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CONSUMER PROTECTION

Regulatory Reform

The CFPB's Authority to Regulate 'Abusive' Consumer Financial Products and Services



BY DAVID N. ANTHONY, ALAN D. WINGFIELD, AND VIRGINIA BELL FLYNN

The Bureau of Consumer Financial Protection (CFPB) has been given a broad and vaguely-defined power to prohibit and punish “unfair, deceptive, and abusive financial practices.” The word “abusive” in particular has raised industry concerns, as it appears on its face to be an open-ended mandate. Therefore, how the CFPB goes about defining the word, and the ultimate meaning it will be given, are issues of consequence to regulated entities.

Background

In 2007 and 2008, the United States experienced a near collapse of its financial markets. While pundits

David Anthony and Alan Wingfield are partners in Troutman Sanders' Richmond office and members of the firm's financial services litigation practice. They focus on resolving the array of issues which confront financial institutions. Virginia Bell Flynn is an associate in the practice.

continue to debate the reasons for the financial crisis, likely contributors have been identified as including poorly-underwritten subprime residential mortgages and the meltdown of “CDOs” and credit default swaps based on those mortgages, the high level of leverage employed by banks and other financial institutions and other “risky or exotic” consumer financial products taxing consumer’s buying power. The immediate response of Congress, the Department of Treasury and the Federal Reserve were dramatic emergency steps to shore up the financial system, including creating the Troubled Asset Relief Program (TARP), cutting interest rates, and lending billions of dollars to and taking a majority stake in companies such as American International Group, Inc.

Given that the immediate response to the crisis was perceived as a bailout of the financial institutions deemed “too big to fail,” many self-described consumer advocates focused on the tangible impact that the financial meltdown had on consumers. Many Americans experienced the decline in the value of their homes, lost their jobs, suffered income declines, defaulted on residential mortgage loans, took on unprecedented amounts of debt, suffered from questionable lending practices and accepted risky consumer financial products – all while funding the bailout as American taxpayers.

Passage of Dodd-Frank and Creation of the CFPB

In an attempt to address the perceived causes of the crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which President Obama signed into law on July 21, 2010. Dodd-Frank represented the most comprehensive legislative overhaul of federal financial regulation since the Glass-Steagall Act passed during the Great Depression. Dodd-Frank's sixteen titles address many perceived problems with the United States financial market, including the stability and accounting of financial institutions, transparency in financial products, needed regulatory reform and oversight, investor safety and consumer protection.

Title X of Dodd-Frank created a new federal agency, the CFPB.¹ This new federal agency is arguably the most significant consumer protection element of Dodd-Frank. The CFPB has been established as an independent federal agency tasked specifically with the protection of consumers related to financial products and services, and vested with sweeping powers to fulfill its mandate.² Essentially, Dodd-Frank transferred the primary rulemaking and enforcement authority over all or parts of eighteen federal consumer protection statutes from seven different federal agencies into one. The purpose of this transfer and the CFPB's creation was to: (1) "heighten government accountability by consolidating in one place responsibilities that had been scattered across government"; (2) provide "responsibility for supervising providers of consumer financial products and services that had not had regular federal oversight and for enforcing the consumer protection laws with respect to such providers"; (3) "protect families from unfair, deceptive, and abusive financial practices"; and (4) "give the consumer agency the same accountability and independence that the other banking agencies have and sufficient funding so it could ensure that financial companies would comply with consumer laws."³ The CFPB was vested with extraordinary powers, so that a single agency would have "effective tools to set the rules for and oversee the whole market."⁴

Structure of the CFPB

In order to maintain a consumer-first focus and avoid "regulatory capture" by the industries that the CFPB is to oversee, Congress established the CFPB as an independent agency within the Federal Reserve System.⁵ The CFPB is to be headed by an independent director appointed by the President and confirmed by the Senate for a five year term.⁶ Dodd-Frank provides the CFPB with broad authority to implement "the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examina-

tions, and enforcement actions."⁷ The Board of the Federal Reserve has no authority over the operations of the CFPB, including its rulemaking, organization, personnel and testimony before Congress.⁸ The CFPB's budget is not directly controlled by Congress through the normal appropriations process.⁹ Rather, the Federal Reserve will transfer certain escalating percentages of its total operating expenses each year to the CFPB.¹⁰

Further, the CFPB has the authority to research, analyze and report on consumer financial products or services of risk to consumers.¹¹ Dodd-Frank requires the CFPB to establish a mechanism to centralize the collection and monitoring of consumer complaints about consumer financial products as well as to forward such complaints to other regulatory agencies.¹² In addition, the CFPB may share data it collects with other federal and state regulators in its efforts to supervise consumer financial products and services.¹³ The Bureau also has wide latitude to regulate, prohibit and enforce against "unfair, deceptive and abusive" behavior.¹⁴

Concerns Over the CFPB's Structure, Power and Authority

Almost immediately upon the passage of Dodd-Frank and the creation of the CFPB, skeptics began raising a number of concerns about the CFPB's structure, power and authority. Many believe that the CFPB is a federal regulatory with "unparalleled powers" regarding everything touching consumers' money.¹⁵ Other commentators have questioned whether the transfer of quasi-legislative powers to an independent federal agency is constitutional.¹⁶

Similarly, in a letter to President Obama, Republican Senators Mitch McConnell and Richard Shelby explained the concerns of the forty-four Republican Senators that "far too much power will be vested in the CFPB director without any effective checks and balances."¹⁷ Senators McConnell and Shelby also pointed out numerous issues regarding the lack of accountability in the CFPB's structure, including: (1) limiting consumers' choices in the purchase of consumer financial products and services; (2) putting small banks and businesses at a competitive disadvantage to larger banks because of the increased compliance costs; (3) making the confirmed CFPB director "effectively answer[able] to no one"; (4) disallowing the removal of CFPB's direc-

⁷ *Id.* at § 1012.

⁸ *Id.*

⁹ *Id.* at § 1017.

¹⁰ *Id.*

¹¹ *Id.* at § 1013.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at §§ 1031, 1036.

¹⁵ Diane Katz, "Reining in the CFPB," *THE DAILY CALLER* (July 20, 2011), <http://dailycaller.com/2011/07/20/reining-in-the-cfpb/>.

¹⁶ Krauss, Michael L., "Tort Lawyers' Dream, Economy's Scourge: Richard Cordray and the CFPB," *AMERICAN THINKER* (Oct. 18, 2011).

¹⁷ See May 2, 2011 Letter from Senators Mitch McConnell and Richard Shelby to President Barack Obama, available at <http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2011/08/44-Senators-Letter-to-President-Obama.pdf>.

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, at § 1011 (2010).

² *Building the CFPB: A Progress Report*, at 8 (July 18, 2011), available at http://www.consumerfinance.gov/wp-content/uploads/2011/07/Report_BuildingTheCfpb1.pdf.

³ *Id.*

⁴ *Id.*

⁵ Dodd-Frank, § 1011.

⁶ *Id.*

tor for poor performance or “ill-conceived regulations”; (5) providing the CFPB director with no Congressional oversight over the CFPB’s budget; (6) failing to make certain that “mechanisms were put in place to ensure that the director is effectively managing public money”; and (7) restricting the circumstances under which a CFPB-issued regulation can be stayed, set aside or overruled to narrow, if not illusory and practically impossible, ones.¹⁸

The letter suggested three fundamental reforms that were needed to the CFPB’s structure: (1) “[e]stablish a board of directors to oversee the Consumer Financial Protection Bureau”; (2) “[s]ubject the Consumer Financial Protection Bureau to the appropriations process;” and (3) “[e]stablish a safety-and-soundness check for prudential regulators.”¹⁹ The Republican leaders vowed to oppose the consideration of any nominee for Director of the CFPB until structural reforms of the CFPB were made.²⁰ As of this publication, no CFPB director has been confirmed. The ultimate resolution of the concerns stated here is very much in doubt.

CFPB’s Broad Authority to Regulate and Prohibit Unfair, Deceptive or ‘Abusive’ Behavior

Given the broad mandates provided to the CFPB, much attention and concern has been focused on the CFPB’s authority to regulate and prohibit “unfair, deceptive, or abusive” acts or practices even though the CFPB’s authority to implement this specific power may be limited until a director is appointed.²¹ “Unfair” and “deceptive” conduct has long been subject to much regulation both at the federal and state level, particularly by the Federal Trade Commission (FTC). Typically, “unfair” and “deceptive” have been terms that have been understood to focus on complete and accurate disclosure of the terms of a consumer transaction or conduct that is coercive to a substantial degree. However, the term “abusive” is a new concept. Under the Dodd-Frank Act, an act or practice is “abusive” if it:

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- (2) takes unreasonable advantage of –
 - (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
 - (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
 - (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.²²

Concerns with the Broad Definition of ‘Abusive’

Critics claim that the vague language defining “abusive” affords the CFPB too much discretion, especially

given the extraordinary independence of the agency.²³ The definition of “abusive” in the Dodd-Frank Act alone raises the following questions of basic statutory interpretation:

- How is an “unfair” or “deceptive” financial product or service similar or dissimilar from an “abusive” one?
- What is the difference between a financial product or service that “materially interferes” with a consumer’s ability to understand a term or condition of a product or service?
- Is “the ability of a consumer to understand a term or condition of a consumer financial product or service” an objective or subjective standard?
- What is the distinction between a financial product or service that takes “unreasonable advantage” of a consumer’s lack of understanding of the material risks, costs or conditions of the product or service as contrasted to taking “reasonable advantage”?
- At what point does a risk, cost or condition of a financial product or service become “material”?
- How will the “inability” of the consumer to protect his or her interests in selecting or using a consumer financial product or service be measured?
- What is the difference between the “reasonable reliance” as opposed to the “reliance” by a consumer on a regulated entity to act in the interests of the consumer?²⁴
- Does this definition give the CFPB the power to apply retroactively the “abusive” standard for behavior that occurred prior to the enactment of Dodd-Frank?
- To what extent does the word “abusive” give the CFPB power to regulate the substance of a consumer product as opposed to regulating the disclosure of the product’s term?

Indeed, as one law professor has noted, “the ‘abusive’ wording is novel enough to give the agency quite a bit of latitude in defining the term.”²⁵

CFPB’s Supervision and Examination Manual

On October 13, 2011, the CFPB released its first Supervision and Examination Manual (Manual), which is a general guide to how the CFPB will supervise and examine consumer financial service providers for compliance with federal consumer financial law, including some explanation of the “abusive” standard.²⁶ In explaining an examiner’s role in the Consumer Complaint Response Examination Procedure, the Manual states that examiners will “identify complaints alleging deception, unfair treatment, unlawful discrimination, or other significant consumer injury.” Indeed, the Manual instructs that consumer complaints “play a key role in the detection of unfair, deceptive or abusive practices,” and describes them as a “red flag indicating that examiners should conduct a detailed review of the relevant practice.”²⁷ Moreover, there will be unprecedented access

²³ See *supra* note 15.

²⁴ Dodd-Frank at § 1031.

²⁵ Joel Poelhuis, “CFPB and ‘The Great Unknown,’” SNL BANK & THRIFT DAILY (Oct. 14, 2011) (citing University of Houston law professor Jim Hawkins).

²⁶ CFPB Supervision & Examination Manual (Oct. 13, 2011), <http://www.consumerfinance.gov/guidance/supervision/manual/>.

²⁷ *Id.*, “Part II, Unfair, Deceptive, or Abusive Acts or Practices,” <http://www.consumerfinance.gov/guidance/supervision/manual/udaap-narrative/>

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ Dodd-Frank at §§ 1031, 1036.

²² *Id.* at § 1031(d).

to and sharing of consumer complaints. In addition to eventually establishing its own complaint system, the CFPB will partner with the FTC and have access to its Sentinel consumer complaint database. Both state banking supervisors and state Attorneys General will have access to complaint data, and the CFPB has stated that state Attorneys General will be important pieces of investigations and enforcement actions. In sum, it is clear that complaints will be mined by regulators to guide supervisory authority and inform enforcement actions.

Within the Risk Assessment template, Part III of the Manual, are some examples of complaints which could be considered unfair, deceptive or abusive, including: misleading or false statements; lack of disclosure of information about material terms of a product or service; unauthorized fees, fees for services not provided, or duplicative fees; previously undisclosed charges; customer service; mortgage loan servicing and collections. Matters which also require attention include violations that involve prohibited kickbacks, discrimination, the need for reimbursements or other harm to consumers. For those servicers where products are not necessarily sold but implemented, third party contractors will be required to follow CFPB procedures. The failure to implement these policies could lead to the CFPB labeling the institution as a high risk which requires more paperwork and more oversight by the CFPB.

Practical Concerns with How the CFPB Will Regulate, Supervise and Enforce ‘Abusive’ Consumer Financial Products or Services

Aside from the consternation over the expansive definition of “abusive” in Section 1031 of Dodd-Frank and lack of clarity in the CFPB’s Supervision and Examination Manual, regulated entities face many practical concerns in the new CFPB paradigm.

CFPB Banning Products or Services. First, businesses fear that the CFPB will attempt to prohibit or ban certain existing or future consumer financial products or services from the market because of their alleged inherently “abusive” nature, such as payday or title lenders. This fear is not unwarranted because the CFPB has exclusive rulemaking, supervision and enforcement authority over a number of federal consumer protection statutes with unknown or limited daily oversight. Indeed, proponents of a vigorous CFPB are already arguing that certain consumer financial products or services, such as payday lending, are fundamentally “abusive.”²⁸ Until the CFPB provides clarity on these issues, this type of pro-consumer rhetoric which pushes for fundamental changes in consumer financial products and services combined with the broad authority given to the CFPB will fuel uncertainty in the marketplace.²⁹

²⁸ Nathalie Martin, “Regulating Payday Loans: Why This Should Make the CFPB’s Short List,” 2 HARVARD BUSINESS LAW REVIEW ONLINE 44, 50-51 (2011) (arguing that “it is hard to picture a product more likely to fit within these definitions of unfair and abusive than a payday loan”).

²⁹ Kerri Panchuk, “Warren’s Future Unknown as CFPB Director Role Remains Empty,” HOUSING WIRE (Apr. 20, 2011).

CFPB’s Supervisory Authority. Second, an open issue remains as to how the CFPB will use its supervisory authority. Practically speaking, the CFPB may examine a regulated entity’s financial condition and business practices. The active nature of the CFPB’s authority to root out abusive behavior before receiving a formal report from a consumer is understandably causing businesses to brace for the worst.³⁰ Said differently, as with many other industries, the threat of governmental supervision and examination is viewed by many businesses as a backdoor effort to change market behavior that is not illegal.

State Attorneys General Coordination With the CFPB. Third, many businesses regulated by the CFPB are worried about what the CFPB’s cooperation with state Attorneys General over “abusive” behavior will mean in real terms. An enforcement mechanism anticipating information sharing and cooperation between the CFPB, a federal agency, and fifty states provokes legitimate concern. For instance, entities regulated by the CFPB are unsure over the patchwork nature and interplay of enforcement with potentially non-uniform standards and perhaps inconsistent political agendas. Businesses want certainty, and the dual enforcement scheme anticipated by Dodd-Frank will not encourage this. Nor will it encourage even application throughout the particular industry.

No Concrete Guidance. Fourth, the subjective nature of what constitutes “abusive” behavior creates challenges to providing concrete guideposts for the regulated industries. In all likelihood, the CFPB will be unable to use its rulemaking authority to provide meaningful guidance – once it kicks in with the appointment and approval of a director – in articulating clear standards across multiple consumer financial industries. For example, what is considered “abusive” behavior by debt collectors will be different from that for residential mortgages, credit card issuers, payday lenders and credit reporting agencies. Accordingly, regulated entities will face some rules and much interpretation on a case-by-case basis.

Consumer Complaint Portal. Fifth, the CFPB recently developed a consumer credit portal to theoretically make it easier for consumers to file credit card and mortgage complaints. While this portal is limited to credit card and mortgage complaints at the present time, the CFPB has made clear that this model will be expanded into other consumer financial products and services, including debt collection and student loans. At the same time, the CFPB now allows companies to view and respond to complaints in the complaints database. The CFPB intends to review the quality and procedures of regulated entities as well as the actual resolution of the consumer’s dispute. Given the broad authority afforded to the CFPB, businesses are anxious as to how the consumer complaints through the portal about supposedly “abusive” behavior will actually work in terms of review and oversight by the CFPB, whether they will serve as a source for further investigations and supervision by the CFPB or state Attorneys General and

³⁰ Pamela Chan, “Shaping the CFPB’s Supervisory Authority,” THE LADDER: A BLOG FROM NEW AMERICA’S ASSET BUILDING PROGRAM (Sept. 1, 2011), http://assets.newamerica.net/blogposts/2011/shaping_the_cfpb_s_supervisory_authority-57092.

whether the consumer complaints will truly be kept confidential.

Duty of Care/Suitability. Sixth, the CFPB has already commented that providers of consumer financial products or services may have a duty of care to ensure that the product or service is appropriate or suitable for the particular consumer. The implications of such a standard are profound ranging from prohibiting certain products or services from being marketed nationally,

increasing costs, creating new legal duties and establishing a subjective standard.

Conclusion

At this time, more can be said with confidence about the process that the CFPB will go through in defining “abusive” than what the actual definition will be. Because the CFPB will be, at least in the short term, complaint driven, businesses simply need to closely monitor ongoing rulemaking and enforcement activity for the indefinite future to learn the meaning of “abusive.”