A Consumer Watchdog On Shaky Footing

Questions about the viability of director's appointment throws the bureau's already-issued rules into doubt

By Ben Weyl

On March 21, 1990, Salvatore R. Martoche was stunned to learn that his leadership of the Office of Thrift Supervision had been deemed unconstitutional.

A federal judge had ruled that Martoche and his controversial predecessor, M. Danny Wall, had been installed invalidly as directors because they hadn't been confirmed by the Senate when the office was created from a predecessor. Moreover, the legality of the agency's seizure of hundreds of failing thrifts was now in question, potentially throwing into disarray the government's effort to respond to a widespread savings and loan collapse.

Looking back, Martoche, now a justice on the New York State Supreme Court, recalls a sense of calm in coping with the disruption. "There was a certain confidence that it was going to cause an Excedrin headache," Martoche says, "but in the end, it was going to wash out."

STILL ON GUARD: Warren says more onerous mortgage requirements could take effect in a stalemate.

TOM WILLIAMS/CQ ROLL CALL

Indeed, President George Bush quickly nominated a new director, T. Timothy Ryan, and within a month he was confirmed by the Senate, clearing away uncertainty and putting the cleanup of the thrift industry back on track.

Facing the possibility of a similar crisis, President Barack Obama — and the financial industry — may not be so lucky.

Last month, a federal court ruled that several of Obama's recess appointments were unconstitutional, casting doubt on Richard Cordray's position as director of the Consumer Financial Protection Bureau.

If Cordray's appointment is overturned by the courts, a year's worth of regulatory actions might also be tossed out, throwing into doubt some of the structural changes the government has sought to bring to the mortgage market since the housing-led financial crisis of 2008.

There are several legal avenues that might keep the rules afloat, but the clearest solution is once again to have an agency director confirmed by the Senate. However, that will require getting past a deep partisan divide over the very nature of the agency itself, a divide far greater than the differences in Washington that existed over the savings and loan crisis.

"The rules of engagement are so different today," Martoche says, with hostility in Washington "at an unprecedented level."

Senate Republicans have vowed to block anyone from serving as director absent structural changes, which they say are needed to improve oversight of the agency.

Democrats reject the demands, which they argue are intended to undermine a watchdog for Americans seeking mortgages, credit cards and other financial products. The demands, the Democrats say, are an attempt to get through the confirmation process changes they were not able to win legislatively in 2010 in the Dodd-Frank regulatory overhaul that created the agency.

During debate over the Dodd-Frank law — which wiped out the Office of Thrift Supervision — the financial industry strongly opposed establishing the consumer bureau, warning that it would be overzealous and deaf to industry concerns. Those fears have largely faded, however, and business groups have been pleasantly surprised by Cordray's outstretched hand.

In fact, the same groups that furiously

opposed the agency's creation may soon find themselves pressed to act as its savior by seeking to keep the bureau running. After years of trouble in the mortgage world, some in the industry are suggesting that the regulatory framework that has been built may be one they can live within, and preferable to the uncertainty that would come from tearing it down in a partisan showdown.

Wary of potential regulatory chaos, David H. Stevens, president of the Mortgage Bankers Association, says, "Our hope is that Republicans and Democrats in the Senate work together to find a solution that addresses concerns in a reasonable way and allows the CFPB to do its job."

Moving Forward

Cordray, an amiable former Ohio attorney general, has been the man in the middle for some time. Obama tapped him after deciding that Elizabeth Warren, the Harvard law professor-turned-senator from Massachusetts who helped dream up the agency, was too controversial to get confirmed.

But Senate Republicans were not mollified, and they filibustered Cordray's nomination just as they promised to block Warren.

In early January 2012, Obama bypassed the Senate with a recess appointment of Cordray, as well as three members of the National Labor Relations Board.

Fast-forward a year, and the U.S. Court of Appeals for the D.C. Circuit ruled in Noel Canning v. NLRB that the Senate had not actually recessed, and so the labor appointments were unconstitutional. Although Cordray's nomination was not at issue in the case, the fate of his position is entwined with the other recess appointments.

Indeed, last month's decision, which the government is likely to appeal, set off alarms in financial institutions across the country. That's because the consumer bureau has been busy over the last year adopting a slew of regulations, including some that will reshape the mortgage market for years to come.

The bureau recently finalized the so-called qualified-mortgage rule, which bars the riskiest types of mortgages and is intended to ensure that prospective homebuyers are able to repay their loans.

Mandated by the Dodd-Frank law, the rule is among the most significant efforts yet to prevent the kind of reckless lending that fueled the 2008 financial crisis.

Before borrowers can be offered a loan, lenders will have to examine their financial information, including employment status, income and credit history, to see if they'll be able to pay it back. The regulation also sets new underwriting standards that lenders must meet to qualify for legal protection in the case of a default. The standards are expected to largely define the universe of credit available to the public going forward.

Despite earlier industry worries, the bureau has won rave reviews for its handling of the rule, including its extensive outreach to stakeholders.

"The process was very good," says Richard Hunt, president of the Consumer Bankers Association. "At several stages of the process, we had an opportunity to speak directly to Cordray and others. There was great give and take."

> "It's going to be the Republicans ... who are injecting more uncertainty into the mortgage market and creating more difficulty for mortgage issuers."
>
> — Sen. **Elizabeth Warren**, D-Mass

Hunt says the agency is the most accessible regulator he's dealt with since coming to Washington in 1994.

Compliance officers across the country are busy preparing for the qualified-mortgage rule and other regulations from the consumer bureau. But if the courts determine that Cordray's appointment was unconstitutional, what happens to the rules he oversaw?

Stevens, of the Mortgage Bankers Association, says his greatest concern would be if the bureau's regulations are simply wiped out, which he says could seize up the mortgage market.

Under Dodd-Frank, the new mortgage requirements were to go into effect in January if regulations had not been finalized. The bureau issued the rule, and lenders now have a year to comply. But if the rule is thrown out, the statutory language takes effect immediately, and that is a far blunter instrument than the new rule. If forced to comply immediately, lenders could be frightened to make all but the safest of loans.

"That will just throw a large amount of uncertainty back into the housing finance system just when it's on a pathway back to recovery," Stevens says. "It would quite frankly block the doors to many qualified families who are looking to buy a home."

Hunt says he is "extremely concerned" with the uncertainty that already exists, saying it's difficult for banks to conduct business in the unknown. There's not much contingency planning they can do: Hunt says his association has talked to 10 lawyers and gotten 15 opinions on what might transpire if Cordray is dismissed.

Seeking a Fix

Alan S. Kaplinsky, a partner at the law firm Ballard Spahr, says there are several potential solutions that might avoid the worst consequences. "There will be legal uncertainty for sure, but that doesn't mean we're in a situation where there is no possible cure for the uncertainty," says Kaplinsky, who leads the firm's consumer financial services group.

The Dodd-Frank law includes a provision that allows the Treasury secretary to exercise some of the bureau's powers when there is no director. Kaplinsky says he believes most of the rules the agency has already issued could be ratified by Treasury if necessary.

Kaplinsky hopes federal officials are discussing such contingency plans, but if they are, they're not saying. Aides at the Treasury Department and the consumer bureau declined to comment on whether there had been any consultations on the matter.

Another way the rules might be saved — even if Cordray's appointment is not — is if the courts uphold the rules under the "de facto officer" doctrine.

Under that scenario, the courts could say that even though the rules were administered by an invalid director, they can stand since Cordray was presumed to have validly held the office. Still, Kaplinsky calls this "a very murky area," adding, "I wouldn't want to give a definitive view."

Ultimately, it could be up to Congress to act to prevent a crisis in the mortgage market.

After the circuit court's decision, Anne Canfield, who runs the Consumer Mortgage Coalition, an organization of mortgage lenders, distributed a suggested legislative fix to Dodd-Frank. Her proposal would delay the new mortgage provisions from taking effect until after the bureau has proposed the rules again.

Such a plan faces political hurdles, however. Congress has struggled to enact even bipartisan technical fixes to Dodd-Frank, because the law is a lightning rod for both parties.

Which brings the discussion back to Cordray, since having a confirmed director would be the easiest way to ensure that the rules are maintained and the playing field is in order.

Senate Republicans have three demands before they'll drop their filibuster against Cordray. They want to replace the director-led bureau with a five-person commission, subject the agency to the congressional appropriations process instead of letting it receive funds from the Federal Reserve and make it easier for other banking regulators to overrule the bureau. Some Republicans believe the circuit court's decision has given them added leverage to get the changes.

Democrats have resisted, saying the shifts would "defang" the bureau and effectively nullify a law that the GOP was not able to defeat legislatively. Earlier this month, all but one Senate Democrat signed on to a letter to Obama underscoring their opposition to structural changes even in exchange for Cordray's confirmation.

Democrats may also be counting on industry to boost the pressure on Republicans.

Warren reminded reporters at a news conference this month that Dodd-Frank's new mortgage requirements would still be in effect, even if the bureau's rules were thrown out. "And those are not the rules that are either most effective for consumers or, more importantly, for the big banks or for the small banks," Warren said. "It's going to be the Republicans who are holding up Rich Cordray's nomination, who are injecting more uncertainty into the mortgage market and creating more difficulty for mortgage issuers."

For now, business groups are walking a careful line in public on the issue, even as they push for a resolution.

Stevens praises Cordray as "accessible, deliberative, communicative," but also says, "questions of governance structure are worthy of discussion."

The Financial Services Roundtable does not take a position on presidential nominations, says Scott Talbott, the group's senior vice president of public policy. At the same time, he adds, "Our message is, we like certainty and predictability." ■

FOR FURTHER READING: *Circuit court decision, CQ Weekly, p. 320; Dodd-Frank on trial, 2012 CQ Weekly, p. 2042; bureau under assault, 2011 Almanac, p. 6-6; Dodd-Frank enactment (PL 111-203), 2010 Almanac, p. 3-3.*

Reprinted from the February 25, 2013 issue of *CQ Weekly*.
Congressional Quarterly's Magazine on government, commerce and politics
© 2013 CQ Roll Call All Rights Reserved.