By creating the Consumer Financial Protection Bureau (CFPB) under the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act, Congress changed the architecture of consumer protection. Along with preserving existing statutes and regulations, lawmakers layered a considerable array of new laws on top of the old ones.

Dodd-Frank created a new agency with extraordinary authority; stripped much of the responsibility for consumer protection at large banks from the prudential regulators; and rewrote the script for supervision and enforcement. Instead of putting a commission at the helm, Dodd-Frank gave authority to a sole director with a five-year term, who could only be removed for cause.

The ambitious goal was to create a single, independent, consumer regulator for all large banks, and give that regulator a singular mission to focus on consumer protection — without rulemaking or supervision on safety and soundness. The CFPB also was given supervisory authority over many nonbanks engaged in consumer financial services, with the purpose of “leveling the playing field” and filling the gaps in consumer protection.

Expanded rulemaking authority empowers the new agency to address whatever products or practices it determines to be “unfair, deceptive, or abusive.” Funded by a large budget drawn from the coffers of the Federal Reserve System and having no need to seek appropriations from Congress, the new agency was given the clout thought necessary to protect consumers in a complex financial marketplace.

These changes are the most significant and far-reaching since the late 60s, when the passage of the Truth in Lending Act (TILA) and the Fair Housing Act forever changed the role of the federal government in consumer financial protection, both regulation and oversight. Most of the ensuing federal consumer protection statutes and regulations built on this foundation and shared a common model. Each had its own respective penalties for violations and, for the most part, private rights of action.

The CFPB will continue to enforce the host of laws passed in the wake of the Truth in Lending Act, but with the added breadth of authority and singular mission deemed necessary to plug the holes in the system. At this writing, the new agency has been regulating financial institutions for about a year and a half, enough time to begin to assess the operating challenges and also the complexities of its mission.

Given the massive undertaking mandated by Congress, the CFPB has made impressive progress in the early days of its existence. Yet there are growing pains and challenges, including deploying a vast new system for examinations; coordinating with other regulatory agencies in areas of overlapping authority; and, importantly, specifically interpreting the authorities conferred by Congress. Many issues undoubtedly will be ironed out over the next few years; others may linger for quite some time.

**LESS OR MORE COMPLEXITY?**

Writing rules is a huge undertaking for the fledgling CFPB agency. But its supervisory responsibility is even more challenging and the impact on the institutions it regulates is much more immediate. The Dodd-Frank Act gives the CFPB supervisory authority over all depository institutions, banks, thrifts, and credit unions with more than $10 billion in assets, plus their affiliates. As field examinations have gotten underway, it is clear that Dodd-Frank has created a complex challenge for all concerned.

The original intent was to create a single agency that would examine all depository institutions for consumer protection. The goal was to eliminate the complex system of bank regulation that had developed over many decades, wherein national banks were supervised by the Office of the Comptroller of the Currency; state chartered banks by the Fed or the Federal Deposit Insurance Corp.; thrifts by the Office of Thrift Supervision; and credit unions by the National Credit Union Administration. A further goal was to end “regulatory
arbitrage” by preventing the possibility of banks shifting charters to find the least stringent supervisor and ending the temptation for supervisory agencies to compete for charter jurisdiction by offering a friendlier environment.

But to minimize the burden on community banks, Congress permitted them to stay with their current prudential regulator rather than make the transition to the CFPB. As a result, rather than significantly reducing the number of supervisors, yet another agency was added to the regulatory mix, increasing complexity instead of reducing it.

The confusing interplay of regulatory agencies is further exacerbated by numerous odd exceptions built into the law, such as:

- The Flood Hazard Protection Act and portions of the Fair Credit Reporting Act remain with the prudential regulators;
- The Community Reinvestment Act stayed within the province of the prudential regulators, although the Home Mortgage Disclosure Act, whose provisions are a component of CRA performance evaluations, made the transition;
- The Equal Credit Opportunity Act, which prohibits discrimination in lending, shifted to the CFPB, but the Fair Housing Act, which prohibits discrimination in real estate-secured lending, stayed behind;
- The prudential regulators retained supervisory responsibility to enforce the prohibition against “unfair or deceptive acts or practices” under the Federal Trade Commission Act, while the CFPB acquired companion authority to enforce against “unfair, deceptive, or abusive” acts or practices under Dodd-Frank; and
- Automobile dealers were exempted from regulation or supervision by the CFPB, but not from compliance with federal consumer protection regulations, resulting in a parallel and virtually identical set of regulations written by the Federal Reserve Board exclusively for auto dealers.

Meanwhile, the prudential regulators continue to include compliance management as part of risk management exams, on the grounds that consumer protection is an important component of operational, legal and reputational risk. The result of all this is that banks over $10 billion now are being examined for consumer compliance by multiple regulatory agencies while also remaining subject to the Fed’s holding company exams and also state examiners. The extensive overlay is a concern for institutions and complicates compliance management. The Dodd-Frank Act requires the agencies to coordinate and they have been working toward that goal, but it is an uphill climb.

LEVEL PLAYING FIELD?
In addition to the largest banks and their affiliates, the CFPB is charged with supervising literally tens of thousands of nonbank consumer financial service providers. These include payday lenders, mortgage companies and nonbank student lenders, as well as an assortment of large nonbank consumer financial service providers in other areas, which the CFPB is required to designate for oversight via the regulatory process.

This extension of authority was designed to “level the playing field” in consumer financial services regulation. The new approach regulates on the basis of product rather than by charter, and the arrangement could ultimately prove to be one of the genuinely beneficial results of the Bureau’s creation if it can be made to work effectively.

At a practical level, however, it would be simply impossible for any federal agency to routinely examine all these additional companies at anywhere near the same level as large banks experience, regardless of budget. The Bureau has its work cut out for it in developing an effective supervisory process for such a vast number of businesses.

The CFPB was unable to begin enforcement or supervision of nonbanks under Dodd-Frank until January 2012, and in the year since then it has begun to define the types of nonbanks that will be subject to its jurisdiction. As of now, large debt collectors and credit bureaus have been brought under the Bureau’s purview; but many other financial service providers are not yet supervised, including large finance companies.

The Bureau has made it clear by its actions that its goal is to level the playing field in the regulation of consumer financial services. A single examination manual has been written for the examination of both banks and nonbanks, albeit with separate sections to address the unique characteristics of the various nonbank companies. The same examiners will be rotated between bank and nonbank supervision, under a single head of policy and a single head of operations.

It will take some time until a solid routine is established for the supervision of nonbanks, with uncertainty about when they will receive a level of oversight anywhere close to that experienced by banks.

STAFFING AND TRAINING
Depository institutions with more than $10 billion in assets are seeing the familiar supervisory process change as traditional examiners from the prudential regulators are replaced by new ones from the CFPB. While many experienced examiners came over from other federal regulatory agencies, their number was not nearly enough to meet the needs of the CFPB, which widened the recruiting net to include professionals from state and nonbank regulatory agencies and
many others from a wide range of backgrounds, including academia and nonprofits. A continuing priority of the CFPB is fleshing out examination teams with qualified personnel and training people already on board.

Along with building examiner expertise in the field, the CFPB is working on the timeliness and quality of final examination reports. In more than a few instances, final exam reports have not been circulated until many months after on-site examiners depart. The reasons are many, including new exam teams, manuals still under construction and a new corporate culture, prompting the CFPB to perform an added central review of work performed in the field.

From the standpoint of institutions being examined, extra reviews in Washington are preferable to a potential rash of inconsistent interpretations in the field. Yet this entails a lengthy wait for exam reports, even for institutions that traditionally have had strong compliance programs.

Long exam delays are problematic. Any compliance issues that are identified may not be made known to the bank until the official report is provided, and the passage of time can be a detriment to an institution’s compliance management. Timely exam results also can be important for other supervisory reasons. Community Reinvestment Act (CRA) performance evaluations, for example, can be affected by the outcome of fair lending and other regulatory compliance exams. So a delay in the compliance exam report can have a domino effect on the CRA exams.

These issues will become less of a concern over time as the CFPB increasingly deploys more experienced and fully trained teams of examiners. The exams themselves will run more smoothly and the exam reports will be provided more promptly. But as with any large start-up organization, it will take a good deal of time to work out the kinks. And transition pressures may be compounded in the near term as nonbank exams become more frequent, spreading limited resources still further.

LINGERING UNCERTAINTY

As provided in the Dodd-Frank Act, the CFPB’s authority to enforce against unfair, deceptive or abusive acts or practices — known UDAAP — gives it a powerful new tool, but it is not yet clear how the agency will make use of it. Of particular concern to the financial services industry is the term “abusive.”

Financial institutions were prohibited from engaging in unfair or deceptive practices long before the Dodd-Frank Act was signed into law. The FTC Act already rendered such activity illegal, and the other federal regulatory agencies along with the FTC already had — and still have — the authority to go after violations. The meaning of the terms “unfair” and “deceptive” in this context have been defined by the FTC and by case law; and the Dodd-Frank Act and the CFPB have adopted them as defined. But the addition of the concept of “abusive” practices heightens the concern of the institutions that are charged with compliance.

A broad and multi-pronged definition of the term is included in the Dodd-Frank Act, but it is unclear how it may be applied. The CFPB is not required to issue regulations to clarify the definition of abusive practices any time soon and seems unlikely to do so. Nor would that necessarily end the lingering uncertainty, since so much will still depend upon the facts and circumstances in each case.

For the time being it appears more likely that the CFPB will use its authority to enforce on a case-by-case basis. Under the supervisory manual, examinations include consideration of UDAAP compliance. Yet, while the manual contains practical examples to accompany the definitions of unfair and deceptive, there are no corresponding examples of “abusive” practices as of yet.

As long as there is lingering doubt about the meaning and application of UDAAP principles by the CFPB, it will be a concern whenever products and services are being developed, complicating efforts by banks and other financial service providers to maintain strong compliance programs without unduly hampering innovation.

GROWING PAINS

The CFPB has achieved a great deal during the short time it has been in existence, yet there are many challenges and questions yet to be resolved, with material ongoing implications for banks and other financial institutions. Despite a potential budget of more than $500 million, it is still a start-up agency wrestling with a new examination staff and an untested mission statement, accompanied by high internal aspirations and considerable external pressures to prove worthy of the cost and effort involved in its creation.

Some of the supervisory problems may resolve themselves as the Bureau matures, builds an infrastructure, and learns how to smoothly carry out its mission. Other issues may prove more intractable, however, perhaps a function of the Bureau’s genetic makeup and its ambitious statutory agenda.

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