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# The New Regulator on the Block—The Bureau of Consumer Financial Protection

*A departure from the disclosure-driven precedents set by past consumer protection laws will usher in the era of the independent consumer financial protection regulator.*

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Once the final details emerge from a congressional conference committee as to the degree of independence, source of funding, and preemptive impact of its rulings, the difficult work of creating a new federal bureau or agency will begin. While the name of the bureau or agency is yet unknown—it may be a stand-alone consumer financial protection agency (CFPA) or a federal bureau—it is clear that a very independent agency with a very distinct mission will soon be in business. The rationale for the creation of a consumer financial protection agency and the congressional intent as to its purpose set the stage for yet another layer of regulation for banks and thrifts and a new era of regulation for many firms that are presently either lightly regulated or unregulated.

## The Regulatory Rationale

While laws such as usury laws (which cap the interest rate that may be charged on a loan) were designed to police the substantive legal fairness of the bargain under which credit is supplied to a consumer, the rules developed in recent decades tended to regulate the *procedures* governing the delivery of credit, especially the disclosures required of banks and other lenders before a consumer could commit to purchase a certain financial product or service. In theory, the American consumer, armed with the details as to the cost of credit and other terms as a result of the Truth in Lending Act of 1968, the Federal Reserve Regulation Z, and additional disclosures required by the Real Estate Settlement Procedures Act—would then shop for the mortgage product with the price and terms that best suited their ability to repay.

As consumer protection laws made consumers more comfortable with the loans they were becoming obligated to repay, consumer credit from regulated and unregulated lenders became more accessible, and all of these factors encouraged increased levels of consumer debt. Coupled with declines in consumer savings, the American consumer was ill prepared when the loan repayment feature they had selected resulted in a huge increase in their mortgage payment, and the reduction in the value of their home took the refinancing option off the table. Consumer protection advocates have cited consumer confusion as to complex mortgage products, abusive lending practices (particularly in the market for subprime and nontraditional mortgages), as well as an inadequate regulatory framework, as the justification for the creation of a single regulatory body, a CFPA with the authority and accountability to make sure that consumer protection regulations are written fairly and enforced vigorously.[1]

**The Congressional Solution**

The Senate version of financial reform, the Restoring American Financial Stability Act of 2010 (S. 3217, the Senate version of H.R. 4173), would create a Bureau of Consumer Financial Protection and house it within the Federal Reserve System. The office would nonetheless be very independent of the Federal Reserve, with a director appointed by the President, not by the governors of the Federal Reserve nor its president. The appointment would be subject to Senate confirmation. The Senate version contains restrictions on the ability of the Federal Reserve to interfere with the bureau's activities, and importantly, with its funding sources. The Director of the Bureau would periodically designate how much of the Federal Reserve's earnings were to be transferred to the bureau to allow the Bureau to carry out its duties. The amount would be subject to a cap of 10% of the Federal Reserve's total operating expenses in 2011, with the cap increasing to 12% in 2013. The Federal Reserve would have no authority as to where, or how, that money would be spent.

The House version of financial reform (H.R. 4173) provides for an independent CFPA, and this version could still emerge from conference as the preferred vehicle. But the fact that the Federal Reserve provides a stable and reliable funding source for a new bureau, one with lofty goals and thousands of new entities to regulate, augurs in favor of the Senate version.

The goals for the bureau as espoused by the Senate would include guaranteeing that consumers receive timely, understandable disclosures and are protected from unfair, deceptive, or abusive acts and practices, and from discrimination. The primary functions of the bureau would include the following:

- To adopt rules and guidance implementing the federal consumer financial protection laws
- To implement those laws
- To supervise and enforce those laws against some financial institutions and companies
- To develop and publish information on risks to consumers and to the markets
- To address consumer complaints

While the bureau would be given expansive rulemaking authority in the area of consumer financial protection laws, the Federal Trade Commission (FTC) would retain some authority to adopt rules under the Federal Trade Commission Act. The division of authority between the new bureau and the FTC, with respect to the FTC's historic focus on consumer protection relating to financial practices, is unclear, including whether the new bureau will have primacy in all consumer financial protection areas. And the bureau would have to consult with federal banking agencies both before proposing a rule and during the public comment phase, to consider whether the rule conflicts with the banking agencies prudential, market, and systemic objectives. These banking regulators would also have the ability to ask the Financial Stability Oversight Council to overturn a regulation promulgated by the bureau, if the council concurs that the rule would jeopardize the safety and soundness of the banking system or the stability of the financial system.

The bureau would be given the authority to directly supervise numerous nonbank companies that provide financial products or services, but which today receive minimal or no supervision. Mortgage loan originators, mortgage loan modifiers, and foreclosure relief companies would be supervised by

[1] U.S. Department of the Treasury, *Financial Regulatory Reform: A New Foundation* (2009).

the bureau, as would be large banks, credit unions, and thrifts with more than $10 billion in total assets. The bureau, in consultation with the FTC, would determine which other parties should be subject to supervision. Service providers to financial firms might also become subject to the authority of the bureau, much like service providers to banks are presently.

Supervisory and enforcement authority over smaller banks, credit unions, and thrifts would remain with the prudential regulators of each.

**Federal Preemption and a Challenge to the National Bank and Federal Thrift Charter**

The National Bank Act of 1863, as amended and interpreted over the years, has enabled national banks to offer uniform products and services to customers throughout the United States. Applying the doctrine of federal preemption, which is derived from the Supremacy Clause of the U.S. Constitution, the Supreme Court over time established that Congress had intended to facilitate a "national banking system," with national banks entitled to charge out-of-state credit card customers an interest rate permitted by the bank's home state, even if that rate was higher than that permitted in the customer's state of residence.[2]

Similarly, the Home Owners' Loan Act of 1933, which created the federal thrift charter, has been interpreted by the Supreme Court to authorize only a thrift's federal regulator to regulate the lending practices of such an institution.[3] Relying on these precedents, national banks and federal thrifts have sought those charters, established their main offices, and developed their branches and delivery systems for their products and services.

In what amounts to a congressional rejection of a recent decision in the Supreme Court case *Watters v. Wachovia*[4] the bureau will be given exclusive supervisory and enforcement authority over the nonbank subsidiaries of insured depository institutions, including those of national banks. The *Watters* case had confirmed that the reach of federal preemption in the National Bank Act extended to the wholly owned operating subsidiaries of national banks, such as, in the case of Wachovia, its mortgage banking subsidiary.

More threatening to the clear-cut preemptive authority of the National Bank Act are amendments to it contained in the Senate version of the reform legislation that will preempt a state consumer financial protection law only when (i) application of the state law would discriminate against the national bank in favor of a state-chartered institution; (ii) the preemption complies with the standards of the *Barnett Bank* case, as determined either by a court or by the Office of the Comptroller of the Currency on a case-by-case basis; or (iii) the state law is preempted by another provision of federal law. Nonbank affiliate and subsidiaries will lose all federal preemption protection under the Senate version.

The House version is viewed even more negatively by proponents of federal preemption as it dispenses with reference to the *Barnett* decision, a key 1996 Supreme Court case in which the Court found that a Florida insurance law which prohibited the sale of insurance by many national banks was preempted

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2 *Marquette National Bank of Minneapolis v. First of Omaha Service Corp*., 439 U.S. 299 (1978).

3 *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141 (1982).

4 *Linda A. Watters, Commissioner, Michigan Office of Insurance and Financial Services v. Wachovia Bank, N.A.*, 127 S.Ct. 1559 (2007).

under the National Bank Act. The Court, in a 9-0 vote, determined that the state could not prevent or significantly interfere with a national bank's exercise of its powers under the National Bank Act.

The preemption standards for federal thrifts under the Senate version of financial reform are the same as those for the national banks.

In addition to the new preemption standards, which could result in years of litigation as courts determine the extent to which the National Bank Act and the Home Owners' Loan Act will preempt state law going forward, the Senate version would give state attorneys general explicit power to enforce the reform legislation, as well as the bureau's regulations, against national banks and federal thrifts, though that authority would be limited to the state attorney general obtaining specified remedies under the legislation, and not bringing civil actions on behalf of its citizens. And the Senate Bill endorses the Supreme Court's 2009 decision in *Cuomo v. Clearing House Assn*.,[5] permitting any state attorney general to bring an action against a national bank in a court of appropriate jurisdiction to enforce any applicable law and to seek relief as authorized by state law. The legislation then grants this same authority to state attorneys general as against federal thrifts.

The House and Senate conferees are expected to address the carve-outs granted to certain businesses in the Senate and House versions, thorough exemptions from the bureau's reach are expected to remain applicable to entities regulated by the Securities and Exchange Commission and the Commodities Futures Trading Commission. The business of insurance is specifically excepted from the definition of a financial product or service to be regulated by the CFPA. The Senate version directs the SEC to consult and coordinate with the bureau with respect to any rule regarding an investment product or service that is the same type of product as, or that competes directly with, a consumer financial product or service subject to the jurisdiction of the bureau. The House version contains a similar consultation and coordination requirement.

We will continue to monitor the ongoing developments of Financial Regulatory Reform. If you have any questions or would like more information on the issues discussed in this Law Flash, please contact the author, **Kathleen W. Collins** (202.739.5642; kcollins@morganlewis.com), or any of the following Morgan Lewis attorneys:


**Washington, D.C.**

| | | |
|---|---|---|
| Kathleen W. Collins | 202.739.5642 | kcollins@morganlewis.com |
| Stephen Paul Mahinka | 202.739.5205 | smahinka@morganlewis.com |

**Philadelphia**

| | | |
|---|---|---|
| Gregory T. Parks | 212.963.5170 | gparks@morganlewis.com |


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5 *Cuomo v. Clearing House Assn., L.L.C.*, 129 S.Ct. 2710 (2009).

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