



Dodd Puts Stamp on Proposed Consumer Financial Protection Agency

November 23, 2009 - On November 17, 2009, Senator Chris Dodd, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, published his "Chairman's Mark Text" version of massive draft legislation entitled the "Restoring American Financial Stability Act of 2009" ("RAFSA"). RAFSA (available [here](#)) contains a relatively comprehensive set of financial regulatory reforms, most of which are similar to reforms that are also currently under consideration in the House of Representatives.

Our Task Force on Modernizing Financial Services Regulation has reported extensively on the significance of such reform proposals for certain of our core client groups, including insurance companies, investment advisers and broker-dealers. This Alert focuses on Title X of RAFSA, the "Consumer Financial Protection Agency Act of 2009" (the "CFPA Act"), which would establish a new Consumer Financial Protection Agency ("CFPA").

In most respects Title X of RAFSA is similar to H.R. 3126, as approved by the House Financial Services Committee on October 22, 2009.^[1] Nevertheless, Title X of RAFSA has some very important differences from H.R. 3126, and this Alert focuses particularly on those differences that are of special interest to insurance and securities firms.

I. Background: General Impact of Title X of RAFSA

A. Potentially Comprehensive Nature of CFPA Regulation

Title X of RAFSA would give the CFPA authority to regulate with extraordinary thoroughness certain "Consumer Financial Products or Services" (as defined in the Act) and certain persons who provide such products and services ("Covered Persons"). CFPA Regulation of Covered Persons, for example, can include requirements to:

- register with the CFPA;
- pay fees prescribed by the CFPA;
- make disclosures to consumers as prescribed by the CFPA;
- maintain records prescribed by, and make periodic reports to, the CFPA;
- submit to examinations by, and information requests from, the CFPA;
- comply with any requirements imposed by the CFPA to ensure that consumers are protected from abuse, unfairness, deception and

- discrimination. This could include, among other things, substantive requirements as to (i) the terms of financial products and services, (ii) amounts charged for the products and services, (iii) the compensation of sales and other personnel who deal with consumers, and (iv) the manner, setting, and circumstances under which the products and services are provided; and
- be subject to extensive enforcement and remediation powers that would be vested in the CFPA.

Despite the fact that CFPA regulation of Covered Persons with respect to Consumer Financial Products and Services would be comprehensive, Title X of RAFSA would (like other versions of the CFPA Act) generally not preempt state regulation. Because CFPA regulation could apply to some activities that are already subject to, for example, state insurance or securities regulation, the CFPA Act potentially would add a layer of regulation that would be in addition to that already imposed by the states on insurance and securities firms.

Moreover, the CFPA Act would go so far as to empower state attorneys general to bring actions on behalf of citizens of their state to redress violations of the Act or rules thereunder. Nor would the CFPA Act generally preempt other federal regulation and enforcement, such as by the SEC, CFTC, or federal self-regulatory bodies.

Thus, insurance and securities firms who are subject to CFPA regulation could find themselves subject to multiple regulatory and enforcement regimes with respect to their Consumer Financial Products and Services. That is yet another reason why 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 Title X of RAFSA is primarily concerned with financial activities such as the following (to the extent in a consumer context):

- taking deposits by banks, savings and loans, credit unions, or the like;
- providing money transfer, check cashing, check guarantee, or bill payment services;
- issuing, purchasing, or servicing mortgages or loans;
- issuing or servicing credit cards or debit cards;
- selling or servicing credit insurance or mortgage insurance;
- providing real estate settlement services, including providing title insurance;
- providing leasing services for personal or real property;
- credit reporting;
- debt collection or negotiation and mortgage modification;
- debt counseling or credit repair;
- acting as custodian of money or financial instruments; and
- providing data processing services in connection with Consumer Financial Products and Services.

As discussed in V. below, Title X of RAFSA also is specifically concerned with certain consumer investment advisory and financial advisory services,

including tax planning and preparation services.

The Director of the CFPB also would generally have broad "catch-all" discretion to adopt regulations defining other financial activities to be subject to the CFPB's jurisdiction. This catch-all authority has been made especially broad, inasmuch as Title X of RAISA omits a requirement that appears in H.R. 3126 and that would require the Director of the CFPB to make certain findings before exercising this authority.

Accordingly, under Title X of RAISA, the potential scope of the CFPB's jurisdiction would be exceedingly broad.

II. Section 989A Senior Investor Protection Program

In addition to the jurisdiction that Title X of RAISA would grant the CFPB, Section 989A of Title IX of RAISA would establish a senior investor protection program (the "Section 989A Senior Investor Protection Program") that would be administered by an "Office of Financial Literacy" within the CFPB. (The Section 989A Senior Investor Protection Program incorporates the Senior Investor Protection Act of 2008 that was first introduced as S. 2794 by Senator Herbert Kohl following hearings of the United States Senate Special Committee on Aging chaired by Senator Kohl.) Specifically, the Office of Financial Literacy would be authorized to make limited monetary grants to states (including state agencies) to provide financing for a wide variety of measures (including enforcement and remedial measures) designed to address the problem of misleading and fraudulent sales of "financial products" to senior citizens. H.R. 3126 would not provide for any such program.

The financial products that would be subject to the Section 989A Senior Investor Protection Program would be extremely broadly defined, to include, *inter alia*, "securities" and "insurance products (including insurance products which pay a return, whether fixed or variable)." Section 989A specifies various suitability, disclosure and other requirements that a state must have implemented in order to qualify for grants, and the CFPB's Office of Financial Literacy would have some interpretive discretion with respect to certain of those requirements, as well as discretion whether to grant funds for the purposes proposed in applications for the grants.

Thus, the Office of Financial Literacy would, through those states that seek grants, be implementing and administering a program of enforcement, remedial, regulatory, and other measures relating to the sale of a wide variety of securities and insurance products, among others. Subsequent parts of this Alert include discussions of various exclusions that Title X of RAISA would provide from CFPB regulation and that may be available to insurance and securities firms. See III.A. and B., IV. and V. below. *None of those exclusions would have any effect on the Section 989A Senior Investor Protection Program.* It is important for the reader to keep that caveat always in mind, although, in the interest of simplicity, we have not repeated it in any of the subsequent parts of this Alert.

III. Applicability to Insurance Firms

For reasons discussed below, some insurance firms would be more likely to

fall within the ambit of CFPB regulation under Title X of RAISA than under H.R. 3126.

A. The Business of Insurance Exclusion

H.R. 3126 would specifically exclude the business of insurance from the Act's definition of "financial activity" and would provide a definition of the "business of insurance." This would have the effect of clearly placing the business of insurance (including reinsurance) outside the scope of the Consumer Financial Products and Services that are subject to regulation under the Act (although, even in H.R. 3126, the definition of business of insurance is not as broad as many in the insurance industry have advocated).

Rather than clearly excluding the business of insurance from being a "financial activity," Title X of RAISA would provide only that "the CFPB may not define as a financial activity, by regulation or otherwise, engaging in the business of insurance." This could be interpreted to mean that what the Act itself defines as a financial activity (without any definitional assistance from the CFPB) may be subject to the CFPB's jurisdiction, even if it is the business of insurance. Thus, the wording of Title X of RAISA is less desirable for insurance firms than the wording of the analogous provision in H.R. 3126.

Moreover, Title X of RAISA contains no definition of the "business of insurance." Again, the absence of such a definition may operate to the disadvantage of some insurance firms.

B. Preservation of State Insurance Regulation.

Both Title X of RAISA and H.R. 3126 specifically provide that the CFPB Act would 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 that regulator. The general intention of these provisions, taken with the "business of insurance" exclusion discussed above, appears to be to preserve intact the current state regulation of the business of insurance.

Nevertheless, as discussed above, the business of insurance exclusion in Title X of RAISA could potentially be interpreted more narrowly than the corresponding exclusion in H.R. 3126. This could mean that, under the former legislation, more products and services offered by insurance firms could be subject to CFPB regulation. To the extent that any product over which the CFPB has jurisdiction is also regulated by state insurance regulators, both versions of the CFPB Act contemplate that there would be concurrent jurisdiction.

C. Credit, Mortgage, and Title Insurance

Like certain earlier versions of the CFPB Act, Title X of RAISA would specifically include the "selling or servicing of credit insurance or mortgage insurance" and "providing title insurance" as types of financial activities that are within the jurisdiction of the CFPB. ("Credit insurance," for this purpose, would be broadly defined to include credit life insurance, credit accident or health insurance, involuntary unemployment insurance, and credit property insurance.) H.R. 3126, however, omits any references to credit insurance or mortgage insurances, and would thus leave these forms of insurance within

the "business of insurance" exclusion from CFPA regulation.

Although Title X of RAFSA, then, would result in concurrent CFPA and state regulation of credit, mortgage and title insurance, Title X provides, in effect, that the CFPA would have no authority to approve or establish rates or premiums with respect these forms of insurance.

D. Effect of SEC, CFTC, or State Securities Regulation

Discussed in IV. 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 those types of regulation, could potentially take advantage of those exclusions. This could be useful to insurance firms that, for example, engage in financial activities that are regulated by the SEC, CFTC or state securities authorities but are deemed to be outside the "business of insurance" exclusion from CFPA regulation.

IV. Applicability to Securities Firms

For reasons discussed below, Title X of RAFSA could result in more securities firms becoming subject to CFPA jurisdiction that would H.R. 3126.

Title X of RAFSA and H.R. 3126 both specifically preserve 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. Title X of RAFSA, however, would make this provision applicable only to the extent that any of such persons is acting in a "regulated capacity," while the analogous provision in H.R. 3126 would be applicable only to the extent any of such persons is acting in a "registered capacity." The distinction between "in a regulated capacity" and "in a registered capacity" for this purpose is a fine one. Nevertheless, it seems that in a "in a regulated capacity" may be broader, in that it would more clearly preserve the SEC's sole jurisdiction over at least some entities or individuals that are not themselves "registered" but are nevertheless subject to regulation with respect to the conduct in question.

Title X of RAFSA contains similar provisions that would preserve the CFTC's sole jurisdiction for certain firms who are subject to CFTC jurisdiction. These provisions in Title X, however, would cover only the CFTC-regulated firms, in contrast to analogous provisions in H.R. 3126 that also would cover such firms' employees, agents, contractors, or service providers. It is unclear why Title X has been drafted to be more limited in this regard.

Title X of RAFSA and H.R. 3126 each also contains a broad provision that would preserve state securities regulators' sole jurisdiction over any persons that they regulate. Curiously, however, Title X of RAFSA (but not H.R. 3126) also contains a much narrower provision that would preserve state securities regulators' sole jurisdiction with respect to any person only to the extent that person is acting in such regulated capacity and is not engaging in activities that are specifically regulated by the Act. These two provisions in Title X of RAFSA seem to be in direct conflict. If, in Title X, the narrower provision were deemed

to control, being subject to state securities regulation could afford considerably less protection from concurrent CFPB jurisdiction.

Currently, investment advisers with less than \$25 million in assets under management are generally precluded from registering as investment advisers with the SEC. Title IV of RAISA is proposing to raise this threshold to \$100 million. This would significantly increase the number of investment advisers who are regulated under state securities laws, rather than by the SEC. If (as discussed in the preceding paragraph) state securities regulation would, under Title X of RAISA, afford less protection against CFTC jurisdiction than would SEC regulation, the proposed increase in the threshold to \$100 million could result in many more advisers being subject to CFPB jurisdiction.

V. Investment Advisory and Financial Advisory Activities

Title X of RAISA and H.R. 3126 each contain specific provisions that would include within the CFPB's jurisdiction any person who is acting as investment adviser to any consumer, other than any person who is regulated by the SEC, the CFTC or a state securities regulator. Title X of RAISA (but not H.R. 3126) contains a further limitation on the latter exclusion (*i.e.*, the exclusion relating to persons regulated by a state securities regulator). Specifically, Title X would limit that exclusion to cases where the person in question is regulated by the state securities authorities "as an investment adviser." Accordingly, this exclusion seems somewhat narrower under Title X than under H.R. 3126.

Both of these proposed pieces of legislation also contain specific provisions that would include within the CFPB's jurisdiction any person who is 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. In the case of H.R. 3126 (but not Title X of RAISA), this provision specifically excludes any person who is regulated by the SEC, the CFTC or a state securities regulator. Thus, Title X, again, seems to provide the CFPB with more expansive jurisdiction than does H.R. 3126.

Also, even though certain of the foregoing provisions relating to investment and financial advisers incorporate exclusions for certain persons regulated by the SEC, CFTC, and state securities regulators, it is not entirely clear what relationship those exclusions have to the more general exclusions (discussed in IV. above) that the legislation would provide these types of regulated persons. In any event, based on the differences in language between Title X of RAISA and H.R. 3126 relating to investment and financial advisory services, some firms that provide investment or financial advisory services would be more likely subject to CFPB jurisdiction under the former legislation than the latter.

Large numbers of insurance and securities firms provide services that could be deemed to constitute investment or financial advisory activities. These firms, therefore, would generally be subject to regulation by the CFPB, except to the extent that these activities were deemed (a) to be "the business of insurance" (as discussed in III.A. above) or (b) to be conducted in the firm's SEC-, CFTC-, or state securities-regulated capacity. It is foreseeable that many questions would arise in particular cases as to whether, for these purposes, (1) a given

activity constitutes the "business of insurance" or (2) the exclusions for SEC-, CFTC-, or state securities-regulated persons are unavailable because the person providing investment advisory or financial services is not doing so "in its regulated capacity."

On balance, for reasons discussed above, insurance and securities firms that provide investment or financial advisory services would in some cases more likely be subject to CFPB jurisdiction under Title X of RAISA than under H.R. 3126.

VI. Other Differences Between Title X of RAISA and H.R. 3126

A. Power Vested in CFPB Board of Directors

Title X of RAISA generally would vest the ultimate governance and power of the CFPB in its Board of Directors, which would consist of five individuals. Four of these individuals would be appointed by the President with the advice and consent of the Senate, from among persons who "have strong competencies and experiences related to consumer financial products and services, including a demonstrated understanding of consumer protection regarding financial products and services." The fifth member of the Board would be, *ex officio*, the Director of the Financial Institutions Regulatory Administration, which is the new consolidated federal bank regulatory body that would be created by RAISA.

The President would appoint one of the other four members as the Director of the CFPB. The Director would generally exercise all executive and administrative functions of the CFPB, but subject to the dictates of the Board.

By contrast, H.R. 3126 generally would vest the governance and power of the CFPB in the person of the CFPB's Director (rather than in any multi-person governing body), who would be appointed by the President for a five year term, with the advice and consent of the Senate. However, a version of H.R. 3126 that was approved by the House Committee on Energy and Commerce on October 29, 2009 more closely resembles Title X of RAISA in this regard. Specifically, the version approved by the House Committee on Energy and Commerce would generally vest the governance and power of the agency (which it would name the Consumer Financial Protection Commission) in a five person Commission appointed by the President, with the advice and consent of the Senate, from among persons who "have strong competencies and experiences related to consumer financial protection."

The question of the extent to which the governance and power of the CFPB should be vested in a single Director or Chairman, as opposed to a broader Board or Commission, has been contentious. For example, this dispute was the subject of an October 29, 2009 public statement of Chairman Frank (available [here](#)) criticizing the position of the House Committee on Energy and Commerce on this point.

B. Possible Requirement for "Standard" Products and Services

Neither Title X of RAISA nor H.R. 3126 contains any specific authorization for the CFPB to prescribe a "standard" version of any Consumer Financial Product

or Service subject to the CFPA's jurisdiction. This is in contrast to certain earlier proposals, which were highly controversial. Indeed, H.R. 3126 would go so far as to prohibit the CFPA from taking any action that would have the effect of requiring any specific product or service to any person. Title X of RAFSA, however, does not contain such a limitation on the CFPA's authority. This is sparking concern in some quarters that the CFPA might exercise its powers so as to effectively require certain standard products and services, even in the absence of specific statutory authorization to do so.

C. Treatment of Service Providers to Covered Persons

Title X of RAFSA and H.R. 3126 both define a category of "Service Providers" who would not be Covered Persons, but who nevertheless would be subject to certain specified aspects of CFPA regulation. For example, Service Providers would be subject to the CFPA's authority to:

- conduct periodic examinations;
- require periodic or special reports or other information;
- prescribe and enforce operational standards; and
- exercise enforcement powers with respect to the statutes and rules that the CFPA administers.

The 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.

However, Title X of RAFSA and H.R. 3126 each specify that "Service Provider" status would *not* arise solely solely as a result of providing the following two types of service to a Covered Person:

1. Support service of a type provided to business generally or a similar ministerial service or
2. Time or space for an advertisement of the Consumer Financial Product or Service.

H.R. 3126 (but not Title X) also specifies a third type of service that will not give rise to service provider status: *i.e.*, any 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. The fact that Title X of RAFSA does not include this third exclusion materially broadens the categories of persons who may be deemed to be Service Providers.

The bottom line is that 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. Moreover, the likelihood of being a Service Provider would be somewhat greater under Title X of RAFSA than under H.R. 3126.

D. Regulation of Related Persons as Covered Persons

As discussed above, the CFP Act generally would regulate "Covered Persons" and "Service Providers." It is important to note, however, that many persons who provide services to Covered Persons would themselves be deemed to be "Covered Persons" and, thus, subject to CFP Act regulation, regardless of whether or not such persons also fall within the definition of a Service Provider.

For example, both Title X of RAFSA and H.R. 3126 would define a category of persons ("Related Persons") that would be deemed to be Covered Persons and subject to most of the regulation to which other types of Covered Persons would be subject. "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 CFP Act'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. Current versions of the CFP Act already make certain concessions in that regard. However, if the Related Person provisions were to be enacted in their current form, the CFP Act would presumably adopt rules or grant exemptions that would further tailor the regulatory scheme to more appropriately fit different categories of Related Persons.

E. Changes in Funding for the CFP Act

Title X of RAFSA would make considerable changes in the arrangements for funding the CFP Act, as compared with H.R. 3126. The general principle remains that Covered Persons would (with certain exceptions) be assessed fees to finance the CFP Act; and, subject to certain limitations, the CFP Act would have broad discretion to set fee rates and to prescribe different fees for different Covered Persons. As a general matter, Title X is less specific than H.R. 3126 as to the factors on which the CFP Act must base the fees. Under H.R. 3126, for example, the CFP Act would be required to consider, among other things, the Covered Person's compliance record under the CFP Act and certain other laws. This somewhat controversial requirement has been omitted from Title X of RAFSA.

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.

[1] You can find more information about H.R. 3126 (which also is entitled the "Consumer Financial Protection Agency Act of 2009") in our Alert (available [here](#)) discussing the House Committee's October 22, 2009 approval of H.R. 3126. There have been various versions of H.R. 3126. Unless the context requires otherwise, however, references to H.R. 3126 in the balance of this Alert are to the version approved by the House Financial Services Committee on October 22, 2009.

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