Consumer Protection Provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act includes two titles that will profoundly affect consumer lending in the United States and increase government scrutiny of providers of consumer financial services. Title X of the Act — known as the Consumer Financial Protection Act of 2010 — creates a new Bureau of Consumer Financial Protection (the "Bureau") and endows it with wide-ranging authority to issue new regulations, supervise institutions, enforce consumer financial services laws and regulations, analyze data from institutions through significant new data collection and reporting obligations, and otherwise prevent "abusive" conduct by lenders and other financial service firms. Title XIV — known as the Mortgage Reform and Anti-Predatory Lending Act — prohibits or restricts many previously common mortgage lending practices and limits a lender's ability to compensate loan officers and brokers. The Dodd-Frank Act also expands the role of state regulators over federally chartered institutions. In all, the Dodd-Frank Act will significantly limit lender practices and will substantially increase the risk that lenders and other financial service providers will face investigations and enforcement actions alleging discriminatory or abusive conduct affecting consumers.

In Part I of this article, we describe the key provisions of Title X and Title XIV. In Part II, we explore the business and policy implications of those provisions.

I. Key Provisions

The two most significant features of Title X are: (i) the creation of the Bureau, which is charged with the sole mission of regulating consumer financial products and services, and (ii) the expansion of state authority to regulate consumer financial services and enforce federal consumer financial services laws. It also enacts a number of "regulatory improvements." Title XIV prohibits or restricts a number of loan features or practices that Congress determined to have been abusive. Under the new provisions, mortgage loans that meet a number of stringent "plain-vanilla" criteria will be deemed "qualified mortgages," and "non-qualified mortgages" will be strongly disincentivized. Substantive changes also include modifications to the rules for mortgage appraisers, expansion of the definition of a "high-cost" loan, and provisions for increased counseling for borrowers, including through the creation of a new "Office of Housing Counseling." Title XIV also mandates a number of studies that could lead to new regulations, enforcement actions, or additional legislation. Finally, both Titles significantly increase reporting requirements for lenders and implement a number of provisions that will increase fair lending and unfair or deceptive act or practice ("UDAP") risk.

The Bureau of Consumer Financial Protection

The Bureau will be a new federal consumer financial regulator with broad rulemaking, supervisory and enforcement powers. The Bureau will be headed by a director appointed by the President to a five-year term, subject to confirmation by the Senate, and will consist of several different functional units.[1]

[1] Act §§ 1011-1013.

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- The Research Unit will analyze trends in the provision of consumer financial products.
- The Community Affairs Unit will focus on educating consumers about consumer financial products and ensuring broad access to financial products.
- The Complaints Unit will maintain a website and toll-free number to centralize collection and monitoring of consumer complaints regarding consumer financial products and services, and will route complaints to other federal and state agencies where appropriate.

The Act establishes several offices within the Bureau:

- The Office of Fair Lending and Equal Opportunity will enforce federal laws relating to fair lending, which the Act defines as "fair, equitable, and nondiscriminatory access to credit for consumers."[2]
- The Office of Financial Education will develop programs to improve consumers' financial literacy and familiarity with consumer financial products.[3]
- The Office of Service Member Affairs will focus on issues relevant to service members, such as the Servicemembers Civil Relief Act.[4]

The Act also establishes two bodies to advise and interact with the Bureau:

- The Financial Stability Oversight Council, comprised of senior government officials, has broad powers to identify and respond to threats to the stability of the banking and financial systems, including the power to set aside any regulation of the Bureau that it determines to be such a threat.[5] See "Key Measures to Address Systemic Risk."
- The Director is required to establish a Consumer Advisory Board comprised of experts in fields such as consumer protection, fair lending and financial services, which will consult with the Bureau on the exercise of its functions and advise it of emerging national and regional trends in the consumer financial products or services industry.[6]

Independence of the Bureau. Although the Bureau will be housed within the Federal Reserve, the Act prohibits the Federal Reserve from intervening in any matter before the director (including enforcement actions and examinations), exercising any appointment or removal powers over Bureau employees, and merging or consolidating any powers of the Bureau with those of divisions or offices of the Federal Reserve and its member banks. The Federal Reserve also is prohibited from exercising approval power over, delaying or preventing the Bureau's issuing of any rule or order.[7]

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[2] Act § 1013(c).

[3] Act § 1013(d).

[4] Act § 1013(e).

[5] Act §§ 111 & 1023.

[6] Act § 1014.

[7] Act §§ 1011 & 1012.

Funding. The Bureau is funded through the budget of the Federal Reserve System based on an amount determined by the director (with several restrictions on the amount the director may request). We expect that the Bureau will be well funded, and the Act authorizes use of those funds to hire a substantial staff of lawyers, economists and examiners.[8]

Purpose and Functions of the Bureau. The purpose of the Bureau is to "seek to implement and, where applicable, enforce federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[9] Under the Act, the Bureau is broadly empowered to regulate the offering and provision of "consumer financial products or services,"[10] which include:

- Brokering, extending and servicing loans or other credit;
- Extending or brokering leases of personal or real property;
- Real estate settlement and appraisal services;
- Deposit-taking activities and transmission and exchange of funds;
- Selling, providing, issuing or reloading stored value or payment instruments (*e.g.*, gift cards) if the seller exercises substantial control over the terms or conditions of the stored value instrument;
- Check cashing, collection or guaranty services;
- Providing financial advisory services or advice on an individualized basis, such as credit counseling and assistance with debt modification;
- Providing consumer credit reports expected to be used in connection with the provision of any consumer financial product or service; and
- Collecting debt related to any consumer financial product or service.

A broad catch-all provision gives the Bureau jurisdiction over any other "financial product or service," if the Bureau determines that it was entered into with an intention to evade federal consumer laws.[11] The Bureau also has jurisdiction over any product that a bank or financial holding company is allowed to offer — except insurance — that is likely to have a material impact on consumers.

As set forth below, the functions of the Bureau include supervising covered institutions for compliance with certain enumerated consumer laws; issuing rules, orders, and guidance implementing those laws; and enforcing those laws and its own regulations.

Supervisory and Examination Authority. The Bureau has varying supervisory and examination authority over three classes of institutions:

[8] Act §§ 1012, 1013 & 1017.

[9] Act § 1021.

[10] Act §§ 1002(5), 1002(15) & 1021.

[11] Act § 1002(15)(xi)(I).

- The Bureau has examination and primary enforcement authority over insured depository institutions with total assets of $10 billion or more and their affiliates. The Bureau must coordinate its supervisory activities with such institutions' prudential regulators and state bank supervisors.[12]
- The Bureau has the discretion to have its examiners participate in a sampling of the prudential regulators' regular examinations of insured depository institutions with total assets less than $10 billion. The Bureau may also require reports from these institutions.[13]
- The Bureau has supervisory, examination and enforcement authority over non-depository institutions that broker, originate or service mortgage and home equity loans. Separately, certain "larger participants" of markets for other consumer financial products or services, as determined by the Bureau and the Federal Trade Commission ("FTC"), also are subject to supervisory, examination and enforcement authority by the Bureau.[14] The Bureau must negotiate an agreement with the FTC for coordinating enforcement actions with respect to any of these institutions, which shall include procedures for notifying the other agency prior to initiating a civil action.

Carveouts. The individuals and institutions over which the Bureau may not exercise any rulemaking, supervisory and enforcement authority include attorneys, accountants, real estate brokers, tax preparers, insurance companies and merchants not significantly engaged in the business of selling financial products or services.[15] Auto dealers also are exempted from general coverage by the Act, unless they provide real estate financing or other non-auto-related credit to consumers, or provide retail credit or leases that they do not merely originate and assign to third parties.[16]

Rulemaking, Investigation and Enforcement Authorities. The Act transfers to the Bureau rulemaking authority with respect to several federal consumer financial laws, including the Equal Credit Opportunity Act ("ECOA"), the Truth In Lending Act ("TILA"), the Real Estate Settlement Procedures Act ("RESPA"), the Fair Credit Reporting Act ("FCRA"), the Fair Debt Collection Practices Act ("FDCPA"), portions of the Gramm-Leach-Bliley Act relating to information privacy, and several other statutes.[17] As noted above, the Bureau also is authorized and charged with preventing covered persons or service providers from committing or engaging in an unfair, deceptive or abusive act or practice under federal law.[18]

In carrying out its mandate under the Act, the Bureau has the authority to investigate potential violations of the enumerated federal consumer financial laws and to conduct hearings, subpoena testimony and records, and issue civil investigative demands. If the Bureau determines that a person has violated a federal consumer financial law, it may issue a notice to the person to appear and contest the issuance of a cease and desist order. The Bureau also may pursue civil actions for violations of federal consumer financial laws. The Bureau has no criminal prosecutorial authority, but it is authorized to refer potential criminal matters to the Department of Justice.[19] In addition, the Bureau is required to refer potential violations of tax law to the Internal Revenue Commissioner.[20]

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[12] Act § 1025.
[13] Act § 1026.
[14] Act § 1024.
[15] Act § 1027.
[16] Act § 1029.
[17] Act §§ 1002(12) & 1022.
[18] Act § 1031.
[19] Act §§ 1052-1056.
[20] Act §§ 1024(b)(6), 1025(b)(5) & 1026(b)(3).

Reporting Responsibilities. The Act mandates that the director appear semiannually before the Senate's Committee on Banking, Housing and Urban Affairs and the House's Committee on Financial Services. Concurrent with these appearances, the director must file reports that include details of significant problems faced by consumers shopping for or obtaining consumer financial products or services; supervisory and enforcement actions taken by the Bureau, and by state regulators and attorneys general with respect to federal consumer financial laws; significant rules and orders adopted by the Bureau; and analyses of consumer complaints received.[21]

Substantive Changes to Lending Law

The Act includes a number of substantive provisions that will significantly affect lenders, servicers and borrowers.

Ban on "Abusive" Acts or Practices. Section 1031 of the Act empowers the Bureau to prevent a covered institution from engaging in an "unfair, deceptive, or abusive act or practice in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service." Although "unfair" and "deceptive" acts or practices have been prohibited for some time under Section 5 of the Federal Trade Commission Act and similar state laws, the prohibition of "abusive" acts or practices is new. While the Act itself provides little guidance as to what constitutes an "abusive" act or practice, the Bureau is expected to provide direct guidance through its regulations and indirect guidance through its enforcement actions.

The Act does articulate one limitation on the authority of the Bureau to define what is abusive, which is notable insofar as it signals what conduct will probably be deemed abusive. According to the Act, 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 (i) materially interferes with a consumer's ability to understand the product or service or (ii) takes unreasonable advantage of the consumer's lack of understanding, inability to protect his or her interests, or reasonable reliance on a covered person to act in the interests of the consumer.[22]

Qualified Mortgages. The Act creates a safe harbor for compliance by defining an important new category of loans called "qualified mortgages."[23] For example, creditors and assignees may presume that qualified mortgages satisfy the requirement that loans be underwritten based on the borrower's ability to repay. A qualified mortgage must meet several criteria, including a requirement that the points and fees total less than 3% of the loan amount. The designation of a qualified mortgage, along with the safe harbor that it provides, is very important because borrowers can raise inability to repay underwriting standards as a foreclosure defense against creditors and assignees, without regard to any statute of limitations. As such, there may be very limited appetite in the secondary market for non-qualified mortgages.[24]

Compensation Prohibitions and Steering Provisions. Section 1403 of the Act amends the TILA to prohibit loan originators from paying loan officers or brokers compensation that varies based on the

[21] Act § 1016.

[22] Act § 1031(d).

[23] Act § 1412.

[24] Act § 1414.

terms of the loan, other than the amount of the principal. Loan originators also may not arrange for a consumer to finance any origination fees or costs except *bona fide* third-party settlement charges not retained by the creditor or loan originator.[25] These provisions are intended to prevent lenders from placing borrowers in loans with rates and fees that are higher than appropriate in light of the borrowers' qualifications.

Additionally, the Act prohibits originators from steering borrowers from a qualified mortgage to a non-qualified mortgage; to a loan that the consumer lacks the ability to repay; and to a loan that has "predatory characteristics (such as equity stripping, excessive fees or abusive terms)."[26]

Finally, the Act empowers the Bureau to issue regulations to prohibit "abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but of different race, ethnicity, gender, or age." The contours of this provision, like many others in the Act, will not be fully known until the Bureau issues its regulations, but one may expect that the regulations will lead to limitations on discretionary underwriting, product selection or pricing practices. Violation of the ban on steering incentives can be raised as a foreclosure defense by a borrower against a creditor or assignee without regard to any statute of limitations.[27]

Ban on Originating Loans Where Borrower Has No "Reasonable Ability" to Repay. One of the most important provisions of the Act sets forth "minimum standards for residential mortgage loans," one of which requires mortgage lenders to determine, "based on verified and documented information," that the consumer has a "reasonable ability to repay the loan."[28] Creditors are required to make the ability to pay determination based on the consumer's credit history, income, obligations, debt-to-income ratio, employment status and other information, utilizing a fully amortizing payment schedule, and lenders should document their consideration of these factors. The statute provides guidance for compliance with this section and provides a limited exception for certain streamlined refinance loans that meet several requirements. The Act does not clearly explain how lenders can determine that a borrower has a reasonable ability to repay balloon loans apart from general guidelines based on the APR and any Board of Governors regulations. The Act also invites the Board of Governors to issue regulations making balloon loans presumptively repayable under certain circumstances.[29] As discussed below, this section raises significant implementation challenges. Like the ban on steering incentives, violation of the ban on considering the borrower's ability to repay for underwriting can be raised as a foreclosure defense by a borrower against a creditor or assignee without regard to any statute of limitations, unless the loan meets the criteria for a qualified mortgage, as explained below.[30]

Ban on Prepayment Penalties for Certain Loans. The Act amends the TILA to prohibit prepayment penalties on residential mortgage loans other than qualified mortgages, which the provision defines as residential mortgages that, among other things, do not have adjustable rates and do not result in negative amortization.[31]

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[25] Act § 1403.
[26] Act § 1403.
[27] Act § 1413.
[28] Act § 1411.
[29] Act § 1412.
[30] Act § 1413.
[31] Act § 1414.

Lowered HOEPA Threshold. The Act lowers the pricing threshold at which a loan will be subject to the restrictions in the Home Ownership and Equity Protection Act ("HOEPA").[32] The new HOEPA triggers are: points and fees exceeding 5% of the loan amount on mortgage loans of at least $20,000, or 8% or a certain dollar amount on loans below $20,000; an APR exceeding the average prime offer rate by 6.5% on first lien loans for $50,000 or more, or 8.5% on smaller loans and second lien loans; or a prepayment penalty provision applicable more than three years after the closing of the loan or that exceeds 2% of the prepayment. Also, the Act expands the definition of points and fees for calculating the HOEPA trigger.

Ban on Arbitration Agreements in Mortgage Loans; Likely Ban in Other Contexts. Mandatory arbitration clauses are prohibited in mortgage or home equity loans.[33] The Act does not directly ban mandatory pre-dispute arbitration agreements between covered persons and consumers in other types of loans, but Section 1028 requires the Bureau to report to Congress on the use of binding arbitration agreements in the consumer financial products or services industry generally. The Act then authorizes the Bureau, consistent with the findings of its study, to prohibit or limit such agreements if the Bureau finds that doing so is "in the public interest and for the protection of consumers."[34]

Requirements for Use of Consumer Credit Reports. The Act amends the Fair Credit Reporting Act by requiring a lender to provide a consumer with the consumer's numerical credit score as well as the factors that affected the score if the lender took any adverse action (including a denial or a higher interest rate) against the consumer based at least in part on that credit score.[35]

Debit and Credit Card Fees and Restrictions. The Act amends the Electronic Funds Transfer Act to require that transaction fees charged to merchants by debit card networks (interchange fees) be "reasonable and proportional to the actual cost incurred" by the card network in effecting the transaction. Card networks will not be allowed to prevent merchants from offering discounts based on the form of payment that a consumer uses (such as credit, debit or cash), and a ban on requirements that debit cards can be used only on certain networks will leave merchants free to select which card network they use to process debit card transactions. Reloadable debit cards are excepted from the Act's mandates, and the Act does not limit transaction maximums or minimums that card networks may set.[36]

Enhanced Disclosures. The Act directs the Bureau to propose a new joint RESPA/TILA disclosure statement and requires a number of enhanced loan disclosures, including new TILA disclosures to be included on each monthly mortgage statement,[37] a notice that an ARM loan with an initial fixed rate is going to reset,[38] a negative amortization feature disclosure,[39] and disclosure of the loss of protection under state laws prohibiting deficiency judgments after foreclosure.[40]

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[32] Act § 1431.

[33] Act § 1414.

[34] Act § 1028.

[35] Act § 1100F (incorporating 15 U.S.C. § 1681g(f)(1)(B)-(E)).

[36] Act § 1075. See also "Payment Card Transactions" for a detailed discussion of Section 1075.

[37] Act § 1420.

[38] Act § 1418.

[39] Act § 1414.

[40] *Id.*

Counseling Programs and Tools. The Act amends the Department of Housing and Urban Development Act ("Housing Act") to establish an Office of Housing Counseling within the Department of Housing and Urban Development ("HUD") with responsibility for, among other things, the development and funding of housing counseling programs and foreclosure rescue education programs.[41] In addition, the Act amends the Housing Act to require the HUD Secretary to provide for the certification of various computer software programs for consumers to use in evaluating different residential mortgage loan proposals, which shall take into account the consumer's financial situation, the amount of time the consumer expects to remain in the home and any other relevant factors that the Secretary identifies.[42] The HUD Secretary must make these software programs widely available through the Internet and at public locations, including public libraries. The HUD Secretary also must conduct an extensive study of the root causes of default and foreclosure of home loans and create a database of such information in consultation with the federal bank regulatory agencies.[43] In reporting the results of the study to Congress, the HUD Secretary must make recommendations for new legislation.[44]

New Servicing Requirements. The Act amends the TILA to enumerate circumstances in which creditors must establish escrow accounts for the payment of taxes and hazard insurance for first lien loans on borrowers' principal dwellings. These include when such an account is required by federal or state law; when the loan is made, guaranteed or insured by a state or federal entity; and when the original principal amount and interest rates meet the Act's threshold requirements.[45] The Act also amends the Real Estate Settlement Procedures Act to define when and how a servicer may obtain force-placed hazard insurance on behalf of a borrower, to prohibit servicers from charging certain fees and to mandate responsiveness to certain borrower requests.[46] In addition, the Act amends the TILA to prohibit servicers from failing to credit a payment to the consumer's loan account as of the date of receipt, except when a delay does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency.[47] The Act also has several provisions designed to enhance transparency in the Administration's Home Affordable Modification Program ("HAMP"), both in information provided to denied applicants and in public availability of certain criteria employed in assessing applications.[48]

Increased Penalties and Longer Limitations Period for TILA Violations. The Act amends TILA to double the monetary fines levied as civil penalties for TILA violations. In addition, the Act extends the statute of limitations period for federal authorities to prosecute TILA violations from one year to three years.[49]

Fair Lending Reporting Provisions

The Act expands the type of loan-level data that lenders must collect and report to the government to enable the government to investigate potential fair lending violations.

[41] Act § 1442.
[42] Act § 1443(a).
[43] Act §§ 1446-1447.
[44] Act § 1447.
[45] Act § 1461(a).
[46] Act § 1463(a).
[47] Act § 1464(a).
[48] Act § 1482(a)-(c).
[49] Act § 1416(a),(b).

Additional Data Collection Requirements. Lenders have been required for many years to collect and report to the federal government certain information about mortgage loan applications and originations under the Home Mortgage Disclosure Act ("HMDA"). The primary purpose of the law has been to help identify potential discrimination by lenders. HMDA initially required lenders to collect and report aggregate lending data by Census tract.[50] The law was then amended to require data on the race, ethnicity and sex of applicants, as well as the application decision.[51] A later amendment required lenders to disclose pricing information for loans that exceeded a rate threshold.[52] Because lenders were not required to report information regarding the applicant's credit, HMDA was a very blunt tool for determining whether a lender was discriminating against borrowers. One purpose of the HMDA amendments in the Act is to sharpen that tool.

In particular, Section 1094 amends HMDA to require lenders to collect and report an applicant's credit score. The section also requires lenders to collect and report other information, including the borrower's age, total points and fees information, loan pricing, prepayment penalty information, house value (for loan-to-value ratios), period of introductory interest rate, interest-only or negative amortization information, term of the loan, and channel of origination.

Small Business Loans. In addition to increasing the amount of mortgage data that must be collected and reported, the Act will require lenders to collect and report small business loan data to the Bureau. Section 1071 of the Act amends the ECOA in order to "facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned and minority-owned small businesses." This provision requires a lender to inquire whether a small business is women- or minority-owned. The lender must also ask about the "race and ethnicity of the principal owners of the business," and collect other information such as the gross annual revenue of the business and the amount of credit that the business is seeking.

Preemption and State Authority

The Act redefines the role of state regulation over federally chartered institutions by enhancing the states' authority to enforce state and federal law against federal banks and other institutions. First, the Act provides that if a majority of states enacts a resolution in support of the establishment or modification of a consumer protection regulation, the Bureau must promulgate a notice of proposed rulemaking relating to the proposal. The Bureau is not, however, required to enact such a final regulation.[53] In addition, the Act provides that state consumer financial laws apply to subsidiaries of federally chartered banks to the same extent that those laws apply to other persons or institutions.[54] It also provides that states may sue national banks and federal savings banks in their own name to enforce regulations promulgated by the Bureau under the Act, but not to enforce the provisions of the Act itself.[55] However, before a state brings suit against a federally chartered bank, it must provide a copy of the complaint to the Bureau and the bank's prudential regulator. Thereafter, the Bureau has the right to intervene, remove the action to federal court, be heard in court and appeal the judgment just like any other party.[56]

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[50] Federal Financial Institutions Examination Council, History of HMDA, http://www.ffiec.gov/HMDA/history2.htm (last visited July 1, 2010).

[51] *Id.*

[52] *Id.*

[53] Act § 1041(c).

[54] Act § 1044(e).

[55] Act § 1042(a).

[56] Act § 1042(b).

The Act also expressly codifies the Supreme Court's decision in *Cuomo v. Clearing House Association*,[57] by providing that no restriction on state exercise of "visitorial" powers shall prevent a state from bringing an action against a federal bank to enforce any "applicable" law (presumably meaning any law that is not substantively preempted).[58] Furthermore, it explicitly preserves current National Bank Act provisions relating to the interest rates that banks may charge.[59] With respect to institutions other than federal banks, the Act states that the Bureau is not authorized to impose a national usury limit.[60]

State Laws Preempted Only if "Inconsistent" With the Act. The Act itself preempts state laws only to the extent that they are "inconsistent" with the Act.[61] Further, it provides that if a state law provides greater protections than the Act, this will not render the state law "inconsistent" with the Act. Finally, the Act clarifies the preemption standard generally by identifying three situations in which a state law will be deemed to be preempted. First, if a state consumer financial law would have a discriminatory effect on federal banks, as compared with banks chartered in that state, the law is preempted. Second, the OCC can preempt state statutes on a case-by-case basis if the Comptroller determines, based on "substantial evidence," that the state law forbids or significantly impairs national bank activities under the standard articulated in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner*.[62] Third, any express preemption of state law set forth in a federal law will remain in effect.

Miscellaneous Provisions and Additional Studies

The Act amends TILA to prohibit the financing of single-premium credit insurance in connection with any mortgage or consumer loan secured by a borrower's home.[63] TILA also is amended to impose several new appraisal independence requirements, including: (i) prohibiting appraisers or appraisal management companies from having direct or indirect interests in the property or transaction at issue, (ii) requiring lenders to compensate appraisers only at a customary and reasonable rate for the property's locality, (iii) prohibiting use of Broker Price Opinions as the primary basis for determining the value of a piece of property being purchased as a consumer's principal dwelling, and (iv) setting forth minimum requirements to be applied by states in the registration of appraisal management companies.[64]

Finally, the Act sets forth the "sense of Congress" regarding the importance of Fannie Mae and Freddie Mac and the need to enact meaningful structural reforms of those institutions.[65] It also requires the Comptroller General to conduct a study of the current interagency efforts to crack down on mortgage foreclosure rescue scams and loan modification fraud and to submit a report to Congress with legislative recommendations.[66]

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[57] 129 S. Ct. 2710 (2009).

[58] Act § 1047.

[59] Act § 1044(a).

[60] Act § 1027(o).

[61] Act §1041(a).

[62] 517 U.S. 25 (1996).

[63] Act § 1414(a).

[64] Act §§ 1471 & 1473.

[65] Act § 1491(a)-(b).

[66] Act § 1492(a)-(b).

II. Business and Policy Implications

The Act changes many of the basic rules of the road in consumer financial services while at the same time appointing a strong, new traffic cop to enforce those rules and write new rules. The substantive provisions of the Act reflect a sea change away from the disclosure-based regime reflected in prior consumer statutes and toward more of a rules-based regime. Under the Act, it is no longer enough for lenders to provide full and accurate disclosures to allow consumers to make decisions based on their own self-interest. In many respects, the loan officers and lenders themselves are now required to make those decisions for the borrowers. To a large degree, therefore, the Act represents a policy choice by Congress to limit freedom of contract by banning or effectively banning certain loans, loan features, and loan practices that Congress determined to have been applied in an abusive manner by certain lenders in the past. From a more practical standpoint, the Act significantly increases both the ways in which a provider of consumer financial services may run afoul of the law and the power of the government to investigate and enforce violations.

Although the ultimate impact of these far-reaching changes may not be apparent for several years, we foresee a number of practical and policy implications of the Act.

New Regulatory Framework

Above all, the Act changes how financial institutions are regulated from a consumer compliance perspective. For the first time, a federal governmental agency will be devoted exclusively to financial consumer compliance issues, with separate offices overseeing fair lending or equal opportunity issues and financial literacy issues. The Bureau itself will become the primary enforcement agency only for the largest financial institutions (those with assets of over $10 billion) and their affiliates, as well as previously unregulated institutions directly involved with the offering or servicing of consumer financial products. However, the impact of the Bureau's actions will be felt in all corners of the financial services industry. Indeed, even those institutions that will not be directly supervised by the Bureau should anticipate that their own regulators may have new examiners, new procedures, new regulations and new expectations.

Financial institutions should expect that the creation of the Bureau and the changes in regulatory enforcement authority required by the Act will result in two high-level shifts. First, the Act and the creation of the Bureau likely will lead to additional consumer protection rules and regulations — some of which will clarify existing ambiguities and some of which may well create new ones. Second, passage of the Act will result in an atmosphere of significantly increased consumer compliance scrutiny, including more frequent examinations of consumer compliance and fair lending issues, as well as likely disagreement among the agencies and between the federal and state governments about how new regulations should be interpreted and enforced.

By granting authority to the Bureau to issue rules and regulations implementing consumer protection statutes, the Act effectively opens the door to new, if not rewritten, requirements under the statutes. Among other things, a fresh review of the regulations by Bureau staff will probably clarify some disputed or unclear issues under current regulations, including those addressing unfair or deceptive acts or practices and Real Estate Settlement Procedures Act rules. However, the Bureau's authority will probably also lead to additional burdens on financial institutions, including the reporting of additional information under HMDA and the prohibition against tying loan officer compensation to the terms of the loan, both of which are addressed directly in the Act. We expect the Bureau to issue additional fair lending regulations as well.

The Act sets forth requirements for a fairly complicated bureaucracy. The speed with which the Bureau acts and the direction it takes will be influenced not only by the staff but by the President's choice of the director of the Bureau. Without doubt, however, passage of the Act will lead to additional focus by regulators on consumer compliance supervisory issues long before all of the Act's provisions are implemented. The consumer focus may, however, lead to some conflict. For example, the prudential regulators can be expected to fight to preserve their independence and stature relative to the new Bureau. In the short term, this means that financial institutions may experience quick resolution of pending examination matters and the issuance of public orders, as well as the opening of new examination matters and fair lending inquiries. The establishment of a new Office of Fair Lending and Equal Opportunity within the Bureau likely will increase significantly the number of investigations of potential discrimination in lending, and may lead to the development of new fair lending theories of liability or statistical methodologies.

In addition, some institutions may be subject to competing or conflicting mandates from their prudential regulator, on the one hand, and the Bureau, on the other hand. For instance, certain fees, interest rate options, or other practices that are approved from a safety and soundness perspective may be viewed as having consumer protection implications, thus putting the institution in a difficult position.

Regardless of how effectively the agencies work together in implementing the Act, however, they are all likely to view the Act as a mandate for increased scrutiny of consumer compliance issues.

Changes to Loan Officer and Broker Compensation

For many lenders, the prohibition on paying loan officers or brokers more money for loans with higher interest rates, fees or other features will significantly alter their relationships with these parties. One likely result will be lower overall income for brokers and loan officers. This new rule also may lead to fewer product and rate choices for consumers with strong bargaining power. As loan origination turns into more of an education and processing task, with potentially reduced compensation, there may well be significant turnover in the loan officer ranks.

Changes to Lending Requirements

The requirement that loan officers determine that borrowers have a reasonable ability to repay will have both short-term and long-term ramifications. Previously, the "ability to pay" requirement was market-based, set by investors or lenders. With this change, the federal government will directly involve itself in the underwriting process as it relates to risk. This federal regulation may lead to inconsistencies across loan products and vague standards for determining what constitutes a "reasonable ability to repay." For example, it is not clear whether the ability to pay standard will be universal across loan products or will be different based on the circumstances of each loan. Nor is it clear what exceptions, if any, will be allowed, and on what basis. Lenders and loan officers should expect a great deal of uncertainty from the federal regulators as this provision is implemented.

The Act also includes provisions to make it easier for borrowers to compare mortgage loan proposals that could affect the evaluation of lenders' compliance with the "ability to pay" requirement. In particular, the requirement that the Secretary of Housing and Urban Development make available software programs designed to aid borrowers as they evaluate their options based on several income and expense factors could expose lenders who do not properly take into account the new requirement. Finally, the outright prohibition of certain loan features, such as single premium credit insurance, signals a skepticism of the efficacy of disclosure for certain products and borrowers and a new willingness by Congress to make choices on behalf of consumers.

Prohibition of Unfair, Deceptive or Abusive Acts

The authority of the Bureau under Section 1031 to take action to prevent unfair, deceptive or abusive acts or practices raises questions about how this new provision will be enforced and whether it has broader policy implications. For example, while the "unfairness" and "deception" doctrines were defined generally by the FTC decades ago, it is not clear what, if any, changes the Bureau will make to their meanings as applied to financial institutions.

In addition to inviting new definitions of "unfair" and "deceptive," the Act also appears to give regulators broad authority to inquire about the consumer's knowledge of the terms of the loan under the new "abusive" standard. Indeed, Section 1031 contemplates that government intervention should occur where a product or service takes "unreasonable advantage" of "the inability of the consumer" to protect his or her own interests. This provision, combined with the requirement that loan officers determine that borrowers have a reasonable ability to repay a loan before making the loan, augurs a more paternalistic approach to the regulation of consumer financial services by calling into doubt the very decisions made by consumers themselves. In addition, Section 1403 amends TILA to require the Board of Governors to prohibit abusive or unfair lending practices that "promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age." This prohibition gives regulators a new and somewhat vague legal theory for pursuing fair lending claims outside of the current disparate impact and disparate treatment regime.

Ultimately, these changes could signal a broader policy shift that will extend beyond consumer financial services. The new paternalism also may lead to a reduction in the amount of credit offered by lenders, as lenders will increasingly seek to minimize or avoid subjective, after-the-fact assessments of their decisions.

Enhanced Tracking of Consumer Complaints

The Act requires significant attention by the Bureau to consumer complaints, which have until now received less formal attention from bank regulators. In particular, the Bureau will devote an entire division to tracking complaints against individual banks and other lenders. That division will produce an annual summary of the complaints, which will be provided to Congress. Given the enhanced emphasis on consumer complaints under the proposed system, institutions should expect to see an increase in complaint campaigns akin to political lobbying efforts. Institutions should begin preparing for these changes by developing strong complaint tracking and response systems. In addition, it will be important that any such system accurately differentiates between frivolous and legitimate complaints and assist the institution in moving quickly to provide remedies where appropriate to borrowers with legitimate complaints.

New Fair Lending Reporting Requirements

The Act will lead to additional fair lending scrutiny because it significantly expands the data required to be reported by financial institutions under the HMDA, as well as the way small businesses' data is maintained and reported under the ECOA.

The additional fields required by the HMDA and ECOA likely will influence how the regulators conduct fair lending statistical screening tests going forward. Currently, regulators identify HMDA "outlier" institutions based principally on the geographic dispersion of their loans, denial disparity rates, and the frequency and magnitude of rate spreads above specified levels. Because the data is limited, this screening cannot answer the question of whether an institution has treated "similarly situated" applicants consistently. As a result, federal regulatory inquiries are often based on "false positives," or instances where raw HMDA data indicates potential lending disparities, but the consideration of other factors used by the institution in its lending decisions (such as credit score and loan-to-value ratio) demonstrates that there are, in fact, no disparities. With this new information, the regulators can further refine their statistical screening practices to control for additional factors such as credit score and loan-to-value ratio, thus theoretically reducing the number of "false positives" and allowing regulators to use their resources more efficiently.

The emphasis on credit score, however, could lead to false positives based on an incomplete understanding of the role that credit score plays in a lender's underwriting or pricing practice. The focus on a single credit score may have the effect of penalizing lenders that consider multiple credit factors — not just a third-party score. This in turn may encourage lenders to abandon a nuanced approach for a one-size-fits-all credit score approach.

Finally, there is little doubt that there will be increased scrutiny of small business fair lending compliance, given the greater availability of data required by the ECOA.

Employee Whistleblower Protections

Section 1057 of the Act prohibits a covered institution from taking any retaliatory action against an employee for providing any information about a potential violation to the Bureau, other federal authorities, or state authorities. The Act also protects an employee who refuses to do something that he or she "reasonably believed to be in violation of any law, rule, order, standard, or prohibition, subject to the jurisdiction of, or enforceable by, the Bureau."[67] For example, covered financial institutions may not terminate the employment of loan officers who raise concerns about compliance with the new provision in the Act that loan officers determine that borrowers have a reasonable ability to repay before making the loan.[68] This new protection will complicate certain personnel decisions. For example, a lender may wish to terminate a loan officer with low production volume. However, the loan officer may protest, arguing that his low volume is due to his strict compliance with the ability to pay requirement. In such a situation, the lender will have to exercise particular caution to ensure that the personnel action does not run afoul of the Act's requirements.

New Servicing Requirements

In many respects, the new servicing rules codify longstanding practices of servicers with respect to force placed insurance and payment posting. However, the new requirements relating to the creation of escrow accounts may lead to confusion about when an escrow account is required, how long the account is required to be maintained and when a borrower may waive the account. In addition, the new requirements for servicers to disclose their NPV calculations for HAMP modifications may lead to additional

[67] Act § 1057.

[68] *Cf.* Act § 1411 (requirement that lenders assess reasonable ability to repay).

scrutiny of servicers' efforts to comply with HAMP and to ensure that borrowers are able to stay in their homes.

Additional Oversight by State Regulators

The Act gives state attorneys general additional latitude to enforce their own consumer protection statutes and any regulations issued by the Bureau against federally chartered banks and their operating subsidiaries.

Institutions should anticipate that the new provisions regarding preemption and visitorial powers will lead to greater involvement by state attorneys general in promulgating and enforcing consumer protection laws. First, as described above, the Act removes the preemption barrier protecting subsidiaries of federal banks, which means that states will have significantly broader authority to enforce state laws against such institutions. In addition, the Act moves the states significantly closer to gaining a seat at the table for deliberations regarding federal regulations by requiring a notice of proposed rulemaking whenever a majority of states enacts a resolution in support of the establishment or modification of a consumer protection regulation. This unique provision could affect jurisprudence on federalism issues and serve as a precedent for federal-state interactions in other industries.

In anticipation of these changes, federal banks may need to prepare for strict regulation of their subsidiaries by state attorneys general. Likewise, all financial institutions — national and state — should expect that the states will issue new and broader consumer protection regulations, many of which will be more comprehensive than the federal regulations. Finally, because the Act strips the subsidiaries of federal banks of their federal preemption, institutions may choose to move lending operations that had been structured as operating subsidiaries to be within the depository institution itself.

Potential Additional Legislation

While the Act will profoundly change the landscape, financial institutions should not expect it to be the final word on the subject of consumer protection. To the contrary, there almost certainly will be further legislation covering many of the same issues, particularly as interest groups, industry participants, and legislators seek to expand, contract, or fine-tune changes affected by the Act.

Some members of Congress may attempt to amend the Act to include additional substantive provisions. For example, the Act's prohibition on the establishment of a national usury limit and the preservation of a national bank's ability to export interest rates may be revisited in the future, especially given that they arguably are in tension with other goals of the Act.

Additionally, interest groups may seek future legislation to exempt certain industry participants from coverage under the Act. In fact, since the Administration proposed the initial draft of the Act, some of the most significant changes have been restrictions to the authority of the Bureau over smaller institutions and other industry participants that have raised concerns about burdensomeness and have stressed their history of responsible practices. It is likely that, after the enactment of the Act, other categories of industry participants may similarly seek to exempt themselves from the Bureau's examination and enforcement authority.

Another area that may ultimately be revisited by future legislation is the regulation of the business of insurance. While the regulation of insurance has traditionally been the domain of the states, certain provisions of the Act explicitly contemplate possible future federal regulation of the industry. Indeed, the Federal Insurance Office, a new agency that is created by the Act, is charged with conducting a study of, among other things, the "consumer protection for insurance products and practices, including gaps in state regulation" and several different aspects of the "potential federal regulation" of insurance. While the ultimate conclusion of this study is unknown, it could well point toward a future of increased federal regulation of the business of insurance. See "Insurance."

Finally, the Act mandates a number of studies and surveys that could serve to spur amendments or new legislation. For example, the Act requires the Secretary of Housing and Urban Development to conduct a study regarding the root causes of default and foreclosure and to recommend legislation to address any issues identified in the study. An initial draft of a report to Congress based on this study is required by the middle of 2011. In addition, the Act requires the Comptroller General to study efforts by the federal government to stop foreclosure rescue scams and loan modification fraud, as well as studying the Act's impact on minorities' access to affordable credit relative to other borrowers. The results of these studies also could lead to additional legislation affecting lenders and servicers.