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Update on Financial Services Reform Bill*Consumer Financial Protection Bureau*

After three failed attempts to begin debate on S.3217, the financial regulatory reform bill, Sen. Richard Shelby (R-Ala.) announced that negotiations between he and Sen. Christopher Dodd (D-Conn.) have reached an impasse and that he will now “defer to the individual judgments [of each Republican Senator] on whether the Senate begins a floor debate on the bill.” With that announcement, it is expected that the necessary 60 votes will be obtained quickly (including the vote of Sen. Ben Nelson (D-Neb.) who had previously voted against and at least one Republican Senator) and debate will begin this week.

Sen. Shelby cited the inability to agree on ending financial firms’ bailouts and “Too Big to Fail” as the reasons for the impasse. He also called the bill’s Consumer Financial Protection Bureau “a sprawling new consumer protection bureau that will find and force its way into facets of our economy that had nothing to do with the housing crisis. This massive new bureaucracy would have unchecked authority to regulate whatever it wants, whenever it wants, however it wants. I am aware of no other arm of the federal government this powerful, yet so unaccountable.”

Many commentators are predicting passage of the bill in a manner similar to that of the recently enacted health care bill. This would involve passage of S.3217 by the Senate, and, rather than holding a joint Senate-House conference to reconcile the House of Representatives bill, H.R. 4173, with S.3217, the House would vote directly on the Dodd Bill. If approved, the Dodd Bill would head to the President for his signature and then become law.

Commentators believe that passage of the bill is likely because there is no “grass-roots” efforts to oppose financial regulatory reform as there was with health care. Furthermore, Republicans, and Democrats that might want to break with the party, do not want to be viewed as standing up for Wall Street, as any opposition to financial regulatory reform may be characterized by the media. While changes in certain sections of the Dodd Bill may be yet to come, many sections are likely to remain unchanged.

Commentators believe that provisions of the Dodd Bill that may be changed include those which create a \$50 billion fund for future bailouts and the resolu-

tion of institutions previously considered “Too Big To Fail.” Under this latter provision of the bill, the FDIC would be granted extraordinary powers to conduct a controlled liquidation of certain financial holding companies in addition to the receivership powers it currently exercises over banks.

Despite Sen. Shelby’s strong objection, it appears that one provision that will not undergo significant change, is the provision which creates the new Consumer Financial Protection Bureau (“CFPB”) which will have broad powers to regulate and enforce substantive standards for any person engaged in offering or selling a “consumer financial product or service.” The CFPB and its enforcement and rulemaking powers will have a substantial effect on all financial institutions.

Structure of CFPB

The CFPB would become a new bureau within the Federal Reserve System (the “Fed”). However, the Board of Governors will have no power to intervene in CFPB examinations or enforcement actions or to delay or prevent the issuance of any CFPB rule or order. The Director of the CFPB will be appointed by the President, by and with the advice and consent of the Senate. Essentially, the CFPB will be an independent agency, with only its budget paid for by the Fed. The CFPB budget will be capped at 10 percent of the total operating expenses of the Federal Reserve System in 2011 (increases to 12 percent for 2013 and every year thereafter). Analysts estimate that this amount would be approximately \$400 million in 2011. This will mean that the CFPB will have significant monetary resources which will likely come from increased fees paid by banks, therefore driving up costs to financial institutions.

Rulemaking Authority

The CFPB would have sole consumer protection rulemaking authority for consumer financial products and services offered by financial institutions and certain non-financial institutions. The CFPB would be permitted to prescribe rules to prevent “unfair, deceptive, or abusive acts and practices.” These vague words give the CFPB immense rule-making authority and many commentators believe

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this will lead to many new rules regarding credit cards, mortgages and any financial product or service that has, or likely will have, a “material impact on consumers.” These new rules will increase the costs of any newly regulated products or services, which may have the effect of making certain products and services unprofitable, thereby resulting in their discontinuance and actually lowering credit alternatives for consumers. For all financial institutions, there will be increased costs associated with compliance with all the new CFPB rules. Smaller financial institutions will take a larger financial hit without the economies of scale available to the larger institutions.

The CFPB’s rulemaking authority is not unchecked, but commentators believe the checks and balances are unlikely to stop the CFPB from most proposed rules. Under S.3217, the Chairman of the Financial Stability Oversight Council¹ may temporarily stay the effectiveness of a CFPB rule if petitioned by a member agency. Upon a 2/3 vote of its members, the Council may permanently set aside a CFPB rule. The Council, however, will be focused on its main duties regarding “Too Big To Fail” and is unlikely to take the necessary time to set aside any but the most egregious CFPB rules, especially since one member of the Council is the Director of the CFPB who would be unlikely to ever vote to set aside a proposed CFPB rule.

Additionally, any prudential regulator may object in writing to a proposed CFPB rule, and the CFPB must include the objection in the release adopting the rule and explain the CFPB’s decision regarding the objection. However, the CFPB may still adopt the rule.

In support of this rulemaking authority, the CFPB is given extensive new information collecting powers over all financial institutions. Moreover, the CFPB may disclose nonconfidential information that it obtains from financial institutions as it deems to be in the best interest of the public.

Enforcement Authority

The CFPB would have examination and enforcement authority over all financial institu-

tions with more than \$10 billion in assets. Any financial institution with \$10 billion or less in assets would be examined by its prudential regulator for compliance with consumer laws. However, S.3217 would still give the CFPB the ability to “require reports [from financial institutions with \$10 billion or less in assets] as necessary to support the role of the CFPB in implementing Federal consumer financial law, to support its examination activities...and to assess and detect risks to consumers and consumer financial markets.” This unclear wording allows a back door to the CFPB to act as a regulator over any financial institution it so chooses and to compel reports from all financial institutions.

Mandatory Arbitration Clause

Under S.3217, the CFPB is required to conduct a study of mandatory predispute arbitration provisions before it may determine to limit their use. Any limits that the CFPB sets must be consistent with the findings of the study. While this provision does not mandate a prohibition on mandatory predispute arbitration, most commentators believe that the CFPB will inevitably find a scaling back of the use of mandatory predispute arbitrations provisions consistent with the findings of any study that they commission under this section of S.3217.

Mandatory predispute arbitration clauses are a vital tool for financial institutions to avoid class action lawsuits. Any prohibition or scaling back of these clauses could open up the floodgates for class action lawsuits involving consumer financial products and services and therefore will undoubtedly increase the costs of providing such products and services.

Preemption of State Law

Under S.3217, the Office of the Comptroller of the Currency (the “OCC”) is authorized to preempt state law “in accordance with the legal standard of the Supreme Court in *Barnett Bank v. Nelson*,” which holds that states may regulate national banks where “doing so does not prevent or significantly interfere with” a national bank’s exercise of its powers. However, national banks and thrifts are still likely to find themselves sub-

ject to potentially hundreds of state and local consumer protection rules because new procedural rules create potential barriers to obtaining preemption decisions. The OCC will not be permitted to preempt state law unless there is substantial evidence of conflict between state and federal law and the OCC finds that there is a substantive federal standard in place that regulates the activity in question. Questions remain to what extent these provisions will impede the ability of courts and Federal regulators to issue preemption decisions.

It should be noted that under S.3217, federal savings associations are subject to the same preemption standards as national banks. This may represent a change in existing thrift preemption provisions and questions remain over how seamlessly this will work.

Operating subsidiaries of national banks and federal savings associations would *not* receive the same preemption protections afforded national banks and federal thrifts. This would undercut protections given to such subsidiaries under existing OCC and the Office of Thrift Supervision rules and the recent decision by the Supreme Court in *Watters v. Wachovia Bank N.A.* This will lead to operating subsidiaries of national banks and federal thrifts being subject to the laws and rules of the state in which they are located.

Expansion of State Attorney Generals’ Powers

Like H.R. 4173, S.3217 expands state Attorney Generals’ general visitatorial powers and their ability both to enforce federal and state laws, and to obtain significant monetary damages on behalf of their citizens against national banks. These provisions go far beyond the recent Supreme Court decision in *Cuomo v. Clearing House Association* that permitted state Attorney Generals to go to court to enforce non-preempted state laws.

Additional Required Disclosures

The CFPB is authorized to issue rules requiring financial institutions to make dis-

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Update on Financial Services Reform Bill (cont'd.)

closures regarding the costs, benefits, and risks, in light of the facts and circumstances, for every covered financial product and service.

Additionally, the CFPB is required to issue rules requiring financial institutions to provide information, including costs, charges, and usage data to any customer who asks for it regarding any transaction with the financial institution. The data is to be made available electronically and through standardized formats, including machine-readable files, that the CFPB will design.

Every financial institution must maintain records of the number and dollar amount of the deposit accounts of its customers, for all branches, ATMs, and other deposit-gathering facilities. Customer addresses are to be geo-coded and identified as a residential or commercial customer. Every bank also is to make annual disclosures, for each branch, ATM or other facility, regarding the type of deposit account (including whether it is a checking or savings account) and data on the number and dollar amount of all accounts, by census tract of customer.

These additional disclosures will require much expense and time to comply with, costs that smaller institutions will have a harder time bearing.

Tax Law Compliance

A provision in S.3217 requires the CFPB to provide the IRS "with any report of examination or related information identifying possible tax law non-compliance." It is unclear whether this provision was intended to make CFPB examiners *de facto* IRS agents, but S.3217 appears to do just that.

Office of Financial Literacy

Under S.3217, the Director of the CFPB is required to establish an Office of Financial Literacy, "which shall be responsible for developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions." The Office of Financial Literacy is required to "develop and implement a strategy to improve the financial literacy of consumers that includes measurable goals and objectives...through activities including providing consumers access to financial counseling and information to assist with the evaluation of" products and services. While it is

impossible to exactly predict the type and effect of any programs implemented by the Office of Financial Literacy, past history may serve as a guide. The City of Chicago instituted an affordable housing program which required first-time home owners in certain areas to receive pre-purchase counseling to provide information on home ownership and mortgage products. Only after receiving a certificate of completion of counseling and meeting certain other requirements, would a potential home-buyer be eligible for the program. Under S.3217, the Office of Financial Literacy would have the authority to implement the same type of program on a nationwide basis.

Endnote

- 1 The Financial Stability Oversight Council consist of the following voting members: (1) the Secretary of the Treasury, who will serve as Chairperson, (2) the Chairman of the Fed, (3) the Comptroller of the Currency, (4) the Director of the CFPB, (5) Director of the Federal Housing Finance Agency, (6) the Chairman of the SEC, (7) the Chairman of the FDIC, (8) the Chairman of the CFTC, and (9) and independent insurance expert. The Council's purposes include identifying systematically important financial and non-financial companies, imposing enhanced prudential standards on such companies and prevent the expectation of taxpayer bailouts.

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