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# The CFPB in Action: Consumer Bureau Harms Those It Claims to Protect

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**Abstract**
*The Consumer Financial Protection Bureau (CFPB) was created in 2010 by the Dodd–Frank Wall Street Reform and Consumer Protection Act, and imbued with unparalleled powers over virtually every consumer financial product and service. With rulemaking and enforcement now underway, there is ample evidence that agency operations represent a radical departure from long-standing regulatory standards. The CFPB's actions are constricting the availability of financial products and services and raising costs—all of which will undermine business investment and consumer credit. Immediate reforms are necessary to impose accountability on the bureau. Ultimately, the CFPB should be eliminated and replaced by coordinated oversight of various enforcement functions among other financial regulators.*

This paper, in its entirety, can be found at **http://report.heritage.org/bg2760**

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The new Consumer Financial Protection Bureau (CFPB), created by the Dodd–Frank Wall Street Reform and Consumer Protection Act, is living up to its billing as one of the most powerful—and unaccountable—federal agencies ever created.[1] After just 18 months—and with a staff exceeding 1,000 and funding of $600 million—the bureau is restructuring the mortgage market; devising restrictions on credit bureaus, education loans, overdraft policies, payday lenders, credit card plans and prepaid cards; and amassing unverified complaints with which to assail creditors and bankers. This inordinate control over consumer finance is constraining credit and harming the economy.

Prior to passage of Dodd–Frank, authority for some 50 rules and orders stemming from 18 consumer protection laws was divided among seven agencies.[2] Title X of the act consolidated this authority within the CFPB, while granting the agency unparalleled, radical powers over virtually every consumer financial product and service.

The bureau was designed to evade the checks and balances that apply to most other regulatory agencies. Its very structure invites expansive rulemaking,[3] as does its

## KEY POINTS

- The Consumer Financial Protection Bureau (CFPB), created by the Dodd–Frank act in 2010, is living up to its billing as one of the most powerful—and unaccountable—federal agencies ever created.
- The CFPB's regulatory standards are neither defined nor fixed, and thus arbitrary.
- The CFPB's rulemaking and enforcement actions are constraining credit and investment, and the CFPB is taking enforcement actions based on a supposition of future harm, rather than on specific violations of law.
- Consumer complaints naming specific companies are posted on the CFPB's website without any verification of the allegations.
- Thousands of pages of new rules and regulations will make mortgages more costly and harder to obtain for Americans.
- The best first step for reform would be outright elimination of the CFPB through repeal of Title X of the Dodd–Frank financial regulation statute.

misappropriation of the emergent theory of behavioral economics that drives bureau decision making. It deems consumers prone to financial irrationality and thus ill-equipped to act in their self-interest. Consequently, the CFPB is compelled to intervene in consumers' personal financial transactions.

Government interference in the financial market does not come without consequences. In the case of the CFPB, the rule of law is being supplanted by regulatory whim, producing deep uncertainty in the consumer financial market. And, the new regulatory strictures will increase consumers' costs and reduce consumers' choices of financial products and services.

Lawmakers must curtail the bureau's unconstrained powers. Outright elimination of the CFPB is the best option. Consumer protection can be advanced instead through better coordination among financial regulators. Proceeding toward bureau dissolution, bureau funding should be controlled by Congress, and the vague language of the CFPB's statutory mandate must be tightened to stop bureaucrats from defining—and expanding—their own powers.

## An Unaccountable Structure

The CFPB became operational on July 21, 2011, but was limited by statute to enforcing existing rules for banks and credit unions (with more than $10 billion in assets) until a director was confirmed by the Senate.

To launch the bureau, President Barack Obama appointed Elizabeth Warren[4] as a "special advisor." The President subsequently dispensed with the confirmation process required in the statute by appointing former Ohio attorney general Richard Cordray as director, claiming the action was a "recess appointment"—though the Senate was not in recess.[5] Bypassing the Senate confirmation process eliminated one of the very few means of bureau oversight held by Congress.[6]

With a director in place, the bureau is authorized to supervise "larger participants"[7] in nonbank services. The CFPB has identified six such services for regulation, including debt collection; consumer reporting; prepaid cards; debt relief; consumer credit; and money transmitting, check cashing, and related activities.

Reflecting the overly broad nature of its powers, the agency may also supervise *any* nonbank financial product or service that it considers to be a "risk" to consumers, or one engaging in "unfair, deceptive, or abusive practices."

Although established within the Federal Reserve System, the bureau operates independently, and with virtually no oversight.[8] CFPB funding is set by law at a fixed percentage of the Federal Reserve's operating budget. This budget independence limits congressional oversight of the agency, and its status within the Fed also precludes presidential oversight. Even the Federal Reserve is statutorily prohibited from "intervening" in bureau affairs.

As with much of Dodd–Frank, a panicked Congress empowered the

1. For example, Representative Spencer Bachus (R–AL), former chairman of the Committee on Financial Services, described the CFPB as "one of the most powerful and least accountable agencies in all of Washington." See News release, "Chairman Bachus Comments on Legal Challenge to Dodd–Frank Act," House Committee on Financial Services, June 21, 2012, http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=300403 (accessed January 10, 2012).
2. Those seven agencies are: the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, the Federal Trade Commission, and the Department of Housing and Urban Development.
3. Diane Katz, "CFPB Wields New Powers with Director," Heritage Foundation *WebMemo* No. 3476, January 30, 2012, http://thf_media.s3.amazonaws.com/2012/pdf/wm3476.pdf.
4. Warren reportedly pitched the idea of a consumer protection agency to then-Senator Barack Obama's office in early 2007. She outlined her regulatory goals in: Elizabeth Warren, "Unsafe at Any Rate," *Democracy*, No. 5 (Summer 2007), http://www.democracyjournal.org/5/6528.php?page=all (accessed January 10, 2013).
5. Proponents claimed that the President was forced to act after some Republicans threatened to block any nomination unless changes were made to the agency's structure.
6. A lawsuit challenging the appointment is pending in the U.S. District Court for the District of Columbia. A ruling against the Administration could jeopardize all rules and regulations promulgated during Cordray's tenure.
7. The official designation of all "larger participants" has not been finalized. In authorizing the bureau to define these "larger participants," Congress has allowed the agency to determine the parameters of its regulatory authority.
8. The bureau can only be overruled by the Financial Stability Oversight Council, composed of representatives from other financial regulatory agencies, if bureau actions would endanger the "safety and soundness of the United States banking system or the stability of the financial system of the United States." Any veto of bureau action would also require the approval of two-thirds of the council's 10-member board.

CFPB without a full understanding of the housing market collapse, the failure of major financial firms, and the resulting shock to the economy. In reality, most consumer financial products and services were not a major factor in the financial crisis. Indeed, many of the Dodd–Frank provisions have long ranked high on activists' wish lists, and the crisis provided a convenient opening to restrain the finance sector in a regulatory headlock.

## The CFPB's Abusive Standards

The bureau is empowered by statute to take action against "unfair, deceptive and abusive practices" in financial products and services. Legal standards for "unfair" and "deceptive" exist,[9] but the CFPB is not necessarily bound by prior interpretations. However, the concept of "abusive" is unfamiliar in regulatory law. As outlined in Title X, the bureau's authority to craft rules and enforce against "abusive" practices is particularly vague:

> The Bureau shall have no authority ... to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice
>
> - materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
> - 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 the interests of the consumer 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 interestsof the consumer.[10]

One must ask just how the CFPB is to determine consumer "ability" or the requisite degree of consumer "understanding" for a population of more than 300 million Americans using thousands of different financial products and services. Concerns about arbitrary enforcement are not assuaged by the testimony of the bureau director who told lawmakers that

> the term abusive in the statute is ... a little bit of a puzzle because it is a new term.... We have been looking at it, trying to understand it, and we have determined that that is going to have to be a fact and circumstances issue; it is not something we are likely to be able to define in the abstract. Probably not useful to try to define a term like that in the abstract; we are going to have to see what kind of situations may arise.[11]

Thus, the bureau intends to regulate virtually the entire financial sector without defined and fixed standards.

Predicating regulation on "consumer understanding" and "consumer interest" represents a "radical" departure from the duty of care long imposed upon banks, according to experts such as John D. Wright, chief regulatory counsel of Wells Fargo & Co.:

> This part of the Act introduces new more subjective standards that appear to require banks to conduct customer-specific inquiries by obtaining information about each customer's financial circumstances and needs, even for mass-marketed commodity products like checking accounts and credit cards.... A requirement for a suitability determination will add significant costs to the delivery of banking products and services, and will create incentives for banks to offer plain vanilla products with a limited menu of features.[12]

9. For example, the Federal Trade Commission Act was amended in 1938 to prohibit "unfair or deceptive acts or practices."
10. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Title X, Subtitle C—Specific Bureau Authorities, Section 1031(d), http://www.govtrack.us/congress/bills/111/hr4173/text (accessed January 14, 2013).
11. "How Will the CFPB Function Under Richard Cordray," transcript of hearing before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, Committee on Oversight and Government Reform, U.S. House of Representatives, January 24, 2012, http://oversight.house.gov/wp-content/uploads/2012/06/01-24-12-Subcommittee-on-TARP-Financial-Services-and-Bailouts-of-Public-and-Private-Programs-Hearing-Transcript.pdf (accessed January 11, 2013).
12. John D. Wright, "Dodd–Frank's 'Abusive' Standard: A Call for Certainty," University of California, Berkeley, Center for Law, Business and the Economy, 2011 Spring Symposium, http://www.law.berkeley.edu/files/bclbe/Dodd_Frank_Abusive_Standard_Paper.pdf (accessed January 11, 2013).

That appears to be precisely what bureau architects intended: force banks to act as advisors rather than expect consumers to determine which products and services will best meet their individual needs. It is the essence of the nanny state. It helps to explain why the bureau is asking consumers to reveal their "common money mistakes" so it may develop "better ways to help others avoid these mistakes in the future."[13]

## Risky Rules Replace the Rule of Law

Identifying the "risks" to consumers from financial products and services is listed in Title X as a primary function of the CFPB "[i]n order to support its rulemaking and other functions." The bureau sets regulatory policy based on "likely risks" associated with buying or using a financial product or service; consumers' "understanding" of such risks; and the extent, if any, to which the risks "may disproportionately affect traditionally underserved consumers."

The problem: There is no definition of "risk" in Title X. The CFPB is thus free to define its powers without the checks and balances that typically protect citizens from government overreach.

According to the bureau's 924-page *Supervision and Examina-tion Manual*, "Risk to consumers is the potential for consumers to suffer economic loss or other legally-cognizable injury (e.g., invasion of privacy) from a violation of Federal consumer financial law."[14] Bureau staff is directed to gauge this risk potential based on "the nature and structure of the products offered, the consumer segments to which such products are offered, the methods of selling the products, and methods of managing the delivery of the products or services and the ongoing relationship with the consumer."

In other words, the bureau will act based on a supposition of future harm rather than actual violation of the law.

Examiners are also expected to determine the likelihood that a supervised entity will not comply with federal consumer financial law, and forecast whether a firm's supposed risks will decrease, increase, or remain unchanged. But predictions are speculative, by definition, and have no place in a regulatory context. Rather than enforce fixed, objective regulatory standards, the bureau will customize criteria by which firms will be variably judged. Companies could be penalized for conduct that they had no reason to believe was improper. Just how such a system comports with traditional notions of due process remains to be seen.

## Heavy-Handed Supervision

The bureau's estimation of risk largely determines whether a financial firm is subjected to ongoing "supervision."[15] Supervision is no small matter. The bureau is empowered to require a firm to divulge documents and records, and submit to ongoing scrutiny of its entire framework of policies and practices. Bureau procedures also call for background checks of company officers, directors, and key personnel. Bonding requirements may be imposed. None of which is triggered by an actual violation of law. Indeed, the bureau may initiate supervision of any financial product or service if it has "reasonable cause to determine … that such [firm] is engaging, or has engaged, in conduct that poses risks to consumers."[16]

To date, the agency has designated "consumer reporting companies" that have $7 million or more in annual receipts as "larger participants." That represents about 30 credit bureaus (and related services), accounting for 94 percent of the annual receipts from the entire consumer reporting sector.[17] The bureau also has designated debt collectors with more than $10 million in annual

13. Barbara Mishkin, "CFPB Wants to Hear About Consumer Mistakes," CFPB *Monitor*, June 7, 2012, http://www.cfpbmonitor.com/2012/06/ (accessed January 1, 2013).
14. *CFPB Supervision and Examination Manual*, Version 2, October 2012, http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf (accessed January 11, 2013).
15. The CFPB describes supervision as "a comprehensive, ongoing process of pre-examination scoping and review of information, data analysis, on-site examinations, and regular communication with supervised entities and prudential regulators, as well as follow-up monitoring. For most depository institutions supervised by the CFPB, periodic examinations will be conducted. For the largest and most complex banks in the country, the agency has implemented a year-round supervision program that will be customized to reflect the consumer protection risk profile of the organization. The agency has implemented a risk-based nonbank supervision program that will include conducting individual examinations and may also include requiring reports from businesses to determine what businesses need greater focus." See CFPB, "Supervision," http://www.consumerfinance.gov/jobs/supervision/ (accessed January 11, 2013).
16. Title X—Bureau of Consumer Financial Protections, Sec. 1024. Supervision of Nondepository Covered Persons.
17. News release, "Consumer Financial Protection Bureau to Supervise Credit Reporting, CFPB, July 16, 2012, http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-to-superivse-credit-reporting/ (accessed January 11, 2013).

receipts as "larger participants." The estimated 175 firms that would exceed the threshold represent an estimated 63 percent of annual receipts in the market.[18]

This approach to risk-based supervision turns the rule of law on its head. The bureau will unilaterally decide what constitutes a risk and impose new burdens on a financial services firm—for conduct that may or may not be improper if practiced by a different service provider at any given time.

## Casting a Big Net

Since its inception, the bureau has launched dozens of investigations and issued more than 100 subpoenas demanding data, testimony from executives, and marketing materials amounting to millions of documents.[19] The bureau is *not* required to possess evidence of wrongdoing before initiating a probe.

The CFPB opens an investigation by issuing a Civil Investigative Demand (CID), which is a form of subpoena, to require testimony, documents, and responses to written questions. While the investigation itself is nonpublic, a petition to modify or set aside the CID will be made public by the CFPB.[20]

A CID recipient has only 10 days to confer with bureau staff if it intends to seek modification of a subpoena. As noted by the law firm of Venable LLP, that is hardly sufficient time to assemble a legal team, evaluate the CID, consult with relevant IT and business personnel, and craft a response.[21]

CID recipients may have counsel present for on-the-record testimony before the bureau, but the opportunity for counsel to make objections is limited.[22]

A petition to modify or set aside any of the investigative demands must be submitted within 20 days of receiving the CID.

CFPB staff may confer in secret, but the decision on a petition to modify a CID rests solely with the director. The rules contain no provision for judicial appeal of the director's decision.[23] A firm's only alternative is to refuse to abide by the CID and raise objections before a judge after the bureau seeks a court order to enforce its demands.

## Unverified Data Drive Policy

CFPB officials tout the bureau as a "data-driven" agency.[24] They emphasize that bureau policies and priorities are based on research and analyses of financial products and services, with particular emphasis on discerning "risk to consumers."[25] Measuring various aspects of a market may be beneficial, of course. But not all data collection leads to credible conclusions. Nor does data, in and of itself, determine sound policy.

Consider the CFPB's use of complaint "data," which officials identify as the "start and end" of the bureau's rulemaking and enforcement,[26] and which Cordray has called the agency's "lifeline."[27] Staff has been instructed to utilize complaint data as "indications of potential regulatory violations, including unfair, deceptive, or abusive acts or practices."[28]

The CFPB initially solicited consumer complaints about credit cards. The collection of mortgage complaints was launched last December,

18. Ibid.
19. Associated Press, "A Look at Some of the Ways the Consumer Financial Protection Bureau Enforces the Law," September 12, 2012.
20. Jonathan L. Pompan and Alexandra Megaris, "What to Expect When You're Under a CFPB Investigation—Negotiating the Scope of the CID," Venable LLP, October 1, 2012, http://www.mondaq.com/unitedstates/x/199248/Consumer+Trading+Unfair+Trading/What+To+Expect+When+Youre+Under+A+CFPB+Investigation+Negotiating+The+Scope+Of+The+CID (accessed January 11, 2013).
21. Ibid.
22. Ibid.
23. Loeb & Loeb Financial Reform Task Force, "CFPB Announces Rules Governing Investigations," CFPB *Alert*, August 2012, http://www.loeb.com/files/Publication/75d89162-5207-4b24-9d22-8185396ed0a0/Presentation/PublicationAttachment/2e238460-8c8a-4f93-9b56-1314a8b53ae2/CFPB%20Announces%20Rules%20Governing%20Investigations%20-%20August%202012.pdf (accessed January 11, 2013).
24. News release, "CFPB Unveils Credit Card Complaint Database," Consumer Bankers Association, June 22, 2012, http://www.cbanet.org/Advocacy/CFPB%20Resource%20Center/2012/06222012_CFPB_Report.aspx (accessed January 11, 2013).
25. News release, "Consumer Financial Protection Bureau Releases Report Showcasing 2012 Highlights," CFPB, July 30, 2012, http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-releases-report-showcasing-2012-highlights/ (accessed January 11, 2013).
26. Title X, Subtitle A—Bureau of Consumer Financial Protection, Sec. 1013.
27. Kate Davidson, "Trying to Stay Above Politics: A Conversation with Richard Cordray," American Banker, March 23, 2012, http://www.americanbanker.com/issues/177_58/cordray-cfpb-supervision-enforcement-consumers-UDAAP-UDAP-1047798-1.html (accessed January 11, 2013).
28. CFPB, *Supervision and Examination Manual*, Examinations 3, October 2011, http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/supervision_examination_manual_11211.pdf (accessed January 11, 2013).

followed by complaints about checking accounts, savings accounts, CDs, and student loans in March.

Each complaint is catalogued on the agency's website, including the name of the accused, the nature of the alleged offense, the date of the complaint, and the zip code of the complainant (whose identity is not revealed). In addition to providing public access to this raw data, the bureau reports the complaints to various federal and state regulatory agencies, and also issues periodic reports.

For all the consequential uses to which the data is put, however, the complaint data is *not* verified.[29] The CFPB is crafting regulations and commencing supervision and enforcement actions based, in part, on consumer allegations that are never checked for accuracy.

There is also no way to determine whether a complaint relates to dissatisfaction with or misunderstanding of legitimate terms of service—as opposed to actual wrongdoing. The system relies on individuals to categorize their complaints, but the limited number of broad categories invites mischaracterization. Nor is there any way to distinguish whether a complaint is made because a company failed to offer an adequate remedy to the customer, or the customer simply rejected a reasonable response.

Moreover, the database lacks statistical validity. The manner of reporting does not ensure that the complaints represent the experiences of the population as a whole. Consequently, any of the policies derived from the data are not applicable to the general population.

The complaint data also lacks context. The bureau reports the total number of complaints by type, but gives no indication of the size of the market. For example, a total of 23,400 credit card complaints have been submitted to the bureau (as of September 30, 2012),[30] but there are 383 million credit card accounts.

Thus, the complaints only represent 6 percent of credit card customers.

Such a system exposes financial firms to unwarranted reputational harm and lawsuits. For example, the aggregation of unverified complaints by zip code may expose firms to claims of lending discrimination or "disparate impact"—which CFPB officials have pledged to aggressively pursue.[31] Congress authorized creation of a complaint database, but set no data quality standards. Perhaps lawmakers assumed the CFPB would manage the data in a more responsible fashion.

## A Rush of Rulemaking

The bureau's authority to prescribe rules and regulations is vast. Title X even instructs the judiciary to grant ultimate deference to the CFPB in the event of territorial squabbles over financial regulations among various regulatory agencies.[32]

As of this writing, the CFPB has issued 21 final rules. Three of those directly regulate financial products and services; nine establish enforcement and supervision procedures; six adjust thresholds for regulations; two make corrections; and one delays implementation of a rule. Another seven rules are pending. The bureau also has solicited comment on education loans, overdraft programs, payday loans, credit card plans, and prepaid cards—all of which will lay the groundwork for rulemaking.

Six pending rules relate to an overhaul of mortgage lending. Until they are finalized, however, the housing market is plagued by uncertainty. Confusion also reigns. For example, the bureau has proposed multiple changes to "Regulation Z" (Truth in Lending Act). However, the bureau has not assembled all the various amendments into a single document. Some of the proposals even conflict. As noted by the National Association of Federal Credit Unions, in a comment letter with 15 other trade associations: "These proposals cross-reference provisions in each other, making it difficult to tell what each references and what Regulation Z

29. The CFPB Consumer Complaint Database states: "We do not verify the accuracy of all facts alleged in these complaints, but we do take steps to confirm a commercial relationship between the consumer and the identified company." See CFPB, Consumer Complaint Database, http://www.consumerfinance.gov/complaintdatabase/ (accessed January 11, 2013).

30. CFPB, "Consumer Response: A Snapshot of Complaints Received," October 10, 2012, http://files.consumerfinance.gov/f/201210_cfpb_consumer_response_september-30-snapshot.pdf (accessed January 11, 2013).

31. CFPB Bulletin 2012–04 declared that the bureau will pursue actions against lenders even if discrimination is unintentional. The bureau is also required to examine the diversity policies and practices of firms, and financial institutions are required to track and report on credit applications made by women and minority-owned businesses and by small businesses.

32. Title X—Bureau of Consumer Financial Protections, Sec. 1022. Rulemaking Authority.

33. Steve Van Beek, "Joint Comment Letter to CFPB: Drop Proposed Change to APR; Where is Full Reg Z?" National Association of Federal Credit Unions Compliance Blog, September 14, 2012, http://nafcucomplianceblog.typepad.com/nafcu_weblog/2012/09/nafcu-comment-letter-to-cfpb-drop-proposed-change-apr-where-is-full-reg-z.html (accessed January 11, 2013).

would look like if all of these proposals are finalized."[33]

A review of some of the bureau's actions to date exposes alarming regulatory excess:

**Mortgage Lending.** Mortgage "simplification" is one of the 400-plus regulatory requirements called for in the 2,300-page Dodd–Frank act. But many of the more confounding complexities in the credit world are a result of legislative and judicial dictates rather than private-sector fine print.

The Dodd–Frank act requires the bureau to devise an "integrated" form to disclose the terms of a mortgage application (the Loan Estimate) and mortgage closing (the Closing Disclosure).

To that end, the CFPB has released a proposal for a more "consumer friendly" mortgage process. The previous loan form had been five pages long; the new one proposed is three. The proposed closing form remains at five pages. But the agency's proposed requirements to implement the new forms and related rules run 1,099 pages.

Once finalized, the new forms will entail major changes to lenders' operations, including revising forms, IT systems, and policies. The CFPB estimates the costs of new software and employee training to be $100 million. The pending reform ranks as lenders' greatest compliance concern, with 48 percent citing it as a "high" concern and an additional 33 percent citing it as a "medium" concern, according to the annual survey by QuestSoft, a regulatory consultancy.[34] "Factor in the CFPB's position that consumers who do not receive proper disclosure should have the right to walk away from a loan, and it is no surprise that disclosure compliance is the top concern," said QuestSoft President Leonard Ryan.[35]

Redesigning the mortgage documents apparently required the assistance of Kleimann Communication Group, Inc., a self-described "small, agile, woman-owned" business, at a cost to taxpayers of nearly $900,000. The Kleimann Group performed "qualitative testing" of various loan formats with 92 consumers and 22 lenders in Baltimore; Los Angeles; Chicago; Albuquerque; Des Moines; Philadelphia; Austin, Texas; Springfield, Massachusetts; and Birmingham, Alabama.

According to the bureau, both forms have been designed to "reduce cognitive burden." The 533-page chronicle of the bureau's feat—"Know Before You Owe: Evolution of the Integrated TILA–RESPA Disclosures"—includes insights such as, "We found the most effective way to reduce confusion surrounding the APR [annual percentage rate] was to clarify that it was not the interest rate by adding the simple statement: 'This is not your interest rate.'"[36]

Rather than empower consumers through disclosure, the bureau has taken the position that "too much information has the potential to detract from consumers' decision-making processes."

Of particular concern is the bureau's treatment of the annual percentage rate (APR), which many borrowers use to compare loan costs. The APR, as a single percentage figure, represents the actual yearly cost of the loan over its entire term. It includes the interest rate, as well as other fees associated with the transaction, such as mortgage insurance, processing fees, and discount points.

The APR has long been prominent on government-mandated disclosure documents. This time around, the bureau's proposed rules relegate the APR to the last page, but added additional costs to the calculation without direction to do so from Congress. Consequently, the APR will be larger. But that could pose major problems for consumers. Higher-cost APR loans are subject to additional rules under the Home Owners Equity Protection Act (HOEPA) as well as some state laws.[37]

The new regulations also prohibit balloon payments, i.e., smaller mortgage payments every month, followed by a single, one-time payoff at the end of the loan. Late fees also are capped, which will likely prompt lenders to vigorously enforce payment deadlines and use of collection agencies. The bureau also is restricting loan-modification fees, which will likely limit lenders' options for customizing loans.

In sum, the bureau's notion of "improving outcomes" will likely result in fewer mortgage options for consumers and higher borrowing costs.

34. News release, "TILA/GFE Reform, Fair Lending and RESPA Tolerances Rank as Mortgage Lenders' Greatest Compliance Concerns," QuestSoft, April 17, 2012, http://www.questsoft.com/downloads/QuestSoft_PR_Compliance_Concerns_12-0417.pdf (accessed January 11, 2013).

35. Ibid.

36. Kleimann Communication Group, Inc., "Know Before You Owe: Evolution of the Integrated TILA–RESPA Disclosures," July 9, 2012, http://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf (accessed January 14, 2013).

37. Letter to the CFPB from the Consumer Mortgage Coalition, the Mortgage Bankers Association, and the Community Mortgage Banking Project, September 7, 2012, http://www.housingwire.com/sites/default/files/editorial/respatila090712.pdf (accessed January 11, 2013).

**Mortgage Servicing.** The bureau has issued more than 560 pages of proposed rules for mortgage servicing, which encompasses the collection of mortgage payments, maintenance of escrow accounts, loan modifications, and foreclosures, among other functions. Many of the provisions would micromanage the timing, content, and format of various disclosures.

The proposed rules coincide with provisions of a settlement between states and the five largest mortgage-servicing banks that had been accused of mistreating borrowers. Bureau officials are hyping the proposed regulations as the solution to the wave of foreclosures in recent years.[38] Lenders will indeed face more requirements in processing a foreclosure, but that won't save borrowers who, for a multitude of reasons, cannot afford their payments. It will make mortgage servicing more time-consuming and costly.

The burden of such rules would fall disproportionately upon community banks, which have far fewer resources to reconfigure services. To the extent that the CFPB's regulatory onslaught overwhelms small banks, their larger brethren will benefit—becoming all the more powerful as community banks close. That is the very outcome that Dodd–Frank supposedly was enacted to prevent.

Of particular concern are the proposed obligations on servicers' dealings with a delinquent borrower. The bureau seems to think it is the responsibility of servicers to rescue such borrowers from their predicament. For example, servicers would be required to inform borrowers about financial "counseling," while also being prohibited from initiating a foreclosure sale until the delinquent borrower has exhausted his or her options and appeals.

Another proposal would prohibit servicers from obtaining "forced-place" insurance upon a finding that the borrower has failed to maintain property insurance as required. Instead, servicers would be required to give borrowers two opportunities to produce proof of insurance over 45 days before charging for insurance, as well as provide advance notice and pricing information to the borrowers and allow them to obtain their own replacement insurance. In other words, borrowers who have violated the conditions of their mortgage by failing to maintain home insurance must be given a second chance (or third or fourth) to honor the terms of their mortgage agreement.

Such requirements effectively rob lenders of control over the loans they make. It is no wonder, then, that more banks are exiting the mortgage-service business.

**Qualified Mortgage.** Of enormous consequence to the fate of the housing market is how the bureau defines a "qualified mortgage." The definition is central to a provision of Dodd–Frank that requires lenders to determine a borrower's "ability to repay" any loan "secured by a dwelling." Once finalized as a rule, the qualified mortgage will act as the standard for loan terms that lenders can reasonably expect a borrower to repay. Billions of dollars in loans and millions of mortgages are on the line.

Too broad a definition would expose lenders to costly litigation from borrowers who default. But an overly stringent standard would make it much harder for consumers to secure a mortgage and thus jeopardize the fragile housing market.

Under this "ability to repay" regime, the lender—not the borrower—can be blamed for a loan default. Dodd-Frank allows homeowners to sue lenders if they cannot make their payments and face foreclosure. Such standards effectively require banks to act as personal advisers or intermediaries despite long-held legal precedent that they are not fiduciaries in retail banking.

How does a lender guarantee that a customer understands the terms of a loan? Will there be a test? And, in the event a bank deems customers' understanding as deficient, is that bank at risk of violating fair lending laws? CFPB officials have emphasized that they will aggressively monitor firms to ensure that financial products and services are available to various racial, ethnic, and gender groups in direct proportion to their share of the population. Thus, lenders are trapped in a Catch-22: To abide by the "ability to repay" rule could mean not meeting the race and gender quotas, or vice versa.

Disclosure and clarity-of-loan terms are important, of course. But rather than simply assist consumers in understanding the terms of service for financial products, the bureau is effectively controlling the type of loans available.

**Prepaid Cards.** General purpose reloadable cards (GPRs), have

38. In a press release announcing the proposed regulations, for example, Cordray claimed the new rules would prevent foreclosures. "Millions of homeowners are struggling to pay their mortgages, often through no fault of their own," he said. "These proposed rules would offer consumers basic protections and put the 'service' back into mortgage servicing. The goal is to prevent mortgage servicers from giving their customers unwelcome surprises and runarounds." News release, "Consumer Financial Protection Bureau Proposes Rules to Protect Mortgage Borrowers," CFPB, August 10, 2012, http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-proposes-rules-to-protect-mortgage-borrowers/ (accessed January 11, 2013).

exploded in popularity. According to one recent study, the amount consumers loaded onto the cards will increase from $28.6 billion in 2009 to $201.9 billion in 2013.[39] Consumers obviously find the cards useful.

One would not know it from the stance of CFPB officials, who are eager to impose the same degree of regulation that has made checking accounts and credit cards more costly—and induced consumers to turn to prepaid cards. In its notice of proposed rulemaking, the CFPB claims to be "particularly interested in learning more about this product." Yet even before "learning more," the bureau has already decided to propose new regulations,[40] which would impose many of the same requirements on prepaid cards that currently apply to credit cards—which would raise costs.

Prepaid cards are available with a variety of terms and fees that vary by issuer. Those options are beneficial to consumers—and particularly so to the "unbanked" and "underbanked" users who heavily rely on the cards. To the extent that regulators impose service conditions and requirements, fewer firms will offer the cards, while the cost of those that remain will rise. Innovation of this nascent product will be inhibited, as well. Indeed, the bureau also intends to regulate mobile devices that access consumer accounts—a grossly overbroad use of its powers.

## Steps for Congress

The best option going forward would be outright elimination of the CFPB through repeal of Title X of the Dodd–Frank financial regulation statute. This does not mean returning to the old regulatory model, whereby different agencies applied different standards to similar products and services. Instead, a council representing the various financial agencies—staffed and paid for without new spending—could conduct coordinated oversight of various enforcement actions to ensure universal coverage.[41] Immediate relief requires the following reforms:

- **Abolish the CFPB'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 bureau 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 services, and the bureau should not have discretion to define its own powers.

- **Specifically require the CFPB 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.

- **Prohibit public release of unconfirmed complaint data.** The publication of mere accusations can subject businesses to undeserved reputational harm and unnecessary litigation.

- **Abolish the inordinate deference in judicial review granted to the CFPB.** The Dodd–Frank statute instructs judges to defer to the bureau's regulatory decisions as if it "were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law." However, judicial scrutiny is a necessary check on the CFPB's otherwise unconstrained powers.

- **Require the CFPB to obtain approval for all major rulemakings from the Office of Information and Regulatory Affairs.** Such oversight would increase agency transparency and accountability.

## Conclusion

The current structure of the CFPB, with its lack of accountability and absence of oversight, invites regulatory excess. Along with its unparalleled powers and approach to regulation and enforcement, the bureau's actions can be expected to chill the

39. Pew Charitable Trusts, "Loaded with Uncertainty: Are Prepaid Cards a Smart Alternative to Checking Accounts?" September 2012, http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Prepaid_Checking_report.pdf (accessed January 11, 2013).

40. "Electronic Fund Transfers (Regulation E)," *Federal Register*, Vol. 77, No. 101, May 24, 2012, p. 30923, http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0019-0001 (accessed January 11, 2013).

41. David C. John, "How to Protect Consumers in the Financial Marketplace: An Alternate Approach," Heritage Foundation *Backgrounder* No. 2314, September 8, 2009, http://s3.amazonaws.com/thf_media/2009/pdf/bg2314.pdf.

availability of financial products and services. The CFPB's paternalistic view of consumers also means fewer choices and higher costs for credit. This will undoubtedly leave families and entrepreneurs without customized options with which to invest and build wealth.

Consumer protection against fraud and other misdeeds is certainly necessary, but the bureau is on a regulatory tear that extends well beyond what is reasonable. The obvious two questions to consider are: (1) Can consumers expect the federal government—with a national debt of $16 trillion—to do a better job of managing individuals' finances than the individuals who know their own circumstances and preferences? They cannot. (2) Are regulators any less "biased" than consumers in their financial preferences? They are not.

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