

# Consumer Finance Monitor (Season 4, Episode 47): “The Case For Regulation Through Rulemaking & Guidance”: A Discussion of the Consumer Bankers Association’s White Paper with Special Guests Dan Smith, CBA Executive Vice President, and Ebony Johnson, CBA Associate General Counsel

Speakers: Chris Willis, Dan Smith and Ebony Johnson

Chris Willis:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers and the industry. I'm your host, Chris Willis, the co-chair of Ballard Spahr's consumer financial services group and I'll be moderating today's program.

Chris Willis:

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Chris Willis:

Now, today we have a very special podcast for you because we're joined by two special guests and friends from the Consumer Bankers Association. If you didn't know it, the Consumer Bankers Association is one of the premiere trade associations in the financial services industry. And, as the name suggests, it is composed of banks who engage in consumer lending. It's also an association that's very, very active in all manner of regulator matters, including both rule making and other activities of the Consumer Financial Protection Bureau.

Chris Willis:

Our special guests today are two members of the CBA. First, we have Dan Smith, who's the executive vice president and head of regulatory affairs for the CBA. And, we also have Ebony Johnson, who is vice president and associate general counsel for the CBA. And, both of them happened to be at the CFPB prior to joining the Consumer Bankers Association, which I think makes them uniquely qualified to talk about our topic today. And, that topic is a recent white paper that was released by the CBA entitled The Case for Regulation Through Rule Making and Guidance, which is a statement about how the CFPB ought to exercise its powers to regulate the consumer financial services marketplace.

Chris Willis:

So, Dan, Ebony, first of all, thank you both very much for being on the podcast today.

Dan Smith:

Thanks, Chris.

Ebony Johnson:

Thank you.

Chris Willis:

So, Dan, as I mentioned a second ago, the title of the paper is The Case for Regulation Through Rule Making and Guidance. So, when I think of regulation, I naturally think of rule making and guidance as the tools of regulation. But, rule making and guidance instead of what? What's the basic point that the CBA's white paper is making?

Dan Smith:

If you look back at the history of the Bureau, they've written many rules and they've gone through the APA process to do it appropriately. From the mortgage rules, to prepaid rule, to HUMDA payday rule. But, there have been occasions where the Bureau used their enforcement tool to set a new standard, to change the way industry complies with laws through that enforcement action. And, this term, it's a term of art almost, regulation by enforcement, is used by many industry participants.

Dan Smith:

We thought it was important to really dive into it and explain what we believe it really is, so that it helps everybody get on the same page. Because it's used so often in many different ways, it loses its integrity when you don't define it appropriately. I have talked to many people, those that have worked inside the Bureau, outside, everybody's got a different idea of what regulation by enforcement is. And, I think in order to have an adult conversation, you really have to come to an understanding on what we mean. Rather than just use three words, regulation by enforcement, we thought it was important to spell it out.

Dan Smith:

So we did that, we went through and we tried to give examples of where we think the Bureau, for example, may have gone above and beyond in an enforcement action and reinterpreted law. Or, introduced a new interpretation to a stated law.

Chris Willis:

So, I understand that and it makes complete sense to me. So from an industry standpoint, it's intuitive about why regulation by enforcement would feel less fair than regulation through rule making or guidance. Because, in the latter instance, industry knows ahead of time what the rule is prior to it being applied to a particular industry participant.

Chris Willis:

But, we of course know that the CFPB is concerned with consumer impact and with its own ability to regulate the market. And, Ebony, I'd love to get your perspective on, from the consumer protection and from the regulatory standpoint, why would rule making and guidance be better?

Ebony Johnson:

Well, Chris, when it comes to consumer protection, avoidance is really the name of the game. Both the regulators and industry should prioritize taking preemptive steps to avoid consumer harm. Now, when the Bureau and other regulators issue formal guidance, or even informal written guidance, it puts industry on notice of what the regulatory expectations are. And, it gives them the opportunity to avoid problematic conduct. It helps the regulator because now, they've got an objective standard by which to evaluate industry conduct. And, obviously and most importantly, it reduces the likelihood of consumer harm from that conduct, which benefits, of course, the consumer industry by avoiding unnecessary enforcement action and the regulator, in ensuring that the industry is working well for the consumer.

Ebony Johnson:

Now, if we thought about this in the context of, say, a basketball game. Imagine if there were no rules governing what constitutes a foul in the game of basketball. And, in watching one game, it may be that standing in front of someone and looking menacing is a foul, but in another instance it may be touching the ball but not the individual. So each game, we're trying to piece together what is or is not conduct that will result in a foul being called. That is the type of impact, the type of effect that we avoid when the regulator announces the conduct, announces the rules at the outset and allows the game to be fairly played.

Chris Willis:

And, ebony, to follow-up on that, I think you're making the point that it's more efficient to advise the market, "Here are the rules," so that everybody's clear on them. What would you say about the clarity of a rule that comes out from an enforcement action, like a consent order, to other industry participants who weren't involved in the consent order?

Ebony Johnson:

Sure. The issue that you run into there is that, one, industry is not necessarily privy to the universe of facts that went into the Bureau's interpretation with respect to the violations found and doesn't necessarily know, from a consent order, what specifically the Bureau is asking industry to take from that order, as a rule moving forward.

Ebony Johnson:

What happens is that some members of industry may interpret a consent order as saying that X conduct needs to be taken and invest time, resources, effort into addressing those issues. Where, another member of the industry may look at Y and think Y is clearly the most important piece of this, and move in that direction. So you've got everyone sitting in a room, looking at this order, taking different things from it and the Bureau is not providing sufficient context for industry to say, "This is the expectation, this is what we should be doing across the board and we should move forward accordingly."

Ebony Johnson:

It does create a lot of inefficiency in terms of improving business practices. But, most importantly it increases the timeframe during which consumers may be harmed by this conduct because it's not being adequately and specifically addressed.

Chris Willis:

Yeah. So to use your analogy, the industry sees a foul called but they didn't actually see the gameplay that led up to the foul call. And so, they are left wondering to what extent is this a rule for everybody versus to what extent is it a rule designed to correct some specific idiosyncratic misconduct committed by the subject of the consent order, so to speak.

Ebony Johnson:

Yeah. And, to take that analogy a bit further, in watching the replay, someone may look at the player running up on the opponent as the foul, some may look at it as grabbing the ball as the foul and some may look at it as the bodily contact is a foul. So now, everyone is moving in different directions to have a nice face on, or smile at the opponent, or run the other way when the ball is thrown and not necessarily understanding what specifically is the problem in that particular play.

Dan Smith:

I'd love to add to this analogy, just because it's a great analogy. Thanks, Ebony.

Dan Smith:

What happens when you all know the rules? We all know what a foul is. If I hit somebody's hand when they go to take a shot, it's a foul, we all know it. But now, the ref decides no, just looking at them is a foul. Or, if I change the rule during the game.

That is another aspect of regulation by enforcement, is when we actually think the rules mean one thing and the agency decides, arbitrarily, to change that.

Dan Smith:

If you look at the PHH case, there was a long history on RSPA Section Eight on what we believe is the interpretation around Section Eight. People can agree or disagree on if it's the right regulation or the right guidance, but it was a known guidance throughout the industry. And then, arbitrarily, the CFPB threw an enforcement action, holds PH accountable for a total different evaluation and standard. That's another type of regulation by enforcement.

Chris Willis:

You've hit on an important point there, Dan, which is to start to explore the ways in which regulation by enforcement can be unfair to an industry participant. Because it has no way of knowing what the regulator is going to call out as a violation until the new rule is announced and retroactively applied to the past conduct, which of course, at that point, you can't do anything about.

Chris Willis:

Are there other aspects of regulation by enforcement that you'd like to call out? In terms of why they are unfair to industry participants.

Dan Smith:

Well, the reality is 99.9% of all financial institutions want to comply with the law. They're not trying to deceive people. Majority, almost all of them. So when you don't give clear guidance, transparent rules, you're not protecting the customer. The reason why rules are in place is so everybody is protected. And, when you're only doing it through an enforcement action, you're only protecting past harm.

Dan Smith:

The reason why you write a rule is to set a standard so that all consumers receive the same kind of protections before the actual harm occurs. It's to prevent the harm. Regulation by enforcement does almost nothing to prevent the harm. And, it actually could cause more harm because now, you've caused confusion in the marketplace on what the Bureau really means. They're guessing. Is this judge going to call this a foul or not? So when you don't have certainty, you cause confusion in the markets.

Dan Smith:

When you look at the mortgage space and PHH, I think the Bureau was trying to set a new standard. The reality is they created a lot more confusion, where some people took advantage of that confusion. And, if they went back and looked, the harm caused post PHH may be just as bad as the harm that they perceived before.

Chris Willis:

I think all of your comments really go to the idea that what's fair, both to consumers and to industry, is to have the rule of law, so to speak, to know what the rules are before they are enforced. Which not only makes intuitive sense, but also seems relatively consistent with our system of law and due process.

Chris Willis:

But, the criticism that you hear from the consumer side ... I remember reading a quote from Elizabeth Warren about this is, "We can make rules and set them out like posts on the prairie," I think it was a quote, something like that. And, as soon as the industry knows what the rules are, they get with their lawyers and they figure out ways to go around the fence posts and

circumvent the intent of the rules. That's why we need flexible enforcement power, where we don't announce everything in advance.

Chris Willis:

So, Ebony, how would you respond to that point? That the Bureau needs to call it like it sees it, rather than having a set of defined rules that everybody knows up front.

Ebony Johnson:

Well, I'll say two things to that, Chris. One is that we're not saying here that enforcement is an unnecessary tool. Enforcement is the right tool to address bad conduct, where that conduct has been identified as bad. And in that situation, all the players know the rules, they know the game and if they choose to foul, so be it. They're accepting that consequence. But, it's in defining what constitutes bad conduct that it provides that opportunity for compliance. And, if we don't know what the bad conduct is, it is very difficult to avoid committing conduct that will later get institutions in trouble.

Ebony Johnson:

I will say, I have yet to run into the institution that's okay with going through an enforcement action. Ultimately, players in any given industry, for the most part, are going to want to avoid conduct. And yes, there are some bad players in some various markets. But, that is not the norm. The norm is these institutions, in our case banks, are looking to do right, or looking to comply or looking to stay out of trouble and it's providing this rule making or this guidance that allows them to do that. Enforcement is not the tool to use when there's conduct that it's not even clear is problematic or not.

Ebony Johnson:

The scenario that you set forth, where there's this nefarious actor intentionally avoiding known violative conduct is very different than what we sometimes see from the Bureau, which is them going after conduct that is completely different than any conduct that has been identified previously as unlawful or wrong. It's a brand new frontier, if you will. In those instances, why is it that the rule can't come first? Why is it that the Bureau can't identify that this type of conduct is bad or, "Oh, we see something happening in this space, we should act," even if it's just to provide some informal written guidance to say, "We're seeing a lot of motion in this area and we think industry needs to be careful." That's really what we're talking about here.

Chris Willis:

I think you've made an important point there, in mentioning the role of informal guidance. Because you could easily see a regulator saying, "Well hey, if I have to go through rule making to identify everything that may harm consumers, that's a long process. The Administrative Procedures Act requires me to do a proposed rule and then, I have to do a SUBREFA panel and then, I have to listen to all these comments and take them into account. And then, come out with a final rule. And then, the compliance date will be later and by the time I do all that, it's going to take two years. Enforcement is faster," they might say.

Chris Willis:

But, is that really the case, when you compare an enforcement action versus say, informal guidance of the nature that you just mentioned?

Ebony Johnson:

I will say it depends. I don't think speed is necessarily the concern, as much as it is effective resolution of the problem.

Ebony Johnson:

When we think about, for example, the supervisory highlights that come out, at the very least, industry knows how to interpret the results from those examinations and knows what they're supposed to take from it. That's the important part, it changes

conduct in a uniform and consistent way. When you try to do that through enforcement and yes, the consent order spells out the terms, the consent order does not tell industry, "Here is exactly what you need to do now, as a result." The consent order is meant to govern specifically the conduct and the relationship between the Bureau and the target institution. That's really the focus, is how do you get the impact that you want in terms of correcting conduct, in a uniform way. And, that even if you can't do the formal rule making process, the written guidance does help.

Ebony Johnson:

But, I do want to highlight that the formal rule making process is the ideal way to develop rules because it allows the Bureau, other regulators to develop informed rules where they are knowingly presenting expectations to industry with full input from industry, from consumers, from other interested parties. So they have taken into account different, specific vulnerabilities, concerns, issues and hopefully, formulating something that is reasonable and effective for the stated purpose. That's a big, big, big issue and something that's very important to any rule making process.

Chris Willis:

Yeah, of course because a consent order is a private negotiation between the Bureau and one party. And, whatever comes out of it is a negotiated outcome and maybe driven by the idiosyncratic interests of whoever the target institution is. They may be exiting the business, for example. Or, they may have a business model that's different from everybody else's, for example. Neither consumer advocates nor industry gets any input into what rules are created through that process, which is exactly your point.

Chris Willis:

But, let's get to practical reality for a second, Dan. We're being signaled, I think, by the Bureau's newly appointed director, as I think we were by the acting director before him, that the Bureau intends to make heavy use of enforcement over the next several years. And in fact, we've seen a good bit of evidence of that this year, since the Administration change.

Chris Willis:

Given that heavy emphasis on enforcement, what is the CBA's hope or expectation about the impact of the white paper that it just released?

Dan Smith:

The reason we wrote the paper is to try to define exactly what we mean as an industry, at least from CBA's perspective, so that we can have a conversation with the Bureau at the appropriate time, when we think they are not being transparent. Director Chopra, in his confirmation hearing, was very clear that he has every intention of being transparent, clear rules of the road so industry can comply. We are already seeing some new ways that the Bureau will pursue actions and change regulations, but we don't know what he means.

Dan Smith:

So we want to be able to say, "Listen, you said you would do this, you would be transparent and we don't think this is clear to the industry how you want them to behave." As he develops his priorities, as he develops rules or he develops guidance through enforcement or without enforcement actions, we have a tool to go and say, "This is what we think you're doing here, this is regulation by enforcement by the way we define it, very narrowly. We don't know the rules or you just changed the rules. We want you to be more clear on what your intentions are and how do we comply with them, rather than guessing and then, being subject to enforcement action based on guessing with you meant."

Chris Willis:

I think that's the perfect way to sum up and end our podcast. The white paper is really about industry wanting to know and understand the rules, before enforcement is applied to it. And also, expression its desire to comply with those rules when they're made clear by the Bureau and by other regulators.

Chris Willis:

So, Dan and Ebony, I wanted to thank you a lot for being on our program today, and thank the Consumer Bankers Association for both publishing the white paper and for the anticipated conversations with the Bureau about the best and fairest way for the Bureau to exercise its various authorities.

Chris Willis:

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