



*GEORGETOWN UNIVERSITY LAW CENTER*

***Adam J. Levitin***

*Professor of Law*

**Written Testimony of**

**Adam J. Levitin**

**Professor of Law**

**Georgetown University Law Center**

Before the United States Senate  
Committee on Banking, Housing, and Urban Affairs

“Enhanced Consumer Financial Protection After the Financial Crisis”

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### **Witness Background Statement**

**Adam J. Levitin** is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in bankruptcy, commercial law, consumer finance, contracts, and structured finance. He has previously served as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP). Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College, all with honors.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony, and is not testifying on behalf of any organization.

Mr. Chairman Johnson, Ranking Member Shelby, Members of the Committee:

My name is Adam Levitin, and I am a Professor of Law at the Georgetown University Law Center in Washington, D.C., where I teach courses consumer finance, contracts, and commercial law.

I am here today to testify before the Committee about the need for enabling the new Consumer Financial Protection Bureau (CFPB) to carry out its mission of ensuring a fair, equitable, and transparent consumer financial products marketplace and protecting consumers from unfair, deceptive, or abusive financial products. The creation of the CFPB was one of the most significant parts of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is important that the CFPB be given a chance to get up and running and before Congress entertains reforms to the Bureau's structure.

The CFPB will go on-line this Thursday, July 21.<sup>1</sup> But the CFPB will not be able to exercise the full powers granted it by Title X of the Dodd-Frank Act, until and unless a Director is appointed by the President. Instead, the Treasury Secretary will become the acting Director, but will be limited to exercising the CFPB's powers under subtitle F of Title X.<sup>2</sup> These powers include enforcement of existing federal consumer financial protection laws and bank examination authority.<sup>3</sup> Absent the appointment of an initial Director, however, the CFPB may not examine non-banks or exercise its organic rulemaking powers, as these powers are granted to the CFPB in other subtitles of Title X of the Dodd-Frank Act.

This past weekend the White House announced that it would be nominating Richard Cordray as Director for the CFPB. Mr. Cordray, currently serving as head of enforcement for the CFPB, is an outstanding and superbly qualified nominee with an impressive record as an advocate for consumer financial protection as the former Attorney General of Ohio. I urge the Senate to act expeditiously on the nomination, so that the CFPB may exercise its full powers and carry out the mission tasked to it by Congress.

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In this written testimony, I address two points: the need for a CFPB and the oversight of the CFPB.

The CFPB was a much-needed response to a deep flaw in the regulatory architecture that left consumer financial protection an "orphan mission" among federal regulators, consistently subordinated to the protection of bank safety-and-soundness—that is the protection of bank profitability. A dedicated, unconflicted consumer financial protection regulator is necessary not only to deal with the "bad apples" that exist in any market because of the strong incentives in the consumer finance marketplace for all financial service providers to avoid transparent products.

In recent months there has been a great deal of attention paid to the accountability and oversight of the CFPB, even before the Bureau is operational. What is remarkable about this concern is the deafening silence about accountability and oversight for the existing federal bank regulators, on whose watch the financial crisis occurred. Congress required a limited, one-time audit of the Federal Reserve<sup>4</sup> and limited the Federal Reserve's ability to bail out individual

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<sup>1</sup> See Pub. L. 111-203, § 1062, 124 Stat. 1376, 2039-40, July 21, 2010.

<sup>2</sup> Pub. L. 111-203, § 1066, 124 Stat. 1376, 2055, July 21, 2010.

<sup>3</sup> Pub. L. 111-203, § 1061, 124 Stat. 1376, 2035-39, July 21, 2010.

<sup>4</sup> Pub. L. 111-203, § 1109, 124 Stat. 1376, 2127, July 21, 2010.

firms (but not entire industries) under section 13(3) of the Federal Reserve Act,<sup>5</sup> and eliminated the Office of Thrift Supervision.<sup>6</sup> But there were no substantive, lasting changes made to the oversight of the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC, the SEC, or the CFTC. These agencies failed epically in their missions of ensuring the safety-and-soundness of US financial institutions and systemic stability, but their oversight has not be changed, whereas the CFPB has not even opened for business and yet it is being proscribed as a “rogue” agency.

Many of those now raising concerns about CFPB oversight were opposed to the creation of the CFPB in the first place. None of them have expressed similar concerns about the oversight of financial regulatory agencies that failed in their missions. Given that the CFPB has, in fact, been designed to be more accountable than any other federal bank regulator, it is hard to ascribe concerns about CFPB accountability and oversight to anything other than a political distaste for consumer financial protection.

As I detail below, the CFPB has unprecedented (and possibly unconstitutional) checks on its authority. To date, the CFPB implementation team has won nothing but praise from its prospective regulates for the thoughtfulness and inclusiveness of its initial steps in the regulatory process.<sup>7</sup> Until and unless actual problems with the CFPB’s operations emerge, there is no reason to adjust its oversight structure. In short, there is no evidence of an oversight problem that needs to be addressed. At this point, it is hard to understand concerns about CFPB oversight other than attempts to hobble the CFPB before it can get up and running.

## **I. WHY A CONSUMER FINANCIAL PROTECTION BUREAU?**

### ***A. The Regulatory Architecture Pre-Dodd-Frank Left Consumer Financial Protection an “Orphan Mission”***

Although the financial crisis is not yet three years old, it is important to recall the reasons for creating a CFPB in the first place.<sup>8</sup> A critical reason for the creation of the CFPB was the recognition that the current system of consumer financial protection does not work and contributed significantly to the housing bubble and financial crisis. In the current system (set to expire on July 21), 17 separate federal consumer financial protection statutes are enforced by ten federal agencies with other primary and often conflicting missions.<sup>9</sup> Figure 1, at the end of this testimony, illustrates the current crazy quilt structure.

Some of these agencies have the ability to promulgate regulations, some also exercise supervisory authority over financial institutions, and some can only enforce existing regulations. Sometimes authority is over a class of institutions, and sometimes it is over a particular type of product. This situation makes industry-wide rule-making extremely difficult. For example, a rulemaking that would cover all credit cards necessitated coordination between the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration. The result was that consumer protection became a bone in regulatory turf wars and inaction dominated.

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<sup>5</sup> Pub. L. 111-203, § 1101, 124 Stat. 1376, 2113, July 21, 2010.

<sup>6</sup> Pub. L. 111-203, Title III, 124 Stat. 1376, 1520-1570, July 21, 2010.

<sup>7</sup> Kate Davidson, *New CFPB Mortgage Disclosures Win Praise for Content and Process*, AM. BANKER, May 19, 2011.

<sup>8</sup> Adam J. Levitin, *The Consumer Financial Protection Agency*, Pew Financial Reform Project, Briefing Paper, No. 2, 2009.

<sup>9</sup> *Id.*

Only one agency currently tasked with consumer financial protection, the Federal Trade Commission, even has consumer protection as its primary role. The FTC, however, has very limited jurisdiction in financial services—it cannot regulate federally-chartered or insured banks, thrifts, or credit unions. This leaves only bit-players in financial services within the FTC’s regulatory ken. The result has been that because consumer protection has been everyone’s responsibility, it has been no one’s responsibility, and accountability and performance have suffered therewith. Put another way, because no agency had as its sole mission consumer financial protection and authority over the entire consumer finance industry, consumer financial protection frequently fell between the cracks—it was an orphan mission.

Nowhere can this problem be seen more clearly than in the run up to the financial crisis. Many factors contributed to the crisis, but none more so than an orgy of unsound leverage in the home mortgage market. Federal financial regulators had sufficient ability to limit the excesses in the mortgage lending market. The Federal Reserve Board had the power to restrict some of the most predatory products under the Home Owners Equity Protection Act, and the Office of Comptroller of the Currency and Office of Thrift Supervision had broad ability to rein in the most egregious bank and bank service company activities both in direct lending and in the warehouse lending and securitization that financed non-bank mortgage lenders. None of them acted.

Astonishingly, the financial crisis has not chastened these regulators. This past year, in the midst of the nation’s worst foreclosure crisis ever, the Federal Reserve Board proposed a rule-making that would have gutted the Truth in Lending Act right of rescission, the strongest defense homeowners have against foreclosures.<sup>10</sup> The Federal Reserve Board again proved itself deaf to consumer protection concerns in its recent rule-making under the Durbin Interchange Amendment, in which ignored basic economics to question whether there would be any consumer savings as the result of lowered interchange fees. And the Office of the Comptroller of the Currency, which used preemption to shield subprime mortgage lenders from state regulation without substituting its own consumer protections,<sup>11</sup> has proposed revised preemption standards that flagrantly disregard Congress’s express directions on preemption in the Dodd-Frank Act.<sup>12</sup>

Had the CFPB existed in 2004-2008, it might well have saved this country from the housing bubble and subsequent collapse. Had the CFPB existed in 2004-2008, it could have regulated the mortgage market to curtail predatory lending practices, such as widespread use of payment-option adjustable rate mortgages (“pick-a-pay” mortgages) and other unsustainable financial products. The CFPB could also have insisted on the very standards that Congress demanded in title XIV of the Dodd-Frank Act, including that mortgage lending be conditioned on the ability to repay, not the ability to refinance.

Congress rightly recognized the severe shortcomings of the current system of consumer financial protection when it enacted Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act and created the Bureau of Consumer Financial Protection. In so doing,

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<sup>10</sup> Donna Borak, *Consumer Groups, Lawmakers Press Fed to Withdraw TILA Plan*, AM. BANKER, Jan. 6, 2011.

<sup>11</sup> See *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007) (upholding OCC preemption of state attempts to regulate subprime mortgage lenders); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143 (2009) (detailing OCC and OTS preemption of state mortgage regulations without substituting equivalent federal regulations).

<sup>12</sup> Pub. L. 111-203, § 1044, 124 Stat. 1376, 2010, July 21, 2010; Letter from Treasury General Counsel George W. Madison to Acting Comptroller of the Currency John Walsh, June 27, 2011 (stating that OCC’s approach to preemption was incompatible with the text and legislative history of Section 1044(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act).

it consolidated consumer financial protection into a single agency with a single director who can be held accountable for the agency's performance. Congress also gave the new agency sufficient funding and budgetary independence to ensure that consumer financial protection, like other parts of bank regulation, will not be held hostage to politics because it is too important to financial stability. The new agency has substantial powers to regulate consumer financial products, but it is also subject to even more substantial safeguards that make it more accountable than any other comparable federal agency.

***B. Competition in the Consumer Finance Market Discourages Product Transparency, so Regulatory Involvement Is Necessary***

The CFPB's mission is to ensure a fair, equitable, and transparent consumer financial products marketplace and protecting consumers from unfair, deceptive, or abusive products. Unfortunately, the dynamics of the consumer finance market place discourage transparency and easy-to-price products. It is precisely this dynamic that calls for regulatory involvement to foster transparency and thus encourage optimal competition.

Transparently priced products have smaller profit margins because consumers can comparison shop more easily on an apples-to-apples basis, as it were. This creates a strong incentive for financial service providers to market complex, opaquely priced products that cannot be readily compared with other products. This is done by having multiple price-points on products or by bundling products together or by having behaviorally-contingent pricing, such as late fees. As a result, it is very difficult to know in advance the total cost of using most consumer financial product.

Consider the purchase of a new car. One can easily shop around on the web for price quotes, but those are quotes for the car itself (and frequently not for exactly the model the dealer has in stock). The car, however, is sold as part of a bundle of goods and services. The total price paid is a combination of the sale price on the car, warranties, financing costs, trade-in value, rust-proofing, gap insurance, etc. It is extremely difficult to do comparison-shopping on the all-in price of the car purchase.

A similar story exists for credit cards. Credit cards have multiple price points—typically a purchase APR, a cash advance APR, and a default APR, an overlimit fee, an annual fee, a late fee, a foreign transaction fee, and numerous other possible fees. They also have rewards programs, which are a type of negative pricing. Unless a consumer knows exactly how he or she will use a card, it is impossible to know just how much the card will cost to use and therefore how it compares with other cards. The Credit CARD Act of 2009 rectified some of these problems, such as the possibility that interest rates would change on cardholders retroactively, but the complexity of credit card pricing still bedevils consumer attempts to compare total costs of use in advance.

In the world of mortgages, it is only slightly better. It is relatively easy to compare the cost of simple, largely standardized products like 30-year fixed-rate mortgages, especially as the Real Estate Settlement Procedures Act requires disclosure of the closing costs in advance.<sup>13</sup> But adjustable-rate products and prepaid interest (points) complicate comparison-shopping. Moreover, there is no place a consumer can go to get mortgage quotes from every lender in the market. The mortgage market is a market where financial institutions from across the US should

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<sup>13</sup> 12 U.S.C. §§ 2603 (requiring use of uniform settlement statement), 2604(c) (requiring good faith estimate of settlement costs).

be competing on every loan. Yet mortgage brokers typically offer quotes from only three or four lenders, and on-line sites like Lending Tree have similarly limited stables of lenders. Comparison is easier, but the menu is restricted.

All of this produces an inefficient consumer finance marketplace in which consumers often overpay for products they neither need (credit life or gap insurance, e.g.) nor want (e.g., American Express provides cardholders with insurance for repatriation of remains if you die abroad—an irrelevant benefit to those who do not travel abroad).<sup>14</sup> Consumer financial products should be commodities—with very thin commodity profit margins; they involve the ultimate fungible—money. Consumer financial product pricing, however, is anything but commoditized. That inefficiency is very profitable, however, to financial institutions that are able to craft their products to take advantage of consumer misperception of total cost.

In this marketplace, it is very difficult for financial institutions, like community banks and credit unions, that offer fair, transparent, simple products to compete. While their products are in fact price-competitive, especially when customer service is accounted for, consumers do not recognize this. For example, a credit card lender that listed only one, all-in interest rate and no fees would have to list a much higher APR than card lenders that use multiple interest rates and also have multiple fees. That high APR would likely scare away potential customers, even if the all-in cost of using the card was lower than that of other cards.<sup>15</sup>

All of this speaks to a need for regulatory involvement in the consumer financial marketplace to encourage more transparent pricing and thus better price competition to benefit consumers. Federal regulation of consumer financial services is primarily through disclosure regulation. Disclosure has only recently become the focus of serious scientific examination; previously it was prescribed as a regulatory fix as a matter of faith, not knowledge. We are quickly learning that while disclosure can have a powerful impact on consumer behavior, the manner in which it is done has an enormous impact on its effectiveness. Done well, disclosure is an important tool producing the information necessary to make markets work. Done poorly, disclosure can actually create market inefficiency. Having an agency like the CFPB that can develop deep expertise on consumer financial products is likely to result in better and more effective disclosures and thus more transparent consumer financial products and more efficient markets.

## **II. THE CFPB IS MORE ACCOUNTABLE THAN ANY OTHER COMPARABLE FEDERAL AGENCY**

Some members of Congress have expressed concern about the CFPB's accountability. As noted above, it is hard to understand these concerns as anything other than cover for a political agenda of gutting the CFPB because there are not the votes to kill off the Bureau outright. As a purely factual matter, concerns about CFPB accountability are puzzling. As detailed below, the CFPB has an extensive and unusual set of oversight provisions that make it more accountable than any other federal financial regulator. Table 1, below, compares the oversight of the CFPB with that of the Environmental Protection Agency, Federal Deposit Insurance Corporation, Federal Reserve Board of Governors, Federal Trade Commission, Office of the Comptroller of the Currency, Office of Thrift Supervision, Securities and Exchange

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<sup>14</sup> This sort of bundling is similar to the problem with cable TV, where consumers are forced to buy bundles of channels that include many channels that they never watch.

<sup>15</sup> See Adam J. Levitin, *New Credit Card Tricks, Traps, and 79.9% APRs*, CREDIT SLIPS, Dec. 18, 2009, at <http://www.creditslips.org/creditslips/2009/12/new-credit-card-tricks-traps-and-799-aprs.html>.

Commission, and the Social Security Administration. The EPA and the Social Security Administration are included in the comparison because the wide-swathes of the economy they effect.

Table 1 shows in succinct form, that the CFPB and these other agencies all share several key oversight devices: APA rulemaking, APA adjudication, Congressional oversight, and moral suasion by the Administration. Beyond that, there is variation in oversight devices. The CFPB is not subject to the same additional oversight devices as the other agencies, but it is certainly subject to significant additional oversight via the annual GAO audit, OIRA SBREFA reviews, a budgetary cap, and the FSOC veto. This is far greater oversight than there is for the other federal bank regulators—OCC, the OTS, the Federal Reserve Board, and the FDIC—or for the SEC. The particular oversight mechanisms that apply to the CFPB are detailed below.

**TABLE 1. COMPARISON OF OVERSIGHT OF CFPB AND OTHER AGENCIES**

|                                                     | EPA | FDIC | FRB | FTC | OCC | OTS | SEC | SSA | CFPB |
|-----------------------------------------------------|-----|------|-----|-----|-----|-----|-----|-----|------|
| <b>APA Rulemaking</b>                               | YES | YES  | YES | YES | YES | YES | YES | YES | YES  |
| <b>APA Adjudication</b>                             | YES | YES  | YES | YES | YES | YES | YES | YES | YES  |
| <b>Budget Subject to Appropriations</b>             | YES |      |     | YES |     |     | YES | YES |      |
| <b>Budget Capped</b>                                |     |      |     |     |     |     |     |     | YES  |
| <b>OIRA Review of Economically Significant Regs</b> | YES |      |     | YES | YES | YES |     | YES |      |
| <b>OIRA SBREFA Review</b>                           | YES |      |     |     |     |     |     |     | YES  |
| <b>FSOC Veto</b>                                    |     |      |     |     |     |     |     |     | YES  |
| <b>Annual GAO Audit</b>                             |     |      |     |     |     |     |     |     | YES  |
| <b>Term in Office &lt;5 Years</b>                   | YES |      |     |     |     |     |     |     |      |
| <b>5-member Commission</b>                          |     | YES  | YES | YES |     |     | YES |     |      |
| <b>Bipartisan Representation Requirement</b>        |     | YES  |     | YES |     |     |     |     |      |
| <b>Presidential Removal without Cause</b>           | YES |      |     |     | ?   | ?   |     |     |      |
| <b>Congressional Oversight</b>                      | YES | YES  | YES | YES | YES | YES | YES | YES | YES  |
| <b>Moral Suasion by Administration</b>              | YES | YES  | ?   | YES | YES | YES | YES | YES | YES  |

### *Administrative Procedures Act Safeguards*

The CFPB is subject to the Administrative Procedures Act and must follow notice-and-comment procedures for rulemaking and adjudication.<sup>16</sup> This means that the CFPB will be required to take account of and respond to a range of views and concerns on any regulatory issue on which it undertakes rule-making and that these rule-makings can be challenged in federal court.

### *OIRA Small Business Impact Reviews*

CFPB rulemaking is subject to Office of Information and Regulatory Affairs (OIRA) review for small business impact.<sup>17</sup> Only the Environmental Protection Agency (EPA) and Occupational Safety and Health Administration (OSHA) are subject to similar requirements.

### *Specific Statutory Limitations on CFPB Rulemaking*

<sup>16</sup> P.L. 111-203, § 1053, 124 Stat. 1376, 2010, July 21, 2010, *codified at* 12 U.S.C. § 5563 (making CFPB hearings and adjudications subject to the Administrative Procedures Act, 5 U.S.C. §§ 553-554).

<sup>17</sup> P.L. 111-203, § 1100G, 124 Stat. 1376, 2112, July 21, 2010; 5 U.S.C §§ 601-612; Executive Order 12866 of September 30, 1993.

The CFPB is specifically limited by statute in its rule-making power. Title X of the Dodd-Frank Act requires that the CFPB make particular findings, including cost-benefit analysis, in order to exercise its authority to restrict or prohibit acts and practices as unfair, deceptive, or abusive.<sup>18</sup> It is also worth emphasizing what the CFPB *cannot* do:

- The CFPB cannot force financial institutions to extend credit.
- The CFPB cannot mandate the offering of any financial product.
- The CFPB cannot require financial institutions to offer “standard” or “plain vanilla” products if they offer “alternative” products.<sup>19</sup>
- The CFPB cannot require consumers to purchase financial products.
- The CFPB cannot impose usury caps.<sup>20</sup>
- The CFPB cannot regulate non-financial businesses.<sup>21</sup>
- The CFPB cannot create private rights of action.

At most, then, the CFPB can curtail the offering of certain financial products. This is a critical point because it means that it is virtually impossible for CFPB actions to be a source of systemic risk because it cannot force financial institutions to make loans that they do not wish to make.

### ***Statutory Budget Cap***

The CFPB is subject to a budgetary cap, unlike any other federal bank regulator. Unlike most regulatory agencies, federal bank regulators are budgetarily independent; they are not funded through the appropriations process. Viewed in this framework, the CFPB is actually less independent than other federal bank regulators. If the Office of Comptroller of the Currency or FDIC or OTS wishes to increase their budget, they can simply increase their assessments on banks without so much as a by-your-leave to Congress. Similarly, the Federal Reserve can simply print money. The CFPB, however, is restricted to a capped percentage of the Federal Reserve’s operating budget.<sup>22</sup> This means that the CFPB actually has less budgetary independence than any other federal bank regulator.

The budgetary independence of bank regulators and the CFPB represents what prominent conservative legal scholar Richard Epstein has termed “second order rationality,” namely steps people take to protect themselves against their own lack of self control. It is tempting for Congress to play politics with bank regulation or consumer protection. Thus, if bank regulators’ budgets were subject to the appropriations process, the agencies’ effectiveness and thus the President’s Constitutional obligation to enforce federal laws could be held hostage by a minority in either house of Congress.

The independent funding of the bank regulators and CFPB is designed to guard against that very possibility. The CFPB’s budgetary independence recognizes that federal budgets are complex, negotiated deals that don’t allow for proper airing of policy issues. In a federal budget, the CFPB’s funding might be held hostage for issues that have nothing to do whatsoever with the CFPB like deficit reduction. One of the insights from the mortgage crisis is that consumer

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<sup>18</sup> P.L. 111-203, § 1031, 124 Stat. 1376, 2005-06, July 21, 2010, *codified at* 12 U.S.C. § 5531

<sup>19</sup> Notably, this “plain vanilla” concept was formerly required by the Federal Home Loan Bank Board, which required federal thrifts that offered adjustable-rate mortgages to also offer borrowers fixed-rate mortgages. 45 Fed. Reg. 79493, Dec. 1, 1980; 12 C.F.R. § 545.6-4(a) (1980).

<sup>20</sup> P.L. 111-203, § 1027(o), § 1027(o), 124 Stat. 1376, 2003, July 21, 2010, *codified at* 12 U.S.C. § 5517(o).

<sup>21</sup> P.L. 111-203, § 1027(a), 124 Stat. 1376, 1995-98, July 21, 2010, *codified at* 12 U.S.C. § 5517(a).

<sup>22</sup> P.L. 111-203, § 1017(a)(2), 124 Stat. 1376, 1975, July 21, 2010, *codified at* 12 U.S.C. § 5497.

protection is simply too central to economic stability to subject to the politic of the appropriations process.

S. 737, the Responsible Consumer Financial Protection Regulations Act of 2011 (the “Moran Bill”) would subject the CFPB—but no other federal bank regulator—to the annual appropriations process. I strongly urge the Committee to reject this proposal. Subjecting the CFPB to the appropriations process would do far greater damage to consumers and the economy than any wayward action by the CFPB. If the CFPB is subject to appropriations, it will be a cyclical and ultimately ineffective agency, as its budget becomes a political football.

### ***GAO Review***

The CFPB’s budget is subject to an annual audit by the Government Accounting Office, with the results reported to Congress.<sup>23</sup> No other federal bank regulator is subject to such an audit.

### ***Financial Stability Oversight Council Veto***

CFPB rulemaking is subject to a veto by the Financial Stability Oversight Council. This is unique for federal bank regulators.<sup>24</sup> The OCC and OTS’s preemption actions, for example, are not subject to review by other federal regulators, even though they were a key element in fostering the excesses in the housing market.<sup>25</sup> The FSOC veto provides an unusually strong check on CFPB rulemaking, not least because no CFPB director would wish to risk a FSOC rebuke.

### ***Congressional Oversight***

The CFPB is subject to oversight by Congress itself. The CFPB Director must make periodic reports to Congress and appear before Congressional committees.<sup>26</sup> This Committee’s actions, as well as those of the House Financial Services Committee and House Government Oversight and Reform Committee, show that this oversight is serious, diligent, and exacting, with no less than six hearings in the past four months focused on the CFPB.<sup>27</sup> Congressional oversight is perhaps the best guarantor that the CFPB will not abuse the authority delegated to it.

### ***Moral Suasion***

The CFPB Director may be removed only “for cause,” a standard that also applies to the Federal Reserve Board, the FDIC, the FTC, and SEC. The standard may also apply to the OCC

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<sup>23</sup> P.L. 111-203, § 1017(a)(5), 124 Stat. 1376, 1976-77, July 21, 2010, *codified at* 12 U.S.C. § 5497.

<sup>24</sup> The only other federal regulatory agency that I have identified that is subject to an override by another agency is the Public Company Accounting Oversight Board (PCAOB). The Supreme Court found the PCAOB structure to be unconstitutional. *Free Enterp. Fund v. Pub. Company Accounting Oversight Bd.*, 130 S. Ct. 3138 (2010).

<sup>25</sup> See *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007) (upholding OCC preemption of state attempts to regulate subprime mortgage lenders); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143 (2009) (detailing OCC and OTS preemption of state mortgage regulations without substituting equivalent federal regulations).

<sup>26</sup> P.L. 111-203, § 1016, 124 Stat. 1376, 1974, July 21, 2010, *codified at* 12 U.S.C. § 5496.

<sup>27</sup> See, e.g., “Consumer Financial Protection Efforts: Answers Needed,” Hearing Before the House Committee on Oversight and Government Reform, July 14, 2011; “Mortgage Servicing: An Examination of the Role of Federal Regulators in Settlement Negotiations and the Future of Mortgage Servicing Standards,” Joint Hearing Before the House Committee on Financial Institutions, Subcommittee on Financial Institutions and Consumer Credit and the Subcommittee on Oversight and Investigations, July 7, 2011; “Who’s Watching the Watchmen? Oversight of the Consumer Financial Protection Bureau,” Hearing Before the House Committee on Oversight and Government Reform, Subcommittee on TARP, Financial Services, and the Bailouts of Public and Private Programs, May 24, 2011; “Legislative Proposals to Improve the Structure of the Consumer Financial Protection Bureau,” Hearing Before the House Committee on Financial Institutions, Subcommittee on Financial Institutions and Consumer Credit, April 6, 2011; “Oversight of the Consumer Financial Protection Bureau,” Hearing Before the House Committee on Financial Institutions, Subcommittee on Financial Institutions and Consumer Credit, Mar. 16, 2011.

and OTS Director; the United States Code is silent in this respect.<sup>28</sup> Even when a for-cause dismissal standard applies, however, a President may exercise considerable moral suasion over the head of an agency. There are few individuals that would refuse a Presidential request to resign even if they were within their legal rights to do so.

### **III. RESTRUCTURING THE CFPB FROM A UNITARY DIRECTORSHIP TO A FIVE-PERSON COMMISSION**

One proposal for “reforming” the structure of the CFPB—the Moran Bill, S. 737 (and its House analog, the Bachus Bill, H.R. 1121)—would replace the CFPB’s unitary director with a five-person commission.<sup>29</sup> While I understand the belief that a five-person commission might result in a more collegial rule-making discourse, there are several strong reasons to eschew such a structure, which will ultimately render the CFPB less effective and less accountable.

In structuring administrative agencies, Congress has variously elected between two models: the Founders’ traditional model of a unitary agency director and the Progressive/New Deal era model of five-person commissions. The Founding Fathers’ model for executive agencies featured a single principal officer appointed by the President with the advice and consent of the Senate. This model is reflected in the federal cabinet agencies. Thus, the Treasury is governed by a single Secretary, rather than by committee. The traditional unitary director model is also featured in the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Internal Revenue Service, the Social Security Administration, Medicare, and the Environmental Protection Agency. This model enhances accountability and enables streamlined, decisive leadership and decision-making.

An alternative agency model arose during the Progressive era and was warmly embraced by New Deal liberals. That is the five-person commission. Thus, Progressive era agencies like the Federal Trade Commission and the classic New Deal agencies like the Securities and Exchange Commission, Federal Deposit Insurance Corporation, and National Labor Relations Board feature five-person commissions, and the National Credit Union Administration has a three-member board. The multi-member commission model is also featured by the Federal Reserve Board of Governors, the Federal Communications Commission, Federal Election Commission, Equal Employment Opportunity Commission, Federal Mine Safety and Health Review Commission, Commodities Futures Trading Commission, and Consumer Product Safety Commission. For some of these agencies there is a limit of the number of commissioners who may belong to any political party, while other agencies, like the Federal Reserve Board, have geographic appointment requirements.

The scholarly literature on agency design has not achieved any consensus as to the superior form of organization.<sup>30</sup> Instead, it recognizes that there are trade-offs involved. Thus, the five-person commission model encourages more collegial discourse and deal-making, but

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<sup>28</sup> An internal Treasury Department Legal Memorandum assumes as a passing point that the OTS Director (and presumably the Comptroller) serves at the pleasure of the President, but this memorandum has no controlling legal effect, and the United States Code is silent on the matter. See Memorandum Opinion for the General Counsel, Department of the Treasury, and the Chief Counsel, Office of Thrift Supervision, Re: Post Employment Restriction of 12 U.S.C. § 1812(e) (Sept. 4, 2001).

<sup>29</sup> S. 737, the Responsible Consumer Financial Protection Regulations Act of 2011 (the “Moran Bill”); H.R. 1121, the Responsible Consumer Financial Protection Regulations Act of 2011 (the “Bachus Bill”).

<sup>30</sup> See, e.g., Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15 (2011). The last time the federal government formally examined the question of agency structure, in 1971 during the Nixon Administration, the President’s Advisory Council on Executive Organization (known as the “Ash Council,” after its Chairman Roy L. Ash) issued as *Report on Selected Independent Regulatory Agencies*, Feb. 11, 1971, that recommended replacing multi-member commissions with single-executive agencies.

comes at the expense of accountability and efficiency. Moreover, it often provides little protection for the minority party on the commission; minority commissioners' views are typically disregarded and provide extremely limited protection against abuses by the majority.

In the case of the CFPB there are particularly salient reasons *not* to adopt a multi-member commission structure. For consumer financial protection, we should want a structural bias toward action rather than inaction. We have seen the result of financial regulators asleep at the switch. The price tag was hundreds of billions of dollars in taxpayer-funded bailouts of Wall Street. It is hard to believe that any member of Congress would want to replicate such a situation. Ensuring that the CFPB retain an organization structure that enables efficient, issue-driven decision-making requires maintaining the CFPB's current single director structure.

***The CFPB's Unitary Directorship Fosters Efficient Decision-making and Avoids Gridlock and Horse-Trading***

A single director is able to exercise decisive leadership in promulgating rules and enforcing them. A single director also does not have to engage with horse-trading with other commission members to wrangle up votes on an issue. This means that each issue will be decided on its own merits, rather than as part of a multi-issue deal involving commissioners' pet projects. Such a streamlined decision-making structure avoids the gridlock that often faces commissions. The five-person commission structure proposed by S.737 and H.R. 1121, would induce inefficiency in government, as it permit rules to be promulgated only when a quorum (generally 3/5 commissioners) affirmatively votes for the rules.

The quorum requirement is a particular concern because of the frictions in the Senate confirmation process. Numerous administrative and judicial positions remain unfilled today because of the difficulty at achieving confirmation of nominees given the Senate's internal rules that effectively create supermajority requirements not found in the Constitution. The effect has been not only to block many nominations, but also to chill potential nominations. The Senate's confirmation process has become so dysfunctional that a bipartisan group of Senators (including Majority Leader Reid, Minority Leader McConnell, and Senators Schumer, Alexander, Collins, and Lieberman) has introduced legislation, S. 679, which would reduce or streamline the number of executive branch positions requiring Senate confirmation by one-third.

This state of affairs presents the most serious threat to the effectiveness of the modern administrative state—federal agencies have had to operate without directors or chairmen or even quorums because of the increased frictions in the confirmation process. As a result, these agencies are less effective or simply ineffective at ensuring that the law is carried out. Thus, in recent years, the Federal Trade Commission, the Consumer Product Safety Commission, and the National Labor Relations Board have all gone through spells where they have been unable to operate because a quorum did not exist.

Simple math says that five confirmations are more difficult to achieve than a single confirmation (even if multiple appointments sets up opportunities to make political deals on appointments). Put differently, adopting a five-person commission instead of a unitary directorship is likely to hobble the CFPB. While I would hope that the production of gridlock is not the motivation for such a proposal, it could well be the consequence.

### ***A Five-Person Commission Would Create Unnecessary Big Government Bloat and Waste***

Changing from a unitary directorship to a 5-person commission would also contribute to big government bloat. There is no reason to pay five people top-of-the-executive-branch pay scale salaries and benefits for work that could be done by one person, not to mention the personal staff, office space, and other accommodations for five commissioners. A five-person commission is simply wasteful and should not be pursued, particularly when we are facing a federal budget crisis.

### ***A Five-Person Commission Would Reduce CFPB Accountability***

A single CFPB director is clearly accountable to both Congress and the American people. A CFPB Director who oversteps his authority or who fails to do enough to protect consumers cannot deflect blame for his actions. A gaggle of commissioners, on the other hand, can always avoid responsibility by pointing to the other four people who make up the commission. If Congress wants to maximize CFPB's accountability, responsiveness, efficiency, and effectiveness, the unitary directorship should be retained.

### ***The CFPB's Unitary Directorship Is Necessary as a Counterweight to the OCC***

A major reason for the creation of CFPB was to create a counterweight to the strength of the federal bank regulators. The primary mission of federal bank regulators is to ensure the safety-and-soundness of their regulatory charges. **Safety and soundness means, first and foremost, profitability.**

It is axiomatic that a financial institution that is not profitable cannot be safe and sound. Consumer financial protection, however, is often inconsistent with bank profitability. Financial institutions only engage in unfair, deceptive and abusive acts and practices because they are profitable; they are not done for spite or Sadism. Predatory mortgage lending, for example, exists only because it is profitable.

Federal bank regulators have repeatedly shown that they will favor bank profitability over consumer protection. Thus, a major impetus for the creation of the CFPB was to separate consumer protection regulation from safety-and-soundness regulation so that consumer would not be subordinated to bank profitability.

To do so effectively, however, it is necessary to give the CFPB the same tool-kit as the most powerful of the federal bank regulators, the Office of the Comptroller of the Currency (OCC). The OCC has a unitary director, an independent source of funding, and substantial statutory independence from Treasury. This allows the OCC to act quickly and decisively and without undue quotidian political pressure and without the politicking and horse-trading that goes on with multi-member commissions. The OCC has proven itself to be a capable and aggressive advocate for the interests of national banks, even at the expense of the national interest. Indeed, the OCC has insisted on such an extreme view of its ability to preempt state law, even post-Dodd-Frank that it was rebuked by the Treasury Department, an unprecedented occurrence.<sup>31</sup>

The CFPB is deliberately designed to be a parallel and counterweight to the OCC to allow consumer protection concerns to be given equal weighting to bank profitability (also

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<sup>31</sup> Letter from Treasury General Counsel George W. Madison to Acting Comptroller of the Currency John Walsh, June 27, 2011 (stating that OCC's approach to preemption was incompatible with the text and legislative history of Section 1044(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act).

known as safety-and-soundness) and avoid the problems that result when consumer protection is subordinated to bank profitability. This requires having a unitary directorate, rather than a multi-member commission.

If the Committee is convinced, however, that a five-person commission is the proper structure for the CFPB, I would urge the Committee to also adopt a five-person commission structure for the Office of Comptroller of the Currency, which would then be the sole federal financial regulator with a unitary directorship. What is good enough for consumers should be good enough for banks.

I would urge the Committee against adopting a five-person commission model for the CFPB. The CFPB has not yet had a chance to get up and running and there is no reason to think that the unitary directorship is a particular problem; the CFPB should be given a chance to prove itself before it is reconfigured by Congress. Given the multiple safeguards that already exist to ensure that the CFPB does not act arbitrarily and capriciously action, it becomes apparent that changing the CFPB from a unitary directorship to a five-member panel would add little. Instead, switching to a five-member panel would tilt the balance at the agency to gridlock and inaction, would add unnecessary big government bloat, and would reduce accountability.

#### **IV. FINANCIAL STABILITY OVERSIGHT COUNCIL REVIEW AUTHORITY**

A second area of proposed “reform” of the CFPB would be to lower the thresholds for the Financial Stability Oversight Council veto. I am not aware of a Senate bill that proposes such a change, but H.R. 1315, the Consumer Financial Protection Safety and Soundness Improvement Act, (the “Duffy Bill”), would amend section 1023 of the Dodd-Frank Act<sup>32</sup> to reduce the thresholds for a Financial Stability Oversight Council veto of CFPB rulemaking. It would do so in two ways.

First, it would reduce the necessary vote from a supermajority of 2/3s of the FSOC members (including the CFPB Director), that is 7 out of 10 votes if all members were present, to a simple majority of FSOC members, not including the CFPB, that is 5 of 9 votes. It would also reduce the necessary finding from the CFPB “regulation or provision would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk” to a less exacting finding merely that the CFPB rulemaking is “inconsistent with the safe and sound operations of United States financial institutions.” Finally, by deleting section 1023(c)(5) of the Dodd-Frank Act, the bill would require the FSOC to take a vote if any FSOC member raised an objection to a CFPB rulemaking.

The FSOC veto power provides an unnecessary and possibly unconstitutional check on the CFPB and should be eliminated, rather than made more stringent.<sup>33</sup> Irrespective, *the Duffy Bill’s proposed finding for an FSOC veto would render virtually every CFPB rulemaking in doubt*. Indeed, under the Duffy Bill’s proposed standard—whether the CFPB rulemaking is “inconsistent with the safe and sound operations of United States financial institutions”—it would be impossible for the CFPB to implement several recent pieces of Congressional

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<sup>32</sup> P.L. 111-203, § 1023, 124 Stat. 1376, 1985, July 21, 2010, *codified at* 12 U.S.C. § 5513.

<sup>33</sup> I would urge that if Congress adopts the five-person commission model for the CFPB per the Bachus Bill, it should eliminate the FSOC veto over CFPB actions.

legislation, including Title XIV of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act.<sup>34</sup>

As noted, above, safety and soundness means, at core, profitability. To the extent that a proposed CFPB regulation would reduce the profitability of a financial institution, it would reduce that institution's safety and soundness. Thus, any CFPB regulation, even if it merely increased compliance costs, would be "inconsistent with the safe and sound operations" of a financial institution.

While bank regulators have argued that consumer protection goes hand in hand with safety and soundness because it is unsafe for a bank to systematically exploit its customers or engage in unfair and deceptive practices, the run up to the financial crisis provides clear evidence that federal bank regulators were unwilling to put the brakes on unfair and deceptive mortgage lending. Similarly, the run up to the Credit CARD Act of 2009 shows that federal regulators were unwilling to act on unfair and deceptive credit card acts and practices until Congress itself started to move. Only then did the Federal Reserve, OTS, and NCUA hustle to amend their unfair and deceptive acts and practices (UDAP) regulations.

To understand just how overbroad the Duffy Bill's proposed rule is, consider, for example, consider if there had been a CFPB in 2005, and it had proposed a rule that would have severely restricted the underwriting of payment-option adjustable-rate mortgages (so-called pick-a-pay mortgages) to borrowers who have demonstrated an ability to repay. Such a rulemaking would have put an end to the "Countrywide special," that was the hallmark of Angelo Mozillo and Countrywide, the nation's largest mortgage lender.

Such a restriction would have significantly curtailed Countrywide's mortgage lending business, and would surely have resulted in the OCC or OTS demanding an FSOC veto. Yet such a move could hardly be called radical. Congress itself passed just such a requirement in section 1411 of the Dodd-Frank Act,<sup>35</sup> and a parallel requirement for credit cards in section 109 of the Credit C.A.R.D. Act of 2009.<sup>36</sup>

Indeed, we actually have an example from 2008 of a bank regulator challenging a proposed consumer financial protection regulation on safety-and-soundness grounds. In August 2008, Comptroller of the Currency John C. Dugan wrote to the Federal Reserve Board to urge it to insert two significant exceptions to the proposed Regulation AA (governing unfair and deceptive acts and practices) rule on credit cards that would limit the ability of card issuers to reprice (or, colloquially, "rate jack") cardholders.<sup>37</sup> Duggan wrote that the restrictions "raise safety and soundness concerns" because they limited the ability of issuers to re-price their loans if issuers determined that the risk profile of the customer had worsened.<sup>38</sup> If the CFPB had proposed such a rule, the OCC would surely have challenged it before the FSOC as "inconsistent

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<sup>34</sup> P.L. 111-203, §§ 1401-1498, 124 Stat. 1376, 2137-2212, July 21, 2010.

<sup>35</sup> P.L. 111-203, § 1411, 124 Stat. 1376, 2142, July 21, 2010, *codified at* 15 U.S.C. § 1693c ("no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.").

<sup>36</sup> P.L. 111-24, 123 Stat. 1743, § 109, May 22, 2009, *codified at* 15 U.S.C. § 1665e ("A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account.").

<sup>37</sup> Letter from Comptroller of the Currency John C. Dugan to Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System, Re: Docket Number R-1314, August 18, 2008.

<sup>38</sup> *Id.*

with the safe and sound operations of United States financial institutions.” Yet, Congress itself passed an even tougher restriction on credit card repricing less than a year later.<sup>39</sup>

Under the Duffy Bill’s standard, several laws passed by Congress in recent years, such as the Credit C.A.R.D. Act and the Mortgage Reform and Anti-Predatory Lending Act would themselves be unenforceable by regulation because the laws themselves might reduce bank safety-and-soundness (i.e., profitability), so any faithful rule-making would have to as well. The effect of the Duffy Bill would be to eviscerate several recent, popular, consumer financial protection statutes.

The CFPB is a new agency tasked with protecting the financial security of American families, ensuring that they can get the information necessary to make responsible, informed financial choices. Congress created the Bureau to ensure that American families can trust the financial products they use to help them achieve their goals, rather than ensnare them with tricks and traps that lead to financial distress. The Duffy Bill’s proposed expansion of the FSOC veto would place bank profits ahead of the well-being of American families, and would put us on a return course to the financial crisis of 2008.<sup>40</sup>

## CONCLUSION

The Consumer Financial Protection Bureau has not even had an opportunity to begin to exercise its regulatory authority. It is simply premature to consider reforms to its oversight, as it is not yet clear whether any changes to the oversight structure are needed, much less what those changes are. At this point, concerns about oversight are simply cover for political attacks on the CFPB’s very existence. Let’s give the CFPB a chance to prove itself and not return to the pre-2008 period when the lack of effective consumer financial protection facilitated the destructive housing bubble and financial collapse from which we have still not recovered.

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<sup>39</sup> P.L. 111-24, § 101, 123 Stat. 1736-37, May 22, 2009, *codified at* 15 U.S.C. § 1666i-1.

<sup>40</sup> I would also note that the FSOC veto under section 1023 of the Dodd-Frank Act is already of dubious constitutionality. On June 28, 2010, a fortnight before the enactment of the Dodd-Frank Act, the Supreme Court handed down its judgment in a case captioned *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 130 S. Ct. 3138 (2010). In this case, the Supreme Court held that it was an unconstitutional violation of the separation of powers to restrict the President in his ability to “remove a [principal] officer of the United States, who is in turn restricted in his ability to remove an inferior officer, even though that inferior officer determines the policy and enforces the laws of the United States”. *Id.* at 3147. This ruling raises the question of whether by giving the FSOC veto power over CFPB rulemaking, Congress has impermissibly restricted the power of the President to “take Care that the Laws be faithfully executed” through his appointee as Director of the Bureau of Consumer Financial Protection. It also raises the concern that the CFPB is not truly an independent agency as it would be subject to a veto exercised in part by cabinet agencies.

The existing FSOC veto power is already constitutionally suspect, and proposals such as the Duffy Bill, which would make exercise of the veto authority mandatory and on a hair-trigger basis, would only increase the likelihood that section 1023 of the Dodd-Frank Act offends the Constitution. I would strongly urge the Senate to request opinion of counsel on the FSOC veto’s constitutionality before taking any action in regard to it.

**Figure 1. The Current Consumer Financial Protection Regulatory Structure vs. the Regulatory Structure with the Consumer Financial Protection Bureau.<sup>41</sup>**

