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REFORMING REGULATION IN THE MARKETS FOR HOME LOANS

Susan Block-Lieb & Edward J. Janger[*]

INTRODUCTION

The recent financial crisis has been variously explained as a crisis of financial gatekeepers, a crisis of consumer borrowing, and a crisis of unregu-

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lated and non-transparent systemic risk. It was all of those things, and more. The 2008 financial crisis highlighted the interdependence of consumer protection, safety, and soundness, and the costs associated with unalloyed solicitude for liquidity. In earlier articles, we retell the story of how the securitization of residential mortgages pumped up the level of risk in the financial system and turned lenders into marketers. We focused primarily on how these innovations encouraged consumer overleverage in the market for home loans.[1] Market incentives were, on their own, insufficient to restrain either lenders' or borrowers' decisionmaking.[2] These catastrophic results of aggressive marketing of residential mortgages credit demonstrates the need for effective consumer protection and consumer education—not just to protect consumers, but also to protect the integrity of the capital markets.

In this Article, we explore the content and institutional context for recently revised regulation of the markets for residential mortgages. We propose a market-sensitive reading of the Wall Street Reform and Consumer Protection Act (the "Act" or the "Dodd-Frank Act"),[3] and suggest that the Bureau of Consumer Financial Protection (the "Bureau") created under the Act should be understood to balance consumer protection with concerns for the liquidity, safety, and soundness of the financial markets. In particular, we argue that the Act has the potential to create a regulatory architecture that protects both consumers and the capital markets by distinguishing between financial products that can safely be financed through the capital markets and those that pose greater risks and should, by design, be more illiquid. This coordinated architecture can be implemented, we believe, by the new Bureau of Consumer Financial Protection through its related powers to prohibit unfair lending practices, promulgate safe harbor notices, and implement certain minimum mortgage origination standards. However, the devil will be in the details—both substantive and institutional—and, in our view, the new Bureau will have to flex its rulemaking muscle a bit to fully implement that vision.

With regard to institutional context, our focus is the newly created Bureau of Consumer Financial Protection. This new agency presents an opportunity for an improvement over episodic consumer financial protection

1. *See* Susan Block-Lieb & Edward J. Janger, *Demand-Side Gatekeepers in the Market for Home Loans*, 82 TEMP. L. REV. 465 (2010). We also argued that gatekeepers could not be relied upon to accomplish this same result. *Id.*

2. Edward J. Janger & Susan Block-Lieb, *Consumer Credit and Competition: The Puzzle of Competitive Credit Markets*, 6 EURO. COMPETITION J. 68 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1665140.

3. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

legislation. Congress historically has been unable to resolve issues of consumer protection without heavy involvement from industry actors who, more often than not, either squelch reform efforts or steer legislation toward non-prescriptive forms of regulation. The Bureau has the potential, particularly with its location in the Federal Reserve System, to use its regulatory authority in a balanced way that considers both the market exigencies of consumer finance and the realities of consumer decisionmaking.

As to substance, we primarily discuss the implications of prescriptive regulation of predatory mortgages found in the Dodd-Frank Act. More than simply granting a newly created Bureau of Consumer Financial Protection the authority to regulate the market for home loans, these provisions establish federal minimum guidelines for mortgage originators, creditors, and (most importantly) their assignees. While industry critics complained that earlier iterations of these provisions would have prevented resuscitation of the still sputtering secondary market in residential mortgages, we are critical of these reforms from a slightly different perspective. The reforms are calculated to increase the liquidity of non-predatory home loans (and, thus, the strengthening of the market for residential mortgage-backed securities from its current moribund levels), while limiting the marketability of non-standard and potentially predatory loans. In our view, unless the Bureau strengthens these provisions through its authority to create standardized forms, prescribe disclosure, and promulgate regulations to prevent unfair, deceptive, and abusive mortgage terms, they will fail to fulfill their potential as a sorting mechanism.

Part I of this Article compares and contrasts House and Senate bills proposed (and/or passed), in the wake of the current financial crisis, both to reconfigure the market for home loans and re-regulate much of the financial services markets. This Part concludes by summarizing the reconciliation of the two bills achieved by the Dodd-Frank Act that combined and modified these earlier proposals. The Act combined the specific statutory protections of earlier legislative proposals with a broad grant of regulatory authority to a new Bureau of Consumer Financial Protection. We believe that the Dodd-Frank Act holds out the possibility (realizable through use of the Bureau's rulemaking authority) of a coordinated and systematized integration of the approaches discussed in those statutes. In Part II, we read Title X of the statute carefully, with one eye on what the statute says about its scope and the other on the Bureau's structural placement within the Federal Reserve. Moving from the creation of the Bureau and its scope of authority, Part III turns to Title XIV of the Act, which contains provisions from the Miller and Frank Bills (precursors to the Dodd-Frank Act) intended to regulate predatory mortgages. Although these provisions are not as strongly protective of consumers in the Dodd-Frank Act as they had been in the

Miller and Frank Bills, or as we would like them to be, their inclusion in the Act clarifies the Bureau's scope of jurisdiction over residential mortgage loans and solidifies the importance of consumer protection in the market for home loans. We conclude by justifying our conclusion that the Act provides a coordinated regulatory architecture and shows how the grant of regulatory authority contained in the Dodd-Frank Act could be used to implement this balanced approach.

I. CURRENT EVENTS

The Dodd-Frank Act took two years for Congress to enact because consumer advocates and industry interests debated how best to respond to the sub-prime mortgage crisis. Initially, proponents of regulatory reform proposed legislation to regulate or proscribe certain consumer financial products.[4] Opponents to regulatory reform argued that attempts to weed out bad actors and products would snuff out credit opportunities for the deserving, and thus that consumer protection legislation would both limit the liquidity of consumer debt and stifle product innovation.[5] In our view, the Wall Street Reform and Consumer Protection Act, signed by President Obama on July 21, 2010, comes close to satisfying both sets of substantive concerns, but much of its success rests on how it is implemented through administrative rulemaking.

Securitization of home mortgages offered considerable benefits for certain borrowers. Access to capital markets financing reduced the cost of certain loans, and hence provided an interest rate advantage. This advantage, however, came with attendant risks. Capital markets borrowers relied heavily on gatekeepers to ensure that the borrowers would have the ability to repay the loans, that the value of the property was as represented, and that the borrower would not have defenses to enforcement. This reliance on gatekeepers created opportunities for abuse by mortgage originators. That abuse took the shape of poor loan origination practices, loan terms that were unsuitable for the particular borrower, and loans that the borrower had no meaningful ability to repay. These risks were greatest with non-standard mortgages, and would have been significantly reduced where a lender was making the loan as an investment for its own account. The goal of the architecture articulated in the bills that preceded Dodd-Frank was to limit the types of mortgages that would have access to securitization to those that were safest. As enacted, these protections were significantly wa-

4. *See infra* notes 10-46 and accompanying text.

5. Mortgage Reform and Anti-Predatory Lending Act, H.R. 1728, 111th Cong. (1st Sess. 2009).

tered down. Nevertheless, because enforcement was entrusted to the Bureau, and the Bureau was also granted rulemaking power, we are hopeful that an effective sorting architecture is still possible.

This Part discusses the various legislative proposals relating to home mortgages that formed the DNA for much of what became the Dodd-Frank Act. The subprime mortgage crisis had prompted members of Congress to introduce a wide range of regulatory proposals in both the 110th and 111th Congresses, and while several of these bills passed the House, none of them were adopted by the Senate until well after administrations changed in 2008. Although many bills had been introduced in the House and Senate, we focus primarily on the Miller and Frank Bills in the House and the Dodd Bill in the Senate.

First, H.R. 1728, a bill introduced in the 111th Congress by North Carolina Representative Brad Miller (the "Miller Bill"), looked to regulate the marketers of mortgages through an approach aimed at mortgage brokers and other mortgage originators—requiring their licensing, mandating disclosure, and holding them accountable should they help originate a mortgage that was unsuitable for the borrower at the time it was originated.[6] Another proposal advocated the creation of a federal consumer financial products safety commission that would act as a novel form of demand-side gatekeeper. Professors Elizabeth Warren and Oren Bar-Gill first proposed this idea in a 2008 law review article.[7] That idea became the template for the Consumer Financial Protection Agency Act of 2009.[8]

By the latter part of 2009, Massachusetts Representative Barney Frank, Chair of the House Financial Services Committee, introduced H.R. 4173, which combined portions of the Miller Bill and the Consumer Financial Protection Agency Act with proposals to re-regulate the financial services industries and the regulatory agencies in charge of these industries (the "Frank Bill"). Although the Frank Bill exceeded 1800 pages, it did not contain a proposal to modify the Bankruptcy Code to enable consumer borrowers to write down the principal on their home loans in the context of a Chapter 13 debt repayment plan. A bankruptcy mortgage modification bill

6. H.R. 3915, 110th Cong. (2d Sess. 2008); H.R. 1728, 111th Cong. (1st Sess. 2009). Unlike state legislation, this federal proposal was careful not to create fiduciary obligations for mortgage originators; it also carved out "safe harbor" provisions that would have protected mortgage originators, creditors, and assignees from liability if they used a "qualified conforming mortgage." *Id.*

7. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008).

8. Helping Families Save Their Homes Act, H.R. 3126, 111th Cong. (1st Sess. 2009); Financial Product Safety Commission Act, H.R. 1705, 111th Cong. (1st Sess. 2009); S. 566, 111th Cong. (1st Sess. 2009).

had, on its own, passed the House more than once, only to meet the full wrath of industry lobbyists (and some academics) who described the enactment of this bill as surely leading to financial armageddon.[9] The Frank Bill passed the House on December 11, 2009.

Faced with the Miller and Frank Bills enrolled in the Senate, Christopher Dodd, the senior Senator from Connecticut and Chair of the Senate Committee on Banking, Housing, and Urban Affairs, introduced S. 3217 to the Senate on April 15, 2010 (the "Dodd Bill"). The Dodd Bill incorporated much of the Frank Bill, but omitted or revised several key aspects. First, S. 3217 omitted the provisions that regulated the terms of mortgages and that had survived in both the Miller and Frank Bills. Second, the Dodd Bill would have created an entity specifically intended to provide consumer protection relating to financial products, but unlike the Frank Bill, which would have created the consumer protection entity as an independent agency, the Dodd Bill created an entity constituting a "bureau" within the Federal Reserve System.

We discuss each piece of pending legislation in turn, but given the bills' lengths, focus primarily on the provisions that affect the markets for home loans.

A. The Miller Bill

1. Appropriateness, Disclosure, and Assignee Liability

The Mortgage Reform and Anti-Predatory Lending Act, sponsored by Representative Miller,[10] would have required mortgage originators (a defined term that would include "any person" who "takes a residential mortgage loan application," "assists a consumer in obtaining or applying" for such a loan, or "offers or negotiates the terms" of a residential mortgage loan)[11] to be qualified, registered, and licensed as a mortgage originator

9. H.R. 1106, 111th Cong. (1st Sess. 2009). The proposal to permit modification of residential mortgages in bankruptcy pursuant to a case under Chapter 13 of the Code had passed the House in March 2009 before introduction of the Frank Bill, but was never enacted in the Senate. For acerbic academic debate on the proposal, see Adam J. Levitin, *Back to the Future with Chapter 13: A Response to Professor Scarberry*, 37 PEPP. L. REV. 1261 (2010); Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565; Mark S. Scarberry, *A Critique of Congressional Proposals to Permit Modification of Home Mortgages in Chapter 13 Bankruptcy*, 37 PEPP. L. REV. 635 (2010); Mark S. Scarberry, *Mortgage Wars Episode V–The Empiricist Strikes Back (Or Out): A Reply to Professor Levitin's Response*, 37 PEPP. L. REV. 1277 (2010).

10. H.R. 3915; H.R. 1728.

11. H.R. 1728 § 101.

under state or federal law.[12] More importantly, mortgage originators would have been required by the legislation to "diligently work to present the consumer with a range of residential mortgage loan products," each of which is "appropriate to the consumer's existing circumstances, based on information known by, or obtained in good faith by, the originator."[13] The originator would also have been required to "make full, complete and timely disclosure" to consumer borrowers of "the comparative costs and benefits of each residential mortgage loan product offered, discussed, or referred to by the originator,"[14] and to disclose "the nature of the originator's relationship" to the consumer and "any relevant conflicts of interest" to the consumer.[15]

The Miller Bill would have presumed that a mortgage was "appropriate" if the mortgage originator determines "in good faith, based on then existing information and without undergoing a full underwriting process," that the consumer has a reasonable ability to repay, that the mortgage loan does not have predatory characteristics, and that she receives a net tangible benefit (applicable primarily to refinancing).[16]

In addition, the Miller Bill would have banned yield spread premiums and other compensation that could cause originators to "steer" mortgage applicants toward costlier mortgages.[17] It would have amended the Truth In Lending Act (TILA) to provide that, "[f]or any mortgage loan, the aggregate amount of direct and indirect compensation from all sources permitted to a mortgage originator may not vary based on the terms of the loan (other than the amount of the principal)."[18]

Under the Miller Bill, a mortgage originator that violated these mortgage loan origination standards would have been liable to a consumer borrower

12. *Id.* § 102 (adding section 129B to the Truth in Lending Act regarding mortgage originators' "duty of care"). Many states already require the registration or licensure of mortgage brokers. Moreover, Congress passed the Secure and Fair Enforcement for Mortgage Licensing Act (referred to as the S.A.F.E. Act). The S.A.F.E. Act became law as a part of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289.

13. H.R. 1728 § 102.

14. *Id.*

15. *Id.*

16. *Id.* (defining "appropriate loan product" for purposes of new section 129B(b)(2)(B)). The Miller Bill also would have authorized the Federal Reserve, OCC, OTS, NCUA, and other banking agencies (the "Agencies") to promulgate regulations implementing these statutory requirements, including further detail on what constitutes an "appropriate" mortgage for these purposes. *Id.* (adding sections 129B(b)(4) and (5)).

17. *Id.* § 103.

18. *Id.*

for an amount equal to the actual damages or three times the brokers' fee plus litigation costs (including attorneys' fees).[19]

The Miller Bill would have done more than set mortgage origination standards. It also would have set federal minimum standards for mortgages, applicable more generally to creditors, their assignees, and securitizers. The Miller Bill would have required a creditor to make a reasonable, good faith determination, at the time the mortgage is entered into, that: (i) the consumer had a reasonable ability to repay the mortgage loan at a fully indexed, fully amortizing rate, based on verified and documented information on the consumer's credit history, current and expected income, debt-to-income ratio, and other financial resources;[20] and (ii) any refinancing will provide a net tangible benefit to the consumer based on information known or obtained in good faith by the creditor.[21] Verification of the consumer's income would have been required by these provisions, which likely were intended to rid the market of the no-income, no asset ("NINA") and no-income, no-job, no-asset verification ("NINJA") mortgage loans that had been prevalent in 2007 and 2008 markets.

Perhaps more important than these minimum standards were the "assignee liability" provisions that would have been adopted in the Miller Bill. These provisions targeted the "originate-to-distribute" model of mortgage financing that had come to dominate the market for home loans. The Miller Bill contained remedies that would have permitted assertion of its "ability to pay" standards against an assignee or securitizer of the mortgage.[22] In the absence of these assignee liability provisions, the "sale" of mortgages into a securitization vehicle might well have insulated assignees from liability for violation of the proposed minimum federal standards under the "holder in due course" doctrine. Under this doctrine, assignees of mortgages that purchase for value and in good faith take the mortgages free of property claims to the instrument and contractual defenses to enforcement that could have been asserted against the originator of the mortgage (often a mortgage broker).[23] This freedom from defenses and claims is a legal liquidity enhancement that is thought to be essential to the origina-

19. *Id.* § 104. Because mortgage brokers are often relatively thinly capitalized entities, this recourse would have been an imperfect remedy, especially where a particular broker was engaged in widespread predation.

20. *Id.* § 201.

21. *Id.* § 202. The Bill further provides that a loan for which the cost of refinancing exceeds the newly advanced principal presumptively does not provide "net tangible benefit," but that the Agencies will have jurisdiction to proscribe regulations further detailing "net tangible benefit." *Id.*

22. *Id.* §§ 203, 204.

23. U.C.C. § 3-302 (2002).

tor's ability to sell the loan to a securitization pool.[24] The Miller Bill would have imposed minimum standards on not only all mortgage creditors, but also all assignees and securitizers of these residential mortgages. The federal minimum standards would have applied regardless of whether the mortgage had been sold, assigned, or securitized.[25] As a result, capital markets investors would have been at risk, if mortgage lenders had included in a securitization pool mortgages that violated the requirement that creditors make a reasonable, good faith determination of consumers' "ability to pay" the loan and the "net tangible benefit" of residential mortgage refinancings. The holder in due course doctrine would not have insulated assignees and securitizers from these federal defenses if raised by consumers, following enactment of these provisions of the Miller Bill.[26]

These assignee liability provisions in the Miller Bill were not designed to put an end to securitization, but instead to serve a sorting function. More than simply enable liability to be asserted against creditors, assignees, and securitizers, the Miller Bill also provided for a limited safe harbor for certain "qualified mortgages."[27] Assignee liability would not have applied to these "qualified mortgages" because "qualified mortgages" presumptively satisfied the "ability to repay" and "net tangible benefit" standards.[28] "Qualified mortgages" were defined in the Miller Bill as a mortgage that "does not allow a consumer to defer payment of principal or interest," and, thus, was neither a negatively amortizing mortgage nor a mortgage with a "balloon payment" (defined as a scheduled payment that is more than twice as large as the average of earlier scheduled payments). "[Q]ualified mortgages" also would have been defined to exclude certain higher-cost mortgages, mortgages with points and fees in excess of two percent of the total loan amount, and mortgages with a term in excess of thirty years.[29] Additionally, "[q]ualified mortgages" would have been required to satisfy a

24. *See, e.g.*, Edward J. Janger, *The Costs of Liquidity Enhancement*, 4 BROOK. J. CORP. FIN. & COM. L. 39, 55-56 (2009); Albert J. Rosenthal, *Negotiability–Who Needs It?*, 71 COLUM. L. REV. 375, 377 (1971).

25. H.R. 1728 §§ 201, 202.

26. *Id.*

27. *Id.* § 203. The Miller Bill defined "qualified mortgages," subject to this rebuttable presumption of satisfaction of the statutory requirements, as loans for which: (i) the Annual Percentage Rate does not exceed an average prime offer rate, published by the Federal Reserve, by more than 1.5 percentage points for a first lien and 3.5 percentage points for a second or other subordinate lien; (ii) the borrowers' income and financial resources are verified; (iii) the underwriting process is based on a fully-indexed rate; (iv) the loan meets a combined debt-to-income test to be prescribed by the Agencies; and (v) the loan has a fixed rate term of not less than or more than thirty years. *Id.*

28. *Id.*

29. *Id.*

debt-to-income ratio to be set by regulation, with the obligors' income and financial resources used to satisfy this ratio both verified and documented.[30]

The penalties in the Miller Bill were quite harsh. "Creditors" violating the "ability to repay" or "net tangible benefit" standards (and who could not establish that the mortgages at issue were "qualified mortgages") would have been liable for rescission plus costs of litigation (including attorneys' fees), unless the creditor "cured" within ninety days by means of a no-cost modification or refinancing of the loan.[31] "Creditors" subject to these remedies would have included transferees, assignees, or securitizers of the mortgage loan, although class action suits would not have been permitted.[32] Moreover, this right of action also would have acted as a defense or counterclaim to any judicial or non-judicial foreclosure action brought against a consumer borrower.[33] In addition, the assignee liability provisions provided in the Miller Bill would have preempted state laws providing additional remedies against any assignee, securitizer, or securitization vehicle, but would not have preempted more general state law provisions, such as laws regarding fraud, misrepresentation, deceptive practices, false advertising, or civil rights laws.[34]

2. High-Cost Mortgages

The Miller Bill would have expanded the scope of the Home Owners' Equity Protection Act (HOEPA) by revising the definition of high-cost mortgages to include purchase money loans, construction loans, and open-end loans, all of which are currently excluded under the statute.[35] It would have conformed the trigger points for determining whether a mortgage is

30. *Id.*

31. *Id.* § 204.

32. *Id.* The Miller Bill expressly excluded from liability the securitization vehicles that hold the loan, the loan pools, purchasers of the securitization vehicles, and investors in any instrument that represents an interest in such pool. *Id.* It also would have exempted from liability assignees or securitizers that had "exercised reasonable due diligence in complying with" these minimum federal requirements. *Id.*

33. *Id.* §§ 204, 205.

34. *Id.* § 208. The Miller Bill also would have required the Department of Housing and Urban Development to provide "a full range of foreclosure legal assistance to low and moderate income homeowners and tenants related to home ownership preservation, home foreclosure preservation, and tenancy associated with home foreclosure." *Id.* § 216. In addition, it provided for the protection of certain tenants in the event of the foreclosure of leased premises that take place after the effective date of the legislation. *Id.* § 220.

35. *Id.* § 302.

high-cost in the 2009 revisions to Regulation Z—the HOEPA Rules[36]—as well as the substantive prohibitions in HOEPA.[37]

3. Housing Counseling

In addition to imposing responsibilities on mortgage originators and assignee liability on creditors and their assigns, providing protections for tenants in the context of foreclosures, and expanding current regulation so that it covers a far broader swath of sub-prime mortgages and prohibits predatory practices rather than simply requiring their disclosure, the Miller Bill would have created a new Office of Housing Counseling (OHC).[38] The OHC would have provided homeownership counseling, rental housing counseling, and education under standards to be set by the U.S. Department of Housing and Urban Development (HUD) and counselors certified by HUD.[39] Most importantly, the Bill authorized appropriations to the Secretary of HUD for these purposes.[40]

4. Mortgage Servicing and Appraisal Activities

The Miller Bill would have required creditors to establish an escrow for the payment of taxes and certain insurance premiums and other payments,[41] or provide enhanced notice to consumers who waive escrow services.[42] It would have amended the Real Estate Settlement Procedures Act (RESPA)[43] to limit the circumstances requiring force-placed hazard insurance[44] and TILA regarding the application of borrowers' payments.[45] Finally, the Bill sought to regulate real estate appraisals made in connection with certain home loans.[46]

36. *Id.*; *see also* Regulation Z, 12 C.F.R. § 226.1 et seq. (2010).
37. H.R. 1728 §§ 302, 303; *see also* 12 C.F.R. § 226.1 et seq.
38. H.R. 1728 § 402.
39. *Id.* § 403.
40. *Id.* § 404.
41. *Id.* § 501.
42. *Id.* § 502.
43. Real Estate Settlement Procedures Act of 1996, 12 U.S.C. § 2605 et seq. (2006).
44. H.R. 1728 § 503; *see also* James M. Cain, *Financial Institution Insurance Activities–A New 2001 Odyssey Begins*, 57 BUS. LAW. 1357, 1368 (2002) (defining "force-placed hazard insurance" as "property and casualty insurance required by a lender to protect collateral securing a loan").
45. H.R. 1728 § 504.
46. *Id.* §§ 601-06.

B. The Financial Product Safety Commission

Under prior law, various federal and state political actors had jurisdiction to regulate consumer credit markets, including the market for home loans.[47] Each of the federal regulators with jurisdiction over financial institutions—the Federal Reserve Board (the "Board" or the "Fed"), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Authority (NCUA)—had regulatory, monitoring, and enforcement authority over unfair and deceptive financial products issued by those institutions. The Federal Trade Commission (FTC) had similar authority over non-depository members of the financial services industry.[48] HUD had some regulatory jurisdiction over residential mortgages and was the regulator with supervisory jurisdiction over Fannie Mae and Freddie Mac, as well as indirect authority over residential mortgage terms. Whether state attorneys' general offices and state banking regulators had jurisdiction over consumer financial protection was an issue on which federal and state regulators differed; the Supreme Court weighed in from time to time on whether federal banking and other laws preempted state actors' consumer protection and other regulatory efforts.[49]

This balkanization left many with authority over, but none with clear responsibility for, regulation of financial products. This state of affairs led Professors Elizabeth Warren and Oren Bar-Gill to propose that a single, centralized, Financial Products Safety Commission be created by Congress.[50] Inspired in large part by this academic work, bills were introduced in both the Senate and House to create a Financial Product Safety Commission (FPSC or the "Commission") that would have jurisdiction to regulate the terms and types of financial products available to consumers.[51] In these bills, the FPSC would have been created as an independent agency.[52] In one iteration of these proposals, the Commission was to be directed by a

47. *See Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve: Hearing Before the Subcomm. on Domestic Monetary Policy and Tech. of the H. Comm. on Fin. Servs.*, 111th Cong. 18-20 (2009) [hereinafter *Regulatory Restructuring*] (statement of Patricia A. McCoy, Dir., Ins. Law Ctr., Univ. of Conn. Law Sch.), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/mccoy_house_testimony_hearing_july_16_2009.pdf; *see also* Ann Graham, *The Consumer Financial Protection Agency: Love It or Hate It, U.S. Financial Regulation Needs It*, 55 VILL. L. REV. 603, 609 (2010).

48. *Regulatory Restructuring*, *supra* note 47.

49. *See generally* Watters v. Wachovia, 550 U.S. 1 (2007); Barnett Bank. of Marion Cnty. v. Nelson, 517 U.S. 25 (1996).

50. *See supra* notes 7-9 and accompanying text.

51. *See supra* notes 6-9.

52. H.R. 1705, 111th Cong. § 4(a)(1) (1st Sess. 2009); S. 566, 111th Cong. § 4(a)(1) (1st Sess. 2009).

five-person board of commissioners, appointed with staggered terms, and led by a chairperson who would be appointed by the President with the advice and consent of the Senate.[53] The Commission would have been vested with authority to "minimize unreasonable consumer risk associated with buying and using consumer financial products," as well as to "collect, investigate, resolve, and inform the public about consumer complaints regarding consumer financial products."[54] The Commission would have been directed to "promulgate consumer financial product safety rules that . . . ban abusive, fraudulent, unfair, deceptive, predatory, anticompetitive, or otherwise anti-consumer practices, products or product features," as well as to provide related educational and other support services.[55] These bills would have left in place other federal agencies with concurrent jurisdiction, but gave the FPSC the first option on enforcement actions, and made clear that FPSC rules would prevail over other rules and regulations if the competing rule "conflicts with a rule promulgated by the Commission" and "is less protective of consumers" than the Commission rule.[56] Similarly, these bills would have limited pre-emption of state law and, indeed, would have required the new Commission to establish a program for coordinating with state and local authorities in "the administration and enforcement of this Act."[57]

Representative Barney Frank introduced his own bill, H.R. 3126, to establish a Consumer Financial Protection Agency (CFPA).[58] H.R. 3126 was built on the earlier bills and, at ten times the length of the earlier bills, provided more detail about the composition of the new Agency but with a more open-ended, less detailed statement of the rulemaking objectives of the Agency. Moreover, unlike the earlier bills, which envisioned an independent agency that worked in tandem with other existing federal agencies and offices having jurisdiction over consumer financial products, the CFPA in H.R. 3126 "shall have the exclusive authority to prescribe regulations, issue guidance, conduct examinations, require reports, or issue exemptions."[59] Unlike the earlier bills, H.R. 3126 contained more nuanced preemption provisions (and maybe less limited) regarding the extent to which state legislators and executives could regulate and bring enforcement actions against banks and other financial entities subject to federal regulation.

53. H.R. 1705 § 4(a)(2); S. 566 § 4(a)(2).
54. H.R. 1705 § 5(a)(1), (7); S. 566 § 5(a)(1), (7).
55. H.R. 1705 § 5(b)(1)(A); S. 566 § 5(b)(1)(A).
56. H.R. 1705 § 6(b); S. 566 § 6(b).
57. H.R. 1705 § 8(b)(2)(A); S. 566 § 8(b)(2)(A).
58. H.R. 3126, 111th Cong. (1st Sess. 2009).
59. *Id.* at § 122(d).

C. The Frank Bill

By the time Representative Frank introduced H.R. 4173, The Wall Street Reform and Consumer Protection Act of 2009, the bill had morphed into omnibus legislation that combined provisions from the Miller Bill to regulate predatory mortgages (appropriateness, disclosure, and assignee liability), provisions from Frank's earlier H.R. 3126 to create a Consumer Financial Protection Agency,[60] and provisions from other pending legislation to re-regulate the financial services markets. For example, the Frank Bill would have folded the OTS and OCC into one organization, still called the OCC;[61] it would have created a Financial Stability Council comprised of all of the financial regulators and housed in the Federal Reserve System;[62] and, it would have established a process for addressing large, failing unregulated financial institutions.[63] It would have given shareholders an advisory vote on executive compensation, enabled regulators to ban certain risky compensation practices, and, in any event, required covered financial industries to disclose incentive-based compensation structures.[64] It would have expanded the regulatory authority of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission, including granting the SEC authority over hedge funds and certain derivatives transactions.[65]

Incorporating the Credit Risk Retention Act,[66] the Frank Bill would have required the "appropriate agencies" to promulgate regulations requiring "any creditor that makes a loan to retain an economic interest in a material portion of the credit risk of any such loan that the creditor transfers, sells, or conveys to a third party," and "any securitizer of asset-backed securities . . . to retain an economic interest in a material portion of any such asset used to back an issuance of securities."[67] It further directed that these regu-

60. There were some changes made to the CFPA proposals that ended up in the Frank Bill. For example, it provides that the Federal Reserve System would pay the budget of the Agency. The CFPA would not have jurisdiction over "small institutions," defined as banks holding less than $10 billion in deposits and credit unions with less than $1.5 billion in deposits. The NCUA would continue to exist under the Frank Bill, but the CFPA could oust it from power under limited circumstances. Neither the SEC nor the Commodity Futures Trading Commission would fall under the CFPA's oversight. *See* H.R. 4173, tit. IV, §§ 4001-4901 (2009) (enacted Pub. L. No. 111-203, 124 Stat. 1376 (2010)).

61. *Id.* § 1207.

62. *Id.* §§ 1001-08.

63. *Id.* tit. I, §§ 1000-1951.

64. *Id.* §§ 2001-04.

65. *Id.* tits. III, V.

66. *See* H.R. 1731, 111th Cong. (1st Sess. 2009); H.R. 3996, 111th Cong. §§ 1501-05 (1st Sess. 2009).

67. H.R. 4173 § 1502(a).

lations should require retention of five percent "of the credit risk on any loan that is transferred, sold, or conveyed by such creditor or securitized by such securitizer," and prohibit the hedging or other transfer of the risk to be retained.[68] The Frank Bill would have allowed these regulators to adopt a "safe harbor" enabling creditors and securitizers to retain less than this five percent interest if

> the loan that is transferred, sold, or conveyed by such creditor or securitized by such securitizer meets terms, conditions, and characteristics that are determined by an appropriate agency to reflect loans with reduced credit risk, such as loans that meet certain interest rate thresholds, loans that are fully amortizing, and loans that are included in a securitization in which a third-party purchaser specifically negotiates for the purchase of the first-loss position and provides due diligence on all individual loans in the pool prior to the issuance of the asset-backed securities, and retains a first-loss position.[69]

The pre-emption provisions in the Frank Bill were narrower, and perhaps more nuanced, than those found in the earlier Miller Bill.[70] Not surprisingly, perhaps, since the Frank Bill was far broader in scope than the Miller Bill had been. In the Frank Bill, federal regulators could have pre-empted state law if the state laws would have a "discriminatory impact on the federally chartered institutions relative to state chartered institution,"[71] the state law is already pre-empted by other federal legislation, or the federal regulator responsible for the federally chartered institution determines on a case-by-case basis that "state consumer financial law prevents, significantly interferes with, or materially impairs the ability of an institution chartered as a national bank to engage in the business of banking."[72] This would need to be shown by "substantial evidence, made on the record of the proceeding."[73]

D. The Dodd Bill

The Frank Bill passed the House in December 2009 and percolated in the Senate before the Senate acted. It was not until April 15, 2010 that Senator Dodd introduced S. 3217, the Restoring American Financial Stability Act of 2010.

68. *Id.*

69. *Id.*

70. *Id.* §§ 4401-10.

71. *Id.*; *see also* Broox W. Peterson, *The Consumer Financial Protection Agency: Different Ship, Same Chairs?*, 28 BANKING & FIN. SERVICES POL'Y REP. 1, 8 (2009).

72. H.R. 4173 § 4409.

73. *Id.*

Like the Frank Bill, the Dodd Bill was omnibus legislation. In broad-brush strokes, the Dodd Bill, like the Frank Bill, combined the creation of a consumer protection entity with complete re-regulation of the financial services sector. True to the Senate's failure to react to the Miller Bill when adopted by the House in 2008 and in the spring of 2009, the Dodd Bill stripped from the Frank Bill any provisions requiring mortgage originators to determine the appropriateness or net benefit of a mortgage, provide specific disclosures to borrowers, or create assignee liability for failure to satisfy these standards. While presumably these regulatory requirements might have been intended to be the proper subject for rulemaking by whatever consumer protection entity Congress created in the end, the Dodd Bill itself removed these provisions.

For our purposes, the most important difference between the Frank Bill and the Dodd Bill (as introduced) is in the nature of the consumer protection entity that would have been created. Under S. 3217, consumer protection would have been housed, not in an independent, newly-created agency, but rather in a "bureau" of the Federal Reserve System.[74] Despite this locational distinction, the Dodd Bill continued to refer to the Bureau of Consumer Financial Protection (BCFP) as autonomous and independent.[75] The House and Senate Bills also differed in terms of how they would have structured the consumer protection entity. The Frank Bill would have created a staggered board of five CFPA commissioners under the leadership of a chairperson.[76] The Dodd Bill instead provided for the appointment of a Bureau director.[77] But the director was to be appointed by the President, not by the Chairman of the Federal Reserve Board, and for the same five-year term that had been specified in the Frank Bill.[78] The Dodd Bill also called for the creation of an Office of Financial Literacy within the BCFP,[79] while the Frank Bill had simply noted the "sense of Congress" regarding the importance of financial literacy.[80]

There are a number of other differences between the Frank Bill (as it passed in the House) and the Dodd Bill (as it was introduced). The Frank Bill would have continued the Fed's supervisory role as central bank over

74. S. 3217, 111th Cong. (1st Sess. 2009).

75. Remember, of course, that the Frank Bill had provided for the CFPA's budget to come out of the Fed's budget, which presumably would not change were consumer protection housed in a bureau of the Fed.

76. *See* S. 3217 §§ 4101-10.

77. Restoring American Financial Stability Act, S. 3217, 111th Cong. § 1013 (2d Sess. 2010).

78. *See* H.R. 4173 § 4103.

79. S. 3217 § 1013.

80. H.R. 4173 § 4816.

the entire financial system; the Dodd Bill would have limited the role of the Fed to financial institutions with assets exceeding fifty billion dollars and specified institutions on a watch-list, only thirty-six institutions in total.[81] The Dodd Bill introduced the so-called Volker Rule into the legislation—a rule allowing regulators to ban proprietary trading at bank holding companies. These holding companies, which have access to the Fed discount window, would have been banned from trading in securities on their own account.[82] This rule also would have allowed a cap on the amount of a particular type of security that a financial firm could hold in its books. While both the Frank and Dodd Bills had certain provisions requiring regulations to be promulgated that required creditors and securitizers to retain credit risk in certain circumstances,[83] the provisions on this topic in the Dodd Bill were more detailed and contained the potential for additional safe harbors in whatever regulations ultimately were adopted.

The Dodd Bill was introduced in April 2010 and the Senate took up debate nearly immediately. On May 19, 2010, after a number of amendments to the Bill had been proposed and voted on, Senate majority leadership called for a vote to end debate on amendments.[84] Although sixty votes were needed to move the bill to the next stage, only fifty-seven senators voted to proceed.[85] Two democratic senators had declined to vote in favor of the proposal because they felt the Bill was still not restrictive enough on the financial services sector. Senator Cantwell, whose amendment on regulating derivatives contracts had been tabled earlier in the week, was among those who voted with Republicans against the proposal to proceed.[86] Senator Feingold indicated that his "no" vote would change only if the Senate voted to repeal the Gramm-Leach-Bliley Act and reinstate the regulatory separation between banking and other financial services. At a press conference held the following day, Senator Harry Reid, majority whip, assured "the American people" that a compromise on the derivatives proposal would be hammered out soon, with a new vote on proceeding to occur

81. *Id.*; S. 3217 § 177 (as introduced).

82. S. 3217 § 619(g).

83. H.R. 4173 § 1502.

84. 156 CONG. REC. S3974 (May 19, 2010) (statement of Senator Dodd noting presence of two cloture motions at the desk).

85. *Democratic Holdouts Block Financial Bill*, N.Y. TIMES, May 19, 2010, http://dealbook.nytimes.com/2010/05/19/democratic-holdouts-block-financial-bill/?scp=3&sq=May%2019,%202010%20%20Dodd%20Bill&st=cse.

86. *Id.*

within days.[87] The Bill passed the Senate the next day and a conference committee was convened.[88]

Since the Frank Bill and Dodd Bill differed from each other, more work was required in the House before the law emerged. A conference committee was created to reconcile the differences between the two bills.[89]

E. The Dodd-Frank Bill Emerges From the Conference Committee

Because both the House and Senate had adopted legislation to reform the financial markets and provide consumer financial protection, a bipartisan conference committee was appointed to resolve the differences in the two bills—the House's Frank Bill and the Senate's Dodd Bill. Deliberations proceeded slowly over the summer, sometimes in windowless chambers on Capitol Hill and sometimes in the bright lights of press conferences held by lobbyists and others. In the end, the Dodd Bill took roughly center stage in the Dodd-Frank Act, with one important exception. The Mortgage Reform and Anti-Predatory Lending Act provisions of the Frank Bill, which traced their origins to the Miller Bill and had not been present in the Dodd Bill, re-emerged as Title XIV of the conference committee's report and so Title XIV of the Dodd-Frank Act.[90] While substantially similar to the legislation that had been proposed in the Miller and Frank Bills in the House, the conference committee made important changes to these provisions before re-inserting them in the reconciliation of the House and Senate versions of the legislation. Most of the changes related to the provisions setting minimum standards for residential mortgages and the assignee liability and remedial provisions intended to enforce these provisions. In addition, the Dodd-Frank Act exempted "qualified [residential] mortgages" from the requirement that securitizers hold five percent "skin in the game."[91] We leave the details of these provisions[92] to the next sections.

87. David M. Herszenhorn, *Senate Fails to Advance Financial Reform Bill*, N.Y. TIMES, May 20, 2010, at B1.

88. 156 CONG. REC. S4078 (May 20, 2010).

89. CONFERENCE REPORT TO ACCOMPANY H.R. 4172, DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, REP. NO. 517 (2d Sess. 2010), *available at* http://thomas.loc.gov/cgi-bin/cpquery/R?cp111:FLD010:@1(hr517).

90. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, tit. XIV–Mortgage Reform and Anti-Predatory Lending Act (July 21, 2010).

91. *Id.*

92. *Id.* §§ 941-45.

F. In Sum

We pause here to note the perhaps surprising omnibus nature of the Dodd-Frank Act's combination of provisions to regulate predatory mortgages (and mortgage practices), provisions to create a consumer financial protection agency, and broad-ranging provisions to regulate the financial services industry. Each of the three proposals was strongly opposed by the financial services industry; weaving the three into a single bill would seem only to concentrate opposition on a bigger target. On the other hand, given the crisis of 2008, it was clear that some sort of a legislative package needed to be enacted in response. Opposition was politically dangerous, and there was probably a sense that there was only the will to enact one statute. Still, it was a bold and audacious move, premised on the near certainty that there would be one, and only one, opportunity for financial reform in the Obama Administration.

Putting aside the issue of scope, there remains the question of substance, and here we were surprised by the conference committee's final report. The Dodd Bill had stripped from its legislative proposal all prescriptive regulation in the residential mortgage market. The predatory mortgage provisions of the Miller Bill (and later in the Frank Bill), which had left the financial services industry apoplectic with their likelihood for killing innovation and liquidity in the market for home loans, were never a part of the Dodd Bill. Surprisingly, the conference committee re-inserted these provisions in somewhat watered down form.[93] These anti-predatory residential mortgage provisions provide substantive consumer financial protection regulation, unlike the remainder of the Act, which is composed almost entirely of provisions that alter the infrastructure but not the substance of consumer financial protection regulation and, more broadly, of regulation of the financial services sector.

II. LOCATION, LOCATION, LOCATION

While the Act has been presented as a comprehensive regulatory reform, and while it certainly contains a fair amount of substantive regulation, its revolutionary nature lies more in its reconfiguration of the regulatory landscape. Now, in addition to the Federal Reserve and other bank regulatory agencies regulating to protect safety and soundness on the supply side, the demand side will also be filtered through regulation enforced and promulgated by the new Bureau of Consumer Financial Protection.

93. *Id.* §§ 1400-98.

A. The Institutional Location of the Bureau and Its Significance

The most significant difference between the House and Senate versions of the Wall Street Reform and Consumer Protection Act involved the relocation of the new entity created to regulate consumer financial protection.[94] In the Frank Bill, consumer financial protection was to occur in an independent agency, but in the Dodd Bill, consumer financial protection was shifted to a bureau within the Federal Reserve Board.[95]

We view the identification of the Bureau's source of funding as indicative of—indeed, as a sort of guarantee of—the Bureau's financial independence from political sources. Because the Fed is independent and self-financed, the Bureau would be beholden only to the Fed and not to Congress or the Executive for funding. Congress cannot cut the Bureau's budget in future years, or under future Administrations, in precisely the same way that neither Congress nor the executive branch has the power of the purse over the Fed.[96] The Fed's financial independence was intentionally assured.[97] We assume that the Bureau's funding through the Fed was also intentionally structured to ensure the Bureau's political independence, rather than to ensure that the Fed could or should control the substance of any regulation promulgated by it, or the enforcement of any laws or regulations over which the Act grants the Bureau jurisdiction.[98]

In addition to ensuring funding, placing the CFPB in the Fed has another advantage over other possible locations. Given the interrelation between consumer protection, liquidity, and safety and soundness, where Congress placed the Bureau is critically important to the political and substantive implications of this structural shift. For example, with placement in the FTC, Congress could have been signaling the preeminence of consumer protection to the work of the Bureau, and the preeminence of the FTC in the area of consumer protectionism. This placement also might have been con-

94. *See supra* notes 74-75 and accompanying text.

95. *Id.*

96. Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 21 (2010) (noting that the "Banking Act of 1935, which established the modern structure of the Federal Reserve, aimed to give the agency more insulation so that it would serve the 'general public interest' and not 'special interests'" (quoting H.R. REP. NO. 74-742, at 1, 6 (1935))).

97. *Id. But see* Gyung-Ho Jeong, Gary J. Miller & Andrew C. Sobel, *Political Compromise and Bureaucratic Structure: The Political Origins of the Federal Reserve System*, 25 J.L. ECON. & ORG. 472, 472 (2009) (arguing that "the structural independence of the Fed is not the result of intentional design but a product of compromise among disparate groups").

98. *See* Barkow, *supra* note 96, at 72-79 (discussing structural insularity of Bureau of Consumer Financial Protection and noting that "whether the CFPB succeeds or fails, it is promising that so much attention was paid to equalizing insulators in the debate over the agency's creation").

strued as limiting the occasion for regulation to the need to eradicate deceptive, abusive, and otherwise unfair financial product or financial contract terms, but not more extensive regulatory goals. If, on the other hand, Congress had placed the Bureau as a part of one of the pre-existing agencies for the regulation of a financial institution, such as within OTS or the OCC, it most likely would have been signaling something very different—the preeminence of the safety and soundness of these financial institutions over consumer protectionism. That regulatory agencies such as the OTS and OCC had historically thwarted consumer protection regulation as inconsistent with the liquidity and innovativeness of the institutions it supervised might also have been an indication of Congress' intent to subvert the strength of the consumer protectionism that the Bureau would have been empowered to pursue.

But Congress did none of these things. Instead, it placed the Bureau as a part of the Fed: the most politically independent financial regulator. Importantly, the Fed has primary jurisdiction over systemic risk, at least after enactment of the Act, and thus has a close eye on the liquidity of the markets for consumer credit. Embedding the Bureau within the Fed makes it unlikely that the Bureau can pursue its consumer protectionist goals without also considering the effects of such regulation on the financial marketplace. Thus, positioning the Bureau within the Federal Reserve System emphasizes the inter-relationship between consumer financial protection and financial regulation, more generally.

In the next section, we turn to the details of the provisions of the Dodd-Frank Act that create the new Bureau of Consumer Financial Protection.

B. Rulemaking Authority: Interactions Between the Bureau and Other Regulatory Agencies

The Act establishes "an independent bureau" within the Federal Reserve System,[99] "which shall regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[100] The powers of the Bureau are defined in this section to include "the establishment of rules for conducting the general business of the Bureau" and implementation of "the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions."[101] A detailed statement of the Bureau's "purpose, ob-

99. Dodd-Frank Act, § 1011.

100. *Id.* § 1011(a). "Federal consumer financial laws" is defined by the Dodd-Frank Act in section 1002(14).

101. *Id.* § 1012(a)(1), (10).

jectives and functions" is found in section 1021 of the Act, where the Bureau is directed to implement and "enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[102]

Five objectives are specified: (i) providing consumers "timely and understandable information so that they can make "responsible decisions about financial transactions"; (ii) protecting consumers from "unfair, deceptive, or abusive acts and practices and from discrimination"; (iii) identifying and redressing "outdated, unnecessary, or unduly burdensome regulations" to "reduce unwarranted regulatory burdens"; (iv) enforcing the Fed-Federal consumer financial laws "consistently, without regard to the status of a person as a depository institution," so as to promote "fair competition"; and (v) ensuring that "markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation."[103] Should these purposes and objectives be unclear, the Act further details the primary functions of the Bureau. Like many administrative agencies, the Bureau holds regulatory responsibility—the responsibility to promulgate new regulations, but also the responsibility to monitor and enforce compliance with existing regulations. The content of these functions is less surprising to us than the order in which they are stated, so we quote this subsection nearly in full:

> (c) Functions—The primary functions of the Bureau are—
>
> (1) conducting financial education programs;
>
> (2) collecting, investigating, and responding to consumer complaints;
>
> (3) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets;
>
> (4) subject to sections 1024 through 1026, supervising covered persons for compliance with Federal consumer financial law, and taking appropriate enforcement action to address violations of Federal consumer financial law;
>
> (5) issuing rules, orders, and guidance implementing Federal consumer financial law; and

102. *Id.* § 1021(a).
103. *Id.* § 1021(c)(1)-(6).

> (6) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau.[104]

Placing regulatory authority fourth on the list of the Bureau's functions may not have been an accident.

The Bureau's rulemaking authority is carefully prescribed within the Act. Section 1022 of the Act provides generously that the Bureau is empowered to "prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable [it] to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."[105] In exercising this authority, however, the Act directs the Bureau to weigh "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule," as well as the impact of these rules on "covered persons," and the impact of these rules on "consumers in rural areas."[106] The Bureau is required, during the comment process specified in the Administrative Procedure Act,[107] to "consult with the appropriate prudential regulators or other Federal agencies" as to the rule's "consistency with prudential, market, or systemic objectives administered by such agencies."[108] While this obligation to "consult" does not give these prudential regulators veto power over rules promulgated by the Bureau,[109] the Council *can* overturn and "set aside" a final regulation prescribed by the Bureau, but only if the Council decides "that the regulation or provision [thereof] 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."[110] Where covered persons are not sub-

104. *Id.* § 1021(b).

105. *Id.* § 1022(b)(1).

106. *Id.* § 1022(b)(2)(A)(i)-(ii).

107. Administrative Procedure Act, 5 U.S.C. § 553(c) (2006).

108. Dodd-Frank Act, § 1022(b)(2)(B).

109. The Dodd-Frank Act makes clear that, with limited exceptions, the Bureau enjoys "exclusive authority" to prescribe rules over the Federal consumer financial laws. *Id.* § 1022(b)(4)(A).

110. *Id.* § 1023(a). Agencies—that is, prudential regulators "represented by a member of the Council"—may petition the Council in writing to stay the effectiveness of a regulation promulgated by the Bureau if the "member agency" has attempted in good faith "to work with the Bureau to resolve concerns regarding the effect of the rule on the safety and soundness of the United States banking system or the stability of the financial system of the United States." *Id.* § 1023(b)(1)(A). In this event, the agency can petition the Council "not later than 10 days after the date on which the regulation has been published in the Federal Register." *Id.* § 1023(b)(1)(B). The Council can stay the effectiveness of the regulation for as long as ninety days. *Id.* § 1023(c). "A decision by the Council to set aside a regulation prescribed by the Bureau, or provision thereof, shall render such regulation, or provision thereof, unenforceable." *Id.* § 1023(b)(4)(A).

ject to prudential regulation by a member agency, the Bureau has jurisdiction to promulgate regulations and otherwise supervise nondepository covered persons, such as mortgage brokers and payday lenders.[111] Even this grant of jurisdiction is conditioned upon the Bureau's consultation with the FTC prior to issuing a rule "to define covered persons subject to this section."[112] And, again, regulation is subject to a cost-benefit analysis that would require the Bureau to assess "the risks posed to consumers in the relevant product markets and geographic markets" in light of "the asset size of the covered person," "the volume of the transactions involving consumer financial products or services," "the risks to consumers created by the provision of such consumer financial products or services," "the extent to which such institutions are subject to oversight by State authorities for consumer protection," and other factors determined to be relevant.[113] As far as enforcement of federal consumer financial laws against these nondepository covered persons, the Act directs the Bureau and the FTC to "negotiate an agreement for coordinating" their enforcement actions.[114]

Despite the coordination and consultation required of the Bureau, the Dodd-Frank Act provides that, with limited exceptions, "the Bureau shall have the exclusive authority to prescribe rules, issue guidance, conduct examinations, require reports, or issue exemptions" relating to nondepository covered persons.[115] The biggest exception to the Bureau's exclusive authority consists of a broad limitation on the Bureau's jurisdiction to exercise rulemaking, supervisory, enforcement, or other authority over merchants, retailers, and other sellers of nonfinancial goods or services unless they are "engaged in offering or providing any consumer financial product or service" or are otherwise subject to the consumer financial laws "for which authorities are transferred" to the Bureau by the Act.[116] Moreover,

111. *Id.* § 1024(a)(1). The Act defines a "covered person" as "any person that engages in offering or providing a consumer financial product or service" and "any affiliate of [such person] if such affiliate acts as a service provider to such person." *Id.* § 1002(6). It further defines "financial product or service" broadly, *id.* § 1002(15), and distinguishes between "covered persons," who are already subject to regulation by OCC, NCUA, or some other financial regulator, and "nondespository covered persons," who are not so regulated. *Id.* § 1024.

112. *Id.* § 1024(a)(2).

113. *Id.* § 1024(b)(2).

114. *Id.* § 1024(c)(3)(A) (requiring this coordination agreement to include "procedures for notice to the other agency, where feasible, prior to initiating a civil action to enforce any Federal law regarding the offering or provision of consumer financial products or services").

115. *Id.* § 1024(d).

116. *Id.* § 1027(a)(1). There are also exceptions relating to real estate brokerage activities, manufactured home retailers, accountants and tax preparers, lawyers, insurance companies and other "persons regulated by a state insurance regulator," employee benefit and compensation plans," persons regulated by state securities commissions, the SEC, CFTC,

the Bureau "may not exercise any rulemaking, supervisory, enforcement or any other authority" over car dealers that are "predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of vehicles, or both."[117] The Act also specifies that, regardless of the scope of its jurisdiction, the Bureau does not have authority "to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law."[118] Moreover, while there are procedural limits imposed, the Bureau is expressly authorized by the Act to study and thereafter restrict mandatory, pre-dispute arbitration clauses in agreements in consumer financial transactions.[119]

As noted above, the Act specifies in excruciating detail whether the Bureau or another agency is to regulate consumer financial products and services. Despite this jurisdictional detail, the Act says relatively little about the substantive breadth of the Bureau's rulemaking authority. The Act provides that the Bureau can "issu[e] rules, orders, and guidance implementing Federal consumer financial law,"[120] but, other than to note that it generally cannot impose usury restrictions, the Act is unclear as to what limits, if any, exist on the Bureau's broad grant of rulemaking authority in this regard.

In part, this ambiguity arises because there are several different statements of the Bureau's rulemaking authority in the Act, some broader than others. Subtitle B sets forth the general powers of the Bureau and begins with the statement that the Bureau "shall seek to implement" and "enforce Federal consumer financial law" with the purpose of "ensuring that all consumers have access to markets for consumer financial products and services" and that these markets are "fair, transparent, and competitive."[121] Specifically with regard to the Bureau's rulemaking authority, it provides that the Director "may prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."[122] This is as broad a statement of rulemaking authority as contained in the TILA.[123] The Supreme Court has construed

Farm Credit Administration, and activities relating to charitable contributions. *Id.* § 1027(b)-(n).

117. *Id.* § 1029.

118. *Id.* § 1027(o).

119. *Id.* § 1028.

120. *Id.* § 1021(c)(5).

121. *Id.* § 1021(a).

122. *Id.* § 1022(b)(1).

123. Section 105 of TILA provides that the Federal Reserve Board is authorized to prescribe regulations "to carry out [its] purposes," and "may provide for such adjustments and

similar statements of broad delegation of rulemaking authority to require courts generally to defer to regulations promulgated under this authority so long as they are "reasonably related" to the "purposes of the enabling legislation."[124] But what are the purposes of the Wall Street Reform and Consumer Protection Act?[125] And are there other limitations on the Bureau's rulemaking authority that undermine this broad, general delegation?

In various places, the Act qualifies and explicates the Bureau's authority to promulgate rules that may be "necessary and appropriate" to implement the purposes of the Act. For example, as noted above, the Act specifies various entities outside the scope of the regulatory jurisdiction—car dealers, and the like.[126] But specifying the scope of persons covered by the Act should not be viewed as undermining the Bureau's regulatory authority over those entities that clearly fit within the scope of the Bureau's jurisdiction. Line drawing should not be viewed as diluting its authority over those that fit within the lines.

Similarly, the Act provides that, "[i]n prescribing a rule under the Federal consumer financial laws," the Bureau should weigh the potential costs and benefits of the rule to consumers and the marketplace, as well as the potential impact of the rule on the market—especially markets in rural

exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of [the Act], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." 15 U.S.C. § 1604 (2006).

124. The Supreme Court has, on several occasions, interpreted this provision to grant extensive deference to the Fed. Indeed,

> [w]here the empowering provision of a statute states simply that the agency may "make . . . such rules and regulations as may be necessary to carry out the provisions of this Act," we have held that the validity of a regulation promulgated thereunder will be sustained so long as it is "reasonably related to the purposes of the enabling legislation."

Mourning v. Family Pub. Serv., 411 U.S. 356, 369 (1973) (quoting Thorpe v. Hous. Auth. of City of Durham, 393 U.S. 268, 280-81 (1969)).

125. A distinct and equally important questions also lurks here: Is the Bureau's rulemaking authority limited by subsequent statements in the Act in a way that permits courts to rule that the Bureau exceeded its statutory authority in promulgating some regulation, or is this determination exclusively reserved for the Council? Section 1022(b)(4)(B) of the Dodd-Frank Act seems to provide that courts should defer to the Bureau so long as its exercise of rulemaking authority is "reasonably related" to the purposes of the Act. It provides that,

> [n]otwithstanding any power granted to any Federal agency or to the Council under this title . . . the deference that a court affords to the Bureau with respect to a determination by the Bureau regarding the meaning or interpretation of any provision of a Federal consumer financial law shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law.

Dodd-Frank Act, § 1022(b)(4)(B).

126. *See supra* note 117 and accompanying text.

areas.[127] But courts and Congress have increasingly required administrative agencies to justify their regulatory action according to similar cost-benefit analyses.[128] That an administrative agency is held to various procedural requirements, including obligations to weigh the costs and benefits of a regulation, should not be viewed to undermine courts' obligations to defer to the agency's (or the Bureau's) administrative expertise.[129]

Finally, Subtitle C of the Act attempts to specify the scope of the subject matter of the Bureau's rulemaking authority with greater detail. Related to the Bureau's express authority to, among other things, ensure that "consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination,"[130] the Act provides that the Bureau "may prescribe rules applicable to a covered person or service provider indentifying as unlawful, unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service."[131] It goes on to define, through exclusion, the terms "unfair" and "abusive."[132] The Act specifies that the Bureau "shall have no authority" to declare an act or practice to be "unfair" unless it has a "reasonable basis" to conclude that:

> (A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and
>
> (B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.[133]

As it relates to a finding by the Bureau that an act or practice is abusive, the Act imposes a slightly different standard of proof, requiring the Bureau to find that the act or practice:

> (1) materially interferes with the ability of a consumer to understand a term or condition or a consumer financial product or service; or
>
> (2) takes unreasonable advantage of—

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127. Dodd Frank Act, § 1022(b)(2)(A).

128. *See, e.g.*, COST BENEFIT ANALYSIS: LEGAL, ECONOMIC AND PHILOSOPHICAL PERSPECTIVES (Matthew D. Adler & Eric Posner eds., 2001).

129. *Id.*

130. Dodd-Frank Act, § 1021(b)(2).

131. *Id.* § 1031(b).

132. *Id.* §§ 1031(c), (d). Presumably, the term "deceptive" is sufficiently well understood to require no additional explication in the statute.

133. *Id.* § 1031(c)(1). Moreover, this section continues: "In determining whether an act or practice is unfair, the Bureau may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determinations." *Id.* § 1031(c)(2).

> (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
>
> (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
>
> (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[134]

Clearly, Congress is looking with this language to define the open-ended terms "unfair" and "abusive," but is it also more broadly looking to limit the Bureau's rulemaking authority in this context? We think not. This language merely codifies existing agency interpretations of the terms, but does not limit in any way current understanding or practices. The definition of "unfair," set by the Act, tracks nearly word for word the standard of proof the FTC is required to meet in finding that an act or practice constitutes an unfair method of competition.[135] Similarly, the Federal Deposit Insurance Corporation (FDIC) follows this standard in determining whether covered financial institutions have engaged in unfair acts or practices.[136] In addition, the definition of "abusive" set by the Act resembles agency guidelines regarding the meaning of "deceptive" practices,[137] although the FDIC Compliance Manual considers the deceptiveness of an act or practice from the "perspective of a reasonable consumer," which the Act does not require.[138]

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134. *Id.* § 1031(d).

135. 15 U.S.C. § 45(n) (2006).

136. The FDIC Compliance Manual provides the following:

> In order to determine whether a practice is "unfair," the FDIC will consider whether the practice "causes or is likely to cause substantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." By adhering to this tenet, the FDIC will take action to address conduct that falls well below the high standards of business practice expected of banks and the parties affiliated with them.

FDIC, COMPLIANCE MANUAL, CHAPTER VII: ABUSIVE PRACTICES (June 2006) [hereinafter FDIC, COMPLIANCE MANUAL] (citing 15 U.S.C. § 45(n)), *available at* http://www.fdic.gov/regulations/compliance/manual/pdf/VII-1.1.pdf. The Treasury applies the same standard. *See* OFFICE OF THRIFT SUPERVISION, EXAMINATION HANDBOOK (2010), *available at* http://www.ots.treas.gov/_files/422369.pdf.

137. *See* FDIC, COMPLIANCE MANUAL, *supra* note 136; *see also* OFFICE OF THRIFT SUPERVISION, *supra* note 136 ("To correct deceptive trade practices, the FDIC will take action against representations, omissions, or practices that are likely to mislead consumers acting reasonably under the circumstances, and are likely to cause such consumers harm. The FDIC will focus on material misrepresentations, i.e., those that affect choices made by consumers because such misrepresentations are most likely to cause consumers financial harm.").

138. FDIC, COMPLIANCE MANUAL, *supra* note 136 ("In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation,

Nonetheless, the Act should not be construed to authorize the Bureau to exercise its rulemaking authority *only* to identify unfair, deceptive, or abusive acts or practices. While section 1031 of the Act expressly authorizes the Bureau to promulgate such regulations,[139] section 1022 more broadly authorizes it to "prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof."[140] And, the Act's statement of purposes and objectives is not limited to protecting consumers from "unfair, deceptive or abusive acts and practices and from discrimination,"[141] although this power is included. The Act also provides that the Bureau should ensure that "consumers are provided with timely and understandable information to make responsible decisions about financial transactions" and that the "markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation."[142]

Consistent with this reading of the breadth of the Bureau's rulemaking authority, section 1032 permits the Bureau to "ensure that the features of any consumer financial product or service . . . are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances."[143] This provision correlates to the statement in section 1021 that the Bureau should ensure that "consumers are provided with timely and understandable information to make responsible decisions about financial transactions."[144] Similarly, sections 1033 and 1034 explicate the Bureau's responsibilities to educate consumers and monitor consumers' complaints, as set forth in section 1021(c)(1), (2), and (3).

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omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.").

139. Dodd-Frank Act, § 1031(b).

140. *Id.* § 1022(b).

141. *Id.* § 1021(b)(2).

142. *Id.* § 1021(b)(1), (5).

143. *Id.* § 1032(a). This section also permits the Bureau to issue model forms, so long as the form has been "validated through consumer testing." *Id.* § 1032(b). Indeed, the Act requires the Bureau to "propose for public comment rules and model disclosures that combine the disclosures required under [TILA and RESPA] into a single, integrated disclosure for mortgage loan transactions." *Id.* § 1032(f). Use by lenders and other covered persons of a model form promulgated by the Bureau under these sections "shall be deemed to be in compliance with the disclosure requirements of this section." *Id.* § 1032(d).

144. *Id.* § 1021(b)(1).

Moreover, the Dodd-Frank Act transfers jurisdiction to the Bureau of regulatory authority over a broad range of consumer financial protection functions from the Federal Reserve Board, the OCC, and OTS, and even the FTC.[145] The Act amends a long list of federal consumer financial protection legislation to substitute the Bureau for pre-existing regulatory jurisdiction.[146] Finally, Title XIV of the Act adds rulemaking authority to the Fed's list of responsibilities;[147] the transfer provisions should shift even this newly conferred jurisdiction to the Bureau as of the "transfer date."

C. A Balancing Act

We read the Dodd-Frank Act as balancing consumer financial protection with market concerns for liquidity, safety, and soundness based on several structural aspects of the Act. First, structuring the Act as omnibus legislation that combined the creation of a Bureau of Consumer Financial Protection with broad reform of regulation of the financial services and capital markets suggests that interests in consumer financial protection cannot be separated from market interests in the supply of such products. Moreover, pairing the creation of the Bureau of Consumer Financial Protection (in Title X of the Dodd-Frank Act) with prescriptive regulation of predatory mortgages (in Title XIV of the Dodd-Frank Act) signals in the structure of the statute itself both the breadth and depth of the Bureau's regulatory authority.

Second, the Act's consolidation of jurisdiction over consumer financial protection with a single regulatory entity, and the placement of that entity as a Bureau within the Federal Reserve System, further signals the interrelatedness of concerns for the demand and supply of consumer financial products. Creation of an independent consumer financial protection regulatory entity provides assurances that consumer financial protection will not be ignored by the agencies with jurisdiction to regulate actors in the various financial services industries; positioning that entity within the aegis of the Federal Reserve System provides additional assurances that concerns regarding liquidity in the market and the soundness of market actors will influence choice among possible methods of regulation of consumer financial products.

In directing the Bureau, at least inferentially, to balance concerns for consumer protection, safety and soundness, and liquidity, has Congress asked the Bureau to do the impossible? Efforts to promote consumer fi-

145. Dodd-Frank Act, tits. X-F.
146. *Id.* at tits. X-H.
147. *Id.* § 1402(a)(2).

nancial protection have long been met with arguments that since the effect of prescriptive regulation is to reduce liquidity (and also perhaps innovation) in the marketplace, disclosure regulation should be preferred. Congress had, indeed, more frequently adopted disclosure regulation than regulation that prohibits financial products or terms.[148]

Our contention that the Act should be read to require the Bureau to consider not simply consumer protection concerns, but also concerns for liquidity in the marketplace and the safety and soundness of financial institutions, is not to argue that the Bureau should promulgate only or even predominantly disclosure regulation. First, the recent subprime mortgage crisis demonstrates that favoring liquidity over consumer protection concerns in all contexts may come at the price of the safety and soundness of financial actors. Second, and perhaps more importantly, a directive to balance concerns for liquidity with concerns for the protection of consumer borrowers is not—and should not be construed as—a guarantee that liquidity levels should remain stable in the face of the new regulation nor that only regulation enhancing liquidity in the marketplace should be adopted. A concern for ensuring the movement of financial products between and among financial actors is distinct from a concern for protecting, at all costs, the dollar values of financial instruments that change hands in the financial markets. Finally, interests in consumer protection vary depending upon the particular purpose at issue. Regulation looking to alleviate deception or abuses in the market may look very different from regulation seeking to ensure that "all consumers have access to markets for consumer financial products and services" and that these markets are "fair, transparent, and competitive."[149]

In the next Part, we further explore the scope of the Bureau's regulatory authority. Title XIV regulates mortgage originators and mortgage lenders and their assignees. With both sorts of prescriptive regulation, the Dodd-Frank Act grants regulatory authority to the Board (but really the Bureau) to effectuate its terms. In doing so, the Act carefully balances concerns for consumer protection with interests in liquidity and the soundness of market actors.

148. *See, e.g.*, Sarbanes-Oxley Act of 2002, §§ 302, 401, 404, 409, 802, Pub. L. No. 107-204, 116 Stat. 745.
149. Dodd-Frank Act, § 1021.

III. SUBSTANCE: PROVISIONS FROM THE MORTGAGE REFORM AND THE ANTI-PREDATORY LENDING ACT

Although the Dodd Bill appeared to eliminate prescriptive regulation from the face of congressional reform of the financial markets, substance crept back in during the conference committee. Specifically, Title XIV of the Dodd-Frank Act includes the Mortgage Reform and Anti-Predatory Lending Act provisions that the Frank Bill incorporated from the earlier Miller Bill. This section of the Act includes eight subtitles: (i) residential mortgage loan origination standards; (ii) minimum standards for mortgages; (iii) high-cost mortgages; (iv) Office of Housing Counseling; (v) mortgage servicing; (vi) appraisal activities; (vii) mortgage resolution and modification; and (viii) miscellaneous provisions. Only the subtitles relating to residential mortgage loan origination standards and minimum standards for mortgages changed much; the remaining subtitles were merely moved, nearly intact, from their earlier placement in the Miller and Frank Bills. Nonetheless, the conference committee did make important changes to the provisions in the first two subtitles. These provisions, especially those imposing assignee liability for failure to meet the standards set for residential mortgage origination, had been among the most controversial provisions in the Frank Bill. They were also the most important provisions, in our view, for effectuating a sorting between securitizable safe mortgages and non-securitizable exotics.

Subtitle A, setting residential mortgage loan origination standards, contains definitional provisions, but fewer of them than had appeared in the Miller Bill. Carving back on the number of definitions was not just an effort by the conference committee to simplify residential mortgage loan origination standards, but rather signals several important changes between the Miller Bill and the Dodd-Frank Act. First, "securitizers" are not defined because the Dodd-Frank Act imposes its standards only on "creditors" and "assignees," but not "securitizers." Second, the "federal banking agencies" are not defined in the Dodd-Frank Act, because the Act confers rulemaking authority in this section on the Board and not a broader range of federal banking agencies (that would have included not only the Board, but also OCC, FDIC, NCUA, and others).

More than merely definitional, Subtitle A also sets standards, but the standards that it sets for mortgage originators are substantially watered down from those included in the earlier Miller and Frank Bills. Importantly, section 1402 of the Dodd-Frank Act cuts back substantially on the duty of care set for mortgage originators. The Act requires mortgage originators to be qualified, registered, and licensed according to applicable state and federal law, and to include on all loan documents "any unique identifier of the mortgage originator provided by the Nationwide Mortgage Licensing System and Registry,"[150] but unlike the Miller and Frank Bills does not require mortgage originators to make "full, complete and timely disclosure" to consumers of information regarding the comparative costs and benefits of the residential mortgage offered, nature of the relationship between the originator and the consumer, or of "any relevant conflicts of interest between the originator and the consumer."[151]

Removing from the Act obligations for mortgage originators to provide disclosure to consumers is perplexing to us. Why shouldn't mortgage originators be required to tell consumers that they are obliged to act in the best interests of lenders, if that is the economic reality of the situation? The deletion is especially troubling because we have elsewhere described mortgage originators as potentially effective in protecting consumers' interests in residential mortgage transactions.[152] The failure to set high standards for mortgage originators strikes us as a disappointing missed opportunity.

Even more perplexing is the removal from the Dodd-Frank Act of earlier provisions that would have imposed on mortgage originators the obligation to present to consumers "a range of residential mortgage loan products," each of which is "appropriate to the consumer's existing circumstances, based on information known by or provided in good faith to the originator."[153] Because the Miller Bill defined "appropriate" to relate to a consumer's "ability to pay,"[154] it correlated the standards applicable to mortgage originators and mortgage creditors. This correlation of standards was critically important to the practical implementation of the Miller Bill's standard since, often, a mortgage originator is at the same time a mortgage creditor at least for the short period between mortgage origination and the distribution of that mortgage to a securitization vehicle.

Remaining in the Dodd-Frank Act, however, are provisions of the earlier Miller and Frank Bills that granted rulemaking authority over the duty of care set for mortgage originators. As noted above, however, the House Bills would have vested the "federal banking agencies" with this rulemaking authority[155] and the Dodd-Frank Act, on its face, vests this authority in

150. *Id.* § 1402(a) (amending TILA to include section 129B regarding mortgage loan origination).

151. Miller Bill, H.R. 1728, 111th Cong. § 102(a) (1st Sess. 2009) (which would have amended TILA to include a much more demanding new section 129B regarding mortgage loan origination).

152. *See* Janger & Block-Lieb, *supra* note 2.

153. H.R. 1728 § 102.

154. *See supra* notes 14-49 and accompanying text.

155. H.R. 1728 § 102(a).

the "Board"[156] (in practice, due to other sections of the Dodd-Frank Act, the Bureau accedes to this rulemaking authority of the Board).[157] In our opinion, this rulemaking authority should be construed to permit the Board (but really the Bureau) to promulgate regulations requiring mortgage originators to provide some or all of the disclosure information cut from the House Bills' requirements. We are hopeful that the Bureau will have the political will to regulate mortgage originators effectively, given the Act's efforts to insulate the Bureau from congressional budget cutting and other consequences.

Regulation of mortgage originators should not, however, come only in the form of disclosure regulation. Enhanced disclosure of the sort promoted in the Miller and Frank Bills may not have had its intended effect; behavioral decision research suggests that individuals rely too heavily on experts, even where disclosure information refutes the expertise or reveals conflicting interests held by experts.[158] Moreover, regulation should be adopted to account for the close and often overlapping relationships between mortgage originators and mortgage creditors.

Importantly, section 1403 of the Dodd-Frank Act prohibits mortgage originators from receiving fees that would encourage them to steer consumers to mortgages that are either higher priced or that contain certain mortgage terms. It also authorizes the Board (but really the Bureau) to prescribe regulations prohibiting mortgage originators from steering consumers to residential mortgages that the consumer "lacks a reasonable ability to repay," "has predatory characteristics or effects," or is not a "qualified mortgage."[159] This provision also authorizes the Board (but really the Bureau) to promulgate regulations prohibiting "abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender or age," as well as practices by mortgage originators to mischaracterize the credit history of the consumer, or the value of the residential property secured by the mortgage.[160]

Section 1405 of the Act expands the Board's (but really the Bureau's) rulemaking authority, whether as applied to mortgage originators or other entities more generally, to permit them to "prohibit or condition terms, acts

156. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, § 1402(a)(2).

157. *Id.* §§ 1401-98.

158. *See, e.g.*, Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure* 3-4 (Univ. of Chi. Law & Econ., Olin Working Paper No. 516, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1567284.

159. Dodd-Frank Act, § 1403 (amending TILA section 129B).

160. *Id.*

or practices relating to residential mortgage loans" found to be "abusive, unfair, deceptive, [or] predatory" with the goal of ensuring that "affordable mortgage credit remains available to consumers."[161]

Section 1404 of the Dodd-Frank Act imposes liability on mortgage originators for violations of TILA (as amended by the Dodd-Frank Act) and any regulations promulgated under it, but provides that the maximum liability that may be imposed against a mortgage originator under this provision

> shall not exceed the greater of actual damages or an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the consumer of the action, including a reasonable attorney's fee.[162]

While this section leaves open the possibility of statutory damages against mortgage originators who violate the Act or the rules promulgated under it, these damages are set at levels likely only to sting but not put violators out of business.

Subtitle B to the Dodd-Frank Act sets federal minimum standards for residential mortgages, but again these standards are a revised version of the original standards set in the earlier House Bills. Unlike the changes made to Subtitle A, which largely eviscerate mortgage originators' obligations, the changes made to Subtitle B reflect efforts to balance consumer protection concerns with market-oriented concerns for liquidity, safety, and soundness. Much of substance is left in these provisions, although more could be done.

Section 1411 of the Dodd-Frank Act sets minimum federal standards for residential mortgage loans relating to consumers' "ability to repay" such mortgages. Specifically, the Act provides that

> 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.[163]

The Act indicates that a determination of a consumer's ability to repay a residential mortgage loan should include looking into the consumer's credit history, current income and expenses, future income that the consumer is

161. *Id.* § 1405 (further amending TILA section 129B).
162. *Id.* § 1404 (further amending TILA section 129B).
163. *Id.* § 1411(a)(2) (amending TILA to add a new section 129C).

"reasonably assured of receiving," employment status, and other factors.[164] It further provides that a creditor should verify the consumer's income "or assets that such creditor relies on" so that the creditor can determine the consumer's repayment ability.[165] Statutorily imposed underwriting standards of such a basic nature might seem intrusive,[166] except in the context of reports of substantial numbers of NINA and NINJA loans for which income and asset verification was absent from mortgage terms or practices. Omitted from the Dodd-Frank Act are provisions found in earlier House Bills requiring refinanced mortgages, at a minimum, to provide a "net tangible benefit" to the consumer.[167]

As noted above, these minimum mortgage underwriting standards expressly restrict decision making by creditors, but other provisions make clear that the obligations are binding on assignees of residential mortgage loans as well. A violation of the "ability to pay" requirements provides a defense to foreclosure.[168] Unlike in the earlier Bills, rescission is not an available remedy;[169] nonetheless, actual damages and statutory damages can be asserted against assignees by way of a claim in recoupment.[170]

164. *Id.*

165. *Id.*

166. Indeed, because federal underwriting standards of such a basic nature could water down stronger underwriting requirements imposed by financial regulators or other financial regulation, the conference committee added section 1411(a)(1) to the Dodd-Frank Act, which provides that "[n]o regulation, order, or guidance issued by the Bureau under this title shall be construed as requiring a depository institution to apply mortgage underwriting standards that do not meet the minimum underwriting standards required by the appropriate prudential regulator of the depository institution." *Id.* § 1411(a)(1).

167. H.R. 1728, 111th Cong. § 202 (2009) (amending TILA section 129B).

168. *See* Regulation Z, 12 C.F.R. §§ 226.34(a)(4), 226.35(b)(1) (2010).

169. The primary differences between Subtitle B of the Dodd-Frank Act and similar provisions in the earlier House Bills are the remedies that follow from a failure to comply with the underwriting standards or the safe harbor provisions identified in those places. In addition to any other liability extended by TILA, the Miller and Frank Bills would have permitted consumers to rescind residential mortgage loans that either did not conform to the minimum underwriting standards set by the Bills, or satisfy the requirements of a "qualified mortgage," subject to the right of creditors, assignees, and securitizers to "cure" under the terms of those Bills. This right of rescission (subject to a right of cure) is altogether absent in the Dodd-Frank Act, deleted as a part of the deliberations of the conference committee.

170. By contrast, the Dodd-Frank Act retains from the Miller and Frank Bills the notion that non-conformity with either the minimum underwriting standards or the safe harbor entitles a consumer to a new federalized defense in any subsequent foreclosure on the mortgage debt. Section 1413 of the Act provides that "when a creditor, assignee, or other holder of a residential mortgage loan or anyone acting on behalf of such creditor, assignee, or holder," brings a judicial or nonjudicial foreclosure action regarding such loan, "a consumer may assert a violation by the creditor" of the underwriting standards, including a failure to satisfy the safe harbor, set by the Act, "as a matter of defense by recoupment or set off without regard for the time limit on a private action for damages." Dodd-Frank Act, § 1413 (amending TILA section 130).

The content of the "ability to pay" requirement is implemented through the availability of safe harbor provisions that grant a rebuttable presumption of ability to pay imposed under section 1412 of the Dodd-Frank Act. Section 1412 provides that "[a]ny creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this title, may presume that the loan has met the [minimum underwriting] requirements of subsection (a), if the loan is a qualified mortgage."[171]

In this section, the Act goes on the define a "qualified mortgage" as excluding most negatively-amortizing residential mortgage loans, as well as residential mortgage loans with certain balloon payments, certain point and fees, and certain reverse mortgages.[172] A qualified mortgage is defined to require "the income and financial resources relied upon to qualify the obligors on the loan" to be "verified and documented."[173] The terms also expressly include fixed rate loans "for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term[,]" and adjustable rate loans "for which the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term."[174] While the details of the language in this section differ from the details found in the earlier House Bills, in substance, the term "qualified mortgage" in the Dodd-Frank Act is nearly identical to the same term in the Miller and Frank Bills.[175] Moreover, rulemaking authority to implement this safe harbor is nearly identical in the Dodd-Frank Act and the earlier House Bills, except that, as noted above, the Dodd-Frank Act vests this authority in the Board (but really in the Bureau) rather than the federal banking agencies.

Unlike the earlier House Bills, the Dodd-Frank Act limits the extent of this defense to the amount to which the consumer would be entitled by way of actual or statutory damages, plus costs and fees, for "a valid claim brought in an original action against the creditor."[176] In a subsequent section of the Dodd-Frank Act, the remedies available for violation of TILA, including presumably violations of the new minimum underwriting standards for residential mortgages, are roughly doubled (although never very

171. *Id.* § 1412 (amending TILA section 129C).
172. *Id.*
173. *Id.*
174. *Id.*
175. *Compare id.*, *with* H.R. 3915, 110th Cong. § 203(c)(3)(B) (2d Sess. 2008), *and* H.R. 1728, 111th Cong. § 203(c)(2)(A) (1st Sess. 2009).
176. Dodd-Frank Act, § 1412.

generous).[177] The remainder of Subtitle B is virtually identical to similar provisions in the Miller and Frank Bills.

Changes to the liability provisions of the earlier House Bills would seem, on their face, to undermine the remedies available for violation of the minimum underwriting standards. We think this reading of the conference committee's revisions to the mortgage reform and anti-predatory loan origination standards would be excessively harsh because it would ignore the practical consequences of the remedies that remain in the Dodd-Frank Act.

Even before amendments added by the Dodd-Frank Act, TILA provided consumers with a right to rescind certain home-equity mortgage transactions within three business days following consummation of the transactions;[178] if the home-equity lender does not provide the notices and disclosures required by TILA, consumers have three years from consummation to rescind.[179] Rescission would unwind the transaction, avoiding both the mortgage and the unpaid portions of the related debt; the consumer could either repay the proceeds of the violating loan or turn over the mortgaged property to the creditor.[180] In a flat real estate market, rescission would leave both the consumer and lender in the position they were in before the offending mortgage transaction was entered into. In a real estate market in which property values diminished since the inception of the loan, however, the lender would be left "holding the bag" for that loss.[181] Moreover, TILA's remedy of rescission was limited to home-equity loans, but not residential mortgage transactions in which a mortgage is taken in a consumer's principal residence to finance the acquisition or initial construction of the dwelling.[182] Unwinding a home equity loan is a far simpler proposition than rescission of a residential mortgage.

In any event, the defense to foreclosure that remains in the Dodd-Frank Act holds important consequences especially for assignees. If the defense

177. *Id.* § 1416 (amending TILA section 129C).

178. Regulation Z, 12 C.F.R. § 226.23(a)(3) (2010). This three-year period is cut short in the event the consumer borrowers sell the property within this period.

179. *Id.*

180. DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 637-38 (5th ed. 2006) ("In theory, the rescission procedure is simple. . . . The consumer gives the notice of rescission; the creditor has 20 days to return the consumer's money and cancel the mortgage; the consumer then tenders back the money or property received; the creditor takes it within 20 days of this tender or forfeits the right to ever receive it."); *see also* Gerasta v. Hibernia Nat'l Bank, 575 F.2d 580 (5th Cir. 1978).

181. And in a real estate market in which property values have increased since the inception of the loan, the consumer would weigh the loss of equity against the loss of the federal defense in any foreclosure action.

182. 12 C.F.R. § 226.23(f) (closed-end home equity loans); *see also id.* § 226.15 (providing similar rules applicable to open-end home equity loans).

can be asserted against a holder, even a holder in due course, then purchaser/assignees will be forced to monitor compliance with the minimum mortgage origination standards.

Finally, the rulemaking authority that the Dodd-Frank Act vests in the Board (but really the Bureau) provides added assurance to us that the consequences of these remedial provisions will have teeth—big, scary canine teeth—in the market for Residential Mortgage-Backed Securities. This is not to say that we think the Bureau should or would promulgate regulations strengthening the remedial provisions removed from the earlier House Bills providing consumers with rights of rescission, but surely it could. Our thinking in this regard is very much colored by our perception of the regulatory architecture of the Dodd-Frank Act, and thus of the scope of the rulemaking authority of the Bureau created by the Act.

CONCLUSION

There is much to applaud in the Dodd-Frank Act with regard to its reform of regulation of the market for home loans. Its creation of the Bureau, regulation of mortgage originators, and promulgation of federal minimum standards for residential mortgages are all steps in the right direction. We hope the Dodd-Frank Act has created a regulatory template that permits the Bureau to minimize the risks of capital markets financing for home mortgages through standardization and simplification of the terms of "qualified mortgages." Similarly, the Bureau's power to define "unfair lending practices," and to prescribe standardized forms consistent with those practices, should give it the necessary tools for guiding mortgage originators and mortgage lenders toward safer lending practices.

That said, there is also reason to be critical. Title XIV of the Dodd-Frank Act is considerably weaker than the regulatory provisions that would have been enacted under the Miller Bill. Removing the link between the concept of a "qualified mortgage" and responsibility for consideration of the ability of a consumer to pay that mortgage may simplify regulation of home lending, but leave consumers without needed advice. Here and in other places, however, we are cautiously optimistic that the Bureau, with its broad rulemaking authority and expertise, may be able to fill in the gaps left by Congress.