Launch Codes

Guiding Principles for the New Bureau of Consumer Financial Protection

July 15, 2010

By Tim Duncan[1]

In the 1972 film *The Candidate*, Robert Redford plays a young, sincere public defender named Bill McKay who stuns the political establishment by winning a year-long U.S. Senate campaign in California. McKay is so absorbed by the campaign, and such an underdog throughout it, that he never particularly contemplates what might happen if he actually were to win the election. After learning he has, in fact, won the contest in the final scene of the film, McKay is suddenly beset by the reality of having to deliver something more than campaign speeches. He nervously asks his campaign manager: "What do we do now?"

With next week's likely enactment of the financial reform bill[2], the much-debated Bureau of Consumer Financial Protection (the "CFPB", or the "Bureau") will have come into being – at least on paper.

That itself may seem quite an accomplishment. The CFPB is the first major federal agency created solely for consumer protection in over 75 years. To its supporters, it represents the reversal of a regulatory pendulum that had been swinging, for decades, towards a certain naive faith in the self-regulatory discipline of financial markets. For some of those supporters, the Bureau even represents the promise of a fair shake in the credit markets for the American middle class.

In reality, though, such wide-eyed optimism must be accompanied by some bare-knuckled determination to succeed in Washington, let alone on Wall Street. Like Redford's McKay, CFPB supporters should make short work of their celebration and start wondering "What do we do now?"

As memories of the financial crisis further fade and budget pressures intensify, the CFPB will be under pressure to ramp up

[1] Tim Duncan, CFA, is an attorney, the president of an investment advisory firm, and the chairman of American Business Leaders for Financial Reform. He has been an entrepreneur and senior executive in finance and in financial technology for 25 years. The Cambridge Winter Center, a non-profit non-partisan think tank focused exclusively on U.S. financial services policy, has published this third-party contribution as an adjunct to its research program entitled "Consumer and Small Business Finance 3.0: Crisis, Reform, and the Next Decade of Lending". Perspectives expressed here are the perspectives of the author, and not necessarily Cambridge Winter Incorporated or its Board of Directors.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Conf. Report 111-517, 111th Cong., 2nd Sess. (June 29, 2010) ("Wall Street Reform Act").

quickly and demonstrate its value to American consumers or to the economy more broadly. Many in Congress remain opposed to, or deeply skeptical of, the need for a new federal agency to address consumer credit. Those Congressional skeptics will be watching closely.

The CFPB is in some sense experimental. Even if its first Director is top-notch, passionate and has the rare ability to apply common sense to government, he or she will have a formidable challenge ahead. With that challenge in mind, this paper presents a brief description of the nuts and bolts of launching the CFPB and, more importantly, six guiding principles for the CFPB in its critical first year.

Nuts and Bolts of the CFPB

Technically, the CFPB will be created at the moment the President signs the financial reform legislation. But though the CFPB will exist as a matter of law, it will likely have no employees or operations for months. The Department of the Treasury has been assigned the task of launching the agency, and is responsible for all of the functions of the CFPB until such time as the Secretary of the Treasury declares the agency is ready to stand on its own - somewhere between six and 18 months down the road.[3] The Treasury has given no indication as to whether it might take any substantive action in the name of the CFPB prior to that time.

Leadership Matters

The President will appoint the Bureau's first Director for the specified five-year term, but then must secure the required Senate confirmation. Given the already-long list of Presidential appointees awaiting Senate confirmation, the imminent Congressional summer recess, and this fall's especially competitive election season, it may be year-end before the CFPB's leader is able to take office. This delay will be unhelpful at best given the enormity of the tasks ahead.

When he or she does eventually take office, though, the Bureau's Director will be in a relatively unique position in the regulatory world. Most federal regulatory agencies are run by an odd-numbered board or commission consisting of members from both major political parties.[4]

The CFPB, by contrast, will be run by a single Director who is solely empowered to "prescribe rules and issue orders . . . as

---

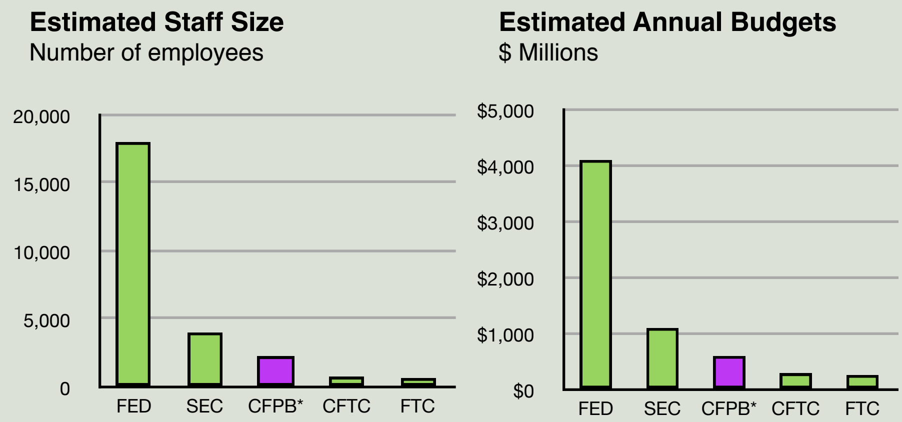
[3] The Treasury Secretary has two months after enactment to set the date upon which the Bureau begins operation. That transfer date must be between six and 12 months after enactment, but can be extended by six months if required. *See* Wall Street Reform Act at section 1066.

[4] The Environmental Protection Agency, which is run by a single "Administrator", is a major exception to this rule; the Federal Housing Finance Agency is another.

may be necessary . . . to enable [the Bureau] to administer and carry out the purposes and objectives of" the federal consumer financial laws.[5] In theory, this characteristic of the CFPB should substantially reduce the time and resources necessary for the Bureau to act, by eliminating much of the internal politics of decision-making by committee.

Figure 1

CFPB Budget and Staff versus other Agencies



Source: Wall Street Reform Act; agency websites; author's analysis

From Many, Come One

Consumer financial protection in the United States has been dysfunctional for years at least in part because the responsibility has been split among different federal agencies – all of which viewed the area as something of an afterthought. Overlapping responsibility created diffuse accountability, which in turn bred institutional complacency.[6]

The reform legislation attempts to remedy this structural defect by ordering the consumer financial functions and personnel at six federal agencies to be transferred to the CFPB on the day the agency is separated from the Treasury Department.[7]

Based on the CFPB's total budget in comparison to similar federal agencies' budgets and employment levels, the CFPB might grow up to some 2,250 employees (likely taking several years to get there). *(Figure 1)*. The legislation contemplates those employees being sourced both through new hires, and, in significant measure, through consumer protection functions at existing federal agencies.

Determining precisely which employees will transfer to the CFPB from other agencies could be rather trickier than mere Congressional mandate. The legislation's only specific instructions in this regard is that the CFPB Director and the boards of the various agencies will "jointly determine" the number of employees from each agency that will be transferred and identify which em-

---

[5] Wall Street Reform Act at section 122(b).

[6] *See generally* Testimony of Richard Carnell, Hearing on Strengthening and Streamlining Bank Supervision, U.S. Senate Committee on Banking, Housing and Urban Affairs (Sept. 29, 2009), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=90e9049f-24c9-472c-99e7-f17101776ee7&Witness_ID=da8b68ea-d183-4919-bcc3-7b2cd60c9521.

[7] The agencies include the FTC, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Federal Reserve, and Office of Thrift Supervision (OTS).

ployees will be transferred. Very different views on what the phrase "jointly determine" means are likely to arise.

Offices and Departments

The Director will have the ultimate authority to determine the Bureau's initial structure. However, the Director is likely to delegate most operational and day-to-day management decisions to the office of "Deputy Director" as provided in the legislation.[8] There are several functional units that will be required immediately for the agency to operate -- including those mandated by the legislation and those necessary to hire personnel, communicate with Congress and the media, promulgate rules, and take enforcement actions under existing laws, rules and regulations. *(Figure 2)*.

Six Commandments for the First Year of the CFPB

Building an institution that can fulfill the Bureau's expansive and important mandate will depend crucially on the Director's earliest decisions. Those decisions should be guided by six "commandments."

#1: In Six Days You Shall Make the Heaven, Earth and Sea

At least that is what everyone will expect. The only real option is to narrow the scope of the agency and to focus, in major part, on putting points on the board as soon as possible. Results will matter; unseen efforts will not.

The creation of new federal bureaucracies is not the stuff from which legends are made, but the first 431 days of the Securities and Exchange Commission (SEC) under its inaugural Chairman, Joseph P. Kennedy, probably comes closest. The SEC was created by the Securities Exchange Act on June 6th, 1934 and

Figure 2

Likely CFPB Offices

Mandated by Congress

OFFICE	DESCRIPTION
Financial Products Research	Research, analyze & report on markets for consumer financial products including markets for alternative products.
Community Affairs	Provide information, guidance and assistance regarding the offering and provision of financial products to undeserved consumers and communities.
Fair Lending	Provide oversight and enforcement of Federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit.
Financial Literacy	Developing and implementing initiatives to educate and empower consumers to make better informed financial decisions.
Service Member Affairs	Develop and implement initiatives for service members and their families.
Economics	Provide economic analysis of impact of proposed regulation and rulemaking prior to implementation as required by law.
General Counsel	Provide legal counsel to director and bureau and represent agency in court.
Congressional Relations	Manage relations between Capitol Hill and agency. Preparation of testimony, reports and responses to inquiries.
Public Affairs	Provide information to media; respond to inquiries.

Source: Wall Street Reform Act; author analysis

[8] *See* Wall Street Reform Act at section 1011.

President Franklin Roosevelt appointed Kennedy as the first Chairman before the end of the same month.

The SEC began with an annual budget of only $300,000. Nevertheless, by the end of its first year of operations Kennedy was able to claim that the agency had investigated thousands of potential fraudsters, put an end to a series of serious frauds, and had referred criminal complaints to the Department of Justice.[9] The agency issued dozens of new regulations and forced every stock exchange in the country to register and disclose previously secret information. Strikingly, the SEC shuttered five exchanges it determined were not cooperating.

Only 431 days into his five-year term, Kennedy resigned from the agency. He explained his early departure by describing himself as a builder - not an administrator. (In fact, he had his sights set on other opportunities in the Roosevelt Administration). Compared to the scope of the SEC's reach a few years later, its achievements under Kennedy were in fact fairly limited. But Kennedy's name recognition going in, his willingness to prioritize, and his ability to sense what would play well with the public enabled him to quickly create broad-based support for the agency and establish a reputation for professionalism that drew top-tier employees to the agency for decades.[10]

Similarly, the CFPB's first Director must focus early on doing a few things well that will be reported widely and will resonate with the public. Building the agency for the long term should not be ignored, of course, but longer-term goals cannot be allowed to crowd out the real need for quick, tangible progress.

#2: Thou Shalt Not Hire People Just to Fill an Organization Chart

The quality and performance of the Bureau's staff will be the most important factor in its ultimate success or failure. The first Director will have to make recruitment from existing agencies and the outside world his or her top priority and be willing to go to the mat with other agency heads to secure experienced, high-quality people. The Bureau should not be tempted into hiring employees simply for the sake of filling in boxes on an organization chart. Recruiting great people takes energy, and it takes patience -- particularly on this scale. *(Figure 3).*

Transfers from existing agencies may offer up employees with excellent experience in their fields. However, federal employees who are comfortably ensconced in their current agencies (many of whom may be looking towards retirement in a few years) may actively shun a transfer to a new and unknown agency where their status (beyond pay grade) may be undefined. Even worse, senior managers at existing agen-

---

[9] *See* SEC Enforcement Actions 1934-35, *available at* http://c0403731.cnd.cloudfiles.rackspacecloud.cm/collection/papers/1930/1935_Enforcement_Activities.pdf.

[10] For an excellent account of the SEC's early days, *see* "431 Days: Joseph P. Kennedy and the Creation of the SEC", *available at* *http://www.sechistorical.org/museum/galleries/kennedy/building_a.php*.

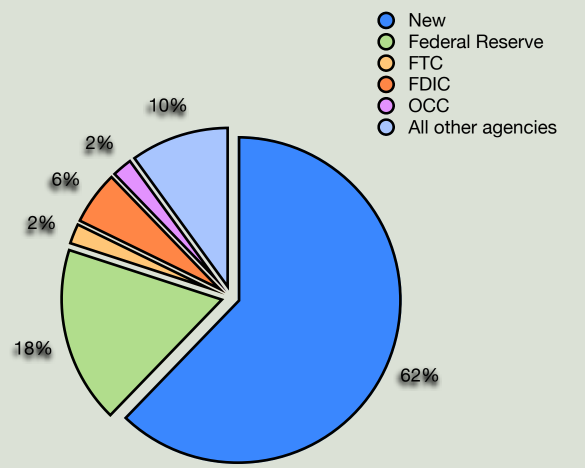
cies may see the transfer mechanism as an easy way to unload underperforming employees onto the CFPB while they quietly hide and protect their best people.

To recruit successfully, the Director will have to be passionate about the agency and its mission and ensure that potential employees share this passion. If successful, many of the employees at the agency in its first years will be dedicated, knowledgeable, and experienced in their fields. If it is not patient, the CFPB could risk being staffed largely by ambivalent cubicle-dwellers waiting out their federal retirements at a weak and directionless agency.

Figure 3

Estimated CFPB Staff, by Source

100% = 2250 employees



Source: Wall Street Reform Act; agency websites; author's analysis

#3: Thou Shalt Not Worship Consultants

During the Kennedy administration, men wore breast pocket handkerchiefs like the President, and women wore pillbox hats like Jackie. During the Carter Administration, peanuts were more popular. During the eight years of our country's first MBA President, government agencies suddenly began hiring management consulting firms and outsourcing warfare to contractors.

These newest serpents in the garden added "mission statements" and "key performance indicators" and other business school jargon to the already-freighted Beltway lexicon. At the start of each year agencies paid management consultants or young MBAs to construct strategic plans with strategic goals and strategic metrics for success. At the end of each year agencies published glossy performance reports with elaborate charts, pictures of happy citizens, and details on how they wisely spent their budgets to meet and surpass the goals they had set out for themselves a year earlier. As our financial markets and economy burned, regulators and consultants fiddled with success metrics.

A depressing example of the results can be seen in the SEC's 2005 Performance Report, wherein the SEC congratulated itself for meeting its strategic number one goal of "Detecting and Sanctioning Violators of Federal Securities Laws."[11] Of course, it was during 2005 that the SEC had received numerous tips and complaints about the Madoff ponzi scheme, but had ignored them. In fact, SEC compliance staff had actually caught Madoff lying about numerous facts during a routine examination, but decided it wasn't worth the trouble to follow up – especially since their performance

[11] SEC 2005 Performance and Accountability Report, *available at* http://www.sec.gov/about/secpar/secpar2005.pdf

metric was based on the number of examinations they completed on an annual basis. Unfortunately, Madoff turned out to be the largest securities fraudster in history.

Granted, the CFPB Director should utilize the help of consultants in specific technical areas. But the passion and spark that will drive the goals and heart of the agency must come from the Director and the employees. Catchy pseudo goals should not replace the genuine desire to make a change in people's lives. If anything has been learned from the failure of our regulatory system to prevent the financial crisis, it is that real problems aren't chased away by glossy reports and loudly declaring "Mission Accomplished".

#4: Honor Thy Fellow Agencies

The CFPB will undoubtedly benefit from good relations with other agencies, and suffer otherwise. Every agency that had anything to do with the financial crisis has acknowledged mistakes and most have made significant changes. Much can be learned and derived from existing agencies by the start-up CFPB.

In addition to the transfer of employees and various functions, the CFPB will be intertwined with other agencies in many ways for years to come. For example, even the seemingly simple mechanism for receiving its annual budget from the Federal Reserve was recently described by former Fed Vice Chairman Alan Blinder as "unworkable."[12] That may be an overstatement, but having a good relationship with the CFPB's titular parent, The Fed, will no doubt make life easier at the Bureau.

Another example: The CFPB will need to work with the FTC extensively to tap into its system for receiving consumer complaints, and its network of state and local authorities. The FTC also retains concurrent jurisdiction in some areas. Integrating these kind of interagency tasks require good relationships among top executives.

While harmonious relations and friendly agreements are the ideal, the CFPB Director should quickly establish a formal mechanism that provides final resolution to inter-agency disputes.[13] Unresolved and ongoing disputes have the potential to turn into feuds that unnecessarily gobble up time and energy. Plus, no good can come to any agency if disputes unnecessarily escalate and spill into the public domain.

#5: Worship Technology from Day One

While other agencies bear the cost and burden of having to morph from an analog to a digital world, the CFPB has an incredible opportunity to design itself to take advantage of the Internet and related technologies. Many of the CFPB's functions -- like receiving and processing consumer

---

[12] Sudeep Reddy, "Consumer Agency's Path Will Be Set by First Chief", *The Wall Street Journal* (July 6, 2010).

[13] This could be accomplished through the Alternative Dispute Resolution Working Group at the Department of Justice, or similar organizations. *See* ADR Interagency Dispute Working Group, http://www.adr.gov/wgi.html. Notably, the CFPB legislation does set out dispute resolution mechanisms for conflicts regarding bank supervision. Wall Street Reform Act at section 1025(e)(4).

complaints, registering small financial companies and analyzing thousands of credit contracts -- can be done more efficiently using the Internet and new technologies.

But to use technology effectively, the management of the agency will have to make it a priority at the outset. The Director would be well advised to quickly reach out to technology thought-leaders for inspiration and ideas on how to design a technology platform for the future. And, yes, this is one area where consultants can help.

#6: Thou Shalt Covet Research

The reform bill mandates that the Bureau include a division focused on empirical research. Managed right, this could enable a practical, fact-based approach to rule-making that otherwise can seem scarce among regulatory bodies.

Disclosure requirements are a good example of the power of an empirical approach. The pre-crisis economic theory that consumers, investors and other market participants always act rationally in view of all available information is itself irrational in light of the facts demonstrated over the past five years. Until recently, regulatory agencies have had a binary approach to regulation - either substitute their judgment for consumers by prohibiting practices and products, or require disclosure of information about a product and hope that consumers would choose wisely.

While disclosure as practiced has repeatedly proved inadequate to prevent abuses and systemic distortions in consumer financial services, the CFPB cannot, politically or practically, attempt to regulate like the Federal Drug Administration, and require approval of all products before they are marketed to the public.

Academics such as Michael Barr (now the Assistant Secretary of the Treasury for Financial Institutions) and Stendhal Mullainathan have suggested new approaches to the disclosure of the terms of financial products, which consider studies of behavior and psychology. The massive amount of data currently disclosed to consumers may indeed contain the necessary information to make wise decisions, but the context, verbiage and volume often make such documents useless -- or worse. The CFPB will have the opportunity to make disclosure requirements more useful, by conducting and applying empirical research (and, hopefully, common sense).

* * *

Bill McKay, our movie candidate, would now be the second most senior member of the United States Senate and approaching 80 years old. No doubt his optimism and enthusiasm would have been dulled by the years. But, we can hope that he would feel somewhat renewed by the passage of financial reform and optimistic about the outcome down the road. The CFPB's launch is one of those reasons to feel optimistic. But it's time to go to work.