

Regulatory Roundup

Summer 2009

The Consumer Financial Protection Agency Act of 2009¹

The proposed Consumer Financial Protection Agency, which was introduced to Congress by the President in June, has been described as a “Food and Drug Administration for consumer financial products.”

The proposal would centralize regulatory authority for consumer protection, taking responsibility away from a handful of federal regulators and transferring it to a new, independent agency devoted entirely to consumer protection. The agency would be responsible for rule-writing, supervision, and enforcement of consumer protection regulations on all consumer financial products, including mortgages, credit and debit cards, and overdraft programs, among others.

The proposed agency is charged with

- ensuring consumers have access to clear, comprehensible information about financial products.
- protecting consumers from abuse, deception and discrimination.
- promoting access to financial products among traditionally underserved groups.
- ensuring that the markets for consumer financial products operate fairly and efficiently while allowing for sustainable growth and innovation.

President Obama’s proposal would grant the Consumer Financial Protection Agency the right to govern compensation, sales, and risk-disclosure practices of consumer financial product providers. It would also protect consumers’ right to access information, and it could require the offering of standardized—or “plain vanilla”—financial products and require lenders to provide warnings on high-risk products. The proposed agency would also have the right to demand reports and information from financial services providers.

The agency would be directed by a board of five, including four presidential appointees and the Director of the National Bank Supervisor—a position proposed by the Obama Administration as part of its broader regulatory reform agenda.² The board would operate much like a corporate board and would have the legal authority to prosecute financial service providers for civil liabilities. The legislation also provides for the establishment of a victims’ relief fund—the Consumer Financial Protection Agency Civil Penalty Fund—to be supported by penalties collected from lenders and from which victims of violations of consumer protection law would receive payments. A Consumer Advisory Board made up of experts in consumer financial products and community development would be assembled to advise the board.

Under the proposal, the new agency would be supported in part by fees charged to covered institutions and in part by Congressional appropriation, although it is unclear from the proposed legislation to what extent each of these funding methods would be relied upon.

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The proposed legislation would also strengthen states' ability to enforce consumer regulations. The President's plan proposes removing federal preemption and allowing states to enforce consumer protection laws that go above and beyond what is required by federal statutes, so long as they do not directly contradict federal law—a policy supported by recent case law. States, however, would likely be limited in their ability to prosecute offenders because they lack the authority to inspect financial institutions' records.

Status

The Consumer Financial Protection Agency Act of 2009 is currently under review by the House Financial Services Committee. Chairman Barney Frank, D-Massachusetts, has introduced an alternative version (H.R. 3126) that includes some changes, most notably that the proposed agency would not have jurisdiction to enforce the Community Reinvestment Act. This is a deviation from the President's proposal, which gives the new agency the authority to enforce all laws related to consumer protection from financial product service providers. Congressman Frank's proposal would also eliminate the role of the Federal Bank Supervisor on the board and instead allow the President to select the director from a pool of five appointees.³

Pros and Cons

Consumer advocacy groups have largely been supportive of the President's reform proposal. Many have argued that the regulatory agencies currently responsible for consumer protection—including, among others, the Federal Reserve Bank, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation—have failed to write and enforce adequate consumer protection rules.

Proponents of the plan have also argued that the Federal Reserve, which shares rule-writing authority for consumer protection with other agencies, has a competing mandate in guiding the country's monetary policy, in that it exerts control over money supply, availability of credit, and interest rates. Similar concerns have been expressed about other banking regulators, on the grounds that their primary mandates lie with protecting the safety and soundness of financial institutions and not with the protection of consumers.

Other reform proponents have expressed concern that the proposed expansion of the Fed's regulatory powers to nonbank entities that pose a "systemic risk" to the economy—part of a separate regulatory reform proposal—might leave the system "spread thin" and therefore not as capable of effectively enforcing consumer protections as a dedicated agency.

On the other hand, opponents of the plan, including many financial industry representatives, have contested that the new agency will create another layer of bureaucracy without ensuring that potentially stronger enforcement powers will be used effectively.

In addition, opponents have argued that the existence of two regulators—one dedicated to ensuring safety and soundness of the financial markets, the other dedicated to protecting

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consumers—may force financial institutions to operate under conflicting orders. Others contest that an independent centralized regulator might be subject to political pressures.

Financial industry sources, in particular, have claimed that compliance with two regulatory bodies will stifle innovation and inflict disproportionate costs on smaller banks.

The Fed's Position

In recent testimony before Congress's Committee on Financial Services, Federal Reserve Board Governor Elizabeth Duke outlined the board's case for maintaining consumer protection powers within the Federal Reserve System.

"A fundamental lesson of the financial crisis is that we need to do a better job for consumers of financial products," she testified. "In our view, the Federal Reserve has the resources, the structure, and the experience to execute an ongoing comprehensive program for effective consumer protection in financial services.

"We believe that replicating in another agency the deep expertise and full array of functions embedded within the Federal Reserve and used to support our consumer protection program would be enormously challenging."⁴

Federal Reserve Board Chairman Ben Bernanke highlighted the Fed's ongoing efforts to protect consumers in testimony to Congress July 21st.

"Over the past three years, the Federal Reserve has written rules providing strong protections for mortgage borrowers and credit card users, among other substantive actions," the chairman testified. "We are expanding our supervisory roles to include risk-focused reviews of consumer compliance in nonbank subsidiaries of holding companies. Our community affairs and research areas have provided support and assistance for organizations specializing in foreclosure mitigation, and we have worked with nonprofit groups on strategies for neighborhood stabilization."⁵

¹ The Consumer Financial Protection Agency Act of 2009—Title X, The U.S. Department of the Treasury, June 30, 2009, available at <http://www.treas.gov/press/releases/tg189.htm>.

² Holzer, Jessica, "White House Reg Plan Would Create National Bank Supervisor," The Wall Street Journal, June 16, 2009.

³ Press Release, "Frank Introduces Obama Administration's Plan to Increase Consumer Protection," House Committee on Financial Services, July 9, 2009, available at http://www.house.gov/apps/list/press/financialsvcs_dem/press_070809.shtml.

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⁴ Testimony, Governor Elizabeth A. Duke, “Consumer Protection,” before the Subcommittee on Domestic Monetary Policy and Technology, U.S. House of representatives, July 16, 2009, available at <http://www.federalreserve.gov/newsevents/testimony/duke20090716a.htm>.

⁵ Testimony, Chairman Ben S. Bernanke, “Semiannual Monetary Policy Report to Congress,” before the Committee on House Financial Services, U.S. House of Representatives, Washington D.C., July 21, 2009, available at <http://www.federalreserve.gov/newsevents/testimony/DBBB5C9F26B6440AA4A21E104A61577A.htm>.