Statement of the U.S. Chamber of Commerce

ON: "Who's in Your Wallet: Examining How Washington Red Tape Impairs Economic Freedom"

TO: House Committee on Financial Services

DATE: April 3, 2014

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on issues are developed by Chamber members serving on committees, subcommittees, councils, and task forces. Nearly 1,900 businesspeople participate in this process.

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, believes that effective regulation is needed to ensure the safety and soundness of the financial markets. The Chamber would like to thank you and the members of the House Financial Services Committee for your continued work and focus on issues of importance to the competitiveness of our capital markets. Sound and balanced regulatory structures are needed for these markets to spur growth and create jobs in a global economy.

In 2007, in order to achieve these goals, the Chamber established the Center for Capital Markets Competitiveness (CCMC) to advocate for the replacement of the existing early twentieth century era financial regulatory system with one to effectively regulate a globally competitive twenty-first century economy. Since that time, the CCMC has worked with the various regulators to promote policies for greater transparency, eliminate regulatory dead-zones, and increase coordination amongst agencies while encouraging greater consumer protection and capital formation. The CCMC has filed well over 500 comment letters and had hundreds of meetings with regulators in this effort.

While some of these efforts have been more successful than others, we would like to share some of the Chamber's experiences as you review the efforts by the banking regulators to oversee the marketplace. We have found that each regulatory agency is different, where some agencies will attempt to regulate through enforcement actions instead of rule-writing, while other agencies have flawed rule-writing processes that do not adhere to statutory requirements. In either case, the outcome is the same: unclear or unworkable rules that hamper the ability of businesses to operate while hindering effective consumer and investor protection.

The Chamber is grateful for the Committee's attention to these issues and welcome the opportunity to provide this statement for the hearing record, which includes nine case studies for your consideration. Each describes an example of agency overreach, the use of a shortcut, or a lack of coordination that threatens to impede capital formation, harm Main Street businesses, or reduce credit options for consumers.

A. <u>Regulating Consumer Credit</u>

We recognize that rulemaking can be time-consuming and that regulators may find other means of setting clear standards to be more effective in certain situations.

But this is no excuse for making regulatory policy behind closed doors. Nor does it justify adopting policies that have been shielded from public comment and economic analysis. This is not how the regulatory system is supposed to function, and for good reason. As the Bipartisan Policy Center explained in the case of the Consumer Financial Protection Bureau (CFPB), using transparent and inclusive procedures generates better outcomes:

> [W]hen the Bureau operated in a transparent, open, and iterative manner, repeatedly seeking input from all stakeholders throughout a process, the results were generally positive. However, **when the Bureau made unilateral decisions, rolled out initiatives, rules, or processes as a result of a more closed, internal deliberation process, the results were far more likely to be problematic.** Sometimes the Bureau went back, sought input, and improved the end result. Sometimes it did not.[1]

Although other financial regulators have made similar mistakes, CFPB unfortunately has been particularly weak in its commitment to transparent and inclusive regulatory policy making. As we explained in a letter to Director Richard Cordray on February 12, 2014, the Chamber is seriously concerned by the Bureau's failure to work toward clear, evenly applied, economically sound standards.[2] CFPB has a variety of tools that would allow it to explain the requirements of statutes and regulations within its jurisdiction. Nonetheless, despite repeated and often bipartisan requests for greater transparency, CFPB frequently has chosen to make regulatory policy without obtaining public input or committing to a clear statement about what the law requires.[3] As a result, CFPB has made it virtually impossible for companies to determine in advance what they should do to comply with the law. Faced with regulatory uncertainty and the real potential of enforcement actions that inflict substantial reputational risk, some market participants are simply abandoning consumer lending in areas that are not core to their business. The result is fewer choices, less competition, and higher costs for consumers.

1. Indirect Auto Lending

[1] Bipartisan Policy Center, *The Consumer Financial Protection Bureau: Measuring the Progress of a New Agency*, at 5 (Sept. 2013) (emphasis added).

[2] It is no coincidence, we believe, that a regulator that is so free from the checks normally provided by other elements of the federal government would make policy in a manner that disclaims any responsibility or accountability to Congress, the public, or other stakeholders.

[3] Congress granted the Bureau broad power to promulgate rules as well as authority to issue clarifying guidance, interpretations, and statements of policy. *See* Pub. L. 111-203 § 1012(a)(10), § 1022 (2010).

The Equal Credit Opportunity Act (ECOA) prohibits lenders from discriminating on the basis of race, sex, and other similar grounds against otherwise creditworthy individuals. The text of the statute prohibits intentional discrimination and the Chamber strongly supports efforts to detect and punish such discrimination; but the statutory text does not impose liability if a facially nondiscriminatory practice has a disparate impact on a group protected by the statute. The Bureau nonetheless has moved—without undertaking a rulemaking on the subject—to impose disparate impact liability on indirect auto lenders through a March 21, 2013 bulletin on "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act."

More specifically, CFPB is seeking to regulate the practices of auto dealers—over whom it has no jurisdiction—by holding liable the banks and other financial institutions that provide auto loans. CFPB claims that the industry's long-established method of compensating dealers for their role in bringing together lenders and auto purchasers, an amount typically set by the dealer and paid by the consumer, could be used to prove disparate impact discrimination by the banks and financial institutions. The Bureau does not believe that it must prove intentional discrimination. Nor is it material to the Bureau that the financial institutions did not know of the claimed discrimination or that each institution has clear policies forbidding discrimination.

CFPB instead believes that it may find an ECOA violation whenever the Bureau's unproven "proxy" analysis for determining "race and national origin probabilities" indicates that dealer compensation resulted in statistically significant differences in the interest rates paid by different demographic groups, and that those differences were not the result of other legitimate pricing variables. By taking this position, CFPB has created enormous uncertainty in the auto finance market, threatening to raise the cost of credit and drive the industry to untested business models that could be harmful to consumers.

These concerns have resonated broadly in this Committee and elsewhere in both the Senate and the House of Representatives. Congress, of course, could have included a provision in the Dodd-Frank Act that imposed disparate impact liability on indirect auto lenders or on auto dealers. It did not. In fact, that Act specifically carved out dealerships engaged in indirect auto financing from the Bureau's jurisdiction.[4] Given this clear expression of congressional intent—as well as the obvious implications for the availability of credit and harm to small businesses—Members of Congress have been concerned, on a bipartisan basis, about the Bureau's disruption of the auto finance market.

[4] Pub. L. 111-203 § 1029 (2010).

Thus, CFPB has received requests for explanation from Members of Congress, both at hearings and in bipartisan letters with numerous signatories. These letters have come from a majority of the members of this Committee, a group of twenty two Senators, and sixteen members of Florida's House delegation who implored CFPB to reverse its previous refusals to provide anyone with the raw data and analytical methods it is using in its disparate impact analyses.[5] In a time of sharp political disagreements, these Members have been able to agree that the Bureau must explain the legal and factual bases for its actions, and why it is creating a very significant incentive for adoption of alternatives to the business models that currently prevail in today's highly efficient auto finance market, alternatives that are likely to restrict credit availability and increase cost.

If CFPB persists in attempting to change the prevailing method by which indirect finance sources compensate dealers for arranging financing for consumers, it should undertake a rulemaking to address the legal, analytical, and practical questions raised by Members of Congress and by market participants to ensure consumers are not needlessly impacted.[6] The Bureau has not done so, however, fostering rather than eliminating ambiguity on this topic.

As a result, important questions remain unanswered. For example:

- Financial institutions do not deal directly with the auto purchasers who are obtaining credit; the auto dealers perform that role—and the law does not permit auto dealers to record information regarding the race, gender, or other characteristics of every auto purchaser; or to provide that information to the financial institutions. Given that reality, how are financial institutions supposed to reliably determine whether there is an impermissible disparate impact, let alone guard against that possibility in the future?

- CFPB's methodology for calculating disparate impact —which relies upon "proxies" (such as name and residence address) to determine an auto purchaser's race and gender, and unknown control factors that lead CFPB to conclude that pricing disparities are the result of discrimination—has never been fully explained, and therefore cannot be replicated by indirect lenders that seek to evaluate their portfolios to ensure that auto dealer

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[5] *See* Letter from Representative Sewell and Representative Scott to Director Richard Cordray (May 31, 2013); Letter from Representative Bachus and Representative Capito to Director Richard Cordray (June 20, 2013); Letter from Senator Portman and Senator Shaheen to Director Richard Cordray (Oct. 30, 2013); Letter from Representative Alcee Hastings and Representative Posey to Director Richard Cordray (Dec. 18, 2013).

[6] The Bureau clearly recognizes its authority over this subject since in 2011 it reissued the implementing regulation for ECOA. *See* 76 Fed. Reg. 79442 (Dec. 21, 2011).

participation in the interest rate is not having a disparate impact. Nor has the Bureau explained what threshold it believes constitutes a statistically significant disparate impact and how it is sure that any such amount is not within the margin of error of its analysis.

CFPB's March 21, 2013, bulletin did not answer these questions.[7] It instead identified a number of steps that lenders could take in hopes of ensuring compliance with ECOA, without any assurance or clarity that these steps would constitute acceptable compliance. The Bureau has said that adoption of flat-fee pricing—requiring auto dealers to charge the same fee to every single customer who obtains financing—would protect indirect lenders against disparate impact liability. That would be a dramatic change in the auto lending market, in which flat fees are not the predominant method of compensating dealers for arranging financing, but CFPB has chosen not to solicit public comments on, and itself has not publicly assessed, the effect on credit availability and cost of the flat fee model it apparently prefers.[8]

The recent enforcement action against Ally Bank demonstrates the very significant problem confronting lenders. The Ally consent order states that the disparities found by CFPB are "statistically significant," that the Bureau identified violations through a proxy methodology described as "the Bayesian Improved Surname Geocoding (BISG) method," and that the explanations offered by Ally did not "appropriately reflect […] legitimate business needs."[9]

But CFPB's order does not explain:

- How its "proxy methodology" works;
- The error rate anticipated by this proxy methodology and the level of errors at which the underlying conclusions about disparate impact would remain statistically valid;
- What it considers a "statistically significant" disparate impact or even whether it gauges that impact by basis points or another measure;
- What analytical controls it applies to ensure that the consumers from different groups who are being compared are "similarly situated" (i.e., what

[7] CFPB Bulletin 2013-02, Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act (Mar. 21, 2013).
[8] *See* Letter from Director Richard Cordray to Senator Rob Portman and Senator Jeanne Shaheen (Nov. 4, 2013).
[9] Consent Order 6, File No. 2013-CFPB-0010 (Consumer Finance Protection Bureau, Dec. 20, 2013).

analytical controls it is applying to isolate a consumer's background as the sole reason for any statistically significant pricing disparities that the Bureau finds between different groups of consumers);

- What it considers to be "legitimate business needs" that properly may result in pricing disparities; and

- How it concluded that the disparities at issue resulted from the subject lending practices.

Because the analysis and factors used by CFPB remain unknown, no company can build a compliance regime that it knows will satisfy the Bureau. Indeed, the continuing monitoring system imposed under the Ally consent order appears premised on the inevitability of future violations,[10] suggesting that no one—including the Bureau—knows how to ensure compliance going forward.

Lenders that are unwilling to operate under the constant threat of disparate impact liability—and no company wants to be labeled "discriminatory" by a government agency—have two choices: either leave the market or move to a flat-fee model.

CFPB appears not to have considered the consequences of such changes for consumers—even though reduced lender participation and the elimination of price discounting could shrink credit availability and raise consumers' costs. So far, in fact, industry groups have had to fill the void for research into the consumer impact associated with a move to a flat-fee model.[11] Surely that is a matter warranting significant attention from the Bureau.

In recent testimony before this Committee, Director Cordray acknowledged the complexity of this issue, and explained that "… in our bulletin, we made it clear that flat fees are one mechanism by which lenders could address this issue. But it's by no means necessarily the only mechanism. And my real answer to your question is I don't know that we know all the mechanisms yet that would be satisfactory. And we are open to auto lenders, and others, bringing those to our attention."

If the adoption of a flat-fee standard is the Bureau's goal, it should pursue that goal through a rulemaking that fully considers any resulting consumer benefit or

[10] *See id.* at ¶ 31(f) (providing for remuneration of affected consumers for future "statistically significant dealer markup disparities for that group at or above the agreed upon target").
[11] *See* Press Release, American Financial Services Association, "Vehicle Finance Industry Commissions Study to Address Fair Lending" (Nov. 12, 2013).

harm. If that is not the goal, as your comments above suggest, the Bureau should provide meaningful guidance, whether through rulemaking or less formal means, that allows indirect auto lenders to build effective compliance regimes.

Of course, the problem is not unique to the indirect auto lending market. Wherever CFPB intends to apply complex statistical analysis to enforce a disparate impact standard, it must be transparent about its methodology and carefully, and publicly, weigh the costs and benefits of any policy change—such as flat pricing—that the Bureau's approach would require, whether as a matter of law or as a matter of practical consequences.

2. "Abusive" Acts or Practices

Consumer protection laws long have prohibited "unfair or deceptive" practices—and those terms have a settled meaning as a result of the Federal Trade Commission's policy statements on "Deception" and "Unfairness" —which themselves rest on and incorporate decades of enforcement decisions and other litigation.[12]

The Dodd-Frank Act, however, goes further, empowering CFPB to prevent a person subject to the Bureau's jurisdiction "from committing or engaging in an unfair, deceptive, *or abusive* act or practice"; unfortunately the statute's ambiguous limiting language provides no practical guidance for a business trying to determine whether particular conduct is lawful.[13]

The "guidance" issued so far by CFPB on the meaning of "abusive" simply recites the statutory language.[14] It does not provide regulated businesses with the clarity available from the FTC policy statements and prior decisions interpreting "unfair" and "deceptive," or even give examples of the types of practices that would be considered abusive but are not otherwise unfair or deceptive. For three years, the Chamber has sought to obtain at least some clarity regarding the scope of the prohibition on abusive acts or practices—out of concern that this prohibition itself

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[12] *See* FTC Policy Statement on Deception (Oct. 14, 1983), *appended to* Cliffdale Associates, Inc., 103 F.T.C. 110, 174 (1984), *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm; FTC Policy Statement on Unfairness (Dec. 17, 1980), *appended to* International Harvester Co., 104 F.T.C. 949, 1070 (1984), *available at* http://www.ftc.gov/bcp/policystmt/ad-unfair.htm.

[13] Pub. L. No. 111-203, § 1031(a) (2010), codified at 12 U.S.C. § 5531.

[14] *See* 12 U.S.C. § 5531(d); *CFPB Supervision and Examination Manual*, Part II.C (Oct. 2012), *available at* http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf; CFPB Bulletin 2013-07, Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts (July 10, 2013), *available at* http://files.consumerfinance.gov/f/201307-_cfpb_bulletin_unfair-deceptive -abusive-practices.pdf.

would be abused to create a vague and potentially very expansive form of liability. The Bureau's recent enforcement actions confirm those fears.

On May 30, 2013, CFPB initiated an action against American Debt Settlement Solutions, Inc. (ADSS). The resulting consent order stated that ADSS's actions were "abusive" in violation of Dodd-Frank because ADSS "knowingly enrolled in its debt-relief programs consumers whose financial conditions make it highly unlikely that they can complete the programs, and ADSS has nonetheless collected fees from consumers who had inadequate income to complete their debt-settlement program."[15]

The conduct described in the consent order was obviously wrongful, and found to be unfair and deceptive. But CFPB nonetheless chose to use an enforcement action in which the "abusive" claim was unnecessary and would go uncontested to begin to establish precedent regarding the meaning of "abusive." Thus, the "abusive" finding in the consent decree was not based on a determination that ADSS acted with wrongful intent—even though the rest of the findings make clear that ADSS did in fact have actual knowledge that the consumers could not complete the program—but rather appears to hinge only on the fact that the company had information indicating that consumers could not complete the program, whether or not the company had actually analyzed those consumers' ability to complete the program. The Bureau, in other words, has at least indicated that "abusive" conduct can be established by simple negligence in offering a product or service to any consumer if information available to the company would show that the product is not suitable for the consumer, even if the company has not undertaken that analysis. But again, the Bureau has espoused that standard indirectly, only by implication.

That leaves companies without any certainty regarding the legal test and, importantly, enables CFPB merely to imply this broad liability standard and therefore avoid responsibility for the adverse consequences that would flow from such a standard, such as the significant reduction in the availability of consumer credit if companies had to shoulder the expense of analyzing each consumer's suitability for every consumer financial product or service before offering the product or service to the consumer. Indeed, the Bureau does not appear to have assessed the consequences of its apparent interpretation or requested public comment on the issue, even though Congress considered the issue and specifically refused to enact suitability-type requirements included in early versions of the Dodd-Frank Act.

CFPB also included an "abusive" allegation in a subsequent enforcement action against Cash Call, Inc., a company that services and collects on consumer installment

[15] *CFPB v. American Debt Settlement Solutions, Inc., et al.*, No. 9:13-cv-80548-DMM, at 7-8 (S.D. Fla., June 7, 2013).

loans.[16] In addition to both an unfairness and a deception claim, the Bureau alleged that Cash Call had engaged in an abusive act or practice by collecting on loans that, according to the Bureau, were void under state law. This allegation raises the question what other violations of state law might, in the Bureau's view, amount to "abusive" acts or practices for the purposes of federal law, even if the company was unaware of the purported state law violation. This litigation will not answer that broad question—and will leave the legal standard uncertain.

Given these two CFPB enforcement actions, what should a regulated business do if it wants to comply with the law? Implement a compliance system based on the broadest possible interpretation of the Bureau's view—even if that will have adverse consequences for credit availability—or implement a system based on a narrower view (such as requiring intentional wrongdoing) and risk the possibility that the Bureau will subsequently interpret the provision more broadly? The Bureau could answer these broad questions—and assess whether its current approach would in fact have adverse consequences for consumers—even if it does not now wish to adopt a definitive construction of the term "abusive."[17]

By leaving these critical questions unanswered, CFPB risks real consumer harm. The Bureau's authority to prohibit "abusive" practices extends over every consumer credit transaction within its jurisdiction. Every market participant now must determine whether it can offer low-cost and innovative credit products without the risk of future second-guessing by the Bureau. This legal uncertainty inevitably will increase consumers' costs, reduce product offerings, and restrict credit availability.

3. Liability for the Acts of Service Providers

Similarly, CFPB has created unnecessary ambiguity regarding the scope of a financial service company's liability for the actions of a service provider. The Bureau has authority to issue rules covering service providers, to supervise those providers, and to bring enforcement actions against them.[18] Congress thus clearly intended the Bureau to be able to hold service providers accountable for any unlawful practices. In contrast, the Dodd-Frank Act does not specify a basis for holding a company liable for the unlawful acts of its service provider.

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[16] *See* Complaint, *Consumer Financial Protection Bureau v. Cash Call, Inc*., No: 1:13-cv-13167-MBB (D.Mass. Dec. 16, 2013).

[17] A public process also would allow the Bureau to explain how its interpretation of abusive acts or practices does not contradict the Dodd-Frank Act's bar on the imposition of interest rate caps. *See* 12 U.S.C. § 5517(o).

[18] *See* 12 U.S.C. §§ 5514(e), 5515(d) (providing supervisory authority over service providers); 12 U.S.C. § 5531(a) (providing enforcement authority over service providers); 12 U.S.C. § 5531(b) (providing authority to prescribe rules applicable to service providers regarding unfair, deceptive, or abusive acts or practices).

The absence of statutory guidance on this significant question argues strongly for CFPB to undertake a rulemaking—or at least issue clear guidance—before imposing liability on a business for the unlawful acts of service providers. The Bureau clearly has the authority to consider a matter so "necessary or appropriate" to the administration of the Federal consumer financial laws.[19]

The only guidance provided by CFPB on this topic came in the form of a bulletin in April 2012. That document makes clear that the Bureau intends to hold companies accountable for failings by their service providers. It does not, however, provide any meaningful explanation of the scope or basis for that liability, or give companies concrete guidance on how to build risk-management regimes. Instead, CFPB states that business arrangements with service providers must not present "unwarranted risks to consumers," that companies must conduct "thorough due diligence" and "appropriate training and oversight," and that companies are obligated to take "prompt action to address fully any problems identified through the monitoring process, including terminating the relationship where appropriate."[20]

The far more detailed guidance issued on the very same topic by the Federal Reserve and the Office of the Comptroller of the Currency[21] makes clear CFPB could do much more to help financial service providers manage risk and comply with the law.

Even in the absence of meaningful guidance to companies, CFPB has enforced standards it has never clearly articulated. A recent enforcement action against GE Capital Retail Bank and CareCredit LLC alleged that consumers were injured when service providers—generally doctors' and dentists' offices—inadequately explained the terms of a deferred interest promotion. The resulting consent order effectively treated these alleged violations of the Dodd-Frank Act as if they were committed directly by the companies themselves. To remedy these alleged violations, the Bureau imposed a monetary fine and a series of specific controls over the service provider relationships going forward.

Again, a law-abiding business would not know whether the terms of the consent order reflect generally applicable standards that CFPB believes other financial institutions should follow. And the Bureau's decision not to obtain public comment

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[19] *See* 12 U.S.C. § 5512(b)(1).
[20] CFPB Bulletin 2012-03, Service Providers at 2-3 (April 13, 2012), *available at* http://consumerfinance.gov/f/201204_cfpb_bulletin_service_providers.pdf.
[21] *See* Board of Governors of the Federal Reserve System, *Guidance on Managing Outsourcing Risk* (Dec. 5, 2013), *available at* http://www.federalreserve.gov/bankinforeg/srletters/sr1319a1.pdf; Office of the Comptroller of the Currency, OCC Bulletin 2013-29, *Third Party Relationships* (Oct. 30, 2013), *available at* http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html.

means it cannot predict the consequences of applying such a rule broadly—for example, that costs to consumers would increase because financial institutions would be forced to duplicate the service provider's own compliance system and that financial institutions will be incentivized to use only very large service providers, because they have the financial means to impose sophisticated compliance regimes and to indemnify the financial institution against any consequences of a compliance failure.

The Bureau has responsibilities to protect consumers and ensure well-functioning credit markets and must be careful to explore the effects of contemplated actions on consumers and the credit markets as it works to make informed, balanced decisions. The notice-and-comment rulemaking process is designed to help the agency do just that.

4. "Best Practices" as Implied Regulation

On February 10, 2014, Director Cordray wrote to the Chief Executive Officers of a number of the largest credit card companies to "strongly urge" those companies to provide free credit scores to their customers on their monthly statements.[22]

The stated goal of this effort was to change consumer behavior. The problem, in the Bureau's judgment, was that American consumers "fail to see the importance of their credit standing even if it has affected them in material ways, such as being rejected for a job or charged a higher price for a loan," and that, even now, "fewer than one in five Americans checks his or her credit report in a given year through either free or paid channels."[23] Disapproving of this consumer behavior, the Bureau was interested in "get[ting] more Americans to pay closer attention to their credit standing," and it was up to the credit card companies to "help us achieve this goal."[24] To that end, Cordray wrote:

> I strongly encourage you to make the credit scores on which you rely available to your customers regularly and freely, along with educational content to help them make use of this information. We will consider this to be a "best practice" in the industry. Doing so through existing channels, such as including credit scores with other on-line account information and on monthly statements, is likely to yield positive returns that outweigh the limited effort involved. Customers who monitor and

[22] Anonymized Letter to CEO of Credit Card Companies (Feb. 10, 2014), *available at* http://files.consumerfinance.gov/f/201402_cfpb_letters_credit-scores.pdf.
[23] *Id.*
[24] *Id.*

manage their credit standing may be less likely to become delinquent or to default.[25]

This de facto directive to credit companies raises a number of technical compliance questions for credit card companies, as well as a broader set of policy issues that call into question the fairness of CFPB's approach to shifting customer and industry behavior. Compliance questions include:

- What score should the credit card company provide to the user? A FICO score from one of the three credit rating agencies, even if that score is not the one the company actually relies on to determine credit-worthiness? The score that the company actually uses to determine credit-worthiness, even if it is on a different scale from the FICO score, is proprietary, and is not readily understandable by consumers?

- Should all credit card companies provide the same scores to consumers? Do companies face a risk of allegations of collusive, anti-competitive behavior if they all decide to provide consumers with the same score?

- Will a company that provides a consumer a FICO score that is not actually used to determine credit-worthiness, or a proprietary score that cannot be easily explained to consumers without revealing trade secrets, be exposed to a charge of "deception" under 12 U.S.C. § 5531(a)?

- What are the legal ramifications of the failure to adopt a "best practice" identified by the Bureau? Will failure to do so affect the supervisory process or color enforcement decisions? What are the reasons that the Bureau will accept for a business concluding that it is impractical, legally risky, or imprudent from a business perspective to adopt a "best practice"?

More broadly, CFPB's attempt to use the announcement of "best practices" to shift industry and even consumer behavior raises substantial legal and policy questions for the Bureau going forward. These questions include:

- Which statutory provision authorizes the CFPB to try to alter consumer behavior by imposing de facto standards on industry through the announcement of a "best practice"? Is the establishment of a "best practice" the issuance of "guidance implementing Federal consumer financial law," *see, e.g.,* 12 U.S.C. § 5511(c) (5)? Or does the Bureau consider

[25] *Id.*

efforts to shape consumer behavior to be an element of its "financial education programs," *see, e.g.*, 12 U.S.C. § 5511(c) (1)?

- Does the issuance of "best practices" without any clear basis in binding legal requirements conflict with the Bureau's statutory purpose of implementing and enforcing Federal consumer financial laws "consistently," *see, e.g.*, 12 U.S.C. § 5511(a)?

- Does informally pushing all market participants to adopt identified "best practices" support or stifle competition in the marketplace, *see generally* 12 U.S.C. § 5511(a)?

- Does the de facto imposition of "best practices" conflict with the Bureau's responsibility to avoid unnecessary regulatory burdens, *see, e.g.*, 12 U.S.C. § 5511(b) (3)?

- Assuming that adoption of identified "best practices" is in fact truly discretionary and not required by the laws that the Bureau has responsibility to implement, what expertise does the Bureau have regarding how companies should make discretionary decisions about how to run their businesses?

- Assuming the issuance of "best practices" is legally proper, what regulatory process should be used to ensure that they are evidence-based and reflect a considered-judgment based on a full understanding of the costs and benefits to consumers and other stakeholders? Should any "best practice" be issued without an opportunity for consumers and industry stakeholders to provide comment and expertise?

CFPB should consider these questions before it issues further "best practices" in an effort to shape consumer behavior and the financial services market more broadly. We particularly emphasize that the Bureau should not use the supervision process to subject company behavior to extralegal standards. The Chamber has been told this is becoming an increasingly common practice among Bureau examination teams, and is extremely concerned about the inevitably inconsistent application of federal law that this will cause. The Chamber strongly believes that it is the role of financial regulators to identify and enforce clear rules of the road, and then to leave the private market to compete within those rules. Informal "best practices" threaten this basic principle.

5. Short-Term Lending

Despite CFPB's reluctance to write rules in other areas, the Bureau made clear that it will begin a comprehensive rulemaking process to address short-term lending. As recently as March 25, Director Cordray explained that the Bureau is in the "late stages" of developing these rules. But even as CFPB gears up to engage in a public discussion about the costs and benefits of regulatory changes in these markets for businesses and consumers, the Department of Justice (DOJ)—apparently in coordination with the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and other agencies—has worked behind the scenes to cut off the short-term lending market from the banking and payment system., and the FDIC and OCC have separately used supervisory guidance to dissuade banks from offering their own, lawful short-tem lending products.

The stated purpose of the enforcement effort is to combat consumer fraud, a goal shared by the Chamber and the members of the financial services industry, and the stated goal of the supervisory effort is to reduce risks to institutions. However, the apparent unspoken goal of the overall effort, and certainly the practical effect, is to fundamentally reshape or eliminate the third-party payment processor and short-term lending markets. Here, once again, ambiguous legal standards are having the effect of lumping in legal products and services with fraudulent activity, disrupting the banking system, and threatening to reduce the availability of consumer credit.

These efforts raise important questions about the proper role of bank regulators in deciding whether entire product categories—in this case third-party payment processing and short-term lending products—are disfavored and thus subject to elimination through legal action or unsupported supervisory guidance. Although the Department of Justice acknowledges that such businesses are not "*per se* fraudulent,"[26] their actions betray deep suspicion of entire business models. In fact, the Justice Department generally categorizes such businesses, even lawful, licensed, highly regulated, and in some cases directly federally supervised, as "high-risk merchants," and provides no clear vision of a role for them in the future of the financial services industry.

But if the goal or anticipated effect is to eliminate risk by reshaping entire product categories—and the many legitimate businesses they contain—surely the proper approach should be a rulemaking based on clear jurisdiction, a full record, and deliberate consideration of the possible harms to consumers associated with the elimination of financial services on which they rely to make ends meet. Federal

[26] *Id.* ¶ 29 & n.1.

regulators and enforcement agencies should articulate specific and clear standards for financial institutions. Regulators then should use their authorities to prevent conduct that violates such standards, not as a means to attack business practices that they otherwise have chosen not to regulate or pursue through direct enforcement.

B. Impeding Capital Formation

In drafting and implementing regulations, the various banking regulators have ignored processes mandated by law. This failure has led to adverse economic ramifications as witnessed by the impact of the Volcker Rule upon trust preferred bonds and collateralized loan obligations. Regulators have also failed to abide by specific limitations imposed by Congress and when Regulators have been given latitude in action, they have not exercised discretion when a rational examination of events call for it to be used to prevent potential instability in the financial system. Listed below are some representative, though not exhaustive, examples of these concerns.

1. Failure to Follow Legally Required Economic Analysis in Rulemaking

The banking regulators have not provided a cost benefit analysis when drafting or finalizing regulations even though they are required to do so by law. This failure to conduct a cost benefit analysis when writing rules is inconsistent with the obligations of the Federal Reserve, FDIC, and OCC under the Riegle Community Development and Regulatory Improvement Act ("Riegle Act", 12 U.S.C. §4802(a)). This law applies to all "Federal banking agencies" defined by cross-reference in Section 4801 of the Riegle Act (12 U.S.C. §1813) to include the OCC, FDIC, and Federal Reserve.

The Riegle Act mandates that "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."[27]

Such a Riegle Act analysis was not provided for the Volcker Rule or other regulations that have been completed. While OCC did conduct an economic analysis for the Volcker Rule, it was published in the Federal Register almost one month after

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[27] 12 U.S.C. §4802(a) (emphasis added).

the final rule had been published. This analysis was conducted under the Unfunded Mandates Reform Act (UMRA) and was not an exhaustive analysis as required under either UMRA or the Riegle Act.

The Chamber has recently written to the banking regulators expressing concerns that proposed regulations such as risk retention, leverage coverage ratio rule and incentive compensation fail to contain Riegle Act analyses

2. Failure to Abide by Statutory Limits Passed by Congress

Senators Pryor and Vitter successfully included a bipartisan amendment in the Dodd-Frank Wall Street Reform and Consumer Protection Act designed to specifically limit the number of non-bank companies that may be considered for potential systemic risk regulation.

The Pryor-Vitter amendment, contained in section 102(b) of the Act, gave the Federal Reserve the authority to "establish by regulation, the requirements for determining if a company is predominantly engaged in financial activities, *as defined in subsection (a) (6)*," which refers to "activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956)." The Dodd-Frank Act did not give the Federal Reserve the authority to establish criteria for determining if a company is predominantly engaged in financial activities of the same general type as those set forth in section 4(k). Nor did it authorize the Federal Reserve to establish by regulation the requirements for determining whether a company is predominantly engaged in financial activities as the Federal Reserve may choose to define that term. It said "as defined in section 4(k)" without limitation, qualification, or any other reservation that permits the Federal Reserve to create a list of activities that are financial in nature for nonbanks that differs in any way from the activities banks are authorized to conduct consistent with section 4(k) and Regulation Y.

Accordingly, by law, the Federal Reserve and Financial Stability Oversight Council (FSOC) can only consider specific banking activities by non-bank financial companies, which then in turn must meet specific threshold criteria, in selecting non-bank financial companies for consideration as a potential systemically important financial institution (SIFI). However, in its regulations implementing the predominantly engaged test, the Federal Reserve broadened the scope of activities that may be considered for non-bank companies.

This contravenes the Congressional intent by increasing the number of businesses that may be considered for SIFI designation which the Pryor-Vitter amendment expressly sought to limit. This was best exemplified by the Office of

Financial Research's (OFR) asset manager study that was openly acknowledged to be the first step in asset management. This interesting to note since certain forms of asset management, such as the operation of mutual funds, do not fall within the prescribed definition of banking activities. Besides the technical issues this raises, it calls into questions the understanding of the regulators regarding the limits of their authority.

3. The Collins Amendment

The Collins Amendment (Section 171 of the Dodd-Frank Act) requires banking regulators to impose leverage and risk based capital standards for depository institutions, bank holding companies, foreign bank organizations, thrifts and non-bank financial companies designated as SIFIs. Even though the drafters of the Collins Amendment have stated that Section 171 gives banking regulators discretion in the development of capital standards, the banking regulators disagree and have imposed bank style capital upon non-bank financial companies.

This is currently being played out with insurance companies that have been designated as SIFIs. By not exercising discretion, banking regulators fail to take into account the different business models that exist within the non-bank world and the insurance industry specifically. This has the potential to cause regulatory mismatches that may conflict with insurance regulations that have been developed for well over 150 years. Regulatory conflicts of this nature will increase risk within the industry rather than temper it. Even with two firms being so designated, the additional bank-centric type regulation will cause ripples throughout the industry that will have negative consequences for the industry's business model.

Banking capital rules do not fit with non-bank companies and will hamper the ability of those firms to meet the needs of their customers, as well as their ability, when it comes to the insurance industry, fulfill its traditional role as the largest long-term investor in the economy. This will have collateral negative impacts for the rest of the economy.

4. Lack of Coordination

The banking regulators have also failed to coordinate with their international counterparts to have consistent rules on capital standards.

International uniform capital rules are only homogeneous if their interpretation, application and enforcement are the same across the board. As an example, differences among national regulators as to the quality of capital that must be held to satisfy Basel III requirements will in fact mean that there is no global uniform set of capital rules. Mechanisms are needed so the interpretation and application of the Basel III rules are the same and followed across the board. Failure to do so will create regulatory capital arbitrage and gaps in the overall financial regulatory architecture.

U.S. banking regulators have been drafting rules to implement Basel III capital standards at the same time international regulators raised concerns that the Basel III capital framework is too complex. Part of the concern is that complexity may cause opaqueness, frustrating the goal of safety and soundness by hampering the ability of regulators and investors to understand the health of individual banks or to compare the soundness of different banks. Rather than provide a clear window into the well-being of financial institutions, Basel III in its current form is creating a kaleidoscope of images. As a result, the Basel Committee on Banking Supervision released for public comment and is contemplating the Basel III capital simplification study to achieve a better understanding of the complexity of capital requirements and how to simplify them to better achieve stability in financial institutions.

This is but one example of regulators, domestic and international, going in opposite directions. Such divergence is not conducive for efficient capital markets in a global economy.

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The Chamber appreciates the Committee's continued attention to the importance of clear, well-reasoned, economically sound, well-coordinated standards for the banking and financial services industry. We look forward to working with the Committee as it continues to support capital and consumer credit markets that are fair and competitive, and that benefit all Americans.