



DODD-FRANK AND THE FUTURE ROLE OF STATE SUPERVISION

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CONFERENCE OF STATE BANK SUPERVISORS

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INTRODUCTION AND BACKGROUND

On July 21, 2010 President Barack Obama signed the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (herein referred to as the Dodd-Frank Act) into law. This landmark legislation is designed to overhaul our nation's financial system, expand consumer protections, and enhance financial regulation. CSBS regards passage of the Dodd-Frank Act as a reaffirmation of the dual-banking system and all that it entails, namely a system of checks and balances between state and federal regulators that limits the consolidation of regulatory authority in Washington, D.C. and of influence into a handful of money-center banks. The law acknowledges the essential role of state regulators and appropriately recalibrates the balance of power between state and federal regulators and offers the prospect of a new era of state-federal collaboration and cooperation.

While enactment of the Dodd-Frank Act was a monumental achievement, implementing the provisions and requirements of the bill will take significant time and resources for federal regulators and the industry. As has been frequently reported, the bill requires 243 rulemakings and 67 studies over the coming months and years. As the Dodd-Frank Act is far reaching in its coverage of financial entities, many of its requirements do not have direct implications for state-chartered banks or other state licensed entities.

Among other things, the law enhances prudential standards for systemically important financial institutions; establishes a resolution procedure for large companies; creates the Financial Services Oversight Council (FSOC) to identify and manage systemic risk in the financial system; implements new restrictions on proprietary trading and investment in hedge funds and private equity funds by insured depository institutions; enhances regulation of the over-the-counter derivatives market; implements corporate governance requirements for all public companies; makes permanent the \$250,000 limit for Federal Deposit Insurance Corporation (FDIC) deposit insurance; and eliminates the Office of Thrift Supervision (OTS). While the Dodd-Frank Act has wide-ranging implications for the financial services industry, this white paper will focus on Title X, the Consumer Financial Protection Act of 2010 (the CFP Act), which establishes the Bureau of Consumer Financial Protection (the Bureau) to implement, examine and enforce compliance with federal consumer financial laws. In particular, this white paper provides a summary of Title X, with an emphasis on the intersections between the Bureau's responsibilities and state authority.

THE BUREAU OF CONSUMER FINANCIAL PROTECTION

This section provides a brief overview of the Bureau's structure, its objectives and its responsibilities.

PURPOSE, OBJECTIVES, AND FUNCTIONS

The Bureau's mission is to serve as a single—and singly accountable—federal agency responsible for implementing and enforcing federal consumer financial law to ensure that all consumers have access to markets for consumer financial products and services and that those markets are fair, transparent, and competitive.

The Dodd-Frank Act mandates that the Bureau's primary functions include:

- Supervising covered persons for compliance with federal consumer financial law and taking appropriate enforcement actions to address violations of such law;
- Collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets;
- Issuing rules, orders, and guidance implementing federal consumer financial law; and
- Collecting, investigating, and responding to consumer complaints.

STRUCTURE AND ADMINISTRATION

The CFP Act establishes the Bureau to develop consumer protection rules for both bank and nonbank companies that offer consumer financial products and services and to enforce compliance with such rules. The Bureau will be an independent federal agency to be located within the Federal Reserve System. Although the Bureau is officially housed within the Federal Reserve, it is autonomous and completely independent from the Federal Reserve. The CFP Act prohibits the Federal Reserve from intervening in examinations or enforcement actions; appointing or removing any officer or employee of the Bureau; merging or consolidating the functions of the Bureau with the Federal Reserve; or reviewing, approving or delaying any rule or order of the Bureau.

The Bureau will be led by a Director, who is appointed by the President and subject to Senate confirmation, for a five-year term. The Director reports directly to the President and may be removed at any time for cause. The Bureau will replace the Office of Thrift Supervision (OTS) on the Federal Financial Institutions Examination Council (FFIEC) and the FDIC Board of Directors. The Secretary of the Treasury is granted interim authority to ensure that the Bureau: (A) has an orderly and organized startup; (B) attracts and retains a qualified workforce; and (C) establishes comprehensive employee training and benefits programs.

The CFP Act requires the creation of an ombudsman to act as a liaison between the Bureau and any affected person and to assure that safeguards exist to encourage confidential complaints.

The Director is also required to establish several specific functional units and offices within the Bureau. These units and offices and their functions are described below:

- *Research Functional Unit*—This unit will study consumer economic behavior, awareness and understanding of financial products, developments in markets for consumer financial products or services, and the access of traditionally underserved communities to financial products and services.
- *Community Affairs Functional Unit*—This unit shall provide information, guidance, and technical assistance regarding the offering and provision of consumer financial products or services to traditionally underserved consumers and communities.
- *Collecting and Tracking Complaints Functional Unit*—The functions of this unit shall include establishing a single, toll-free phone number, a website, and a database (or utilizing an existing database) to facilitate the centralized collection of, monitoring of, and response to consumer complaints. The Bureau will coordinate with other federal agencies to route complaints to such agencies as appropriate. Further, the Bureau will route calls to state agencies if:
 - The state has the functional capacity to receive calls or electronic reports by the Bureau’s system;
 - The state has satisfied any conditions of participation in the Bureau’s system; and
 - Participation by the state includes necessary measures to protect personal information and to provide appropriate data security.
- *Office of Fair Lending and Equal Opportunity (OFLEO)*—The OFLEO will provide oversight and enforcement of federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities. To achieve its objective, OFLEO will coordinate with other federal agencies and state regulators, as well as private industry, fair lending, civil rights, consumer and community advocates to promote consistent and effective enforcement of and compliance with fair lending and equal opportunity laws.
- *Office of Financial Education (OFE)*—The OFE will be responsible for developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions.
- *Office of Service Member Affairs*—This office will be responsible for developing and implementing initiatives intended to educate and empower service members and their families to make better informed financial decisions. This office will also coordinate with the Collecting and Tracking Complaints Functional Unit to monitor complaints by service members and with other federal agencies and state regulators regarding consumer protection measures relating to products and services offered to service members and their families.
- *Office of Financial Protection for Older Americans (OFPOA)*—The OFPOA will facilitate the financial literacy of individuals age 62 or older on unfair, deceptive, and abusive practices and on current and future financial choices. The office will also produce recommendations on legislation to improve financial services to seniors.

Finally, the CFP Act requires the establishment of a Consumer Advisory Board to advise and consult with the Bureau in the exercise of its functions under the federal consumer financial laws, and to provide information on emerging practices in the consumer products or services industry. Members of the Consumer Advisory Board will include experts in consumer protection, financial services, community development, fair lending and civil rights, and consumer financial products or services, as well as representatives of depository institutions that primarily serve underserved communities and representatives of communities that have been significantly impacted by higher-priced mortgage loans. There will be at least six board members to be appointed upon recommendation of regional Federal Reserve Bank Presidents.

FUNDING

Again, while independent from Federal Reserve governance, the Bureau will largely be funded by the Federal Reserve. The Bureau will receive an annual transfer from the Federal Reserve's total operating budget. The transfer is 10-12% of the Federal Reserve's total operating budget, which is estimated at \$430 million.¹ In addition, until 2014, Congress may appropriate up to an additional \$200 million to the Bureau annually if requested to do so by the Director. The Bureau does not have direct assessment authority of its regulated entities.

COVERED PERSONS, EXCLUSIONS, AND EXEMPTIONS

The CFP Act defines "covered person" as any person, or their affiliate, that engages in offering or providing a consumer financial product or service. However, various persons and activities are excluded from the authority of the Bureau, including: persons regulated by the Securities Exchange Commission, Commodity Futures Trading Commission, Farm Credit Administration, a state insurance regulator, or a state securities commission; auto dealers; accountants and tax preparers; attorneys; realtors; manufactured and modular home retailers; employee benefit plans; and activities relating to charitable contributions. Further, the Bureau may, by rule, exempt any class of covered persons or consumer financial products or services from any provision of the CFP Act or any rules promulgated by the Bureau.

RULEMAKING

The Bureau has sole or partial authority for implementing and enforcing the following federal laws:

- The Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.);
- The Consumer Leasing Act of 1976 (15 U.S.C. 1667 et seq.);
- The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.);
- The Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.);

¹ Source: Board of Governors of the Federal Reserve System *Annual Report: Budget Review 2010*, http://www.federalreserve.gov/boarddocs/RptCongress/budgetrev10/ar_br10.pdf.

- The Fair Credit Billing Act (15 U.S.C. 1666 et seq.);
- The Fair Credit Reporting Act (15 U.S.C. 1681 et seq.), except with respect to sections 615(e) and 628 of that Act (15 U.S.C. 1681m(e), 1681w);
- The Home Owners Protection Act of 1998 (12 U.S.C. 4901 et seq.);
- The Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.);
- Subsections (b) through (f) of section 43 of the Federal Deposit Insurance Act (12 U.S.C. 1831t(c)-(f));
- Sections 502 through 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6802-6809), except for section 505 as it applies to section 501(b);
- The Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2801 et seq.);
- The Home Ownership and Equity Protection Act of 1994 (15 U.S.C. 1601 note);
- The Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.);
- The S.A.F.E. Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.);
- The Truth in Lending Act (15 U.S.C. 1601 et seq.);
- The Truth in Savings Act (12 U.S.C. 4301 et seq.);
- Section 626 of the Omnibus Appropriations Act, 2009 (Public Law 111-8); and
- The Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701).

At the time of the transfer date,² the Bureau will also assume regulatory authority over most of the mortgage reforms contained in Title XIV of the Dodd-Frank Act. Finally, it is worth noting that the Community Reinvestment Act is not under the purview of the Bureau.³

The Bureau may also prescribe rules applicable to a covered person identifying as unlawful unfair, deceptive or abusive acts or practices in connection with any consumer financial product or service transaction, and to ensure the features of a consumer product or service are fully, accurately and effectively disclosed to consumers.

Among the Bureau's rulemaking mandates is the requirement to propose for public comment, within one year of the transfer date, rules and model disclosures that combine the disclosures required by the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) into a single, integrated disclosure for mortgage loan transactions.

The Bureau is required to consult with the appropriate federal prudential regulator prior to proposing a rule and during the comment process regarding the consistency with objectives administered by such agencies. If, during the consultation process, a federal prudential

² The transfer date is the date upon which the various authorities conferred on the Bureau will transfer to the Bureau. The Treasury Department has announced that the transfer date will be July 21, 2011.

³ For those insured depository institutions with over \$10 billion in assets, this will result in a change in supervision. Currently, HMDA and ECOA examinations are generally conducted in conjunction with CRA examinations. The Dodd-Frank Act retains authority for the prudential federal supervisor to conduct CRA examinations, but the Bureau is granted authority to conduct examinations for HMDA and ECOA.

regulator provides the Bureau with an objection to the proposed rule, the Bureau shall include in the adopting release a description of the objection and the basis for the Bureau decision, if any, regarding the objection.

In developing rules, the Bureau is required to consider the costs and benefits to consumers and covered persons, the impact upon small insured depository institutions (those institutions with \$10 billion and less in assets), the impact upon consumers in rural areas, and the impact on small businesses.

The Bureau must also coordinate with federal and state regulators to ensure consistent regulatory treatment of consumer financial and investment products and services.

Finally, the rules promulgated by the Bureau are subject to review by the FSOC. If the FSOC decides that the rule would put the safety and soundness of the banking system or the stability of the financial system at risk, the FSOC may stay the effectiveness of a regulation to allow appropriate consideration of the FSOC's concerns or may set aside a regulation, thereby rendering it unenforceable.

AUTHORITY

Large Insured Depository Institutions—The Bureau has exclusive consumer rulemaking authority and exclusive examination authority over any insured depository institution or credit union with total assets in excess of \$10 billion, or any affiliate thereof. For state-chartered depositories with over \$10 billion in assets, the Bureau is required to pursue arrangements and agreements with state regulators on joint and coordinated examinations. To minimize regulatory burden, the Bureau shall coordinate its supervisory activities with the supervisory activities conducted by prudential federal regulators and the state bank regulatory authorities, including consultation regarding their respective schedules for examining covered persons and requirements regarding reports to be submitted by covered persons. To that end, the Bureau shall, to the fullest extent possible, use reports that have been provided to a federal or state agency and information that has been publicly reported. The Bureau also has primary enforcement authority over insured depositories and credit unions over \$10 billion. Any other federal agency authorized to enforce a federal consumer financial law may recommend that the Bureau initiate an enforcement action. If the Bureau fails to do so within 120 days, the other agency is authorized to initiate an enforcement proceeding and to conduct follow-up supervisory functions. For state-chartered depositories over \$10 billion in assets, state banking regulators and state attorneys general retain existing enforcement authority, as well as authority to enforce federal consumer financial protection laws and Bureau regulations.

Smaller Insured Depository Institutions—The Bureau has exclusive consumer protection related rulemaking authority for insured depository institutions and credit unions with total assets of \$10 billion or less. The Bureau will have the authority to require reports from these institutions and refer suspected violations of law to other agencies and regulators. However, the existing banking agencies continue to have examination and enforcement authority for these institutions. The Bureau may participate in examinations conducted by prudential regulators on a sampling basis. The prudential federal regulator retains exclusive federal enforcement authority. For state-chartered institutions with \$10 billion or less in assets, state banking regulators and state attorneys general retain existing state enforcement authority, as well as authority to enforce federal consumer protection laws and Bureau regulations.

Non-Depositories—The Bureau will have supervisory and enforcement authority over non-depository covered persons. The Bureau can define the class of non-depository covered persons as they see fit, but the definition at a minimum must include mortgage-related businesses (regardless of size), payday lenders (regardless of size), and private student loan providers. Ultimately, the Bureau will have supervisory and enforcement authority over non-depository covered persons such as money services businesses. The Bureau has exclusive rulemaking and examination authority, but shares enforcement authority with state regulators and state attorneys general.⁴ The Bureau may require reports and recordkeeping requirements on such entities. Non-depositories may also be required to register with either an existing system, such as the CSBS/AARMR Nationwide Mortgage Licensing System & Registry (NMLS), or with a new system. The Bureau is required to consult with state regulators on the coordinated or combined use of registration systems. Further, the Bureau is directed to implement a risk-based supervision program based on the risks to consumers and shall include the consideration of existing state consumer protection supervision, the asset size of the covered entity, and the transaction volume of the covered entity. The Bureau is also directed to coordinate with federal prudential regulators and state banking regulators.

APPLICABLE LAW AND PREEMPTION

Preemption—The CFP Act dictates that federal consumer financial laws constitute a floor above which states can promulgate consumer financial laws that are more protective of consumers than the federal standards to be imposed by the Bureau. Further, if a majority of states enact a resolution in support of the establishment of a consumer protection, the Bureau is required to issue a notice of proposed rulemaking on the issue.

⁴ As discussed elsewhere in this white paper, states have the authority to establish and enforce more stringent consumer protection standards. The Dodd-Frank Act is silent about the Bureau’s authority to enforce more stringent state consumer protection standards.

The CFP Act does permit preemption of state consumer financial laws for federally chartered banks and thrifts if: (1) the state law has a discriminatory effect on national banks and federal thrifts as compared to such state's state-chartered institutions; (2) in accordance with the preemption standard in the U.S. Supreme Court's decision in *Barnett Bank v. Nelson*, the state law "prevents or significantly interferes" with the national bank's or federal thrift's exercise of its powers, as determined by the Office of the Comptroller of the Currency (OCC) on a case-by-case basis; or (3) are preempted by another provision of federal law. Any federal preemption of a state law will not apply to a subsidiary and/or affiliate of a national bank or federal thrift if the subsidiary or affiliate is not itself a national bank or federal thrift.

When making a preemption determination, the OCC must first consult with the Bureau and take its views into account when making any preemption determination. A judicial court reviewing any determinations by the OCC shall assess the validity of such determinations, depending upon the thoroughness in the consideration, the validity of the reasoning, the consistency with other valid determinations, and other factors the court finds persuasive and relevant. Finally, the OCC must conduct reviews of their preemption determinations every five years.

The CFP Act also requires the Comptroller of the Currency to determine preemption on a case-by-case basis moving forward. In addition, at least every five years, the Comptroller of the Currency must conduct a review, through public notice and comment, of each preemption determination. This will afford state authorities and the public an opportunity to publicly comment on preemption determinations made by the Comptroller of the Currency.

Enforcement by State Authorities—State attorneys general may enforce Bureau regulations against national banks and federal thrifts. Other state regulators may bring actions against entities that are state-chartered, licensed, or otherwise authorized to do business under state law. The attorneys general and state regulators must first consult with the Bureau before bringing an action, and the Bureau may prescribe rules and guidance to further such coordination.

Visitorial Standards—In accordance with the U.S. Supreme Court's decision in *Cuomo v. Clearing House Association, LLC*, the visitorial powers provisions of federal law shall not be construed to limit the authority of state attorneys general to bring an action in court, nor does the OCC's enforcement authority preclude a private party from enforcing rights granted under federal or state law in the courts against national banks or federal thrifts.

EXPLICIT INTERACTION WITH STATE AUTHORITIES

There are several provisions in the CFP Act that explicitly require the Bureau to coordinate or consult with state authorities. These areas provide opportunities for state regulators to have some measure of interaction with the Bureau.

REQUIRED COORDINATION, CONSULTATION, AND INFORMATION SHARING WITH STATE AGENCIES

Throughout the CFP Act, there are multiple provisions which require or encourage the Bureau to coordinate, consult, or share information with state regulators to promote consistent regulatory treatment of consumer financial and investment products and services.

Consumer Complaints—The Collecting and Tracking Complaints Functional Unit that must be established within the Bureau may route complaints to the appropriate state agency for resolution, but only if certain conditions are met by the state agency. The state agency must have the functional capacity to receive calls or electronic reports from the Bureau; must satisfy any conditions of participation in the system that the Bureau may establish; and must enact measures necessary to provide for protection of information that conforms to the standards for protection of the confidentiality of personally identifiable information and for data integrity and security that apply to the federal banking agencies.

Further, the Bureau shall establish, in consultation with the appropriate federal agencies, reasonable procedures to provide timely response to consumers to complaints against, or inquiries concerning, a covered person, included: (A) steps taken by the regulator in response to the complaint or inquiry of the consumer; (B) any responses received by the regulator from the covered person; and (C) any follow-up actions or planned follow-up actions by the regulator in response to the complaint or inquiry of the consumer.

The Bureau is also required to present an annual report to Congress on the consumer complaints received the prior year. To facilitate preparation of the report, supervision and enforcement activities, and monitoring of the market for consumer financial products and services, the Bureau is directed to share consumer complaint information with prudential regulators and state agencies. State agencies must meet the conditions described above to receive the consumer complaint information.

Registration—The Bureau may prescribe rules regarding registration requirements for non-depository covered persons. If the Bureau decides to develop and implement registration requirements, they must consult with state agencies regarding requirements or systems, including coordinated or combined systems for registration.

SUPERVISION

Upon providing reasonable assurances of confidentiality, a state regulator having jurisdiction over a covered person or service provider shall have access to any report of examination made by the Bureau. In addition, the Bureau may, at its discretion, furnish to a state regulator any other report or confidential supervisory information concerning covered persons.

The sections detailing supervision of non-depository covered persons, very large banks, savings associations, and credit unions, and other banks, savings associations and credit unions require the Bureau to coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and state bank regulatory authorities. This coordination includes establishing examination schedules for covered persons and requirements regarding reports to be submitted by covered persons. The Bureau is directed, to the fullest extent possible, to use reports pertaining to covered persons that have been provided or required to have been provided to a federal or state agency.

For very large insured depository institutions (defined in the CFP Act as those institutions with over \$10 billion in assets), the Bureau is required to pursue arrangements and agreements with state bank supervisors to coordinate examinations. This includes coordinating examinations, conducting simultaneous examinations, sharing drafts of exam reports, and taking into consideration any concerns raised before issuing either a final report or a supervisory action.

APPLICABLE LAW

The CFP Act does much to preserve state authority to enact and enforce state law and can be reasonably interpreted to roll back much OCC and OTS preemption of state consumer protection law.

Floor for State Action—The CFP Act determines that if a statute, regulation, order, or interpretation in effect in any state affords consumers greater protection than protections provided by the Bureau, they are not inconsistent with the CFP Act. This provision establishes rules or regulations promulgated by the Bureau as a floor, allowing states to enact more protective measures if necessary.

State-Driven Bureau Action—If a majority of states enact a resolution in support of the establishment or modification of a consumer protection regulated by the Bureau, the Bureau is required to issue a notice of proposed rulemaking. Before prescribing a final regulation, the Bureau must take into account whether: (A) the proposed regulation would afford greater protection than any existing regulation; (B) the intended benefits would outweigh any

increased costs or inconveniences, and would not discriminate unfairly against certain consumers; and (C) a federal banking agency has advised that the proposed regulation does not pose a safety and soundness risk to institutions. A discussion of these considerations must be included in the Federal Register notice of a final regulation. If the Bureau decides not to issue a final regulation, it must publish an explanation in the Federal Register and provide a copy to each state that enacted the resolution and Congress.

PREEMPTION

State Law Preemption Standards—The CFP Act toughens the preemption standards for state consumer protection laws under the National Bank Act. Under the CFP Act, state consumer protection laws are preempted only if: (A) application of a state law would have a discriminatory effect on national banks; (B) in accordance with the U.S. Supreme Court’s decision of *Barnett Bank v. Nelson*, the state law prevents or significantly interferes with the exercise by the national bank of its powers; or (C) the state law is preempted by a provision of other federal law.

Another significant provision reverses the Supreme Court’s decision in *Watters v. Wachovia*, providing that state consumer protection laws shall apply to a subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is a national charter) to the same extent that the state law applies to any other person or entity subject to the law.

ENFORCEMENT AND VISITORIAL STANDARDS

Preservation of Enforcement Powers—The CFP Act specifically grants authority to state attorneys general to bring civil actions to enforce provisions of the CFP Act or regulations issued by the Bureau and to secure remedies with respect to any entity that is state-chartered, incorporated, licensed, or otherwise authorized to do business under state law. Even more significant, state attorneys general may bring a civil action against a national bank or federal savings association to enforce a regulation prescribed by the Bureau and to secure remedies.

However, before initiating any action or administrative or regulatory proceeding to enforce regulations prescribed by the Bureau, a state attorney general or state regulator must provide a copy of the complete complaint to be filed and written notice describing such action to the Bureau and the covered person’s prudential federal regulator. The Bureau is authorized to intervene in the action as a party, remove the action to the appropriate U.S. District Court, to be heard on all matters arising in the action, and to appeal any order or judgment.

Visitorial Standards—In accordance with the U.S. Supreme Court’s decision of *Cuomo v. Clearing House Association*, no provision of the CFP Act which relates to visitorial powers or

otherwise limits or restricts the visitorial authority to which any national bank is subject shall be construed as limiting or restricting the authority of any state attorney general to bring an action against a national bank to enforce an applicable law and to seek relief.

Relief Available—If any action is brought by the Bureau, a state attorney general, or any state regulator to enforce any federal consumer financial law, the Bureau, the state attorney general, or the state regulator may recover its costs in connection with prosecuting such action if they are the prevailing party in the action.