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The Case for Regulation Through Rulemaking & Guidance

Clear and Transparent Rules Help Protect All Consumers and Create Better Functioning Markets

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Introduction

Regulation is most effective when industry has clear notice of the rules of the road. Just as our national highway transportation system works most effectively when all drivers on the road know what safe driving habits are (e.g., observing the speed limit, signaling before changing lanes), our financial system works best when all participants have clear notice of what is acceptable. As a financial regulator, the Consumer Financial Protection Bureau (CFPB) is charged with ensuring all entities observe the laws. This includes punishing bad actors who fail to comply with applicable laws and regulations. The most effective way to protect consumers from harmful practices is by establishing clear and transparent expectations for the industry. Punishing an entity for conduct based on an agency's interpretation of the law not previously communicated to industry is not in the best interest of the consumer because it creates barriers to financial services, limits consumer choice, and creates market disparities between entities subject to standards set through enforcement action and those governed by supervisory pronouncements. Consumers benefit from an open, transparent process when markets are regulated through reliance on well-founded rules that are debated, examined, and their impact carefully considered before being applied to the marketplace.

CFPB Director Rohit Chopra acknowledges the value of a transparent approach to financial service regulation and supervision. At his confirmation hearing in early March before the Senate Banking Committee, Mr. Chopra stated, "I also will commit that the CFPB and every federal agency should be focused on fixing harms, making it clear to market participants what's expected of them. Ultimately that is what creates a vibrant market and that is something that the CFPB must do, adhering to all of the procedures Congress has laid out and I am absolutely committed to." Ensuring the Bureau lives up to his stated commitment to transparency as he takes the reins as the director of the Bureau will lead to a more effective marketplace that operates in the best interests of industry and consumers alike.

Enforcement is only effective when used as a penalty for failure to comply with established rules.

The CFPB communicates new or revised regulatory expectations to industry participants through rulemaking, informal written guidance, and enforcement actions. The Bureau engages in formal rulemaking under the Administrative Procedures Act (APA), which requires the CFPB to issue a notice of proposed rulemaking, solicit and accept public comments on the rule, and then consider all the comments submitted in promulgating a final rule. The

CFPB also regularly issues informal written guidance to the industry. This guidance includes quarterly Supervisory Highlights, bulletins, advisory opinions, and reports. The CFPB also, of course, has the power to bring enforcement actions. Bringing such actions against those who break well-established consumer protection rules deters others who test the boundaries of the law. Indeed, no reasonable person would argue that a regulator should not use such power to protect consumers against rule breaking industry members. However, using enforcement actions in an attempt to define legal standards in the first instance or to walk back established and long-standing industry practices makes it difficult for industry participants to clearly understand the regulatory message the CFPB is trying to send. The Bureau's use of its enforcement tool in this context is akin to a police officer ticketing a driver for going 25 miles per hour on an unmarked road or deciding that doing 30 miles per hour in a zone marked 35 miles per hour now constitutes speeding. In both contexts, the post hoc establishment of standards fails to broadly and adequately communicate expectations.

Consent orders negotiated in the settlement of enforcement actions do not clearly communicate to industry the Bureau's regulatory expectations. Industry participants may question whether the provisions of a consent order are specific to the facts of the enforcement target's conduct or the announcement of a new industry-wide standard. The conduct provisions in a particular matter may be perceived as overcompensating for the target's idiosyncratic compliance efforts or controls, leaving it unclear as to which conduct provisions are truly applicable to other industry members. Additionally, conduct provisions are set to account for the target's operational capabilities, so industry members with different capabilities may not be able to adapt those provisions to their own operations. Finally, consent orders often are incomplete and imperfect indicators of the Bureau's positions and expectations of industry because they are heavily negotiated and often impacted by whether the enforcement target is a supervised entity. Consequently, consent orders frequently provide more industry confusion than clarity by forcing industry members to engage in guesswork about which parts have general applicability and which are target specific. Initiating uncertainty and forcing industry members to rely or surmise is not the optimal way for the Bureau to set compliance standards.

Attempts to change long-standing regulatory interpretations retroactively through litigation of enforcement actions run the risk that the CFPB will lose control of the message absorbed by industry, or that the Bureau will fail to establish a standard at all. For example, in *PHH Corporation, et al. v. Consumer Protection Financial Protection Bureau*, 881 F.3d 75 (D.C. Cir. 2018), the CFPB alleged that PHH's captive mortgage re-insurance arrangement violated the Real Estate Settlement Procedures Act (RESPA), a departure from the Department of Housing and Urban Development's (HUD) prior interpretation. Then-Director Richard Cordray's initial findings were appealed to the U.S. Court of Appeals for the D.C. Circuit. Years later, the court vacated the CFPB's order, finding the Bureau's interpretation of RESPA incorrect and that the statute of limitations applied in administrative enforcement actions. During the years the appeal was pending, market participants adopted varying and inconsistent approaches in response to the litigation due to uncertainty over the regulatory state of play. Ultimately the CFPB failed to modify HUD's controlling interpretation on the RESPA issue and disrupted industry practice unnecessarily.

Attempts to retroactively establish new industry regulatory standards through enforcement actions similarly fail. The CFPB used enforcement to create a new standard for the automobile finance industry related to alleged disparate impact in dealer discretionary pricing. Between 2013 and 2016, the CFPB and Department of Justice brought a series of joint enforcement actions against indirect automobile lenders for violations of the Equal Credit Opportunity Act (ECOA). The enforcement actions created an uneven playing field amongst competitors as industry players adopted different rules and practices depending on whether they were receiving direction through enforcement or supervisory channels. Some financial institutions were required to implement a lower cap on dealer participation rates, while others were only required to monitor for and redress any future disparities at both the dealer and portfolio level. Similar to *PHH*, the CFPB ultimately failed to change industry practice. In May 2018, Congress used the Congressional Review Act to repeal the Bureau's 2013 guidance. The attempts to change industry practice through enforcement made the market worse for consumers by creating inconsistency in automobile credit across market participants depending on level and type of CFPB oversight.

In all of the instances discussed above, had the Bureau proceeded through rulemaking, all industry participants would have competed under one set of rules and their respective markets would have moved together, creating a level playing field and better achieving the Bureau's policy goals.

Rulemaking is best for consumers and markets.

Formal rulemaking and informal written guidance provide more benefit to consumers when compared to policy announcements issued through enforcement actions.

The CFPB's expectations and their general applicability across markets are more clearly communicated through rulemaking. When all industry participants have a clear understanding of applicable legal and regulatory expectations, they are all better able to comply, which in turn strengthens protections for all consumers, not just those doing business with the target of an enforcement action.

Rulemaking and informal written guidance can address general industry practices and variations in those practices and make clear how the Bureau will apply the law to those practices. This leaves much less room for doubt and error on the part of industry participants, meaning that practices change more quickly and more widely than through enforcement. It also puts industry "on notice" of the Bureau's expectations, thereby allowing industry to avoid conduct the Bureau deems harmful to consumers. Rulemaking is best suited to significant regulatory changes to industry-wide practices because the Bureau can explain its priorities in addition to the text of the proposed and final rules. This gives industry a great deal of information to use in complying with the applicable requirements. Informal written guidance can also be used to provide transparency to the entire market regarding best practices, even though it does not carry the force of law. It is therefore helpful, even if it does not have the same utility as rulemaking.

Rulemaking and informal written guidance can communicate regulatory expectations industry-wide more quickly than enforcement actions, which can take more than two years to reach a public resolution (or longer if a settlement is not reached and the action is litigated). Through rulemaking, the Bureau can begin shaping industry behavior very early in the rulemaking process through an advanced notice of proposed rulemaking, a notice of proposed rulemaking a SBREFA outline, and other tools like requests for information (RFIs). Thus, rules and informal written guidance provide clearer direction to industry and can more quickly communicate the CFPB's consumer protection priorities to begin effecting change sooner.

Rulemaking and informal written guidance benefit consumers by setting regulatory equity across market participants. These approaches allow for industry participation, provide transparency on the rules, and avoid unfair retroactive application of new standards. The result is a level playing field for all market participants which fosters competition. As noted by the Biden Administration, competition in the rapidly evolving banking industry generally benefits consumers through lower costs and the development of innovative products and services.

Formal rulemaking also gives industry an opportunity to participate in the rulemaking process under the APA, which benefits the CFPB and industry. The APA's minimum requirements for rulemaking are notice and an opportunity for interested parties to comment on proposed rules. Public participation supplies the Bureau with information it needs to make its decisions (including the variety of industry practices that need to be accounted for), while consumer groups, industry participants, and other members of the public benefit from an opportunity to participate in shaping the final agency action. Notice and comment rulemaking should be the preferred course of action when new standards are being set, or industry-wide conduct is at issue, because it provides the greatest amount of information to the Bureau and the greatest opportunity for all involved stakeholders – including consumers – to provide input. By incorporating feedback from the industry and the public the Bureau can fashion rules that avoid potential unintended consequences which could undermine the Bureau's policy goals, ensure effective and fair regulation across the spectrum of industry participants, and reduce the perception of unfair retroactive application of new standards. It also allows industry to cooperate with the Bureau to implement the Bureau's priorities in a way that can be feasibly put into practice, with accompanying controls and monitoring tailored to real-world market conditions.

It is worth noting, even when issuing informal written guidance, the Bureau has provided public notice in the past through RFIs and solicited input from both industry and consumer stakeholders, again allowing the Bureau to make more informed decisions and the public to participate in the process. This opportunity for public participation is helpful and important to the development of informal written guidance and should be employed by the Bureau regularly when announcing regulatory standards by this method.

Examples of successful CFPB and other regulatory guidance and rulemaking, including UDAAP

There are many examples of clear and effective rulemaking and written informal guidance issued by the CFPB and other federal regulators, even involving broad concepts like unfair, deceptive, and abusive practices. These examples make it clear that rulemaking and guidance can be very effective in achieving the Bureau's consumer protection goals.

With respect to formal rulemaking, the Bureau has engaged in the APA process many times and issued regulations that provide clear "rules of the road" that extend to the entire market. Examples include the Qualified Mortgage Rule, the Truth in Lending Act/RESPA Integrated Disclosure Rule (TRID), and the Remittance Rule. In enacting each of these rules, the CFPB issued a notice of proposed rulemaking and provided all stakeholders an opportunity to provide feedback to the CFPB. All these rules have had multiple rulemakings and amendments that identified and corrected problems or made adjustments in response to concerns raised by different stakeholders.[1]

The CFPB issues several types of informal written guidance. The CFPB regularly issues Supervisory Highlights in which the CFPB reports on trends and issues identified during the previous quarter's confidential supervisory examinations. Industry closely monitors the Supervisory Highlights for potential compliance issues. For example, in the Fall 2016 edition, the CFPB found it is an unfair or deceptive act or practice to charge auto loan borrowers a fee to recover their personal property from a repossessed vehicle unless the fee is disclosed in the underlying agreement.[2] Even when the consumer agreements and state law support the lawfulness of charging a storage fee, examiners concluded there were no circumstances in which it was lawful to refuse to return property until the consumer remitted payment rather than adding the fee to the borrower's balance. Therefore, the CFPB issued a clear expectation to the auto finance industry that personal property must be returned to a debtor/borrower who is unwilling or unable to pay the disclosed storage fee (and the fee could be added to the borrower's balance). Industry responded quickly to this statement and uniformly moved away from allowing repossession agents to charge such fees.

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[1] *See, e.g.*, Ability to Repay/Qualified Mortgage Rule, https://www.consumerfinance.gov/rules-policy/final-rules/ability-to-pay-qualified-mortgage-rule/; TRID Rule, https://www.consumerfinance.gov/rules-policy/final-rules/2013-integrated-mortgage-disclosure-rule-under-real-estate-settlement-procedures-act-regulation-x-and-truth-lending-act-regulation-z/; Remittance Rules, https://www.consumerfinance.gov/rules-policy/final-rules/electronic-fund-transfers-regulation-e/.

[2] Consumer Financial Protection Bureau, Supervisory Highlights, Issue 13, Fall 2016, https://files.consumerfinance.gov/f/documents/Supervisory_Highlights_Issue_13__Final_10.31.16.pdf.

The CFPB issues other written informal guidance less consistently that is also helpful. One recent and welcome example was the CFPB's Statement Regarding the Provision of Financial Products and Services to Consumers with Limited English Proficiency (LEP), which was published on January 13, 2021.[3] The statement provides principles and guidelines to assist financial institutions in decision-making concerning how best to serve LEP consumers and to facilitate compliance with ECOA and UDAAP laws by providing "clear rules of the road." Importantly, while the statement lacks the force of law, the CFPB solicited and received input from both industry and consumer groups to develop guidance that encourages serving customers in non-English languages while avoiding UDAAP and fair lending concerns. The Bureau's guidance helped to reverse some industry hesitancy to offer services in non-English languages brought about by years of enforcement activity by the FTC, CFPB, state attorneys general, and other regulators, which clearly demonstrated that UDAAP risk existed, but failed to clearly and consistently describe the contours of that risk and the steps necessary to mitigate it.

The CFPB also conducts market research and issues reports identifying concerns in certain industries. This research is often informed by requests for information issued to industry participants. For example, every two years, the CFPB is required under Dodd-Frank to issue CARD Act Reports to Congress regarding the state of the credit card market. In each report, the CFPB identifies potential UDAAP issues, indirectly communicating concerns to industry. For example, in 2013, the CFPB identified potential UDAAP issues related to credit card rewards programs. Credit card issuers responded by improving disclosures, limiting points forfeiture, and voluntarily adopting a set of transparency principles for credit card rewards programs, all benefiting consumers. The Bureau did not bring any enforcement actions in this area, but nevertheless guided the industry in a manner that benefitted consumers.

Finally, the Federal Trade Commission's Online Advertising Guide is an excellent example of a practical, useful set of guidance for industry on UDAP issues.[4] The practical guidance is widely followed by industry participants in formulating online advertisements for financial products and services. The FTC periodically updates the guide and related advertising resources.

These examples make it clear that rulemaking and informal written guidance are powerful, effective tools for the Bureau to use in shaping industry conduct while strengthening protections for consumers. The idea that enforcement is a necessary – or even preferable – manner for the Bureau to announce industry standards is refuted by the success of the Bureau's more transparent and inclusive methods of providing guidance.

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[3] Consumer Financial Protection Bureau, Statement Regarding the Provision of Financial Products and Services to Consumers with Limited English Proficiency, https://files.consumerfinance.gov/f/documents/cfpb_lep-statement_2021-01.pdf (Jan. 13, 2021).
[4] Federal Trade Commission, Advertising and Marketing on the Internet: Rules of the Road, https://www.ftc.gov/tips-advice/business-center/guidance/advertising-marketing-internet-rules-road.

Conclusion

There is no doubt enforcement is an important tool for the Bureau's consumer protection efforts. When legal requirements have been clearly communicated and industry actors fail to comply with those clear rules, enforcement is undoubtedly appropriate. But enforcement is an ineffective, imprecise, and slow method for the Bureau to announce new standards and expectations to industry. The use of rulemaking and informal written guidance promotes faster and more uniform compliance among a broader set of industry participants and serves the critical need for the Bureau to be explicit about the "rules of the road" for industry to follow. Industry has shown it is ready and willing to follow those clear rules when provided. If the Bureau prioritizes rulemaking over regulation by enforcement, the American consumers will be most effectively served.