

## E-ALERT | Financial Institutions

May 26, 2010

### FINANCIAL REGULATORY REFORM LEGISLATION

#### SENATE PASSES CONSUMER FINANCIAL PROTECTION LEGISLATION

On May 20, 2010, the U.S. Senate passed the Consumer Financial Protection Act of 2010, under Title X of the Restoring American Financial Stability Act of 2010. The Senate bill must now be reconciled through the conference process with the House’s version of consumer financial protection reform legislation, which was passed in December 2009.<sup>1</sup>

Both the House and the Senate versions of the consumer financial protection reform legislation would create a new, independent Federal regulatory body with broad new authorities as well as authorities transferred from other regulators under existing consumer financial protection laws. These authorities would extend to a wide array of people and institutions (or “covered persons”) engaged in certain activities related to consumer financial products or services.

There follows a side-by-side comparison that summarizes the key elements of the House-passed legislation and that also identifies the principal respects in which the Senate-passed legislation differs from the House-passed version. If you should have any questions regarding either the House-passed legislation or the Senate-passed legislation, please free to contact any of the members of Covington’s Financial Institutions Group listed at the end of this alert.

HOUSE BILL	SENATE BILL
<p><b>CFPA AUTHORITY</b></p> <ul style="list-style-type: none"> <li>■ Consumer Financial Protection Agency (CFPA) is established as a new independent federal agency (headed by a Director for the first two years and thereafter by a five-member Commission) that is empowered to exercise broad regulatory, supervisory and enforcement authority over “covered persons” and “service providers” with respect to both new consumer financial protection provisions (see below) and an array of existing Federal consumer financial protection laws and provisions for which responsibility is transferred from the federal banking agencies, including:</li> </ul>	<p><b>CFPB AUTHORITY</b></p> <ul style="list-style-type: none"> <li>■ <u>Senate Bill Differences</u> – Bureau of Consumer Financial Protection (CFPB) is established within the Federal Reserve System (headed by a Director appointed by the President for a 5-year term), with broad regulatory, supervisory, and enforcement authority similar to that provided in the House Bill.</li> <li>■ Federal Reserve Board (the “Board”) may delegate to the CFPB authority to examine persons subject to the Board’s jurisdiction for compliance with federal consumer financial laws, but the Board may not appoint, direct, or remove any CFPB officer or employees and</li> </ul>

<sup>1</sup> The House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) on December 11, 2009. The Senate legislation was passed as a substitute amendment to H.R. 4173.

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<ul style="list-style-type: none"> <li>➤ The Electronic Funds Transfer Act.</li> <li>➤ The Equal Credit Opportunity Act.</li> <li>➤ The Fair Credit Reporting Act.</li> <li>➤ The Fair Debt Collection Practices Act.</li> <li>➤ The Home Mortgage Disclosure Act.</li> <li>➤ The Real Estate Settlement Procedures Act.</li> <li>➤ The Secure and Fair Enforcement for Mortgage Licensing Act.</li> <li>➤ The Truth in Lending Act.</li> <li>➤ The Truth in Savings Act.</li> </ul>	<p>may not intervene in any CFPB matter or proceedings (including any examination or enforcement proceeding) unless specifically authorized by other Federal law.</p> <ul style="list-style-type: none"> <li>■ The Truth in Lending Act is amended to prohibit the compensation paid to loan originators from varying based on loan terms <i>other than</i> the loan principal amount.</li> <li>■ The Senate Bill would prohibit prepayment penalties for residential mortgage loans that do not meet specified criteria (<u>e.g.</u>, fully documented, fixed-rate, and fully amortizing mortgage loans).</li> <li>■ Otherwise, the CFPB provisions of the Senate Bill are generally comparable to those of the House Bill, with exceptions noted below.</li> </ul>
<p><b>DEFINITIONS</b></p> <ul style="list-style-type: none"> <li>■ <u>“Covered Persons”</u> – Any person who engages directly or indirectly in a “financial activity” “in connection with” the advertising, marketing, solicitation, sale, disclosure, delivery, or account maintenance or servicing of a “consumer financial product or service.”</li> <li>■ <u>“Service Provider”</u> – Any person who provides a “material service” to a covered person in the advertising, marketing, solicitation, sale, disclosure, delivery, or account maintenance or servicing of a consumer financial product or service.</li> <li>■ <u>“Consumer Financial Product or Service”</u> – Any product or service that results from or is related to engaging in a financial activity and that is to be used by a consumer “primarily for personal, family or household purposes.”</li> <li>■ <u>“Consumer”</u> – Any individual or an agent, trust or representative acting on behalf of an individual (there is no net worth or other limitation).</li> <li>■ <u>“Financial Activity”</u> – Includes: <ul style="list-style-type: none"> <li>➤ Deposit-taking.</li> <li>➤ Extending credit and servicing loans, and any activity “usual” in connection with</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ <u>“Covered Persons”</u> – Any person or affiliate service provider who engages in “offering or providing” a “consumer financial product or service.”</li> <li>■ <u>“Service Provider”</u> – Any person who provides a “material service” to a covered person, although the “provision” of a material service is not expressly defined.</li> <li>■ <u>“Financial Product”</u> – In addition to the financial activities listed in the House Bill, includes: <ul style="list-style-type: none"> <li>➤ Providing payments or other financial</li> </ul> </li> </ul>

HOUSE BILL	SENATE BILL
<p>extensions of credit or servicing loans.</p> <ul style="list-style-type: none"> <li>➤ Check-cashing and check-guarantee services.</li> <li>➤ Collecting, analyzing, maintaining and providing consumer report information or other account information.</li> <li>➤ Collection of debt related to any consumer financial product or service.</li> <li>➤ Providing real estate settlement services.</li> <li>➤ Leasing real or personal property (on a non-operating lease basis).</li> <li>➤ Acting as an investment or financial adviser (if not regulated by SEC, CFTC or a state securities regulator).</li> <li>➤ Financial data processing where the data are financial, banking or economic in nature.</li> <li>➤ Money transmitting.</li> <li>➤ Sale, provision, or issuance of stored value.</li> <li>➤ Acting as a money services business.</li> <li>➤ Acting as a custodian of money or any financial instrument.</li> <li>➤ Any other activity that the CFPB defines, by regulation, to be a financial activity (subject to certain required findings).</li> </ul>	<p>data processing products or services to a consumer by any means, including “payments made through an online banking system or mobile telecommunications network.”</p>
<p><b>EXCLUSIONS</b></p> <ul style="list-style-type: none"> <li>■ The CFPB’s authority is subject to a number of express exclusions, including for: <ul style="list-style-type: none"> <li>➤ The business of insurance.</li> <li>➤ Persons regulated by state insurance regulators, but only to the extent acting in a regulated capacity.</li> <li>➤ Persons registered with or regulated by the SEC or by a state securities</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ Exclusions from the CFPB’s authority are similar to the exclusions in the House Bill, with the following exception: <ul style="list-style-type: none"> <li>➤ Auto dealers are not given the same broad exemption as in the House Bill.</li> </ul> </li> </ul>

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<p>commission, but only to the extent acting in a registered capacity.</p> <ul style="list-style-type: none"> <li>➤ Persons registered with or regulated by the CFTC, but only to the extent acting in a registered capacity.</li> <li>➤ Merchants, retailers and sellers of non-financial products; accountants, tax preparers and attorneys; real estate license holders; auto dealers; and retailers of manufactured or modular homes.</li> </ul>	
<p><b>SCOPE OF CFPA AUTHORITY</b></p> <ul style="list-style-type: none"> <li>■ The CFPA’s authority includes: <ul style="list-style-type: none"> <li>➤ Examination, reporting and enforcement authority<sup>2</sup> over all “covered persons” and “service producers” with respect to all laws and regulations within the CFPA’s jurisdiction, subject to an exception for insured depository institutions with assets of \$10 billion or less as to which primary examination and enforcement authority is to be exercised by an institution’s primary federal regulator (with the CFPA having back-up enforcement authority and authority to remove the primary federal regulator for failure to conduct adequate examinations or bring appropriate enforcement actions).</li> <li>➤ Development of registration requirements for all “covered persons” that are not credit unions or “depository institutions,” and also of mandatory examination programs for such covered persons.</li> </ul> </li> </ul>	<p><b>SCOPE OF CFPB AUTHORITY</b></p> <ul style="list-style-type: none"> <li>■ The CFPB’s authority includes: <ul style="list-style-type: none"> <li>➤ Primary enforcement authority over insured depository institutions or insured credit unions with more than \$10 billion in total assets, and over any affiliates of such a depository institution or credit union (unless the affiliate is expressly exempt from CFPB authority, <u>e.g.</u>, registered broker-dealers).</li> <li>➤ Secondary enforcement authority over insured depository institutions or insured credit unions with total assets of \$10 billion or less, and over any affiliate of such a depository institution or credit union (unless the affiliate is expressly exempt from CFPB authority).</li> <li>➤ Power to require reports and conduct periodic examinations of certain <i>nondepository</i> “covered persons,” with: <ul style="list-style-type: none"> <li>○ Shared enforcement authority with the FTC over a “covered person” who provides origination, brokerage, loan servicing, loan modification, or foreclosure relief services for loans secured by real estate for “personal, family, or household” purposes.</li> </ul> </li> </ul> </li> </ul>

<sup>2</sup> Under the House Bill, to the extent that the CFPA and another federal agency both have enforcement authority over a provision of law, the CFPA is to have “primary” enforcement authority, except that where the CFPA and the FTC have common enforcement authority, either agency can initially exercise such authority and then the other may intervene in the enforcement action.

HOUSE BILL	SENATE BILL
<ul style="list-style-type: none"> <li>➤ Promulgation of new regulations –                             <ul style="list-style-type: none"> <li>○ To “ensure timely, appropriate and effective disclosure to consumers of the costs, benefits and risks associated with any consumer financial product or service.”</li> <li>○ “Regarding the manner, settings, and circumstances for the provision of any consumer financial products or services. . . .”</li> <li>○ To identify “unlawful, unfair, deceptive, or abusive acts or practices” in connection with any transaction with or offering of a consumer for a consumer financial product or service.</li> <li>○ Prescribing “minimum standards” to “deter and detect unfair, deceptive,</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>○ Exclusive enforcement authority over any “larger participant of a market for other consumer financial products or services.”</li> <li>○ Exclusive rulemaking and examination authority over all nondepository covered persons.</li> <li>➤ Power to exercise authority over a service provider to any covered person to the same extent that the covered person is subject to CFPB authority with regard to the activity in which the service provider is engaged on behalf of the covered person.</li> <li>➤ Transfer of authority from the Federal Trade Commission to the new CFPB under enumerated consumer laws, authorities which include rulemaking, conducting studies, and issuing guidelines or reports; but this transfer of authority does not affect the FTC’s existing authority under the Federal Trade Commission Act or any law other than an enumerated consumer law. Also, the FTC is given authority to enforce CFPB-issued regulations with respect to covered persons subject to FTC jurisdiction under the FTC Act.</li> <li>➤ Promulgation of new regulations –                             <ul style="list-style-type: none"> <li>○ To “ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers,” to permit consumers to understand the “costs, benefits, and risks” associated with the product or service.</li> <li>○ To set new limits on fees charged by payment card networks with respect to debit card transactions, commonly called “interchange transaction” fees.</li> </ul> </li> <li>■ Regulations promulgated by the CFPB may be appealed by a Federal banking agency to the Financial Stability Oversight Council, which upon a 2/3 vote may issue a stay (postponing the effective date of a regulation) or a set</li> </ul>

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<p>abusive, fraudulent, or illegal transactions” in the provision of consumer financial products or services by covered persons that are not federally or state regulated depository institutions.</p> <ul style="list-style-type: none"> <li>○ Imposing “duties” on any covered person, and their employees, agents and independent contractors, who deal or communicate directly with consumers in the provision of a consumer financial product or service, as the CFPB deems necessary or appropriate “to ensure fair dealing with consumers.”</li> <li>○ Requiring banks to display prominently in each consumer branch office information regarding fees and charges associated with the bank’s overdraft protection program.</li> <li>○ Identifying “unlawful, unfair, deceptive, or abusive” acts or practices in connection with reverse mortgage transactions or the offering of reverse mortgages.</li> </ul>	<p>aside (rendering the regulation unenforceable).</p> <ul style="list-style-type: none"> <li>■ The CFPB lacks authority to:                             <ul style="list-style-type: none"> <li>➤ Prescribe new “duties” for covered persons, or their employees, agents, and independent contractors who deal directly with consumers in the provision of a consumer financial product or service.</li> </ul> </li> </ul>
<p><b>FUNDING AND ASSESSMENTS</b></p> <ul style="list-style-type: none"> <li>■ The CFPB is to be funded by:                             <ul style="list-style-type: none"> <li>➤ An annual transfer from Fed of an amount equal to 10 percent of Fed’s total expenses for the most recent year, and</li> <li>➤ Assessments of covered persons based on their size, complexity, risks posed by such persons, and record of compliance with applicable consumer laws and regulations, with such assessments subject to –</li> </ul> </li> <li>○ Cap for insured depository institutions so that such an institution’s total annual charterer/regulator assessments for the first three years following the enactment of the Act do not exceed its total assessments for 2009.</li> </ul>	<ul style="list-style-type: none"> <li>■ The CFPB is to be funded by an annual transfer from the Fed of an amount “determined by the Director to be reasonably necessary to carry out the authorities of the Bureau under Federal consumer financial law.” This transfer is limited to a percentage of the total operating expenses of the Federal Reserve, capped at 10% for 2011, 11% for 2012, and 12% for subsequent years.</li> </ul>

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<ul style="list-style-type: none"> <li>○ Prohibition on any assessment of an insured depository institution with total assets of \$10 billion or less.</li> </ul>	
<p><b>NATIONAL BANK ACT (NBA) AND HOME OWNERS' LOAN ACT (HOLA) PREEMPTION AND OCC VISITORIAL POWERS</b></p> <ul style="list-style-type: none"> <li>■ Expressly restricts NBA and HOLA preemption of all state laws to instances where one of the following requirements is met –               <ul style="list-style-type: none"> <li>➢ Application of a state law would have a “discriminatory effect” on federally-chartered institutions in comparison to state-chartered institutions.</li> <li>➢ State consumer financial laws are preempted by the NBA or HOLA only to the extent they discriminate against the federally-chartered institutions or they are preempted, on a case-by-case basis, under the standard set forth by the Supreme Court of the United States in <i>Barnett Bank of Marion County, N.A. v. Nelson</i>, 517 U.S. 25 (1996). The case-by-case determination may be made by the Comptroller based on “substantial evidence” or by a court de novo. Before state consumer financial law may be found preempted, it must first be determined that there is an applicable federal standard to govern the conduct regulated by the preempted state consumer financial law.</li> <li>➢ State law is preempted by a federal law other than the NBA or HOLA.</li> </ul> </li> <li>■ Overturns Supreme Court’s <i>Watters</i> decision and eliminates NBA and HOLA preemption for operating subsidiaries.</li> <li>■ Restricts judicial deference to OCC preemption determinations.</li> <li>■ Codifies Supreme Court’s <i>Cuomo</i> decision allowing State Attorneys General to enforce non-preempted state laws against federally-chartered institutions, and in addition</li> </ul>	<ul style="list-style-type: none"> <li>■ NBA and HOLA preemption of state consumer protection laws under the Senate Bill mirrors the House provisions:               <ul style="list-style-type: none"> <li>➢ State attorney general may bring judicial action against federally-chartered institutions to enforce a rule of the CFPB after prior notice to the CFPB and the OCC.</li> <li>➢ Same substantive NBA and HOLA preemption standard as House bill except that a federal standards determination is not required for a state consumer financial law to be preempted by the NBA or HOLA; nor is a court required to make a de novo determination.</li> </ul> </li> <li>■ Visitorial powers provision adopts the <i>Cuomo</i> ruling by statute; state attorneys general may bring court actions to enforce applicable law against federally-chartered institutions; no provision made for parens patriae actions as</li> </ul>

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<p>empowers State Attorneys General –</p> <ul style="list-style-type: none"> <li>➤ To enforce any applicable <i>federal</i> law against a federally-chartered institution.</li> <li>➤ To bring actions against federally-chartered institutions on behalf of state residents seeking damages or other relief based on any applicable federal or state law.</li> </ul>	<p>in House bill, nor for explicit enforcement authority of federal law by state attorneys general against federally-chartered institutions.</p>

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Attorneys in Covington’s Financial Institutions Group advise a range of clients on recent financial services and banking developments. The Financial Institutions Group’s expertise derives from advising clients on the impact of such developments over the course of the past three decades. Please do not hesitate to contact any member of our Financial Institutions Group, including the undersigned, should you have any questions.

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