps and restrictions exceed the normal notice and comment procedures of the Administrative Procedure Act, which generally apply to agency rulemaking.[45]

With regard to preemption of state laws, the preemption language of the "enumerated consumer laws" largely would remain unchanged by the CFPA Act.[46] However, for matters unrelated to enumerated consumer laws that include provisions explicitly delineating how such federal laws shall interact with state laws,[47] the Act would *not* preempt state consumer protection laws and

[37] CFPA Act § 1022(b).

[38] The Agency may delay the report for up to five years after the effective date if it determines that three years is not enough time to adequately review the rule. CFPA Act § 1024.

[39] CFPA Act § 1024.

[40] CFPA Act § 1031.

[41] CFPA Act §§ 1032 and 1034.

[42] CFPA Act § 1035.

[43] CFPA Act § 1036.

[44] CFPA Act § 1037. The Agency would only be able to enforce violations of duties prescribed under the authority of § 1037 in accordance with an adjudicatory proceeding described in great detail in §§ 1051-1058 of the Act. CFPA Act § 1037.

[45] 5 U.S.C. § 553. See, also, CRS Report RL32240, *The Federal Rulemaking Process: An Overview*, by Curtis W. Copeland.

[46] CFPA Act § 1041(b) (The one exception is with regard to the preemption language of the Alternative Mortgage Transaction Parity Act).

[47] For example, 15 U.S.C. § 1610 of the Truth in Lending Act states in part: "Except as provided in subsection (e) of this section, this part and parts B and C of this subchapter, do not annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency."

regulations that provide greater protections to consumers, but would preempt otherwise conflicting state laws. The CFPA would decide whether or not particular state laws conflict with the Act,[48] with specific decisions subject to judicial review.[49] Any generally applicable state consumer law would apply to national banks and savings and loans unless it discriminates against them (presumably to the benefit of intrastate financial institutions) or conflicts with the Act.[50] Additionally, any state consumer law regulating state banks or state savings and loans that was enacted in compliance with federal law also would apply to national banks and savings and loans unless it discriminates against the federally chartered institutions or conflicts with the CFPA Act.[51] Depending on how they are interpreted by the Agency and the courts, these provisions could result in a departure from current federal banking law, which the OCC and other banking regulators interpret as preempting many state consumer laws.[52]

The CFPA would be provided the authority to enforce the requirements of the CFPA Act and the enumerated consumer laws, as well as the rules and regulations promulgated under the authority of those laws.[53] State attorneys general also would be given authority to enforce the CFPA Act and its regulations on behalf of residents of their state; however, before doing so, state attorneys general, under most circumstances, would have to provide advance notice to the CFPA, and the Agency would have the authority to intervene in the civil action. The Act would not alter the authority (or lack thereof) of state attorneys general to enforce the enumerated consumer laws.[54]

H.R. 3126, as Ordered to Be Reported by House Financial Services

There are a number of substantive differences between H.R. 3126, as ordered to be reported by the House Financial Services Committee on October 22, 2009, and the Obama Proposal, many of which are detailed below.

Organizational Structure

H.R. 3126 would establish an agency structure wholly different from that of the Obama Administration proposal. Under H.R. 3126 virtually all of the CFPA's powers would be held by the Agency's director. The director would be a Presidential appointee, subject to the advice and consent of the Senate, who would serve for a five-year term, from which he could only be removed for cause.[55] The bill also would create a Consumer Financial Protection Oversight

[48] CFPA Act § 1041.

[49] For a description of judicial review of statutory interpretation by agencies, see CRS Report R40595, *Cuomo v. Clearing House Association, L.L.C: National Banks Are Subject to State Lawsuits to Enforce Non-Preempted State Laws* , by M. Maureen Murphy.

[50] CFPA Act §§ 1043(b)-(c) and 1046(b)-(c).

[51] CFPA Act §§ 1042(d) and 1046(d).

[52] See, e.g., 12 C.F.R. §§ 7.4000 *et seq.* and Part 34. See, also, CRS Report RL32197, *Preemption of State Law for National Banks and Their Subsidiaries by the Office of the Comptroller of the Currency*, by M. Maureen Murphy.

[53] CFPA Act § 1022.

[54] CFPA Act § 1042.

[55] H.R. 3126 § 112.

Board, composed of most of the other federal financial regulators, to offer the CFPA director advice. This oversight board would not have any substantive authority over the Agency.[56]

Covered Entities and Activities

H.R. 3126 generally would exempt a number of entities from the Agency's "rulemaking, supervisory, enforcement or other authority, including authority to order assessments." These exempted entities include retailers, merchants, and sellers of primarily non-financial goods when providing a good or service directly to a consumer but only to the extent "in which the good or service being provided is not itself a consumer financial product or service." Accountants, income tax preparers, attorneys, real estate brokers and agents, automobile dealers and sellers, and others also would generally be exempt from the CFPA's authority when they are engaged in the normal, *nonfinancial* activities of their respective businesses. However, the CFPA would retain any authority provided by an enumerated consumer law over these entities.[57]

Examination and Enforcement Powers

The primary examination and enforcement powers for consumer compliance issues over banks with $10 billion or less in assets and credit unions with $1.5 billion or less in assets would remain with those institutions' safety-and-soundness regulator, rather than being transferred to the CFPA. However, the bill would provide a procedure by which the CFPA could acquire these powers over institutions that have not been adequately supervised by the prudential regulator. The CFPA generally would not have the authority to impose assessments on these smaller banks and credit unions.[58]

For those covered entities that the CFPA does have primary examination and enforcement powers for consumer compliance issues, the Agency generally would have to coordinate its compliance examinations to occur along with the safety-and-soundness examinations of the prudential regulators.[59]

Funding and Assessments

H.R. 3126 would require 10% of the Federal Reserve System's total expenses to be transferred to the CFPA to implement the authorities provided by the bill. This percentage roughly accounts for the compliance and supervisory costs of implementing the authorities transferred from the Federal Reserve to the CFPA. The CFPA also would have the authority to assess fees on covered entities. However, the Agency would have to keep the fees brought in from banks and non-banks separate, and ensure that the fees assessed against banks are not used for the examination and compliance of non-banks. The bill also would provide protections that smaller institutions would not be assessed disproportionately as compared to larger institutions.[60]

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[56] H.R. 3126 § 113.

[57] H.R. 3126 § 124.

[58] H.R. 3126, Amd. 5, markup, House Committee on Financial Services.

[59] H.R. 3126 § 123.

[60] H.R. 3126 § 119. The bill does still leave open the possibility of funding coming through appropriations, much like the Administration's CFPA Act.

Specific Authorities

Under the H.R. 3126, as ordered to be reported by the House Financial Services Committee, the CFPA would no longer have the authority to promulgate regulations concerning the provision of "standard consumer financial products or services" that may serve as a comparison to similar, but less traditional products or services (a.k.a. "plain-vanilla" products and services).

Preemption

H.R. 3126, as ordered to be reported by the House Financial Services Committee, also would impose a different preemption standard from the Obama Administration's proposal. Under H.R. 3126, state laws would be preempted only if:

(1) it would have a discriminatory effect on national banks, as compared to state banks;

(2) the national bank regulator determines that the state law "prevents or significantly interferes with the ability of a [national bank] to engage in the business of banking"; or

(3) the state law is preempted by another federal law (other than the National Bank Act or the Home Owners' Loan Act).

H.R. 3126 would not preempt state laws as they apply to banks' subsidiaries or affiliates.[61]

H.R. 3126, as Ordered to Be Reported by House Energy and Commerce

H.R. 3126, as ordered to be reported by the House Energy and Commerce Committee on October 29, 2009, is very similar to the version that was ordered to be reported by the Financial Services Committee. The main differences between the two relate to the organizational structure of the CFPA and the authorities of the FTC. Rather than being run by a single director, Energy and Commerce's version would establish a five-member commission. Each member would be appointed by the President, subject to the advice and consent of the Senate, for staggered terms, and could only be removed for "inefficiency, neglect of duty, or malfeasance in office." The bill also would prohibit more than three of the five members from being affiliated with the same political party. Additionally, the Energy and Commerce Committee's version would strengthen the FTC's enforcement authority of consumer protection laws and regulations.[62]

[61] H.R. 3126, Amd. 9, markup, House Committee on Financial Services. In other words, this preemption language would only apply to institutions with federally insured deposits.

[62] H.R. 3126, Manager's Amd., markup, House Committee on Energy and Commerce.

Would the CFPA Be an Improvement?

The Treasury's White Paper argues that the CFPA is necessary because recent events in financial markets have exposed the inadequacy of the current regulatory framework. As an example, the White Paper cites overly complicated, nontraditional mortgages that were unsuitable for the many borrowers who lost their homes to foreclosure.[63] By creating an agency dedicated exclusively to consumer protection, Treasury hopes to raise standards for financial intermediaries and ultimately foster a culture of consumer protection within financial firms. In the White Paper's analysis, the imperative to protect consumers was simply overwhelmed by profit considerations—by its very existence, the CFPA is intended to right the balance.[64]

There are benefits to having a single agency in charge of virtually all consumer financial products and services and consumer protection laws. But there are also costs, which may fall either on regulated financial institutions or on consumers. The CFPA proposal raises a number of possible issues about the structure and purposes of regulation.

Redundancy

The powers that the CFPA would have are primarily derived from federal banking statutes. This raises the objection that the existing bank regulators already have full authority to do what the new agency would do. What would prevent failures in regulation from being addressed within the existing structure?

One can argue that there is a conflict between safety and soundness regulation and consumer protection. When a banking activity is profitable, regulators tend to look upon it favorably, since it enables the bank to meet capital requirements and withstand financial shocks. According to the White Paper, professional bank examiners are trained "to see the world through the lenses of institutions and markets, not consumers."[65] This conflict may be especially sharp in consumer lending.

Over the past several decades, banks and other financial institutions have expanded the scale and scope of their consumer lending programs. Partly driven by competition from the securities industry (which has largely supplanted banks as a source of funds for large corporations), and partly by the availability of computerized credit scoring models (which dramatically reduce the cost of evaluating borrowers' creditworthiness), mainstream lenders have made credit available to consumers who not long ago would have been viewed as too risky and unqualified.[66]

Credit card and subprime mortgage lending are perhaps the most visible results of this trend. On the one hand, they represent a great expansion in the availability of credit and have allowed many consumers to raise their standard of living. On the other hand, both have been criticized for high costs to borrowers, hidden fees, and/or excessive complexity, to the extent that lending practices have been described as unscrupulous and abusive.

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[63] White Paper at 55.

[64] White Paper at 57.

[65] White Paper at 56.

[66] Darryl E. Getter, "Consumer Credit Risk and Pricing," *Journal of Consumer Affairs*, vol. 40, Summer 2006, p. 41.

Have the traditional bank regulators been too slow to detect potentially harmful features of new sources of banking profits? Could a consumer agency, without the continuous oversight of bank finances that bank examiners exercise, do a better job of identifying emerging problems in new consumer finance markets?

Financial Innovation

An argument against the CFPA is that it could stifle financial innovation. Innovative practices are by definition less well understood than traditional ones,[67] and financial institutions tend to earn higher margins on new products, at least until their competitors enter the market and compete away excess profits. Both factors might appear problematic to a consumer protection regulator, though not necessarily to a safety and soundness regulator.

The White Paper is explicit about favoring and promoting traditional, "plain-vanilla" financial products. The White Paper stresses the need to achieve simplicity, fairness, and reasonable disclosure;[68] and the Act would provide the CFPA the authority to impose duties of care and suitability requirements on financial firms. Opponents of the CFPA might argue that this attitude could lead to the creation of barriers and hurdles—perhaps in the form of slow approval of disclosure forms—to the introduction of new products.

Treasury officials have made clear their concern that the classical economic model of rational, informed consumers, able to act in their self-interest, is not a sound basis for regulation. For example:

> Michael Barr [Assistant Secretary for Financial Institutions], who is leading the consumer-protection efforts, said the "plain-vanilla" financial products have their roots in behavioral economics and psychology. It isn't enough to provide consumers with more disclosure and more information, since people often get easily overwhelmed and make mistakes, said Mr. Barr, a former academic who studied the financial markets.
>
> Most people, for example, don't understand the effects of compounding of interest—which leads them to undersave and to overborrow—a basic human failing that some financial institutions have an incentive to exploit.[69]

The debate over strengthened consumer protection, in other words, involves the age-old question of how much government intervention into markets is warranted: should consumers be protected from their mistakes, or trusted to make decisions that will enhance individual and common welfare? The issue of financial innovation can be framed similarly: is development of new and/or exotic financial products to be encouraged, or are they potentially troublesome if they gain wide currency before the risks are fully understood by regulators and market participants?

[67] This is the case for all financial products, not just those designed for consumers.

[68] White Paper at 63-67.

[69] Jane J. Kim, "Plain-Vanilla Financing Could Melt Bank Profits – U.S.'s Bid to Help Consumers; Mystery of Compound Interest," *Wall Street Journal*, Jun. 26, 2009, p. C1. Behavioral finance posits that consumers are "hard-wired" to make bad financial choices, and that education is only a partial remedy.

Jurisdiction

Under the Treasury proposal, the SEC and CFTC generally would retain their consumer protection role in securities and derivatives markets.[70] This could be viewed as a flaw, which would preserve the existing fragmented federal regulatory structure. The banking and securities industries have for years offered products that compete with each other—money market funds, brokerage checking accounts, investment advice through bank trust departments, etc.—and issues of overly complex products, inadequate disclosure, conflicts of interest, and the extent of fiduciary duties are common to both.

Since the onset of the financial crisis, households' losses in real estate have been exceeded by their losses in securities investments.[71] Not all those losses resulted from fraud or regulatory failure, but the SEC's recent record is not notably better than the bank regulators'. The logic of creating a single agency exclusively concerned with consumer financial protection, and excluding securities (and futures[72]) may not be clear.

For comparison, the Financial Services Authority in the United Kingdom has consumer protection powers over all financial industries, including banking, securities, derivatives, and insurance. Its objectives, as posted on its website, appear to mirror those of the proposed CFPA. The Financial Services and Markets Act gives the FSA four statutory objectives:

- Market confidence: maintaining confidence in the financial system;
- Public awareness: promoting public understanding of the financial system;
- Consumer protection: securing the appropriate degree of protection for consumers; and
- The reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.[73]

Is there a different regulatory structure, where jurisdiction is split differently among multiple regulators, that could lead to a greater balance of the regulatory costs and benefits? Are there other products and services that should be excepted from the CFPA's jurisdiction?

Questions Left Unanswered

Preemption

How narrowly or broadly would the Agency interpret potential conflicts between state and federal law? If interpreted narrowly, then the Act's preemption language could have a detrimental effect on banks and other entities that provide consumer financial products and services in multiple

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[70] The White Paper does recommend certain enhancements to the SEC's authority: see, e.g., p. 70.

[71] Between the end of 2006 and the first quarter of 2009, households lost $4.01 trillion of the value of their real estate holdings, while the value of corporate stock and mutual funds held by households (and non-profits) fell by $5.10 trillion. Federal Reserve, Flow of Funds Accounts, Table B. 100.

[72] Although relatively few individuals trade in derivatives markets.

[73] http://www.fsa.gov.uk/Pages/about/aims/statutory/index.shtml.

states because they would be working within multiple regulatory regimes, increasing administrative costs that likely would be passed on to consumers.[74] If the Agency interprets conflicts broadly, then interstate actors may only have a single set of rules to follow, but consumers may not be as fully protected from predatory products, services, and practices as they would be otherwise.

Funding

How much funding would come from fees on covered entities? If such fees were assessed, would those costs be passed onto the consumer? Would that be more beneficial to the public as a whole than paying for the Agency through normal appropriations? The agencies from which many of the CFPA employees would be transferred are largely self-funded through fees assessed on the companies under their regulatory jurisdiction. Some have argued that this source of funding played a role in lax regulatory enforcement by federal agencies because banks have an incentive to seek the regulator they believe will have the lightest regulatory touch, while the regulators generate more fees with every institution they bring under their jurisdiction.[75] Would funding the CFPA through fees lead to similar problems? On the other hand, running the Agency would be expensive. The ability of the CFPA to generate at least some of its own funding could reduce the Agency's need for general appropriations.

Rulemaking

Are the Act's rulemaking procedures appropriately drawn? As previously mentioned, agency rulemaking generally requires public notice of proposed rulemaking and a period for public comment on the matter. The Act would require steps in addition to notice and comment. For instance, the CFPA would have to make findings regarding the costs of potential rules on both industry and consumers. Additionally, the Agency would have to review any significant rule within three to five years after its effective date. The Act would impose other restrictions on rulemaking, as well. If rulemaking procedures are too easily met, then the Agency could go too far, promulgating rules that have a deleterious effect on consumers' access to credit and on industry's profitability. If procedures are so restrictive that the Agency is unable to promulgate rules in a timely fashion, consumers could be harmed by otherwise preventable predatory products and practices, which also could lead to long-term harm to industry.

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[74] This potentially could put entities acting only within a single state at a competitive advantage over interstate actors.

[75] See, e.g., Adam Levitin, *Bank Regulatory Arbitrage and Deregulation: The Number of Bank Regulators Matters*, Credit Slips: A Discussion on Credit and Bankruptcy, available at http://www.creditslips.org/creditslips/2009/06/one-of-the-key-points-of-debate-over-financial-institution-regulation-reform-is-how-many-different-bank-regulators-there-shou.html.

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