The Early Agenda of the Consumer Financial Protection Bureau: The Nonbank Supervision Program

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Summary

The Consumer Financial Protection Bureau (CFPB) was established by Title X of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (P.L. 111-203, the Dodd-Frank Act). The creation of the CFPB consolidates many existing consumer financial protection responsibilities into one agency. The Dodd-Frank Act states that the purpose of the CFPB is to implement and enforce federal consumer financial law while ensuring that consumers can access financial products and services. The CFPB is also instructed to ensure that the markets for consumer financial services and products are fair, transparent, and competitive. To fulfill its mandate, the CFPB can issue rules, examine certain institutions, and enforce consumer protection laws and regulations.

On January 4, 2012, President Obama installed Richard Cordray as the director of the Consumer Financial Protection Bureau via recess appointment. As explained in CRS Report R41839, *Limitations on the Secretary of the Treasury's Authority to Exercise the Powers of the Bureau of Consumer Financial Protection*, by (name redacted), the Dodd-Frank Act transferred some powers to the CFPB and established new powers. The CFPB could not exercise its new powers until a director was appointed. Included in the newly established powers is the authority to regulate certain nonbanks for consumer protection. Under the new authority conferred by the appointment of Cordray, the CFPB announced the Nonbank Supervision Program. A nonbank is an institution that provides financial services but does not have a bank, thrift, or credit union charter. The Nonbank Supervision Program will subject some nonbanks to the same consumer protection standards as currently applied to banks. Under the program, the CFPB will supervise three groups of nonbanks. First, the CFPB can regulate nonbanks in three specific markets—mortgage companies, payday lenders, and private education lenders. Second, the CFPB can regulate the "larger participants" in other financial markets. Third, the CFPB may supervise a nonbank that is performing actions that may pose a risk to consumers with regard to consumer financial products or services. This report describes the Nonbank Supervision Program as well as other initiatives that the CFPB has started since its creation.

This report does not address arguments that have been made against the validity of the recess appointment itself, nor does it address related questions that have been raised regarding the scope of Cordray's authority as the director of the CFPB while serving pursuant to a recess appointment.

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Introduction

One of the first actions by the Consumer Financial Protection Bureau (CFPB) after the appointment of Richard Cordray as its director was to announce its new Nonbank Supervision Program. A nonbank is an institution that provides financial services or products but does not have a bank, thrift, or credit union charter.[1] The Nonbank Supervision Program will subject some nonbanks to the same consumer protection standards as currently applied to banks. This report will describe the Nonbank Supervision Program, the structure and powers of the CFPB, and other early CFPB initiatives.

This report does not address arguments that have been made against the validity of the recess appointment itself, nor does it address related questions that have been raised regarding the scope of Cordray's authority as the director of the CFPB while serving pursuant to a recess appointment.[2]

Overview of the Bureau

The Consumer Financial Protection Bureau was established by Title X of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (P.L. 111-203, the Dodd-Frank Act).[3] The creation of the CFPB consolidates many consumer financial protection responsibilities into one agency. The Dodd-Frank Act states that the purpose of the CFPB is to implement and enforce federal consumer financial law while ensuring that consumers can access financial products and services.[4] The CFPB is also instructed to ensure that the markets for consumer financial services and products are fair, transparent, and competitive.[5] To fulfill its mandate, the CFPB can issue rules, examine certain institutions, and enforce consumer protection laws and regulations.

The Dodd-Frank Act further established that the CFPB is to be headed by a director, appointed by the President by and with the advice and consent of the Senate, who shall serve a five-year term. The bureau is located within the Federal Reserve System (FRS). The Federal Reserve Board, however, cannot veto a rule issued by the CFPB, but the Financial Stability Oversight Council (FSOC), with the vote of two-thirds of its members, can set aside a CFPB proposed rule.[6] The CFPB is funded through the earnings of the FRS, which is not subject to congressional appropriation. The Dodd-Frank Act caps the CFPB's funding at 11% of the FRS's operating expense for FY2011 and at 12% thereafter. If the director determines that additional funding is

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[1] See http://www.consumerfinance.gov/the-cfpb-launches-its-nonbank-supervision-program/.

[2] See CRS Report R42323, *President Obama's January 4, 2012, Recess Appointments: Legal Issues*, by (name red acted) et al.

[3] See CRS Report R41338, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, by (name redacted).

[4] Dodd-Frank Act §1021.

[5] Ibid.

[6] The FSOC is a council of financial regulators, including CFPB, that is charged with monitoring systemic risk in the financial system and coordinating several federal financial regulators. For more on the FSOC, see CRS Report R42083, *Financial Stability Oversight Council: A Framework to Mitigate Systemic Risk*, by (name redacted). The authority to review CFPB regulations is found in Dodd-Frank §1023.

needed, the Dodd-Frank Act provides authorization for an additional $200 million in appropriations per year through FY2014.

The CFPB has the authority to enforce many of the financial consumer laws,[7] primarily for large depository institutions with assets of more than $10 billion as well as some nonbank institutions.[8] However, some consumer protection responsibilities were not given to the Bureau. The CFPB is not the primary consumer protection regulator of depositories with less than $10 billion in assets. The prudential regulators that regulate the smaller institutions for safety and soundness will continue to regulate them for consumer protection.[9] The Dodd-Frank Act also provides some industries with exemptions from CFPB regulation. The CFPB will not oversee automobile dealers, merchants, retailers, and sellers of nonfinancial goods and services, real estate brokers, real estate agents, sellers of manufactured and mobile homes, income tax preparers, insurance companies, and accountants.[10]

Initiatives Undertaken Before the Director's Appointment

The CFPB has undertaken several policy initiatives since its creation, including the following:[11]

- The "Know Before You Owe" project is simplifying and consolidating disclosure forms for mortgages, credit cards, and student loans.[12] For example, the adequate disclosure of mortgage terms is a long-standing issue that has prompted several congressional actions. The Truth-In-Lending Act (TILA) of 1968[13] and the Real Estate Settlement Procedures Act (RESPA) of 1974[14] were enacted to require disclosures of credit costs and terms to borrowers. The regulatory agencies needed additional legislative action to include both TILA and RESPA disclosures on a single form. The Dodd-Frank Act mandated that the CFPB revisit disclosure stipulations for mortgage loans and gave it the authority to consolidate the mandatory TILA and RESPA disclosures into one "good faith estimate" form.[15]

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[7] For the list of the enumerated consumer laws that have been transferred to the CFPB see Dodd-Frank Section 1002.

[8] For more on the CFPB's authority over nonbanks, see the section 'Early Agenda of the New Director: Nonbank Supervision Program' in this report.

[9] For more on the regulation of financial institutions, see CRS Report R40249, *Who Regulates Whom? An Overview of U.S. Financial Supervision*, by (name redacted) and (name redacted).

[10] The Dodd-Frank Act provides exceptions such that, under certain conditions, the CFPB may regulate these otherwise excluded industries. See CRS Report R41338, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, by (name redacted).

[11] This section does not provide a comprehensive list of CFPB initiatives but highlights some of it current efforts.

[12] See http://www.consumerfinance.gov/knowbeforeyouowe/.

[13] TILA is contained in Title I of the Consumer Credit Protection Act, P.L. 90-301, 81 Stat. 146, as amended by 15 U.S.C. Section 1601 et seq.

[14] P.L. 93-533, 88 Stat. 1724, 12 U.S.C. Sections 2601-2617.

[15] For a more through discussion of the progress CFBP has made with respect to implementing RESPA, see CRS Report R41980, *Revisiting Mortgage Loan Disclosures Under the Consumer Financial Protection Bureau*, by (name r edacted) and (name redacted).

- The CFPB is collecting mortgage and credit card complaints made by borrowers.[16] CFPB forwards the complaint to the relevant company and keeps the borrower updated on the status of the complaint. Also, the complaints will be used to inform CFPB's supervision of companies and its enforcement of consumer protection laws and regulations.
- The CFPB is providing resources to help servicemembers, students, and older Americans handle their unique financial circumstances.[17] For example, the CFPB's Office of Servicemember Affairs is designed to help servicemembers with future financial planning and protecting their personal finances.
- The CFPB will implement rules such as the qualified mortgages rule. On April 19, 2011, the Federal Reserve, as mandated by the Dodd-Frank Act, announced a proposed rule that would require all creditors or lenders to make a good faith estimate that a borrower has a reasonable ability to repay. The rule would also establish minimum mortgage underwriting standards.[18] The rule would expand ability-to-repay standards to cover all residential mortgage loans. The Dodd-Frank Act transferred the authority to prescribe final regulations to the CFPB on July 21, 2011. CFPB final rulemaking would not necessarily be bound by the Federal Reserve's proposed regulation.[19]

Early Agenda of the New Director: Nonbank Supervision Program

On January 4, 2012, President Obama installed Richard Cordray as the director of the Consumer Financial Protection Bureau via recess appointment.[20] As stated in CRS Report R41839, *Limitations on the Secretary of the Treasury's Authority to Exercise the Powers of the Bureau of Consumer Financial Protection*, by (name redacted) ,

> Until a CFPB Director is appointed, the CFP Act provides the Secretary (of the Treasury) the authority to exercise *some, but not all* of the Bureau's authorities. Although not beyond debate, the CFP Act appears to provide the Secretary the authority to exercise the Bureau's

[16] See https://help.consumerfinance.gov/app/mortgage/ask and https://help.consumerfinance.gov/app/ask_cc_complaint.

[17] See http://www.consumerfinance.gov/servicemembers/, http://www.consumerfinance.gov/students/, and http://www.consumerfinance.gov/older-americans/.

[18] See http://www.federalreserve.gov/newsevents/press/bcreg/20110419a.htm. The rule was published in the *Federal Register* on May 11, 2011. See http://www.gpo.gov/fdsys/pkg/FR-2011-05-11/pdf/2011-9766.pdf. General rulemaking authority for the Truth-in-Lending Act, which is implemented under Regulation Z, transfers to the CFPB on July 21, 2011. See CRS Report R41338, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, by (name redacted). For more information about the proposed rule, see CRS Report R42056, *Ability to Repay, Risk-Retention Standards, and Mortgage Credit Access*, by (name redacted).

[19] See CRS Report R41839, *Limitations on the Secretary of the Treasury's Authority to Exercise the Powers of the Bureau of Consumer Financial Protection*, by (name redacted).

[20] As noted above this report does not address questions that have been raised regarding the validity or effect of this recess appointment. For more on recess appointments, see CRS Report RS21308, *Recess Appointments: Frequently Asked Questions*, by (name redacted), and CRS Report RL33009, *Recess Appointments: A Legal Overview*, by (name r edacted).

> *transferred* powers, but not the authority to exercise the Bureau's *newly established* powers.[21]

The report goes on to state that,

> The Bureau's newly established authorities largely consist of: enhanced, up-front supervisory powers over covered non-depository financial institutions; new rulemaking powers, distinct from the rulemaking authorities provided under the 18 enumerated consumer laws; and certain limited consumer compliance enforcement and examination powers over "smaller depository institutions" (i.e., banks, thrifts, savings associations, and credit unions with $10 billion or less in assets).[22]

Using its "newly established" powers after Cordray's appointment, the CFPB announced its Nonbank Supervision Program. The Nonbank Supervision Program will subject some nonbanks to the same consumer protection standards as currently applied to banks. Under the Program, the CFPB has authority to supervise three groups of nonbanks. First, the CFPB can regulate nonbanks in three specific markets—mortgage companies, payday lenders, and private education lenders. Second, the CFPB can regulate the "larger participants" in other financial markets. Third, the CFPB may supervise a nonbank that is performing actions that may pose a risk to consumers with regard to consumer financial products or services. These three areas of the Nonbank Supervision Program are discussed below.

Specific Markets

Mortgage Companies

Mortgages are not necessarily originated or serviced just by banks but also by nonbanks. Prior to the financial crisis, nonbanks were a major source of subprime lending, which some point to as one of the possible causes of the financial crisis.[23] The CFPB has authority to oversee nonbank originators, mortgage servicers, and loan modification and foreclosure relief service providers. According to the CFPB, it will investigate allegations of abuse and discrimination directed towards mortgage originators[24] to ensure that they follow applicable laws for consumer protection.[25] In addition, the CFPB will have authority to protect consumers from abuses by bank and nonbank mortgage servicers. Mortgage servicers collect payments from borrowers and forward them to the mortgage holders. If a borrower is delinquent, the servicer facilitates a loss mitigation option to make the loan current or proceeds with a foreclosure. In April 2010, the Federal Reserve, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision issued enforcement actions against some of the largest mortgage servicers because of

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[21] See CRS Report R41839, *Limitations on the Secretary of the Treasury's Authority to Exercise the Powers of the Bureau of Consumer Financial Protection*, by (name redacted).

[22] See CRS Report R41839, *Limitations on the Secretary of the Treasury's Authority to Exercise the Powers of the Bureau of Consumer Financial Protection*, by (name redacted).

[23] See CRS Report R40173, *Causes of the Financial Crisis*, by (name redacted).

[24] For an example of allegations of discrimination by a mortgage originator, see the Department of Justice's settlement with Bank of America. United States Department of Justice, "Justice Department Reaches $335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation," press release, December 21, 2011, http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html.

[25] See http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-releases-mortgage-origination-examination-procedures/.

deficient servicing practices.[26] Servicers were also alleged to have engaged in "robo-signing," where a small number of individuals sign a large number of affidavits and other legal documents that mortgage companies submit to courts and other public authorities to execute foreclosures.[27] The CFPB will attempt to protect consumers from abuses by mortgage servicers through data analysis, onsite examinations, and other forms of monitoring.[28]

Payday Lenders

Under the Nonbank Supervision Program, the CFPB has authority to oversee payday lenders to ensure they comply with federal consumer financial laws. A payday loan is typically a small ($100-$500) cash advance to a borrower who writes a post-dated check for the loan amount plus a fee to the lender, who holds it for a short period of time (until the customer's next payday or 7 to 30 days).[29] Payday lenders require identification, proof of income, and ownership of a checking account, but they do not check into a borrower's credit history or assess the ability to repay the loan. Hence, payday loans are expensive. The fee or financing charge is the equivalent of paying an estimated annual percentage rate (APR) lending rate ranging from 260% to 520%. Such costs for credit may become very expensive for borrowers if they need to be rolled over or extended for additional periods.

Payday loans are considered abusive by some consumer advocates who argue that the industry targets vulnerable consumers. This type of lending may encourage chronic borrowing that causes frequent users to become trapped in a cycle of expensive debt.[30] On the other hand, it is difficult for traditional financial institutions to meet such immediate credit needs if full underwriting costs should exceed the actual loan amounts.[31] In addition, some research has found payday loan fees may even be lower than fees associated with bounced checks or credit card late fees and interest charges.[32]

Although payday loans are still subject to the disclosure provisions of the federal Truth-In-Lending Act, state laws have generally governed payday lending. State laws, however, are not uniform in their treatment of payday lending. Some states do not have specific payday lending legislation, whereas other states impose limits on finance charges and set a maximum loan

[26] See http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

[27] See CRS Report R41491, *"Robo-Signing" and Other Alleged Documentation Problems in Judicial and Nonjudicial Foreclosure Processes*, by (name redacted).

[28] See http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-releases-mortgage-origination-examination-procedures/.

[29] See CRS Report RS21728, Payday Loans: Federal Regulatory Initiatives, by (name redacted) and Determinants of the Locations of Payday Lenders, Pawnshops, and Check-Cashing Outlets by Robin A. Prager, Board of Governors of the Federal Reserve System, Finance and Economics Discussion Series 2009-33, Washington, DC, June 2009, http://www.federalreserve.gov/pubs/feds/2009/200933/200933pap.pdf.

[30] See Center for Responsible Lending, *Payday Loans Put Families in the Red*, CRL Issue Brief, February 2009, http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

[31] See Edward C. Lawrence and Gregory Elliehausen, "A Comparative Analysis of Payday Loan Customers," *Contemporary Economic Policy*, April 2008, pp. 299-316.

[32] See Donald P. Morgan and Michael R. Strain, *Payday Holiday: How Households Fare After Payday Credit Bans*, Federal Reserve Bank of New York, Staff Reports no. 309, New York, NY, February 2008, http://www.newyorkfed.org/research/staff_reports/sr309.pdf.

amount. Hence, the CFPB has the authority to establish regulations that would achieve consistent lending standards throughout the nation.[33]

Private Education Lenders

The CFPB can regulate nonbank private education lenders under the Nonbank Supervision Program.[34] Private education loans are loans that are used for higher education but are not originated through the federal student loan program.[35] The number of students borrowing and the amount they borrow has been increasing over time.[36] This raises concerns about the burdens of indebtedness as well as the potential for abuse. The CFPB may focus on issues related to the marketing of private education loans to students as well as the disclosures required for these loans. For example, the CFPB is working with the Department of Education to develop a "financial aid shopping sheet" to inform borrowers about their loan options.[37] Also, the Dodd-Frank Act requires the CFPB to partner with the Department of Education and other agencies to publish a report on private education loans and private educational lenders. In November 2011, the CFPB published a request for information about the private education loan market.[38]

Defining Larger Participants

The CFPB has authority to oversee all nonbanks in the residential mortgage, payday lending, and private education lending markets, but can only oversee the nonbank "larger participants" in other financial markets.[39] In June 2011, the CFPB submitted a notice and request for comment on a proposed rule with two main components: determining the threshold that will designate a market participant as "larger" and deciding what markets will be regulated.[40] In determining the threshold, the CFPB solicited comments on, among other things, whether to use absolute or relative measures of size as well as the type of data that should be used. For which markets to regulate, the CFPB proposed six possible industries to monitor: debt collection, consumer reporting, consumer credit, money transmitting and check cashing, prepaid cards, and debt relief services. The CFPB received comments on the proposed rule but has not published the initial

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[33] The CFPB held a field hearing on payday lending products on January 19, 2012, in Birmingham, Alabama. See http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-convenes-field-hearing-in-birmingham-alabama-on-payday-lending/.

[34] For more on private education lenders, see CRS Report RL34654, *The Higher Education Opportunity Act: Reauthorization of the Higher Education Act*, by (name redacted) et al.

[35] See http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-aims-to-shed-light-on-the-private-student-loan-industry/.

[36] For example, more than $100 billion in student loans were taken out in 2010, which increases the outstanding education debt total to more than $1 trillion. See http://www.usatoday.com/money/perfi/college/story/2011-10-19/student-loan-debt/50818676/1. Also, approximately $7.9 billion of student loans in 2010 came from private and state sources, but these sectors had provided $24 billion in student loans in 2007. See http://trends.collegeboard.org/downloads/Student_Aid_2011.pdf.

[37] See http://www.consumerfinance.gov/students/knowbeforeyouowe/.

[38] See Consumer Financial Protection Bureau, "Request for Information Regarding Private Education Loans and Private Educational Lenders," 76 *Federal Register* 71329-71331, November 17, 2011.

[39] Dodd-Frank §1024 (a)(1)(B).

[40] Consumer Financial Protection Bureau, "Defining Larger Participants in Certain Consumer Financial Products and Services Markets," 76 *Federal Register* 38059-38062, August 15, 2011.

rule. The Dodd-Frank Act instructs the CFPB to issue its initial rule on larger participants by July 2012.

Other Nonbanks

The Dodd-Frank Act gives CFPB authority to supervise a nonbank that would not meet the previously described requirements if, based on the complaints it has received or from other sources, it has reason to believe the nonbank poses risks to consumers in offering its financial services or products.[41] The CFPB has not yet published a final rule to establish procedures to supervise a nonbank under this authority.

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[41] Dodd-Frank §1024 (a)(1)(C). As mentioned previously, see CRS Report R41338, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Title X, The Consumer Financial Protection Bureau*, by (name redacted), for when previously exempted industries may be regulated by the CFPB.