

## ADVISORY | Dodd-Frank Act

July 21, 2010

### BUREAU OF CONSUMER FINANCIAL PROTECTION

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). The Act will create a new Bureau of Consumer Financial Protection (CFPB).

Under the Act, the CFPB is tasked with implementing and enforcing Federal consumer financial law to ensure that consumers have access to markets for consumer financial products and services, and that such markets are “fair, transparent, and competitive.”

#### Statutory Authority of the CFPB

The Act establishes the CFPB within the Federal Reserve System as an independent bureau, headed by an independent director appointed by the President for a 5-year term. Generally, the CFPB would have authority to regulate the offering and provision of “consumer financial products or services” under Federal consumer financial laws.

- Under the Act, the CFPB is given broad regulatory, supervisory, and enforcement authority over “covered persons” and “service providers” with respect to both new consumer financial protection provisions and an array of existing Federal consumer financial protection laws and provisions that are to be transferred to the CFPB from existing Federal banking agencies.
- Consumer financial protection responsibilities transferred to the CFPB from Federal banking agencies include authority under:
  - The Electronic Funds Transfer Act
  - The Equal Credit Opportunity Act
  - The Fair Credit Reporting Act
  - The Fair Debt Collection Practices Act
  - The Home Mortgage Disclosure Act
  - The Real Estate Settlement Procedures Act
  - The Secure and Fair Enforcement for Mortgage Licensing Act
  - The Truth in Lending Act
  - The Truth in Savings Act

#### Scope of CFPB Authority

##### Entities and Activities Subject to CFPB Jurisdiction

- The CFPB has authority to regulate any person who engages in offering or providing a “consumer financial product or service,” or any affiliate service provider of such a person.

- Consumer financial products or services include:
  - Financial products or services that are “offered or provided for use by consumers primarily for personal, family, or household purposes.”
  - Certain financial products or services that are delivered, offered, or provided in connection with a consumer financial product—specifically, those related to extending credit and loan servicing, real estate settlement services, consumer reporting, and debt collection.
- “Consumers” include both individuals and agents, trustees, or representatives acting on behalf of individuals.
- Financial products or services subject to CFPB jurisdiction include:
  - Extending credit and servicing loans (broadly defined to include acquiring, purchasing, selling, brokering, and certain other extensions of credit).
  - Deposit-taking.
  - Acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer.
  - Leasing real or personal property on a non-operating basis.
  - Providing real estate settlement services.
  - Selling, providing, or issuing stored value or payment instruments.
  - Providing check cashing, check collection, or check guaranty services.
  - Providing payments or financial data processing products or services to any consumer by “any technological means,” including payments made through an online banking system or mobile telecommunications network.
  - Providing financial advisory services to consumers on individual financial matters or relating to proprietary financial products or services, including credit counseling, debt management, and avoiding foreclosure.
  - Collecting, analyzing, maintaining, or providing consumer financial report information or other account information, including credit history, for certain purposes related to consumer financial products and services.
  - Collecting debt related to a consumer financial product or service.
  - Other financial products or services “defined by the Bureau by regulation,” if the product or service is either (1) “entered into or conducted as a subterfuge” or “to evade any Federal consumer financial law,” or (2) is permissible for a bank or financial holding company to offer and will likely have a “material impact” on consumers.

#### **Limitations on CFPB Jurisdiction**

- Excluded from CFPB jurisdiction are the following entities and activities:
  - The business of insurance.
  - Electronic conduit services, including electronic data transmission, routing, intermediate or transient storage, or connections to a telecommunications system or network.
  - Persons regulated by state insurance regulators, but only to the extent those persons are acting in a regulated capacity.

- Persons registered with or regulated by the SEC or by a state securities commission, but only to the extent those persons are acting in a regulated capacity.
- Persons registered with or regulated by the CFTC, but only to the extent those persons are acting in a regulated capacity.
  - Both the SEC and CFTC must consult and coordinate with the CFPB on the passage of consumer protection rules regarding a “product or service that is the same type of product as, or that competes directly with, a consumer financial product or service” subject to CFPB jurisdiction.
- Accountants performing “customary and usual” accounting activities, tax preparers, and licensed attorneys.
- Employee benefit and compensation plans, except to the extent that the Secretary of the Treasury and Secretary of Labor request the CFPB, or approve a request by CFPB, to exercise rulemaking or to enforce a rule.
- Merchants, retailers, and sellers of non-financial products; real estate license holders; and retailers of manufactured or modular homes.
  - This exclusion does not apply to any credit transaction or collection of debt by a merchant, retailer, or seller, when such person is “engaged significantly” in offering or providing consumer financial products or services, and (1) the consumer debt is assigned, sold, or conveyed to another person, (2) the credit extended significantly exceeds the market value of the non-financial good or service, or (3) the credit is subject to a finance charge and the merchant regularly extends such credit to consumers.
  - Notwithstanding the limitations on this exclusion, certain “small businesses” with annual receipts or number of employees below certain thresholds are excluded from CFPB jurisdiction.
- Persons regulated by the Farm Credit Administration.
- Activities related to charitable contributions, including the solicitation or making of a voluntary contribution to a tax-exempt organization.
- Auto dealers with respect to the sale, servicing, and leasing of motor vehicles.
  - The auto dealer exclusion does not apply to dealers who (1) provide financial services related to residential or commercial mortgages, (2) operate a business to extend credit or leases involving motor vehicles in which the extension of credit is offered directly to consumers and is not routinely assigned to an unaffiliated third party, or (3) offer a financial product or service unrelated to the auto dealer business.
- The Act does not confer authority on the CFPB to impose a usury limit applicable to an extension of credit by a covered person to a consumer.

### Specific Powers of the CFPB: Rulemaking, Enforcement, and Examination

#### CFPB Authority Over “Very Large” Banks, Savings Associations, Credit Unions, and Their Respective Affiliates

- The CFPB has primary enforcement authority over “very large” insured depository institutions or insured credit unions, having total assets of more than \$10 billion, and their affiliates. Any Federal agency authorized to enforce a consumer financial protection law with respect to a “very large” institution is given backup enforcement authority.

- The CFPB has exclusive supervision authority, including examination authority, over these institutions and their affiliates to assess compliance with Federal consumer financial laws, obtain information about the institutions' activities and compliance systems and procedures, and to detect and assess risks to consumers and markets.
- Affiliates of a "very large" insured institution would be subject to CFPB enforcement and supervision to the same extent as the "very large" insured institution itself.
- A service provider to a "very large" insured depository institution (or an affiliate) is subject to the authority of the CFPB to the same extent as if the activities being performed by the service provider for such institution (or an affiliate) were performed by the depository institution (or its affiliate) itself.

#### **CFPB Authority Over Other Banks, Savings Associations, and Credit Unions**

- The CFPB is authorized to require reports from "other" insured depository institutions and insured credit unions with total assets equal to or less than \$10 billion. Such reports may be required as necessary to support the CFPB in implementing Federal consumer financial laws, supporting examination activities, and assessing and detecting risks to consumers and financial markets.
- The CFPB has limited examination authority with respect to these "other" institutions. Specifically, a CFPB examiner may be included on a sampling basis in the examinations performed by the institution's prudential regulator; the CFPB examiner's role is limited to assessing compliance with Federal consumer financial law.
- The prudential regulator has exclusive authority to enforce Federal consumer financial laws with respect to these "other" institutions, and unlike the affiliates of "very large" institutions, affiliates of these "other" institutions are not expressly subject to CFPB enforcement.
- A service provider that provides services to substantial numbers of "other" insured depository institutions is subject to the authority of the CFPB to the same extent as if the activities being performed by the service provider for such institutions were being performed by the institutions themselves.

#### **CFPB Authority Over Non-Depository Institutions**

- The Act authorizes the CFPB to supervise certain non-depository institutions, including:
  - Any covered person<sup>1</sup> who offers or provides (a) origination, brokerage, or servicing of certain loans secured by real estate, or (b) loan modification or foreclosure relief services in connection with such loans.
  - Any covered person who is a "larger participant" of a market for other consumer financial products or services (to be defined by CFPB regulation after consultation with the FTC).
  - Any covered person whom the CFPB has reasonable cause to determine is engaging or has engaged in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.
  - Any covered person who offers or provides any private education loan or any payday loan.
- The CFPB's authority over non-depository institutions includes the ability to require reports and conduct periodic examinations, but the extent of this supervision authority is made dependent on the CFPB's assessment of the risks posed to consumers by the non-depository institution, taking

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<sup>1</sup> The Act generally refers to "any person that engages in offering or providing a consumer financial product or service," and any affiliate service providers of such persons, as "covered persons."

into consideration the assets of the institution, volumes of transactions involving consumer financial products or services, the risks to consumers created by the institution’s provision of consumer financial products or services, the extent of State oversight, and any other factors determined to be relevant by the CFPB.

- The CFPB must coordinate this supervision authority with prudential regulators and State bank regulators to minimize the burden on non-depository institutions.
- The CFPB generally is given exclusive authority to enforce Federal consumer financial protection law with respect to covered non-depository institutions, but must “coordinate” its efforts with the FTC through an agreement to be negotiated between the CFPB and the FTC.
- The CFPB is given exclusive rulemaking and examination authority over covered non-depository institutions for purposes of assuring compliance with Federal consumer financial protection law and any regulations thereunder.
- A service provider to a covered non-depository institution is subject to CFPB authority to the same extent as if the activities being performed by the service provider for such non-depository institution were being performed by the non-depository institution itself.

### **Rulemaking Authority**

- The CFPB is given broad authority to prescribe rules and issue orders and guidance, in consultation with the appropriate prudential regulatory or other Federal agency, to carry out the CFPB’s regulatory responsibilities. In exercising its rulemaking authority, the CFPB is required to consider the benefits and costs of rules on covered persons and consumers, and the impact of proposed rules on covered persons and consumers in rural areas.
- In the event the CFPB and another agency are both authorized to issue regulations under a provision of Federal consumer financial protection law, the CFPB is given exclusive authority to prescribe rules. In addition, a court must afford deference to the CFPB regarding the meaning or interpretation of such Federal consumer financial protection laws, as if the CFPB were the only agency authorized to apply, enforce, interpret, or administer such laws.
- The CFPB is given authority to promulgate specific new rules:
  - Identifying any unlawful “unfair, deceptive, or abusive acts or practices” in connection with consumer transactions for consumer financial products or services. Under this authority, the CFPB may identify an act or practice as “unfair” only if it has a reasonable basis to conclude that (1) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers and (2) such injury is not outweighed by countervailing benefits to consumers or to competition. Likewise, the CFPB may only identify an act or practice as “abusive” if it (1) materially interferes with the ability of a consumer to understand a consumer financial product, or (2) takes unreasonable advantage of the consumer’s lack of understanding, inability to protect the consumer’s own interests in selecting or using the product or service, or the consumer’s reasonable reliance on a covered person under the Act to act in the consumer’s interest.
  - 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,” in order to permit consumers to understand the “costs, benefits, and risks” associated with the product or service.
  - Prohibiting or imposing conditions on the use of any agreement between covered persons and consumers providing for the arbitration of any future disputes.

- Identifying unlawful, unfair, deceptive, or abusive acts or practices in connection with reverse mortgage transactions or the offering of reverse mortgages.
- Regulations promulgated by the CFPB may be appealed by a Federal banking agency to the Financial Stability Oversight Council. The Council, upon a 2/3 vote, may issue a stay (postponing the effective date of a regulation) or a set aside (rendering the regulation unenforceable), if it finds that the regulation or provision would put the safety and soundness of the United States banking system or the stability of the financial system at risk.

### Monitoring and Registration of Certain Covered Persons

- The CFPB is authorized to monitor the offering or provision of consumer financial products or services, including market developments, for risks to consumers. To facilitate this monitoring, the CFPB may require covered persons (other than an insured depository institution, insured credit union, or related person<sup>2</sup>) to register with the CFPB.

### Funding of the CFPB

- The CFPB is to be funded by an annual transfer from the Federal Reserve in an amount the CFPB Director determines is reasonably necessary to carry out the authorities of the Bureau. The Act does not provide assessments as a source of funding for the CFPB.
  - The annual transfer to the CFPB is subject to a cap based on a percentage of the Federal Reserve System budget as reported in its 2009 Annual Report to the Board of Governors, adjusted annually based on the employment cost index for State and local government workers published by the Federal Government. This cap is set at 10% for 2011, 11% for 2012, and 12% for 2013 and thereafter.
  - The CFPB budget is not subject to review by the Appropriations Committees of the House or Senate, but the budget is subject to annual audit by the Government Accountability Office.
- Any civil money penalties collected by the CFPB are transferred to a separate “Consumer Financial Civil Penalty Fund,” which may be used to compensate victims of the activities for which the penalties were imposed, or in some cases for consumer education and financial literacy programs.
- In the event the CFPB Director determines that the funding of the CFPB will be insufficient to carry out the Bureau’s responsibilities, additional funding appropriations up to \$200 million may be authorized for each of the fiscal years 2010 through 2014.
  - Funds received from the CFPB through the annual transfer from the Federal Reserve are not subject to apportionment, but any additional amounts transferred pursuant to the appropriations process are subject to apportionment.

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<sup>2</sup> For this purpose, “related persons” include: any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for a covered person; any shareholder, consultant, joint venture partner, or other person who materially participates in the conduct of the covered person’s affairs; and any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any violation of any provision of law or regulation, or any breach of a fiduciary duty.

## National Bank Act (NBA) and Home Owners' Loan Act (HOLA) Preemption and OCC Visitorial Powers

### Scope of NBA and HOLA Preemption

- The Act restricts NBA and HOLA preemption of all state consumer financial laws to instances where one of the following requirements is met:
  - Application of a state law would have a “discriminatory effect” on federally-chartered institutions in comparison to state-chartered institutions.
  - A state consumer financial law “prevents or significantly interferes with the exercise by the national bank of its powers,” under the standard set forth by the Supreme Court of the United States in Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25 (1996).
    - This preemption determination may be made by a court. Such a determination may also be made by regulation or order of the Comptroller, on a case-by-case basis. The case-by-case determination must be made by the Comptroller based on “substantial evidence.”
    - A court reviewing a decision by the Comptroller is to assess the validity of the Comptroller’s ruling based on “the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant.”
  - A Federal law other than the NBA or HOLA preempts the state law.

### Elimination of Preemption for Operating Subsidiaries of Federally-Chartered Institutions

- The Act overturns the Supreme Court’s Watters decision by eliminating NBA and HOLA preemption for national bank and Federal thrift operating subsidiaries.

### Authority for State Attorneys General to Enforce Applicable Laws

- The Act codifies the Supreme Court’s Cuomo decision; State Attorneys General may enforce “an applicable law” against federally-chartered depository institutions. State Attorneys General also are authorized to bring civil actions against federally-chartered institutions to enforce regulations prescribed by the CFPB or to secure other remedies.

## Implementation Timeline

### Creation of the Agency

- The CFPB is established on the Act’s date of enactment.

### Transfer of Consumer Protection Authority to the CFPB

- Consumer financial protection functions will be transferred from various existing Federal financial regulatory agencies to the CFPB on the “designated transfer date.” The transferred consumer financial protection functions include significant rulemaking and examination authority previously allocated to a number of these other Federal regulatory agencies (transferor agencies).
- The “designated transfer date” is to be prescribed by the Secretary of the Treasury and shall be 180 days to 12 months after the Act’s date of enactment, unless the Secretary extends the

designated transfer date, in which case the date may not be later than 18 months after the date of enactment.

### Promulgation of Rules

- The CFPB, in consultation with the FTC, must define non-depository institutions subject to the authority of the CFPB as “covered persons” under the Act not later than one year after the designated transfer date.
  - As discussed above, the Act gives the CFPB, effective on the date of enactment, specific rulemaking authority that includes CFPB authority (i) to identify certain acts or practices in connection with transactions in or offerings of consumer financial products as unlawful, unfair, deceptive, or abusive, and (ii) to prescribe rules ensuring that the features of consumer financial products and services are fully, accurately, and effectively disclosed to consumers.
    - As also discussed above, the CFPB is given additional rulemaking authority under transferred “consumer financial protection functions,” previously exercised by transferor agencies, effective on the “designated transfer date.”
    - Rulings, orders, determinations, agreements, and resolutions relating to consumer financial protection, in effect before the “designated transfer date,” will remain in effect after such date. Only certain previously-enacted rules and orders identified by the CFPB will be enforced by the CFPB.
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If you would like to discuss the Act and our capabilities to assist you in the upcoming rulemaking process, please contact the following members of our firm:

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