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CFPB Wields New Powers with Director

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Within hours of Richard Cordray assuming the role of director[1] at the Consumer Financial Protection Bureau (CFPB), agency officials began exercising their newly expanded powers. Their immediate target is all manner of "nonbank"[2] financial services used by millions of households. While proponents contend that the new regulations will benefit consumers, the structure of the bureau—its unparalleled power magnified by an absence of accountability—bodes ill for most Americans.

New Director Prompts New Powers. The CFPB became operational on July 21, 2011, but was limited by statute to enforcing existing rules over banks and credit unions (with more than $10 billion in assets) until a director was nominated and confirmed. With Cordray in place on January 4, the bureau immediately launched its supervision of "nonbank" mortgage originators, brokers, and servicers, as well as payday lenders and private education loans, as permitted by statute following confirmation of a director.

The bureau is also now authorized to supervise "larger participants" in other nonbank services. The CFPB has identified six such services for regulation, including debt collection; consumer reporting; prepaid cards; debt relief services; consumer credit; and money transmitting, check cashing, and related activities. The designation of "larger participants" must be finalized by July 21, 2012.

Reflecting the overly broad nature of its powers, the agency may also supervise *any* nonbank that it deems as posing a "risk" to consumers or engaging in "unfair, deceptive, or abusive" practices. While *unfair* and *deceptive* have been defined in other regulatory contexts, the addition of the term *abusive*, which has not previously been defined in law, grants CFPB officials inordinate discretion.

Regulatory Excess Harms Consumers. There are some bad actors in the nonbank sector (as in all endeavors, including government). But at least 40 million adults benefit from alternative financial services, citing convenience, cost, or ease of qualification for doing so.[3] Contrary to conventional wisdom, there is no "void" of conventional banking in neighborhoods where alternative service providers locate, according to a survey by the Urban Institute.[4]

To the extent that the bureau's regulatory crackdown constrains nonbank services, tens of millions of consumers would be hit with fewer choices and higher costs or be drawn to offshore lenders who operate beyond U.S. jurisdiction.[5] Those without

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alternatives could face late fees, service suspensions, foreclosure, or repossession.

Contrary to the rhetoric of bureau advocates, nonbanks do not currently operate in a regulatory vacuum. For example, consumers have recourse under the federal Truth in Lending Act and the Real Estate Settlement Procedures Act. Moreover, many states and municipalities regulate (or prohibit) a variety of alternative financial services. The primary difference with CFPB oversight is the unparalleled scope of its regulatory discretion and its unaccountability.

A Risky Regulatory Regime. Bureau officials have outlined some elements of their new regime, including requiring non-banks to file reports, scrutiny of companies' marketing materials, reviews of internal compliance procedures, and evaluation of services.[6] Bureau officials say that regulatory and enforcement actions will be based on their assessments of consumer "risk."

According to the bureau, risk constitutes the *potential* for consumers to suffer economic loss or other injury. To gauge potential risk, the agency will assess "the inherent risk in the particular line of business or the entity overall" as well as "the quality of controls that manage and mitigate that risk." Bureau examiners also will be expected to forecast whether the risk will decrease, increase, or remain unchanged—a magical ability that every investor would covet.

Paternalism Gone Wild. Rather than establish regulatory standards, the bureau's risk regime entails customizing ever-shifting criteria upon which firms will be judged. Moreover, the bureau will act based on a supposition of harm rather than actual violation of the law, and CFPB officials will determine whether a company's "compliance management system" is adequate irrespective of its actual record of compliance.

Just how such a system comports with traditional notions of due process remains to be seen. As noted by The Heritage Foundation's James Gattuso, the bureau "will be making political calls, determining not just whether rules have been broken, but what those rules should be and how widely they will apply."[7]

In reality, all financial service involves risk—to consumer and service provider alike. Consumers may choose to shop around, seek recommendations from friends and family, or employ experts on their

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1. According to former Attorney General Ed Meese and Todd Gaziano of The Heritage Foundation, President Obama's "recess" appointment of Cordray is unconstitutional because it was made when the Senate was in session. See Todd Gaziano, "A Tyrannical Abuse of Power: Obama Attempts to Appoint Cordray to CFPB," The Foundry, January 4, 2012, at *http://blog.heritage.org/2012/01/04/a-tyrannical-abuse-of-power-obama-attempts-to-appoint-cordray-to-cfpb/*.
2. The CFPB defines a non-bank as "a company that offers or provides consumer financial products or services but does not have a bank, thrift, or credit union charter. Nonbanks include companies such as mortgage lenders, mortgage servicers, payday lenders, consumer reporting agencies, debt collectors, and money services companies." See press release, "Consumer Financial Protection Bureau Launches Nonbank Supervision Program," Consumer Financial Protection Bureau, January 5, 2012, at *http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-launches-nonbank-supervision-program/* (January 25, 2012).
3. Federal Deposit Insurance Corporation, "National Survey of Unbanked and Underbanked Households," December 2009, at *http://www.fdic.gov/householdsurvey/full_report.pdf* (January 17, 2012).
4. Kenneth Temkin and Noah Sawyer, "Analysis of Alternative Financial Service Providers," Urban Institute, study prepared for the Fannie Mae Foundation, at *http://www.urban.org/uploadedpdf/410935_altfinservproviders.pdf* (January 17, 2012).
5. Todd Zywicki and Astrid Arca, "The Case Against New Restrictions on Payday Lending," Mercatus Center, January 2010, at *http://mercatus.org/sites/default/files/publication/MOP64_FMWG_Payday%20Lending_web.pdf* (January 25, 2012).
6. Consumer Financial Protection Bureau, *Supervision and Examination Manual—Version 1.0*, at *http://www.consumerfinance.gov/guidance/supervision/manual/supervision-examination-process-overview/* (January 16, 2012).
7. James Gattuso, "New Consumer Bureau Will Run Free of Any Leash," Heritage Foundation *Commentary*, April 12, 2011, at *http://www.heritage.org/research/commentary/2011/04/new-consumer-bureau-will-run-free-of-any-leash* (January 17, 2012).

behalf to weigh the drawbacks and benefits of a particular financial service. Firms largely offset risk in their pricing. For example, payday lenders are routinely castigated for extracting exorbitant fees. But researchers have documented that "fixed operating costs and loan loss rates justify a large part of those fees."[8] Perhaps most important, the fees are often on par with—or cheaper than—bounced checks, late fees, repossessions, and similar alternatives.[9]

Abuse of Regulatory Discretion. Similarly problematic is the authority granted the bureau to prohibit "abusive" practices by non-bank service providers. The term *abusive* is largely undefined in any regulatory context, thereby leaving it to CFPB to set the standard. The statute characterizes as abusive any action that:

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 lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
    - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
    - The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

It is fair to ask just how the CFPB is to determine consumer "ability" or the requisite degree of consumer "understanding" for a population of over 300 million. In effect, the bureau will regulate commerce based on its own assessment of consumers' aptitude and their supposed inability to make rational decisions about financial matters.

The insult is exacerbated by the faulty premise that the economic crisis was a consequence of too little regulation of financial services—as opposed to misguided housing policies and twisted tax and regulatory incentives.[10]

Bureau Lacks Accountability. Nonbanks have little recourse to challenge the bureau's regulatory actions. Congressional power over the CFPB is limited, since its most effective tool—funding control—has been neutered. Bureau funding is set by law at a fixed percentage of the Federal Reserve's operating budget. For its part, the Fed itself has little control over its ostensible subsidiary, being barred from modifying or overturning decisions made by the bureau. The CFPB's decisions can be reversed only by a two-thirds vote of the 12-member Financial Stability Oversight Board.

The best option going forward would be outright elimination of the bureau through repeal of Title X of the Dodd–Frank financial regulation statute. Short of that, the following reforms are urgently needed:

- Abolish the bureau's current funding mechanism and subject it instead to congressional control. Although some financial regulatory agencies (such as the Federal Deposit Insurance Corporation and the Fed itself) also fall outside the congressional appropriations process, they are the exceptions rather than the rule among government agencies. Given the CFPB's broad policymaking role, there is no justification for allowing the agency to escape congressional oversight.
- Strike the undefined term *abusive* from the list of practices under CFPB purview. There is no regulatory precedent or jurisprudence that interprets the term in the context of consumer financial

8. Mark J. Flannery and Katherine Samolyk, "Payday Lending: Do the Costs Justify the Price?" Federal Deposit Insurance Corporation, Center for Financial Research *Working Paper* No. 2005/09, June 2005, at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=771624* (January 16, 2012).
9. Adair Morse, "Payday Lenders: Heroes or Villains?" January 2009, at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1344397* (January 17, 2012).
10. James Gattuso, "Meltdowns and Myths: Did Deregulation Cause the Financial Crisis?" Heritage Foundation *WebMemo* No. 2109, October 22, 2008, at *http://www.heritage.org/research/reports/2008/10/meltdowns-and-myths-did-deregulation-cause-the-financial-crisis*.

services, and the bureau should not have discretion to define its own powers.

- The bureau should be explicitly required to apply definitions of *unfair* and *deceptive* practices in a manner consistent with case law. Otherwise, regulatory uncertainty will inhibit the availability of financial products and services.

Fewer Choices, Higher Costs. Absent structural reform of the CFPB, consumers will begin to experience all too soon the consequences of this unchecked regulatory agency: fewer choices among financial products and services and higher costs for those that are available.

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