

Will There be a Consumer Financial Protection Agency?

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Introduction

Apart perhaps from the health care legislation, the bill that would create the Consumer Financial Protection Agency is probably the most complex piece of legislation Congress will take up this year or next. The definition section in the House version, H.R. 3126, is 20 pages long, with eight pages just to define “financial activity.” The list of included services is enormous, ranging from deposit-taking to servicing loans, debt collection, leasing, and financial data processing. And then, of course, at the end, there is authority for the agency to add any other business it thinks should be added to the list to protect consumers, if that business is incidental or complementary to a financial activity.

It is interesting to see which groups got themselves exempted from the bill that was reported out of the House Financial Services Committee—lawyers, accountants, real estate brokers, and auto dealers (including, I suppose, used car salesmen—the only group ranked lower in esteem among the public than Congress itself).

The exemption for real estate brokerage is particularly interesting. That, apparently, is not a financial activity against which consumers need protection, although leasing real property is. Mortgage brokerage is covered, of course, since some people—like the President of the United States—think it is the cause of the entire financial crisis. So consumers need protection when they rent a home and finance it, but not when they buy it.

These inclusions and exclusions are symptomatic of the problem presented by the CFPA: where does its jurisdiction actually end? It’s relatively easy to come up with activities that might or might not be included in the law that is eventually enacted, and the litigation could be endless.

Let’s take insurance brokerage. Acting as a broker for “personal property” is a financial activity under the bill. Is an insurance policy personal property? If so, then brokering insurance would be a financial activity.

However, the “business of insurance” itself is not a “financial activity,” and H.R. 3126 defines it this way:

The term “business of insurance” means the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by

persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons.

Does the phrase “all acts necessary to such writing” include brokerage? If so, then insurance brokerage is excluded.

But then there’s Section 125(d)(1)

Nothing in this title shall be construed as limiting the authority of the Director and the Agency from exercising powers under this Act with respect to the provision by a covered person of a product or service, not otherwise subject to this Act, for or on behalf of a person regulated by a State insurance regulator, in connection with a financial activity.

Insurance brokers are generally regulated by state insurance regulators, so maybe they are covered.

But then there’s section 142(d) (3):

No provision of this title shall be construed as altering, limiting, or affecting the authority of a State insurance commission or State insurance regulator under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or regulator.

So, maybe insurance brokers are subject to *both* the CFPA and to state insurance regulators.

This then raises the thorny issue of preemption. The question whether the law will ultimately include a provision to the effect that the national rule will preempt state rules on consumer protection is probably the most controversial element of this controversial legislation.

Like the rest of the bill, it’s also immensely complicated, and we haven’t even begun to plumb the confusions that can arise here.

The bill that emerged from the House Financial Services Committee has a complicated provision on preemption, but it applies only to the preemption of state laws as they apply to national banks. That’s the easy part.

As controversial as it is, preemption is relatively easy to understand when we are talking about the national bank regulator having authority to preempt state laws applicable to national banks.

But if preemption is written into this law, it would have far more unsettling effects than traditional preemption. For example, it’s one thing to say that national bank regulations preempt state consumer protection rules for nationally chartered banks. But the CFPA has authority over deposit-taking and lending generally, so that if there is preemption in this law it could mean that states cannot apply their own consumer protection rules to their own state-chartered banks. This would be national rules preempting *state* regulations applicable to *state* banks.

It also has peculiar effects elsewhere. If there is preemption, an ordinary corporation engaged in, say, check cashing, could operate under a national rule in every state, but national retailers—which are excluded from the CFPA’s coverage under H.R. 3126—would be subject to state-by-state regulation. Under some circumstances, it would be better for a company to be covered by the CFPA than to be exempt.

On the other hand, if there is no pre-emption, many small companies that are today subject to few or no consumer protection laws in many of the states in which they operate, would suddenly become subject to a new and costly regulatory regime. The effect would be to drive the smaller companies out of business or force them to consolidate.

The bill also contains significant new powers for the SEC, and an attempt to reverse a Supreme Court decision last year in the Stoneridge case that limited the scope of so-called “scheme liability” in securities class actions.

The statute’s complexity is such that there are bound to be many questions about its language raised in the House. The Senate is likely to be an even more hostile environment.

The powerful banking industry opposes the bill, and the powerful consumer groups favor it. The new powers for the SEC and the reversal of the Stoneridge case will bring in the entire business community on one side and the trial lawyers on the other. Needless to say, the bank regulators do not favor the loss of their consumer protection role.

The question we’ll review today is whether a bill this complex and far-reaching—with potential anti-competitive effects across our entire economy—can make it through the legislative process this year, or even in 2010.

None of the experts on our panel is a specialist in the arcane business of predicting what Congress will or can do, but the issues they will raise should allow you to understand what is at stake in this legislation and how difficult it will be to get it through Congress this year or next.