

Consumer Financial Protection Agency Act Clears House Financial Services Committee

Introduction

Last week's 39-29 vote on the Consumer Financial Protection Agency Act by the House Committee on Financial Services is the latest stage in the discussion, debate and intense lobbying around the scope of the CFPA's authority and jurisdiction. This memorandum describes the key differences between the version of the bill reported out of the committee on October 22nd and Chairman Frank's September 25th discussion draft. The House Committee on Energy and Commerce will take up the bill next, after which it will be considered by the full House. The Senate has not yet begun to consider the CFPA Act. The September 25th discussion draft is available [here](#); although an official version of the amended bill is not yet available, the individual amendments are available [here](#).

The amended bill reflects an effort on the part of Chairman Frank and others to craft a compromise that responds to the concerns expressed by clashing interest groups and stakeholders. In the manner of most compromises, the amended bill gives a little to each and is likely to satisfy no one completely. Chairman Frank has already indicated that he will seek some changes to the bill before it comes to a vote on the House floor. Highlights of the amended bill include:

- within an overall framework that would generally require national banks and thrifts to comply with both federal and state consumer protection laws, a compromise that would, subject to certain conditions, permit the OCC or the OTS to preempt state consumer financial protection laws by regulation or order, on a case-by-case basis, upon a finding that a state law "prevents or significantly interferes" with the exercise of a national bank's or thrift's powers;
- within an overall framework that would subject small banks, thrifts and credit unions to the standards and rulemaking authority of the CFPA, the retention by the appropriate federal banking agency of examination and enforcement authority with respect to CFPA-promulgated and other consumer protection laws, subject to recapture of that authority by the CFPA in certain circumstances;
- new and clarified exclusions from the authority and jurisdiction of the CFPA for certain persons and financial activities, including securities market participants required to be registered with the SEC, the insurance sector, and auto dealers with respect to the extension of dealer-assisted financing;
- concentration of the agency's power in its Director; and
- expansion of the bill's coverage to include "service providers," *i.e.*, those who provide material services to covered persons in the provision of a financial product or service

Further detail is set forth below.

Previous Davis Polk publications related to the Consumer Financial Protection Agency Act can be accessed below:

- ▶ [Highlights of the Proposed Consumer Financial Protection Agency Act of 2009](#) (July 3, 2009)
- ▶ [Notable Revisions to the Consumer Financial Protection Agency Act](#) (September 29, 2009)
- ▶ [The Davis Polk Financial Crisis Manual](#) (September 24, 2009)

Latest Amendments to the Consumer Protection Agency Act of 2009

Preemption of State Consumer Protection Laws

The allocation of rulemaking and enforcement power between the CFPB and state regulators continues to bedevil lawmakers. Adhering to Obama Administration policy, the amended bill would establish an overall framework in which national banks and thrifts would find themselves generally subject to both federal and state consumer laws. The preemption section of the amended bill explicitly states that the CFPB Act will not occupy the field. Within that context, the compromise reached in the amended bill would slightly expand the power of the OCC and the OTS to preempt state consumer laws, although it would increase the procedural burdens that must be met under current law to exercise preemption authority. These new burdens include requiring a specific, on-the-record finding that a state law prevents or significantly interferes with a national bank's or thrift's exercise of authority explicitly granted by Congress and advance consultation with the CFPB. In addition, the amended bill states that there will be no deference to any federal agency's interpretation that the CFPB Act itself preempts a state law. As currently drafted, the amended bill seems likely to engender controversy and litigation.

In the amended bill, state consumer financial laws may be preempted in three circumstances:

- if a state law has a “discriminatory effect” on national banks or thrifts in comparison with institutions chartered by that state;
- if the OCC or the OTS formally determines, on a case-by-case basis, that a state law “prevents or significantly interferes” with the ability of a national bank or thrift to engage in its business; or
- if a state law is preempted by other federal law not relevant to the CFPB Act

The amended bill makes it clear that state securities and insurance regulators may adopt rules and initiate enforcement proceedings under state law with respect to persons regulated by them. State regulators may also enforce CFPB regulations as long as they first consult the CFPB.

Limitation on CFPB Authority Over Small Banks, Thrifts and Credit Unions

Contrary to some news reports, under the amended bill the requirements of the CFPB Act and any regulations promulgated under it apply in full to small banks, thrifts and credit unions. However, examination and enforcement authority with respect to compliance with the CFPB Act, regulations promulgated by the CFPB or other consumer laws by small institutions are now reserved to the appropriate federal banking agency or the National Credit Union Administration (“NCUA”), as appropriate. Small institutions include all insured depository institutions with total assets of \$10 billion or less and all insured credit unions with total assets of \$1.5 billion or less. As described below, however, even with respect to small institutions the CFPB may retain, or may recapture under certain circumstances, a great deal of the examination and enforcement authority granted to it in the September 25th discussion draft.

A. Examination

The amended bill grants the authority to examine small institutions for compliance with consumer laws, and the authority to enforce these laws, to the appropriate federal banking agency or the NCUA, as appropriate. These agencies, however, are required to furnish all documentation related to examinations to the CFPB “on a timely and ongoing basis.” In addition, the CFPB can compel the agencies to “involve” a CFPB examiner in the examination process, including with respect to “setting [an examination's scope],” “participating” in examinations and “providing input” on examination reports and determination of examination ratings.

According to Chairman Frank, 98 percent of banks would not be examined by the CFPA, although the approximately 150 banks that would fall under the direct examination and enforcement authority of the CFPA would represent nearly 80 percent of all assets held by banks.

B. Enforcement

The amended bill provides that the appropriate federal banking agency or the NCUA, as appropriate, has “primary authority” to enforce compliance with consumer laws. Should the CFPA recommend in writing that an agency initiate an enforcement proceeding, however, it may initiate a proceeding if the agency fails to do so within 120 days of receipt of the recommendation. Additionally, in the event that “through the [CFPA’s] consumer complaint system” the CFPA has “reasonable cause” to believe that a small institution “demonstrates noncompliance” with consumer laws, the CFPA may “directly investigate” and take any enforcement action permitted under the CFPA Act.

C. Removal

The CFPA is authorized under the amended bill to remove an appropriate federal banking agency or the NCUA, as appropriate, from its examination and enforcement role with respect to a small institution’s compliance with consumer laws if it determines that the agency has failed adequately to conduct examinations or to bring enforcement actions. The small institution would then be subject to the examination and enforcement authority of the CFPA as though it were a covered person under the CFPA Act. The Secretary of the Treasury, to whom the automatically-lodged appeal of a removal is directed, is now tasked with promulgating regulations that establish the standards to be applied by the CFPA in deciding whether to remove an agency from its examination and enforcement role.

D. Fees

The CFPA may not assess fees on a small institution.

Certain New or Expanded Exclusions from the Authority and Jurisdiction of the CFPA

The amended bill expands and/or clarifies the categories of persons and financial activities that are excluded from the authority and jurisdiction of the CFPA, including:

A. Acting as an investment adviser

The amended bill slightly alters the exclusion of certain investment advisers from the authority and jurisdiction of the CFPA. The September 25 discussion draft’s exclusion of investment advisers who are “subject to regulation by or registered with” the SEC or the CFTC is replaced with the exclusion of investment advisers “regulated by” the SEC or CFTC. Arguably, investment advisers that have failed to comply with a registration requirement will fall within the authority and jurisdiction of the CFPA. More importantly, the amended bill excludes investment advisers “regulated by . . . any securities commission (or any agency or office performing like functions) of any State.”

B. Persons regulated by the Securities and Exchange Commission

The amended bill expands the exclusion from the authority and jurisdiction of the CFPA of any “person regulated by the Securities and Exchange Commission” to cover:

- any SEC-registered municipal securities dealer;
- any SEC-registered SRO;
- any national securities exchange or other entity that is required to be registered under the Securities Exchange Act; and
- the Municipal Securities Rulemaking Board

The new language excluding “any...other entity that is required to be registered under the Securities Exchange Act” from the authority and jurisdiction of the CFPA would mean that new categories of entities, such as Nationally Registered Statistical Rating Organizations, as well as entities that may come within SEC jurisdiction under proposed over-the-counter derivatives legislation, such as security-based swap dealers and major security-based swap participants, may be outside the CFPA’s authority as well.

C. Persons regulated by the Commodity Futures Trading Commission

The amended bill expands the exclusion from the authority and jurisdiction of the CFPA of any “person regulated by the Commodity Futures Trading Commission” to cover, to the extent that their actions are subject to the CFTC’s jurisdiction under the Commodity Exchange Act:

- boards of trade;
- derivatives clearing organizations;
- multilateral clearing organizations; and
- to the extent that they act in a registered capacity, any agent, employee or contractor acting on behalf of, registered with, or providing services to any of the organizations identified in this exclusion

D. Persons regulated by a state insurance regulator

The amended bill clarifies the exclusion from the authority and jurisdiction of the CFPA of insurers in a way that is favorable to the insurance industry and in line with the Obama Administration’s decision in its regulatory reform efforts not to disturb the policy of leaving the vast majority of insurance regulation at the state level. Formerly, the exclusion was limited to a provision prohibiting the CFPA from “defin[ing] engaging in the business of insurance as a financial activity.” The amended bill explicitly excludes from the authority and jurisdiction of the CFPA all persons “engaged in the business of insurance” and “subject to regulation by any State insurance regulator,” but “only to the extent that such person acts in such capacity.”

The amended bill also explicitly reserves to state insurance regulators the power to adopt rules and initiate enforcement proceedings with respect to persons they regulate, and states that the CFPA would generally “have no authority to exercise any power to enforce this title” against such persons. The amended bill does, however, place within the CFPA’s authority and jurisdiction the provision by a covered person of a product or service not regulated under the CFPA Act for or on behalf of insurers, in connection with a financial activity.

E. Acting as a financial adviser

The CFPA’s authority and jurisdiction over persons “acting as a financial adviser” has been expanded to include persons providing tax planning services. However, the amended bill excludes from the definition, and thus from the CFPA’s authority and jurisdiction:

- preparing tax returns or tax refund claims;
- publishing generally and regularly circulated publications that include such information as market data, investment information or recommendations not tailored to a particular consumer; and
- providing advice, analysis or reports relating largely to Treasury and municipal securities

Concentration of Authority in the Director of the CFPA

The Director of the CFPA would have extensive authority under the amended bill. Among other powers granted to the Director is the power to:

- exercise all executive and administrative powers of the CFPA;

- issue regulations and orders and establish standards for covered persons;
- exempt any person or consumer financial product or service from the CFPA Act or other consumer law, as the Director deems necessary or appropriate;
- define an activity as a “financial activity,” and thereby bring it within the jurisdiction of the CFPA;
- examine any covered person or service provider;
- require reports from any covered person;
- intervene in an FTC enforcement action;
- with respect to complaints arising out of the consumer complaint system, directly investigate an institution for noncompliance with consumer laws and take enforcement action
- remove a federal banking regulator from its examination and enforcement role with respect to the consumer financial activities of a small institution;
- assess fees on covered persons in “necessary” amounts;
- be removed from a 5-year term only for cause;
- receive each year from the Federal Reserve, and then appropriate, funds totaling 10% of the Fed’s total systems expenses

Please [click here](#) to see a diagram of the roles of the Director and the two advisory boards.

Service Providers

Under the amended bill, the CFPA has authority, nearly co-extensive with its authority over covered persons, over a new category of persons: “service providers.” A service provider “provides a material service to a covered person in the provision of a consumer financial product or service,” and includes any person who, with respect to such a product or service:

- facilitates its design or operations relating to its delivery;
- directly interacts with a consumer regarding it; or
- processes transactions relating to it

The term “material service” is no longer defined in the text of the bill, but the substance of the definition appearing in the September 25th discussion draft has been partially imported into the definition of “service provider,” and expanded. Echoing the old language, a person will not be deemed to be a service provider “solely by virtue” of providing to a covered person “a support service of a type provided to businesses generally or a similar ministerial service.” New language protects a person from being deemed a service provider if the service such person provides to a covered person does not materially affect the terms or conditions, performance or operation, or propensity of a consumer to obtain a consumer financial product or service. Sale of advertising is also carved out of the authority and jurisdiction of the CFPA.

Exemption for Auto Dealers

The amended bill greatly expands the scope of the exclusion of auto dealers from the authority and jurisdiction of the CFPA that initially appeared in the September 25th discussion draft. That exclusion extended only to dealer activities unconnected to the extension of financing. The amended exclusion encompasses so-called “dealer-assisted financing,” *i.e.*, arranging for customers to secure credit from third party finance companies or extending credit to customers if a dealer has separately incorporated an affiliated finance operation.

Because the amended exclusion extends only to persons “primarily engaged” in the sale, lease or servicing of motor vehicles, captive finance companies appear to remain within the authority and jurisdiction of the CFPA. So-called “buy here, pay here” operations, or dealerships that extend credit directly to customers and retain the financing contracts, rather than assigning them to third party finance companies, also remain within the authority and jurisdiction of the CFPA.

The consumer financial protection functions of the FTC and the Federal Reserve with respect to auto dealers would not be transferred to the CFPA.

Other Amendments of Note

Certain other key changes to the September 25th discussion draft include:

- expanding the definition of “financial activities” that are within the authority and jurisdiction of the CFPA to include:
 - issuance of stored value cards
 - collection, analysis, maintenance and provision of consumer report information, including credit histories of consumers
- excluding from the definition of “financial activities,” and thus from the authority and jurisdiction of the CFPA, the sale of credit and mortgage insurance
- building on the September 25th discussion draft’s elimination of the requirement that covered persons offer “standard,” or “plain vanilla,” financial products or services, prohibiting the CFPA from taking any action, including promulgating regulations, to require a covered person to offer a “specific” financial product or service
- requiring the CFPA to provide the IRS with “any report of examination or related information identifying possible tax law noncompliance”
- requiring the CFPA to conduct an annual “financial autopsy,” identifying the “underlying causes . . . including any specific financial products or services” of foreclosures and bankruptcies in each state, and thereafter reporting to Congress those financial products or services found to have caused a “substantial number” of foreclosures and bankruptcies as well as which companies or individuals provided those products and services
- requiring the CFPA to lead a rulemaking committee that promulgates appraisal independence requirements for residential loan purposes, which requirements would replace the Home Valuation Code of Conduct announced by the Federal Housing Finance Agency in December, 2008
- in the remittance transfer area, imposing expansive new disclosure and other obligations on persons and depository institutions that electronically transfer funds on behalf of customers to persons in foreign countries in the ordinary course of business; authorizing the CFPA to issue and enforce regulations related thereto; and providing that relevant state laws are not preempted to the extent not inconsistent with the CFPA Act
- with respect to extensions by merchants of purchase money credit directly to consumers, bringing within the authority and jurisdiction of the CFPA transactions in which:
 - the debt is transferred to a third party; or
 - the credit provided significantly exceeds the market value of the product or service purchased by the consumer and the CFPA finds the sale of the product or service was done to circumvent the requirements of the CFPA Act

- prohibiting promulgation by the CFPB of regulations that “directly or indirectly treat, or are interpreted to disparately treat, or disparately impact” any entity employing a covered person
- requiring that a national toll-free number for consumer complaints be established, from which calls may be routed to state agencies
- requiring the federal financial institution regulatory agencies to report to Congress within six months of the CFPB Act’s passage on their efforts to establish a public interagency website for directing and referring consumer complaints and inquiries concerning any financial institution to the CFPB
- establishing an Office of Financial Literacy, which would develop goals for consumer financial educations programs, recommendations regarding effective certification of persons providing such programs, technology tools to collect data on financial education and counseling outcomes and conduct research to identify effective education methods
- requiring the Director to appear before the House Committee on Financial Services annually to discuss the efforts, activities, objectives and plans of the CFPB

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