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Consumer Finance Protection Bureau: Part 2

Teacher's Discussion Guide

This guide was prepared by Professor Howell Jackson and Kelley O'Mara, HLS JD '14 for the sole purpose of aiding classroom instructors in the use of "Consumer Finance Protection Bureau: Part 2." It provides analysis and questions that are intended to present alternative approaches to deepening students' comprehension of legal issues and energizing classroom discussion. HLS cases are developed solely as the basis for class discussion and participation. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective legal representation.

Exhibit 1: *Electronic Funds Transfer Act Remittance Rules* (February 2012 Final Rulemaking)

Purpose: The Bureau amended Regulation E, which implements the Electronic Funds Transfer Act. The amendments provide new protections, including disclosures, error resolution procedures and cancellation rights, to consumers who send remittance transfers to other consumers or businesses in a foreign country.

Overview of CBA:

- "The Bureau notes at the outset that there is a limited amount of data that is publicly available and representative of the full universe or population of remittance transfers with which to quantify the potential benefits, costs, and impacts of the rule." In particular, the Bureau had trouble sizing and segmenting the market.
- The Bureau was unable to quantify costs, partially due to a lack of costing by commenters. "[I]ndustry commenters did not provide precise or comprehensive information from which to estimate [relevant] figures [to size the industry]. Such data would provide the starting point for quantifying the cost to providers of complying with the rule."
- Given the lack of data, the Bureau provided "a qualitative discussion of the benefits, costs, and impacts of the final rule." The Bureau stated that it relied on "general economic principles" in putting together its qualitative analysis.

Benefits	Costs
Disclosure of Accurate Exchange Rates, Fees, and Taxes	
• Reliable information about how much consumers must spend to deliver a specific amount in a foreign currency allows consumers to better manage their household income • Disclosure will enable customers to engage in comparison shopping, since it will account for exchange rate, taxes and fees • Consumers will be less susceptible to deceptive and unfair business practices that may prevail absent disclosure. • Consumers who shop for remittance transfers place competitive pressure on providers, who may lower their prices in response.	• Compliance with disclosure requirements will likely require providers to update systems, revise contracts, change communication protocols and business practices • Providers that use "floating rate" products will need to adjust their business processes and relationships for setting exchange rates, and change the way they manage foreign exchange rate risk. • Some providers may find it difficult to obtain information that must be provided in the disclosures
Disclosure of Estimated Exchange Rates, Fees, and Taxes	
• Exception for insured depository institutions or credit unions (when	• Comments on the proposed rule did not provide any data on how costly it

they cannot determine the actual amount to be received) will reduce compliance costs, benefiting consumers. The estimation will still provide some of the benefits of actual disclosure (above). • Safe Harbor for countries where accurate estimates are not available allows for continued, uninterrupted service to those countries and reduces burden on having to assess the metrics needed for disclosure.	may be for insured depositories and credit unions to use the allowed methods of estimation • The costs of estimation may be high and potentially prohibitive for transfers to some countries • Comments indicate that the costs will be passed onto or shared with consumers
Formatting, Retainability, and Language Requirements in Disclosures	
• Formatting requirements (tested for effectiveness) ensure that consumers are not overloaded or diverted by less critical information. • Retainable disclosures (primary method) will allow consumers to track costs over time • Nonretainable disclosures (e.g., text messages) are quicker and more convenient for consumers • Language requirements increase understanding	• One-time cost for programing or updating systems to produce disclosures that comply with the requirements. • Language requirements may increase costs
Error Resolution	
• Regulation provides that if the transaction is for less than was initially stated, providers must complete the transaction at no additional charge or return undelivered funds • Consumers benefit from knowing error resolution procedures exist, since it makes remittance transfers less risky • Providers will be deterred from committing errors, since they will incur the costs	• Providers may be required to refund funds or fees that have already been received and which cannot be recouped • A provider may face additional exchange rate risk, due to liability resulting from making errors • Business practices may need to be adjusted to reduce errors • Costs may be indirectly passed onto consumers
Cancellation and Refund	
• A brief cancellation period may provide benefits to consumers by allowing them to review disclosure documents one additional time to	• Compliance costs are minimal • Delay of transmission of funds is minimal, but may be an inconvenience

confirm that they wish to complete the transaction and to identify any scrivener's errors on the receipt • Allows for a quicker correction of errors, at a point when it may be less expensive to correct • Not clear that a longer cancellation period would be more helpful for consumers	
Conditions of Agent Liability	
• In states where there is not currently a strict liability standard for acts of agents, this will provide incentive for providers to oversee and police their agents	• Additional monitoring costs

The Bureau was unable to quantify any of the costs or benefits of these rules, partly because of a lack of data provided by commenters. (Compare to the TILA/RESPA rulemaking below, wherein the agency takes a macro approach to quantifying benefits.) The qualitative rulemaking does call on economic principles, and the Bureau does provide explanations for why it could not quantify further. However, the purely qualitative analysis may not be adequate under *Business Roundtable* standards.

Exhibit 2: *Defining Larger Participants of the Consumer Reporting Markets* Rulemaking Costs and Benefits (July 2012 Final Rulemaking)

Purpose: To define "larger" nonbank participants of a market for consumer reporting, for the purpose of supervision of these persons.

Overview of CBA:

- The Bureau acknowledged its reliance on qualitative discussion due to the fact that "limited data [we]re publicly available with which to quantify the potential benefits, costs, and impacts of the rule." However, the CFPB stated, "where possible, the Bureau has made quantitative estimates based on these principles and data as well as its experience of supervision."
- After assessing the costs and benefits, the Bureau – at length – addresses and responds to a number of comments received, addressing costs and benefits.
- The Bureau also addressed alternative thresholds for the rule.

Benefits	Costs
• Increased compliance with existing statutes regarding consumer reporting would likely result in the availability of more accurate	• Increased compliance costs o Hire and train additional personnel to gather and pass on information ($49/ hour for 6

information in the marketplace o Could minimize denials of loans when warranted o Could minimize erroneous awarding of loans to those unable to pay o Could restrict dissemination of consumer information in inappropriate situations • Supervisory activities could benefit firms by informing them of problems with their systems, which could potentially expose them to liability o Could help to catch flaws when they are still relatively inexpensive to fix o Information gained by the Bureau could also help the CFPB to improve its methods of regulating	weeks – 8 months. Market-wide costs anticipated at .008% of receipts) o Increased share of management time to gather relevant information o Invest in system changes o Costs may be passed onto consumers • Companies may incur costs to evaluate or contest their status as a participating company

The Bureau followed the SEC's new guidelines to some extent. In the area where costs were easily ascertainable (compliance labor), the Bureau did choose to quantify. However, it is really a matter of opinion whether or not the quantification was adequate.

When compared to the Proxy Access rule (analyzed in teacher's discussion guide for PSW Day 1), this CBA does seem to be an improvement in three ways: (1) The quantitative effort appears stronger than in the proxy access rulemaking; (2) the Bureau extensively acknowledged the reasons why it could not quantify further; (3) the response to commenters about costs and benefits is more robust.

Exhibit 3: *Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z)* (July 2012 Proposed Rulemaking)

Purpose: Bureau is proposing to amend Regulation X (Real Estate Settlement Procedures Act) and Regulation Z (Truth in Lending) to establish new disclosure requirements and forms in Regulation Z for mortgage transactions

Overview of CBA:

- Bureau begins by pointing out that most of the costs are one-time adjustments, while the benefits are ongoing.
- Bureau acknowledged lack of data for various benefits, due to the nebulous nature of the purported benefits. However, the Bureau did choose to

quantify the benefits for the first proposed change, demonstrating the magnitude of impact a small change could make.

- The Bureau distinguished between costs that could be incurred by consumers (and passed onto consumers) and those that they believe will be incurred by creditors only, with minimal impact on consumers.
- Where benefits could not be quantified, the Bureau often identified the necessary data for such quantification. May be relevant in the 5-year review of the rule.
- Where possible, one-time costs were quantified using numbers from the Bureau of Labor statistics.
- Where relevant, the Bureau considered a potential alternative to the proposed rule, (Section 5) and conducted an alternate CBA.
- Bureau has invited comment on its CBA.

Benefits	**Costs**
Integrated Initial and Closing Disclosures	
Loan Estimate • Helps consumers make better decisions by giving them better information in a more digestible fashion • Enables consumers to pick the loan that suits their needs • Facilitates comparison shopping among consumers **Closing Disclosure** • Enables consumer comparisons of terms of loan estimate and actual terms • May encourage creditors to take care to ensure that Loan Estimates are accurate, discouraging unscrupulous creditors from "bait and switch" procedures **Quantification** • Hard to know because of lack of data • If new disclosures affect 10% of consumers and lowers interest rates 1/8 of a percentage point, would lead to an annual savings of $1.25 billion • If closing costs are lowered $150, would translate into $120 million per year • Could save industry $16.50 per	• Bureau does not believe significant costs will be passed onto consumers • Software and compliance systems would have to be adapted to produce new forms • 95% of small originators rely on vendor software. The Bureau estimates that each of these vendors would spend roughly $500,000 to $2,000,000 to determine what changes need to be made to come into compliance and to update the software that they provide to creditors. Costs may not be passed on directly to client creditors. • Small fraction of small originators that do not use vendors would incur costs of roughly $100,000 to update their systems to comply with the proposal. Firms are expected to amortize this cost over a period of years. • The largest 20 mortgage creditors would need to revise their compliance software and systems. The Bureau estimates that on average the cost per creditor for this category of creditor would be $1,000,000, for a

closing because of simplicity	total of $20,000,000. Amortized over five years, the estimated annual cost for large creditors to update compliance systems is $4,000,000 for the largest 20 mortgage creditors combined. • Covered persons would incur one-time costs associated with training employees to use new forms and any new compliance software and systems. 83,000 loan officers at $46/our for officer, $39/hour for trainer at 2 hours of training. Amortized over five years, this is an annual cost of $1,660,000 for all mortgage creditors combined. • Taken together, the Bureau estimates that the total one-time costs of complying with the proposed Loan Estimate and Closing Disclosure would be roughly $100,100,000. Amortized over five years, this is an annual cost of $20,020,000 for all mortgage creditors combined
Definition of Loan Application [Not in Student Excerpt]	
• May benefit consumers by ensuring that consumers receive Loan Estimates early enough in the lending process to use them in shopping for their loan. • The Bureau cannot estimate the magnitude of the benefits of improved shopping, but believes that they could be very large.	• No anticipated costs to consumers • Could increase the burden on creditors and mortgage brokers to the extent that it causes them to issue more Loan Estimates than they would under the current definition of application.
Disclaimer on Pre-Application Estimates	
• May benefit consumers by clearly distinguishing disclosures that are subject to TILA and RESPA protections from those that are not	• Could impose costs on consumers, in the form of reduced information about mortgage loan options, if it makes creditors or mortgage brokers less willing to provide written pre-application estimates of loan terms • Lenders would have to bear the costs of adding a disclaimer to those communications
Changes in Settlement Costs/Redisclosures	

• Consumers may benefit when fewer fees are permitted to change from the Loan Estimate. • Consumers that rely on the Loan Estimate to shop for a loan would be able to make decisions based on estimated costs that more closely reflect the actual costs they would bear, making shopping more effective • The Bureau cannot quantify the magnitude of these benefits • Covered persons may benefit from the proposed rule because it reduces compliance burden by resolving current regulatory ambiguities • To the extent that restricting certain changes in fees reduces bait-and-switch tactics by some creditors, this provision may also benefit honest creditors that do not use these tactics	• The restriction on changes to these costs may cause some creditors to provide higher initial estimates, making shopping less effective as consumers rely on less accurate information • Covered persons may experience increased costs as a result of a rule that applied the zero tolerance category to a larger range of charges. Creditors may be required to absorb more costs. • May result in increased use of affiliated service providers, so that creditors can more directly control changes in settlement costs, which could have a negative impact on independent providers
Provision of Closing Disclosure (*Alternative considered)	
• Ensures that consumers receive the disclosures far enough in advance of consummation that they can review the final details of the transaction. • Should allow consumers to have a better understanding of the final terms of the transaction and how and whether those terms have changed since the consumer received the Loan Estimate. • Improves consumer's ability to compare early and final disclosures and identify changes in loan terms may better enable consumers to recognize and challenge increased settlement costs or loan terms that are different from the initial disclosure • May encourage all creditors to take greater care to ensure that Loan Estimates are accurate and may discourage unscrupulous creditors	• May result in closing delays, which could come at a cost to consumers. • In extreme cases, such delays could cause a transaction to fall through if a consumer is under a contractual obligation to close by a certain date. • If the requirement does lead to delayed or canceled closings, this would impose costs on covered persons. Such closing delays could result in loss of revenue for transactions that fall through due to a delay. • May also create legal and reputational risks for creditors or settlement agents that are unable to close loans as planned.

<table>
<tr><td>from attempting to "bait and switch" consumers with initial Loan Estimates that have better loan terms or lower settlement costs than the final transaction.
The Bureau cannot quantify the magnitude of the benefits</td><td></td></tr>
<tr><td colspan="2">Recordkeeping of Machine Readable Data</td></tr>
<tr><td>May improve the ability of the Bureau and other regulators to monitor compliance with applicable requirements and to evaluate whether the rules adequately protect consumers against impermissible changes in settlement costs and loan terms
May increase efficiency across the entire mortgage origination industry through the use of a standardized data format (Reducing long run industry costs)
Consumers may benefit from the expanded finance charge definition to the extent it discourages the proliferation of certain "junk fees," such as fees for preparing loan-related documents, which are currently excluded from the finance charge</td><td>Creditors may be required to reconfigure existing document production and retention systems
Creditors with existing electronic storage systems would need to expend 40 hours of software and IT staff time to develop the ability to export data from existing systems to a standardized format
20 largest firms: $1,600,000 (rounded to nearest $100,000). Amortized over five years, this is an annual cost of roughly $320,000 for all mortgage creditors combine
Smaller originators that rely on vendors: already covered in loan estimate and closing disclosure analysis</td></tr>
<tr><td colspan="2">Expanded Definition of Finance Charge [Not in Student Excerpt]</td></tr>
<tr><td>Consumers could gain a better understanding of the risks associated with the loan through additional disclosures (which, in turn, may reduce the likelihood a consumer takes out a mortgage he or she cannot afford), better loan terms due to increased shopping, and an absence of loan features whose associated risks may be difficult for consumers to understand
Could assist consumers in planning for Escrow costs
More loans could be subject to the separate underwriting standards</td><td>May pass on increase costs to consumers taking out higher-risk mortgages
May lead to a higher cost of credit for some consumers or reduced access to credit if creditors choose not to make loans that would be classified as high-cost, higher-priced, or higher-risk, or if consumers cannot qualify for credit as a result of the separate underwriting standards that could apply to higher-priced balloon loans.
Creditors may be required to update compliance systems to reflect changes to the finance charge</td></tr>
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required for higher-priced balloon loans, which could help to ensure consumers' ability to repay such loans and fewer loans would be classified as "qualified mortgages." • May benefit covered persons by easing regulatory burden and litigation risk associated with the current complex rules for determining which fees are part of the finance charge.	calculation. These updates may involve one-time costs associated with software updates, legal expenses, and personnel training time. • A small number of creditors may also lose a very small fraction of revenue if they are reluctant to make high-cost, higher-priced, or higher-risk mortgage loans and cannot offer alternatives that are as profitable as those loans.

The Bureau followed the SEC's new guidelines to a large extent. The effort to quantify costs was particularly thorough, though the notice-and-comment procedure may reveal flaws. The top-down effort to quantify benefits demonstrates the magnitude of seemingly small changes. In this proposed rulemaking, the Bureau did not have the opportunity to respond to comments; however, it has already included insights received from industry members during the research process.

Exhibit 4: *Teaching Notes on Cost-Benefit Analysis*

Hierarchy of preferred methods in CBA

1. **Monetization**: Costs and benefits are put in real economic terms

   E.g., Regulation will cost to providers $100,000 to implement
2. **Quantification**: While not in dollar terms, the costs and benefits are provided in an aggregate numerical form

   E.g., One million consumers will be affected
3. **Quantitative Information**: Ascertainable numbers are provided, even if an aggregate number cannot be calculated

   E.g., While it is unclear how often this option will be used, it could affect between 100-5000 companies
4. **Qualitative Discussion**: Costs and benefits are discussed and explored without numerical sizing

   E.g., Consumers will be better able to compare two loans with disclosure information

Costs v. Benefits

- Typically, costs for a new regulation are easier to ascertain than benefits, because the new processes for compliance are reasonably foreseeable.
  - Benefits often appear speculative; hard to estimate real impact to the economy and consumers
  - Often industry groups and affected parties provide cost estimates in comment letters. The agency may or may not want to accept these

numbers, but will have to take them into account as a part of the notice-and-comment process.

- In many situations, the costs are just as difficult to quantify as the benefits
    - Where a regulation is less prescriptive, or where is unknown the extent to which the rule departs from current practice, it can be very difficult to quantify costs.
        - E.g., Rule that requires that servicers make oral contact with delinquent borrowers and inform them about loan modification options, orally notify borrowers who submit an incomplete application about the requirements to complete the application, and upon receiving a complete application, consider the borrower for all available options.
    - Even where a regulation requires a specific action, the agency encounters significant challenges in estimating the costs of program systems, training employees, etc.

<u>Difficulties of Defining a Baseline</u>

- Both OMB Circular A-4 and the SEC Guidelines highlight the importance of choosing an appropriate baseline. Many of the particular difficulties are beyond the scope of the PSW problem, but it may be helpful to discuss briefly.
- For the Bureau, most of the rules being issued pursuant to Dodd-Frank are implementing statutory provisions which are self-executing; using a post-statutory baseline (i.e. a baseline assuming that the statute were effective without the regulations) leads to the conclusion that the regulation reduces costs by reducing uncertainty and by providing occasional safe harbors, adjustments or exemptions. The costs look quite different viewed against a pre-statutory baseline.
    - In this context, the benefits may be simply to particularize, and rationalize statutory provisions enacted by Congress, even if those legislative actions cannot be justified by reference to any of the behavioral justifications for market intervention

