

The United States Dodd-Frank Wall Street Reform and Consumer Protection Act

Overview

The Dodd-Frank Wall Street Reform and Consumer Protection Act, [United States H.R. 4173](#), was passed by Congress July 15 and signed into law by President Barack Obama July 21. The 848-page bill, now Public Law No. 111-203, has been hailed as the biggest financial regulatory bill since those enacted by Franklin D. Roosevelt during the Great Depression of the 1930s. The Act was born out of the financial crisis that started in 2007 and spurred on by public pushback over the \$700 billion bailout of banks that was used to stabilize markets at the height of the crisis. In response, in June 2009, President Obama introduced his original proposal for a “sweeping overhaul of the United States financial regulatory system” called “[A New Foundation: Rebuilding Financial Supervision and Regulation](#).”

The final Act is categorized into sixteen titles, and requires that regulators create approximately 243 rules, conduct 67 studies, and issue 22 periodic reports. These rules will not preempt state law unless the state law:

- Would have a discriminatory effect on national banks.
- Prevents or materially impairs the ability of a national bank to engage in the business of banking.
- Would be preempted by an existing enumerated federal consumer law.

The stated aim of the legislation is:

“To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end “too big to fail,” to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”¹

Title X and the Consumer Financial Protection Act of 2010

BCFP Structure

¹ pp.1 of U.S. H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Title X contains the Consumer Financial Protection component of the Act and specifically creates an entity within the Federal Reserve System called the Bureau of Consumer Financial Protection (BCFP), which will be run by a presidential-appointed, Senate-approved director for a five year term. The Bureau is separated into eight functional units or divisions including:

- A research arm to monitor the consumer financial product marketplace and develop consumer education programs.
- A community affairs arm to provide information, guidance and assistance to traditionally underserved consumers and communities.
- A unit to track consumer complaints and route those complaints to the proper federal or state agency.
- An Office of Financial Education.
- An Office of Fair Lending and Equal Opportunity to provide oversight and enforcement of federal fair lending laws.
- A Consumer Advisory Board to advise and consult on BCFP functions and the enumerated consumer laws and to provide information on emerging practices in the consumer financial products or services industry.
- An Office of Service Member Affairs to provide financial-services education to service members (including any member of the Armed Forces and any member of the National Guard or Reserves).
- An Office of Financial Protection for Older Americans to facilitate financial literacy for people who are 62 years old or above.

BCFP Authority

The Bureau has been given exclusive authority to aggressively seek consumer financial protection by rulemaking, supervision (by exam and data-collection) and enforcement. Specifically, the Bureau has exclusive rulemaking authority to promulgate regulations related to enforcing the “enumerated” consumer protection laws, which include:

- [The Alternative Mortgage Transaction Parity Act](#)
- [The Fair Credit Reporting Act \(FCRA\)](#)
- [The Fair Credit Billing Act](#)
- [The Home Owners Protection Act](#)
- [The Fair Debt Collection Practices Act \(FDCPA\)](#)
- [The Home Mortgage Disclosure Act \(HMDA\)](#)
- [The Home Owners Equity Protection Act \(HOEPA\)](#)
- [The Real Estate Settlement Procedures Act \(RESPA\)](#)
- [The Secure and Fair Enforcement for Mortgage Licensing \(SAFE\) Act](#)
- [The Truth in Lending Act \(TILA\)](#)

- [The Equal Credit Opportunity Act \(ECOA\)](#)
- [The Unfair and Deceptive Acts and Practices \(UDAP\)](#)

The BCFP has been given broad oversight to regulate “covered persons,” “related persons” and “service providers” that provide, deliver or offer “consumer financial products or services.” Please click [here](#) to go to the Act’s definitions of these terms. When overseeing covered persons the Bureau must also:

- Define and enforce “unfair,” “deceptive” and “abusive” acts or practices.
- Regulate consumer disclosures, including costs, benefits and risks of any consumer financial product or service.
- Implement a combined TILA/RESPA disclosure within one year.
- Provide consumers access to credit score and transaction files (unless confidential).
- Provide firm deadlines in which covered persons must respond to the Bureau in a timely manner concerning consumer complaints and comply with the consumer’s request for information.

The BCFP is also charged with these depository supervisory duties:

- For banks with assets of over \$10 billion, the BCFP will:
 - Provide exclusive authority to require reports and conduct compliance exams.
 - Coordinate exams with prudential regulator.
 - Develop appeals process for conflicting examination findings.
 - Work strategically with state Attorney Generals to enforce federal consumer finance laws and regulations.
- For banks with assets of \$10 billion or less:
 - Prudential regulators retain exclusive compliance authority, but BCFP can require compliance reports.
 - BCFP can work with the prudential regulator to include its examiners on a “sampling basis” on compliance exams.
 - BCFP must notify prudential regulator of any known material violations and can make recommendations of appropriate action.

Specific entities are exempt from the Bureau’s oversight, including:

- Merchants, retailers or sellers of nonfinancial goods or services.
- Licensed real estate brokers/agents.
- Accountants, tax preparers, attorneys.
- Auto dealers.
- Persons regulated by:
 - U.S. Securities and Exchange Commission (SEC)

- U.S. Commodity Futures Trading Commission (CFTC)
- Any state securities or insurance regulator.
- Qualified retirement or eligible deferred compensation plans.

The Bureau is also not permitted to establish a usury limit unless expressly authorized by law, but may be able to indirectly regulate interest rates by imposing strict disclosure requirements or by arguing that the current rate is “unfair”.

The Dodd-Frank Act provides that in order to enforce their authority the Bureau can issue these civil penalties to covered persons found to be in violation of any Bureau rule or order:

- Any violation: \$ 5,000 per day.
- Reckless violation: \$25,000 per day.
- Knowing violation: \$1,000,000 per day.

BCFP Timeline and Effective Dates

The Bureau became effective upon the day of enactment, July 21, and was granted exclusive rulemaking authority. State Attorneys General were also granted enforcement power on the day of enactment. Most of the other provisions in Title X will become effective on the “Designated Transfer Date,” which the Secretary of the Treasury will determine between 180 days and 18 months after enactment. Within 60 days of enactment, or by September 19, the Secretary of the Treasury must publish a notice of the Designated Transfer Date in the Federal Register.

On the designated transfer date, all consumer financial protection functions will be transferred to the BCFP from these agencies:

- [FDIC – Federal Deposit Insurance Corporation](#)
- [Fed – Federal Reserve System](#)
- [FTC – Federal Trade Commission](#)
- [HUD – \(Dept.\) Housing and Urban Development](#)
- [NCUA – National Credit Union Administration](#)
- [OCC – Office of Comptroller of Currency](#)
- [OTS – Office of Thrift Supervision](#) (this agency will be abolished on the DTD)

After the designated transfer date the BCFP and the FTC must issue their definition of a “nondepository covered person,” the BCFP must rule on whether they will restrict the use of mandatory pre-dispute arbitration agreements and issue disclosure rules and model disclosures for mortgages.

Reform Implications for Credit Cards

There is a provision in the Dodd-Frank Act, called [the Durbin Amendment](#), which requires the Federal Reserve, within the next nine months, to establish standards for interchange fees that are “reasonable and proportional” to the cost of processing debit card transactions and reloadable prepaid debit card transactions. Though financial institutions with less than \$10 billion in assets are exempted from the provisions of the amendment, these banks and credit unions will be affected by the restrictions as their larger competitors will lower interchange fees.

Benefit cards issued by state and federal government agencies, cards issued by financial institutions with less than \$10 billion in consolidated assets, and general purpose prepaid cards that are not sold as gift cards are exempt from the Durbin Amendment.

Interchange fees typically cost merchants between one and two percent of each debit card transaction, and two percent of each credit card transaction, according to the [National Retail Federation](#). The retail group also estimates that U.S. retailers paid \$48 billion in interchange fees in 2008.

Also, the new Act will:

- Prevent card networks from imposing exclusivity obligations.
- Now allow merchants to set minimum card purchase requirements, which cannot exceed \$10.
- Now allow merchants to offer discounts for their preferred payment method, i.e., cash, check or debit.

Reform Implications for Mortgage Lending

Mortgage Originators

Title XIV of the Dodd-Frank Act is called the Mortgage Reform and Anti-Predatory Lending Act. This part of the Act creates a new definition of “mortgage originator,” which includes: persons taking applications, assisting consumers in obtaining a mortgage, or negotiating the terms of a mortgage. A person “assists a consumer in obtaining or applying to obtain a residential mortgage loan” by: advising on residential mortgage loan terms, preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan.

The Act bans yield spread premiums, providing that mortgage originators may no longer be compensated, directly or indirectly, based on the terms of the loan other than the amount of the principal. A mortgage originator will also be prohibited from receiving origination fees from

both the borrower and the lender, although this does not apply to third party fees paid to non-affiliates. The BCFP must implement further mortgage originators regulations, including those that prevent:

- Steering a consumer into a loan in which they lack a reasonable ability to repay, or any loan that has predatory characteristics.
- Steering a consumer from a qualified mortgage to a mortgage that does not meet those standards.
- Engaging in abusive or unfair lending practices that promote disparities.
- Misrepresenting consumer credit history, the products available to a consumer, the appraised value of a property, or discouraging a consumer from seeking a loan from another mortgage originator if unable to suggest a loan not more expensive than the one for which the consumer qualifies.

Underwriting Standards for Mortgages

A component of the Dodd-Frank Act will establish national underwriting standards for residential loans that require the loan originator to make a reasonable and “good faith effort” 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 the terms, and all applicable taxes, insurance and other assessments. In addition, the determination must be made using a payment schedule that fully amortizes the loan over its full term.

The Act will provide some exemption benefits from the regulatory restrictions for mortgages that fall under the definition of “qualified mortgages.” Qualified mortgages are defined as any residential mortgage loans:

- For which the regular periodic payments for the loan may not;
 - Result in an increase of the principal balance;
 - Except as provided in subparagraph (E), allow the consumer to defer repayment of principal.
- Except as provided in subparagraph (E), the terms of which do not result in a balloon payment, where a ‘balloon payment’ is a scheduled payment that is more than twice as large as the average of earlier scheduled payments.
- For which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented.
- In the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments.
- In the case of an adjustable rate loan for which the underwriting is based on the maximum rate permitted under the loan during the first five years, and a payment

schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes insurance and assessments.

- That complies with any guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph (3)(B)(i).
- For which the total points and fees (as defined in subparagraph (C)) payable in connection with the loan do not exceed 3 percent of the total loan amount.
- For which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (3), such as in high-cost areas.
- A reverse mortgage which meets the standards for a qualified mortgage as set by the Board in rules consistent with the purposes of this subsection.

Qualified mortgages will be given safe harbor for the ability to repay test and will be exempt from:

- The risk retention requirement.
- The pre-payment penalty prohibition.
- Being defined as a “higher risk mortgage”.

Other Mortgage Provisions

The Act will also impose new disclosure requirements for mortgages, including:

- Policies regarding partial payments prior to settlement.
- Rate resets for loans that go from fixed rates to adjustable rates.
- The aggregate amount of settlement charges, the fees paid to the originator, and the amount of interest paid over the life of a loan.
- Variable rate loans for which an escrow account is established relating to the initial and fully-indexed amount of payment.
- Periodic statements for mortgage loans.

The Act also adds new restrictions on “High Cost Mortgages”, adds escrow requirements for specific loans that must survive five years unless the PMI can be eliminated, adds specific appraiser and appraisal practice requirements and makes changes to the Home Affordable Modification Program.

Reform Implications for Personal Loans

Regulation of Credit Risk Retention

The Act's mortgage lending provisions have implications for the personal loan industry, especially in terms of new requirements regarding credit risk retention and asset-backed securities. New credit risk retention requirements will be established by the Bureau that will require all lenders to retain some of the risk of asset-backed securities (ABS) backed by residential mortgages and all other classes of asset-backed securities. Securitizers and mortgage originators alike will have "skin in the game" or be responsible for some of the risks of loans. These regulations will become effective:

- One year after the date on which the final rules are published in the final register for asset-backed securities backed by residential mortgages.
- Two years after the date on which the final rules are published in the final register for all other classes of asset-backed securities.

Regulations will be issued to require any securitizer to retain an economic interest in a portion of the credit risk for any asset sold or transferred to a third party. Securitizers would be required to retain at least 5 percent of the risk for any asset that is not a qualified mortgage and that is transferred or sold through the issuance of an ABS. They would be required to retain less than 5 percent if the originator meets certain underwriting standards.

Payday Lending

The Dodd-Frank Act also gives the BCFP jurisdiction and oversight authority over lenders of private student loans and payday loans. Rather than requiring specific regulations related to payday lending, the Dodd-Frank Act provides incentives to financial institutions to offer small-dollar loan products with lower interest rates and less predatory practices. The Act authorizes the Secretary of the Treasury to establish grants to eligible entities to provide low-cost small-dollar loans. Eligible entities include:

- Any FDIC institution.
- State, local or tribal government entities.
- Community development financial institutions (CDFI's).
- 501(c)3 organizations.

In order to receive a grant, the loan provider must offer financial literacy and educational opportunities to each small-dollar loan consumer.

Financial Products at Risk

Recent analysis from Craig Varga from Varga, Berger, Ledsky, Hayes and Casey² identified these possible at-risk personal lending products or practices as a fall-out from the Dodd-Frank Act:

- Refund anticipation loans
- Rule of 78's
- Refinancings -- "cycle of debt"
- Creditor/retailer compensation arrangements
 - APR splits/buy rates
 - Dealer discounts
- Characterization of credit as closed-end or open-end
- Security interest practices
 - "oversecuring"
 - "undersecuring"
- Credit insurance sales
 - Exemption for insurers nevertheless leaves overall transactions, and creditors at risk
- Collection of debt
 - Creditors
 - Creditor agents or independent contractors
- Arbitration clauses

Reform Implications for Vehicle Finance

The Dodd-Frank Act exempts auto dealers from the Bureau's jurisdiction, but provides these specific exclusions:

- Does not exempt auto dealers who engage in the extension of credit or leases directly to consumers that are not routinely assigned to an unaffiliated third party finance or leasing source.
- Does not exempt auto dealers who sell consumer financial products or services unrelated to the sale, financing, leasing, rental, repair, refurbishment, maintenance, or other servicing of motor vehicles, motor vehicle parts, or any related or ancillary product or services.
- Does not exempt auto dealers who provide mortgages or who extend retail credit directly to consumers without assigning that credit to a third party.

² From the July 29 AFSA webinar regarding personal loans and the Consumer Protection Act.

The Dodd-Frank Act preserves the current FTC regulatory regime for exempted dealers and grants expedited rulemaking authority to the FTC to define unfair and deceptive practices of auto dealers. In recent analysis from Michael Benoit from Hudson, Cook LLP³, they said the increased regulation of the finance industry will likely have these effects on the vehicle finance industry:

- More substantive restrictions on how pay compensation is delivered to dealers and the types of financial products that can be included in the contracts bought by financial institutions.
- More extensive verifications of applicants.
- Increased fair-lending testing and reporting requirements, and generally higher and more constant scrutiny of fair lending practices.
- Increased costs to prepare and file reports on regulatory compliance.
- Consumer information rights likely to increase administrative burdens and cost risk association with resolving customer complaints.
- Mandatory pre-dispute arbitration at risk.

Title X relevant definitions:

Abusive: An abusive act or practice;

- A. Materially interferes with a consumer to understand a term or condition of a consumer financial service or product.
- B. Takes unreasonable advantage of:
 - i. a lack of understanding on the part of the consumer of the material risks, costs and conditions of the product or service;
 - ii. the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service;
 - iii. the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

Consumer: The term “consumer” means an individual or an agent, trustee or representative acting on behalf of an individual.

Consumer financial products or services: The term “Consumer financial product or service” includes, but is not limited to:

- A. Extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit.
- B. Extending or brokering leases of personal or real property that are the functional equivalent of purchase finance arrangements.

³ From the July 21 AFSA Webinar regarding vehicle finance and the Consumer Protection Act.

- C. Providing real estate settlement services, except performing appraisals of real estate or personal property.
- D. Engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument.
- E. Selling, providing, or issuing stored value cards or payment instruments. Reloadable stored value cards will only be deemed a financial product or service if the seller retains substantial control over the terms or conditions of the card.
- F. Providing check cashing, check collection, or check guaranty services.
- G. Providing payments or other financial data processing products or services to a consumer including payments made through an online banking system or mobile telecommunications network.
- H. Providing financial advisory services to consumers on individual financial matters or relating to proprietary financial products or services, including:
 - i. Providing credit counseling to any consumer.
 - ii. Providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit, or avoiding foreclosure.
- I. Collecting, analyzing, maintaining, or providing consumer report information or other account information, including information relating to the credit history of consumers, including credit scores.
- J. Collecting debt related to any consumer financial product or service.

Specifically excluded from the definition of “financial product” is the “business of insurance” and “electronic conduit services.”

Covered persons: The term “covered persons” means:

- A. Any person that engages in offering or providing a consumer financial product or service; and
- B. Or any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person.

Related persons: The term “related persons”:

- A. Shall apply only with respect to a covered person that is not a bank holding company (as that term is defined section 2 of the Bank Holding Company act of 1956), credit union or depository institution;
- B. Shall be deemed to mean a covered person for all purposes of any provision of Federal consumer financial law; and
- C. Means;
 - i. Any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person;
 - ii. Any shareholder, consultant or joint venture partner, or other person, as determined by the Bureau (by rule or on case to case basis) who materially participates in the conduct of the affairs of such covered person; and

- iii. Any independent contractor (including any attorney, appraiser or accountant) who knowingly or recklessly participates in any;
 - I. Violation of any provision of law or regulation; or
 - II. Breach of a fiduciary duty.

Qualified Mortgage: the meaning of the term “qualified mortgage” means any residential mortgage loan;

- A. For which the regular periodic payments for the loan may not;
 - i. Result in an increase of the principal balance; or
 - ii. Except as provided in subparagraph (E), allow the consumer to defer repayment of principal.
- B. Except as provided in subparagraph (E), the terms of which do not result in a balloon payment, where a ‘balloon payment’ is a scheduled payment that is more than twice as large as the average of earlier scheduled payments;
- C. For which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented;
- D. In the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;
- E. In the case of an adjustable rate loan 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 and takes into account all applicable taxes insurance and assessments;
- F. That complies with any guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph (3)(B)(i);
- G. For which the total points and fees (as defined in subparagraph (C)) payable in connection with the loan do not exceed 3 percent of the total loan amount;
- H. For which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (3), such as in high-cost areas; and
- I. In the case of a reverse mortgage (except for the purposes of subsection (a) of section 129C, to the extent that such mortgages are exempt altogether from those requirements), a reverse mortgage which meets the standards for a qualified mortgage , as set by the Board in rules that are consistent with the purposes of this subsection.

Unfair: is an act or practice that;

- A. Causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers;
- B. Such substantial injury is not outweighed by countervailing benefits to consumers or to competition.

Conclusions

The federal agencies and departments with responsibility for the various aspects of the Act have begun their rule making to implement the law. This is a process that could take two years or more, and most elements will build in a grace-period for compliance. Lobbying by affected parties is set to continue during this phase and it is possible that the final form of the implemented rules falls short of Congress' true intent. Business opposition remains strong as evidenced by Thomas Donohue, the President and CEO of the U.S. Chamber of Commerce, who today called the law "a financial regulatory boondoggle".

The media and other commentators are beginning to focus their attention on assessing whether or not the law is sound and well-drawn enough to prevent another financial crisis. Like Cold War academics assessing the deterrence value of nuclear weapons, the prevailing feeling appears to be "let's hope we never have to find out."