



House Committee Approves Proposed Consumer Financial Protection Agency

October 28, 2009 - On October 22, 2009, the House Financial Services Committee approved legislation that would establish a new Consumer Financial Protection Agency ("CFPA"). The legislation approved by the Committee is a considerably revised version of H.R. 3126 (the "Consumer Financial Protection Agency Act of 2009"), which was originally introduced by Committee Chairman Barney Frank on July 8, 2009. As originally introduced, H.R. 3126 was, in turn, very similar to draft legislation that the Treasury Department had publicly released on behalf of the Obama administration on June 30, 2009.

Our Task Force on Modernizing Financial Services Regulation has reported extensively on the potential significance of the various iterations of the Consumer Financial Protection Agency Act of 2009 (the "CFPA Act") for certain of our core client groups, including insurance companies, investment advisers, and broker-dealers. This Alert is another in that series of reports.

I. Background: General Impact of CFPA Act

A. Potentially Comprehensive Nature of CFPA Regulation

The CFPA Act would give the CFPA authority to regulate with extraordinary thoroughness any "Consumer Financial Product or Service" (as defined in the Act) and any persons who provide such products and services ("Covered Persons"). Accordingly, the CFPA Act is potentially of utmost consequence to any product, service or person that falls within its purview.

B. The CFPA's Primary Areas of Concern

In some respects, it is not clear to what extent the CFPA would have jurisdiction over insurance and securities firms. It is clear that the CFPA Act is primarily concerned with consumer financial activities such as:

- taking deposits by banks, savings and loans, credit unions, and the like;
- providing money transfer, check guarantee, and bill payment services;
- issuing and servicing mortgages and consumer loans;
- issuing and servicing credit cards and debit cards;
- providing real estate settlement services;
- providing leasing services for personal or real property;
- credit reporting;

- debt collection and negotiation and mortgage modification; and
- debt counseling and credit repair.

As discussed in IV. below, the CFPA Act also is specifically concerned with certain investment advisory and financial advisory services.

The Director of the CFPA also would generally have broad discretion to adopt regulations defining other financial activities to be subject to the CFPA's jurisdiction. For example, one of several bases on which the Act authorizes the Director to do this is if the Director finds that "the activity has, or there is a substantial likelihood that the activity will have, a material adverse impact on the creditworthiness or financial well being of consumers."

Accordingly, the potential scope of the CFPA's jurisdiction is exceedingly broad.

II. Applicability to Insurance Firms

As approved by the Committee, however, the CFPA Act contains: (i) an exclusion from the definition of "financial activity" for the "business of insurance," which is defined to include both insurance and reinsurance; and (ii) a provision preserving the existing regulatory authority of state insurance regulators. These significant developments for the insurance industry, as well as some others, are discussed below.

A. The Business of Insurance Exclusion

The exclusion of the business of insurance from the definition of "financial activity" now clearly places the business of insurance outside the scope of the Consumer Financial Products and Services that are subject to regulation under the CFPA Act. In addition, the CFPA Act now for the first time contains a definition of the "business of insurance":

The "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.

Although not clear, the scope of the term "business of insurance" as used in this legislation likely is intended to be the same as the scope of the term "business of insurance" used in the McCarran-Ferguson Act, 15 U.S.C. §1012. Nevertheless, to the extent that an insurance firm engages in consumer financial activities that are not within the "business of insurance," such activities may be within the jurisdiction of the CFPA.

B. Preservation of State Insurance Regulation

The Committee also added language that the CFPA Act shall not be construed as "altering, amending, or affecting the authority of any State insurance regulator" to take action with respect to "a person regulated by any State insurance regulator." The intention of this provision, taken with the exclusion of the "business of insurance" from the definition of "financial activity," appears

to be to preserve intact the current state regulation of the business of insurance.

C. Credit, Mortgage, and Title Insurance

The CFPA Act formerly contained language that made the Act specifically applicable to credit insurance, mortgage insurance and title insurance and services related thereto. The Committee, however, deleted this language, thus bringing these forms of insurance within the exclusion for the "business of insurance."

D. Persons Subject to SEC, CFTC, or State Securities Law Regulation

Discussed in III. below are certain limited exclusions from the CFPA's jurisdiction for persons who are subject to SEC, CFTC or state securities law regulation. Insurance firms (or their affiliates) who are subject to SEC, CFTC or state securities law regulation could also take advantage of those exclusions, subject to the limitations provided therein. This could be useful to insurance firms that, for example, engage in financial activities that are not the business of insurance and that are, therefore, subject to CFPA regulation, absent some other exclusion.

III. Applicability to Securities Firms

The CFPA Act specifically preserves the SEC's sole jurisdiction over (*inter alia*) (i) broker-dealers registered under the Securities Exchange Act of 1934, (ii) advisers registered under the Investment Advisers Act of 1940, (iii) funds registered under the Investment Company Act of 1940, and (iv) any employee, agent, or contractor acting on behalf of, registered with, or providing services to, any such person. There is a similar exclusion for persons who are regulated by the CFTC. Also, the Committee, in approving this legislation, expanded these exclusions to cover persons who are subject to state securities regulation.

The CFPA Act provides, however, that the exclusions for SEC or CFTC-regulated persons apply only to the extent that the person in question acts in its "registered capacity" (and, although the Act does not specifically so state, we would assume that the CFPA would take the position that this limitation would apply as well to persons seeking to be excluded based on state securities regulation). Accordingly, questions will doubtless arise concerning whether a person engaged in a particular financial activity is acting in a registered capacity. Suppose, for example, an SEC-registered broker-dealer firm engages in sales activities with respect to a product that does not constitute a security. Could this conduct of the firm be deemed to be "in a registered capacity" by virtue of the fact that FINRA has at least some policies that touch upon this conduct? It is entirely unclear at this point what the answers to such questions would be.

IV. Investment Advisory and Financial Advisory Activities

The CFPA Act would specifically include within its jurisdiction the following financial activities:

- acting as investment adviser to any consumer and
- acting as financial adviser to any consumer, including the provision of (i) financial and other related advisory services, (ii) educational courses and instructional materials on individual financial management matters, or (iii) credit counseling or tax planning services.

Large numbers of insurance and securities firms provide services that could constitute these types of investment and financial advisory activities. These firms, therefore, would generally be subject to regulation by the CFPA, except to the extent that these activities were deemed (a) to be "the business of insurance" (as discussed in II.A. above) or (b) to be conducted in the firm's registered capacity with the SEC, CFTC, or a state securities regulator (as discussed in III. above). As noted previously, it is foreseeable that questions may arise as to what constitutes "engaging in the business of insurance" or in a "registered capacity" for these purposes.

As previously discussed, the CFPA Act's exclusion for persons regulated by state securities laws was added by the Committee in the context of its recent deliberations on the Act. This change may considerably reduce the number of firms who become subject to the CFPA's jurisdiction as a result of providing investment and financial advisory services. That is because a large number of such firms are not regulated by the SEC or CFTC, but are regulated under state securities laws.

Providing "tax-planning or tax-preparation services" to consumers had previously been specifically listed in the CFPA Act as types of financial planning activities over which the CFPA would have jurisdiction. The Committee-approved version, however, modifies this language so that it now refers only to "tax planning" services, thus omitting any reference to tax preparation services. Indeed, language also now has been added that specifically excludes tax preparation services from the CFPA's jurisdiction.

V. Other Changes Approved by the Committee

The version of the CFPA Act that the Committee approved also differs in many other important respects from the version of the Act as originally introduced by Chairman Frank.

A. Power Centralized in CFPA Director

For example, as approved by the Committee, the governance and power of the CFPA would be centralized in the person of a single "Director" appointed by the President for a five year term, with the advice and consent of the Senate. In contrast, the original version of this legislation provided for a five person governing "Board."

As approved by the Committee, however, the Act would, provide for a Consumer Financial Protection Oversight Board, which would consist of the Chairman of the Federal Reserve Board; the head of the agency responsible for regulating national banks (the Comptroller of the Currency, under current law); the Chairman of the FDIC; the Chairman of the National Credit Union Administration; the Chairman of the Federal Trade Commission; the Secretary of Housing and Urban Development; the Chairman of the liaison committee of

the representatives of state supervisory agencies to the Financial Institutions Examination Council; and five additional members (appointed by the President with the advice and consent of the Senate) from among experts in the fields of consumer protection, fair lending and civil rights, representatives of depository institutions that primarily serve underserved communities, or representatives of communities that have been significantly impacted by higher-priced mortgage loans. The functions of the Consumer Financial Protection Oversight Board would be solely advisory and consultative, however.

B. No Requirement for "Standard" Products and Services

As approved by the Committee, the CFPB Act does not contain any specific authorization for the CFPB to prescribe a "standard" version of any Consumer Financial Product or Service subject to the CFPB's jurisdiction. Indeed, it contains a provision that, in effect, prohibits the CFPB from imposing any such requirement for a standard version.

C. Revised Treatment of Service Providers to Covered Persons

Previous versions of the CFPB Act defined "Covered Persons" to include not only those who provide Consumer Financial Products and Services, but also those who "provide a material service to, or process a transaction on behalf of" any Covered Person. Thus, persons providing such services could have been subject to the full panoply of the CFPB Act's regulatory scheme. Moreover, as originally introduced by Chairman Frank, the Act was essentially silent on the subject of what might constitute providing a "material service" to a Covered Person.

These potential difficulties have been somewhat alleviated. As approved by the Committee, the CFPB Act no longer specifically defines as Covered Persons those who merely provide material services to or process transactions for any Covered Person. Instead, the term "Service Provider" has now been defined, and those who fall within the definition would be subject only to certain specified aspects of CFPB regulation. For example, Service Providers would be subject to the CFPB's authority to:

- conduct periodic examinations;
- require periodic or special reports or other information;
- develop "risk-based" supervision programs" (as described in F. below), except any registration requirements thereof;
- prescribe and enforce operational standards; and
- exercise enforcement powers with respect to the statutes and rules that the CFPB administers.

The new concept of "Service Provider" is defined broadly. It would include any person who provides a material service to a Covered Person in providing a Consumer Financial Product or Service, including:

- Facilitating the design of, or operations relating to the provision of, the Consumer Financial Product or Service;
- Interacting directly with consumers regarding the Consumer Financial Product or Service; or
- Processing transactions relating to the Consumer Financial Product or

Service.

A person would *not* be considered to be a Service Provider, however, solely by virtue of such person's providing or selling to a Covered Person:

- Support service of a type provided to business generally or a similar ministerial service;
- A service that does not materially affect the terms or conditions of the Consumer Financial Product or Service, its performance or operation, or the propensity of a consumer to obtain or use it; or
- Time or space for an advertisement of the Consumer Financial Product or Service.

Despite these modifications, even insurance or securities firms that are not themselves Covered Persons would in many cases need to consider whether they (or their affiliates) are subject to various provisions of the CFPA Act as a result of being Service Providers to persons who are Covered Persons.

D. Inclusion of Related Persons as Covered Persons

As approved by the Committee, the CFPA Act would define a category of persons ("Related Persons") that was not specifically addressed in the Act as originally introduced by Chairman Frank. Now, however, Related Persons would be deemed to be Covered Persons, who could be subject to almost the full array of regulation under the Act. "Related Person" would be broadly defined, to include:

- Any director, officer, employee charged with managerial responsibility, or controlling stockholder of, or agent for, the Covered Person;
- Any shareholder, consultant, joint venture partner, and any other person as determined by the CFPA's Director who materially participates in the conduct of the Covered Person's affairs; and
- Any independent contractor (including any attorney, appraiser, or accountant), with respect to the Covered Person who knowingly participates in a violation of any law or regulation or in any breach of fiduciary duty.

It clearly would make little sense for every Related Person to be subject to essentially the same regulatory requirements as Covered Persons. For example, every director or officer of a firm that provides a Consumer Financial Product or Service should not individually be subject to the same regulatory requirements that apply to the firm itself. Accordingly, if the Related Person provisions were to be enacted in their current form, the CFPA would presumably adopt rules or grant exemptions that would tailor the regulatory scheme to more appropriately fit different categories of Related Persons.

E. Changes in Funding for the CFPA

Considerable changes have been made in the arrangements for funding the CFPA, as compared with the version of the CFPA Act that Chairman Frank originally introduced. The general principle remains that Covered Persons would be assessed fees to finance the CFPA, and the CFPA would have considerable discretion to set fee rates and to prescribe different fees for different Covered Persons. As a general matter, the CFPA Act directs that the

fees be established based on the "size and complexity" of the Covered Person. As approved by the Committee, however, the CFPA Act now also directs the CFPA to consider the Covered Person's compliance record under the Act and certain other laws. Such variations in fees based on a Covered Person's compliance record, of course, would involve a potentially mischievous blurring of the important distinction between a fee and a sanction.

F. Risk-Based Supervision Programs

The CFPA Act, as approved by the Committee, adds a mandate that the CFPA develop "risk-based programs" to supervise Covered Persons that are not credit unions or other depository institutions, "by prescribing registration requirements, reporting requirements, and examination standards and procedures." Although not contained in the version of the Act that Chairman Frank originally introduced, these provisions are in many respects duplicative of other portions of that earlier version (and of the current version). In any event, these new requirements pertaining to risk-based supervision programs serve to emphasize, if any emphasis were needed, the thoroughgoing nature of the regulation to which Covered Persons could be subject at the hands of the CFPA.

G. Assessment of Enforcement Costs Against Covered Persons

The legislation as approved by the Committee adds a provision to the effect that, in any action brought by the CFPA to enforce any of the laws or regulations under its jurisdiction, the CFPA "may recover its costs in connection with prosecuting such action," if the CFPA is the prevailing party in such action. The CFPA's "costs" of course could be very large in relation to the gravity of any violation that the defendant in the action may have committed or in relation to any penalty imposed upon the defendant. Accordingly, the potentially oppressive nature of the new provision for assessing enforcement costs against Covered Persons is self evident.

For additional information:

Jorden Burt has formed a special Task Force to monitor this legislation and other proposals relating to reform of financial services regulation. To obtain additional information about particular proposals that might have an impact on the insurance or reinsurance industries, you may contact Roland Goss (rcg@jordenusa.com or (202) 965-8148). To obtain additional information about particular proposals that might have an impact on the investment adviser and fund industries you may contact Tom Lauerman (tcl@jordenusa.com or (202) 965-8156). Or you may contact any of Jorden Burt's other regulatory attorneys.

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