THIRD WAY

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What's Going On at the CFPB?

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Introduction

In a previous paper, Third Way highlighted the fourteen most significant reforms included in the Dodd-Frank Act. One of those reforms was the creation of the Consumer Financial Protection Bureau, or CFPB. On March 3, CFPB Director Richard Cordray is making his semi-annual visit to the House Financial Services Committee. We thought it would be a good time to take a look at what CFPB has been up to lately.

CFPB was one of the more controversial aspects of Dodd-Frank. In wake of the financial crisis, Democrats felt a consumer finance agency was an essential component of any reform measure for consumer protection – from payday lending and reverse mortgages to credit cards and home loans. For the most part, Republicans opposed the creation of a consumer finance agency, arguing it would be redundant and an unchecked, unaccountable regulatory power.

As Dodd-Frank approached a final vote, some Democrats feared that inclusion of the CFPB would sink the entire bill. There was talk of jettisoning the provision in favor of a less powerful consumer advisory board. But in the end, Senator

Chris Dodd and Rep. Barney Frank were able to secure majorities (in the case of the Senate, a 60-vote majority) and pass the bill with CFPB.

CFPB: A Cop on the Consumer Beat

Prior to Dodd-Frank, a patchwork strategy of consumer protections existed for mortgages and other consumer financial products. Consumer protection law enforcement was in the hands of multiple regulators. A bank's primary regulator would examine the bank for safety and soundness, and would also be responsible for enforcing consumer protection laws. This presented a conflict and led to inconsistent (or non-existent) enforcement of consumer protection laws.

The conflict was due to the fact that safety and soundness examinations focus on a bank's profitability and the likelihood that the bank will fail. But consumer protection laws have a completely different focus. For example, to be in compliance with the Truth in Lending Act (TILA), a lender needs to properly disclose loan terms to a borrower and worries little about bank profitability standards. Pre-Dodd-Frank, TILA responsibility fell to the Federal Reserve Board as, arguably, a minor part of its portfolio. That is to say, there was no agency in the federal government in which the director woke up each morning and asked, "How do I protect finance consumers?"

To enhance and simplify consumer protection, Dodd-Frank consolidates enforcement laws into a single point of authority wholly focused on protecting consumers—the CFPB. The CFPB has a very broad consumer mandate. It is not just about protecting consumers in the mortgage, credit card, and bank-lending markets. Dodd-Frank gives the CFPB the ability to enforce consumer protection laws in the non-bank consumer lending markets as well. This includes payday lenders, student loan lenders, and even debt collectors could conceivably come under the watchful eye of the CFPB.

CFPB was controversial during consideration of Dodd-Frank, and it remains controversial to this day. As a result, policymakers are still struggling to parse out the right balance between the Bureau's independence (i.e. insulation from political pressures) and Congress' ability to hold the Bureau accountable for its actions. Critics worry the CFPB has unprecedented power and believe its structure makes it unconstitutional. [1] Supporters think the CFPB deserves more resources to effectively accomplish its mission of protecting consumers.

What's been going on at the CFPB

Since its creation in 2011, CFPB has been very active. Below is a snapshot of some of the Bureau's recent activities.

Qualified Mortgage (QM) Rule Relaxation

In January 2015, the CFPB relaxed some of its rulemakings so more small and rural lenders can retain their "small-creditor" status and make more qualified mortgages. The qualified mortgage rule requires lenders to make a good faith determination that borrowers can afford to pay back their loans. Under the recent change, the CFPB would raise the "small-creditor" loan origination limit (meaning the amount of loans a single lender can issue at any given time) from 500 to 2,000. The rule also would exclude loans from this limit as long as the lenders hold the loans in-house on their portfolios, as opposed to selling them off.

To some, the loan limit increase is a signal of CFPB's willingness to monitor and adjust regulations based on market reaction. Given this flexibility from the CFPB, this also provides Members of Congress an opportunity to weigh in and challenge the CFPB for changes to regulations outside of this recent change to qualified mortgages.

Pending Rulemakings on Debt Collection and Payday Lenders

The CFPB will soon propose several highly anticipated regulations including restrictions on how debt collectors handle disputes—a first at the federal level. There are many questions about who will fall within the scope of these regulations: banks and other original creditors collecting for themselves, third-party debt collectors, and others.

CFPB is also planning to issue rules for payday lending, which are generally very short-term loans with very high interest rates. According to Pew, the average loan size is $375 (with fees averaging $55 per loan and the average borrowers spending $520 on interest per year). [2] Research shows that average borrowers have a credit score in the low 500s and earn around $30,000 per year. Another report by Pew found that 12 million individuals spend more than $7 billion per year on payday loans, half of whom take out loans within a sequence of more than 10 loans. The payday industry is worried that any changes to the current regulatory patchwork at the state-level will significantly reshape the payday lending market threatening its existence altogether. One likely change the CFPB is considering setting is an ability-to-repay standard that will shift the market toward installment loans.

Also on the radar are regulations concerning overdraft protection likely to come out in the summer and disclosure requirements for prepaid cards expected to follow next year.

Mortgage Servicing Rules and Enforcement

Last year, the CFPB finalized mortgage servicing rules, but to the surprise of mortgage servicers, the Bureau decided to immediately revise those rules. Those revisions are close to being finalized. To supporters of CFPB, this serves as another example of their commitment to adjusting rules as they see how the market responds. To detractors, it's another example of overly burdensome rules that weren't given enough thought before being implemented.

Furthermore, mortgage servicers were shaken by the CFPB's September 2014 citation of Flagstar Bank for violating the new mortgage servicing rules. [3] The dollar amount of the fine wasn't as newsworthy as was the fact that the violation was for activities dating back to 2011, before CFPB issued the rules.

Conclusion

The debate over CFPB continues to fall on predictable partisan lines: too much authority or too little authority? Redundant regulatory power or unique regulatory power? Punishing the private sector or guiding the private sector? And ultimately, limiting consumer choice or limiting consumer damage?

With any new agency there are bound to be growing pains. Insofar as voters know about CFPB, they like it. [4] They know financial institutions are complicated and they fear there are enough bad actors that a watchdog is warranted. Nonetheless, we expect the fight over CFPB and its merits to continue.

We hope this short explainer helped to illuminate these arguments.

END NOTES

1. In fact, just last year a California federal court heard a case on exactly this issue—the structure of CFPB being unconstitutional. The case was struck down. See "CA federal court rejects challenge to CFPB's constitutionality," *CFPB* Monitor, January 15, 2014. Accessed February 27, 2015. Available at: http://www.cfpbmonitor.com/2014/01/15/ca-federal-court-rejects-challenge-to-cfpbs-constitutionality/.

2. Nick Bourke, Alex Horwitz, and Tara Roche, "Payday Lending in America: Who Borrows, Where They Borrow, and Why," Report, Pew Charitable Trusts, July 2012. Accessed February 27, 2015. Available at: http://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why.

3. Rachel Witkowski, "CFPB Plans Packed Agenda for 2015," *American Banker*, January 2, 2015. Accessed February 27, 2015. Available at: http://www.americanbanker.com/news/law-regulation/cfpb-plans-packed-agenda-for-2015-1071985-1.html?zkPrintable=1&nopagination=1.

4. "CFPB: Regulation done right," *The Hill*, January 2, 2014. Accessed March 1, 2015. Available at: http://thehill.com/blogs/congress-blog/economy-budget/194277-cfpb-regulation-done-right.