BUTERA & ANDREWS

Memorandum

July 6, 2009

To: Interested Parties
From: Wright Andrews
Re: House Hearing on Consumer Financial Protection Agency Proposal

On June 24, 2009, the U.S. House Financial Services Committee held an initial hearing the Obama Administration's proposal to create a federal Consumer Financial Protection Agency (CFPA). Many of the witnesses provided lengthy and detailed comments, and they generally set forth most of the likely primary pro and con arguments that will be raised by various parties throughout the legislative debate on whether to establish CFPA and how it should be structured. This memo provides a detailed summary of major points made in the written statements of key witnesses at this hearing.[1] In many cases, this summary quotes sections of witnesses' testimony, albeit often omitting most examples, footnotes and less central points and utilizing some reformatting to condense their remarks. While this summary is admittedly long, it should provide the reader with a good grounding in the arguments that will be raised repeatedly as Congress addresses this issue.

Statement of Elizabeth Warren, Harvard Law School Professor and the original proponent of CFPA

"[W]e are here today because of a problem that can be explained in five blunt words: the credit market is broken. That problem not only caused the current financial crisis, but it threatens to perpetuate the crisis and also trigger similar economic tragedy in the future."

"I'm not here today to talk about everyone who has gotten into trouble on a credit card or who has a mortgage that is too big. The need for personal responsibility is as strong as ever….We are here today to talk about broken markets—and about the consequences of those broken markets for hard-working, play-by-the-rules families, for financial institutions competing on a skewed playing field, and for our entire economy….when a market is broken, the cost is enormous—not just for consumers, but for everyone. I'm happy to be here today to talk about how I think we can

[1] Statements by witnesses who addressed whether CFPA's jurisdiction should include regular life and health insurance products are not covered by this summary. All witnesses' statements are available at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/hrfc_062409.shtml . The Administration released proposed statutory language after the hearing. This memorandum does not comment on this legislative text, which will be discussed in a separate, subsequent document

help fix the broken credit market. And I can sum it up in four words: Consumer Financial Protection Agency."

"The [old banking] model was simple and effective: consumers shopped around for products and terms, and lenders evaluated the creditworthiness of potential borrowers before making loans. Today, the business model has shifted. Giant lenders 'compete' for business by talking about nominal interest rates, free gifts, and warm feelings, but the fine print hides the things that really rake in the cash. Today's business model is about making money through tricks and traps."

"Plain and simple, consumers cannot compare financial products because the financial products have become too complicated…..Part of the problem is some bad regulations that encourage fine print. But much of the problem is part of the business plan. Study after study shows that credit products are designed in ways that obscure the meaning and trick consumers…..Consumers who face financial documents that do not communicate the basic terms of a credit agreement cannot make accurate predictions about how much risk they are taking on and cannot make effective comparisons among products. A straightforward comparison among credit products is now impossible."

"Economists of all stripes agree that thriving markets depend on information. The invisible hand of the market works well only when buyers and sellers both have full information about the value of the items they exchange. Without information, market innovations do not work."

"The broken credit market also creates problems for the lenders. The lack of meaningful competition has tilted the playing field between small and large institutions. Large institutions have the capacity to spend billions of dollars on advertisements to lure customers from local and regional banks and credit unions—even when those community banks or credit unions are offering better products with fewer—or no—tricks and traps.
Similarly, our existing body of complicated regulations helps large institutions and hurts the smaller ones. While a big institution can hire an army of lawyers and regulatory compliance specialists—and spread the costs over tens of millions of customers—regulatory costs can put enormous financial pressure on a small institution. In addition, as we have learned painfully, large financial institutions can take huge risks—including shaky consumer mortgages and credit cards—knowing that taxpayers will pick up the tab if they fail….Because the comparison among products is not clear, the playing field between big banks and local banks is not level."

"[A] third problem with the broken credit markets—systemic risk—is a problem that affects everyone…The broken credit market helped create the crisis we are in now… We have all been hurt. If we do not fix this, we will be hurt again and again."

"In times of great crisis, narrow interests give way to an American public looking for Congress to get things right. This is an historic moment, and today you have a rare opportunity to bypass those narrow interests and serve the public interest."

"….I believe that the establishment of a Consumer Financial Protection Agency is the best way to get things right….

- It will reduce systemic risk.
- A single regulatory agency watching out for families and individuals can reduce the overall regulatory burden. Right now, we have layers of contradictory, expensive, and sometimes flat-out useless regulations. We need to cut through all that, to authorize one agency to encourage and help develop some plain-vanilla, safe-harbor mortgages, credit cards, car loans and the like that will automatically pass regulatory muster…..Yes, banks could offer something else, but they have to show it meets basic safety rules—things like whether a customer can read it in four minutes or less. It is time to spend less time and less money on regulations that don't work and pass those savings on to the customers.
- [It] will foster innovation. Some are arguing that the Agency will limit consumer choice. They say that consumers should choose the products they want for themselves without Big Brother stepping in. But how can consumers pick the products they want when they are unable to make real comparisons between them? What kind of choice is presented by stacks of paper with incomprehensible legalese—and a billion-dollar ad campaign to sell consumers on the highest-profit items? The Agency will fix the market by putting consumers in a position to make the best decisions for themselves. The financial institutions who have profited from hiding tricks and traps in the fine print may not like reform, but that is what happens when markets work like they should.
- [It] will provide a regulatory home for specialists who care about this issue and whose priority is to level the playing field and give American families a fair shake. We need an agency that allows regulators to make consumers their first priority—not where consumer protection plays second fiddle to bank profitability. We need specialists who won't just be on the bottom rung of an agency dedicated to other priorities."

"[In conclusion, Congress has] a rare opportunity to get things right. Now is the time for a Consumer Financial Protection Agency to repair a broken market, to give families the properly functioning credit market that they deserve, to level the playing field among financial institutions, and to prevent the next economic crisis."

Statement of William Galvin, Secretary of Massachusetts

"I commend and support the President's plan to strengthen and rationalize financial regulation, to provide greater protection against systemic risks in the financial markets, and to create a federal agency to protect consumers in credit transactions."

"We support the creation of [CFPA] to enhance the protection of consumers entering into credit, savings, and payment transactions….[E]xisting regulatory agencies dropped the ball. While some problems have slipped through the cracks of existing rules, too often regulators failed to maintain their independence from the industries they regulate, and they failed to use their powers to promulgate and enforce rules to protect the public. A key lesson is that regulators must maintain their independence, which often means standing up to powerful interests. The problems of abusive credit transactions are well documented: predatory mortgage lending, unfair and abusive credit

card and consumer loan terms, payday loans, purported loan restructuring companies, and abusive financial transactions that target the elderly and members of the armed forces."

'Bad lending standards and unsound mortgages are also at the root of many failed mortgage-backed securities, which in turn led to the collapse of major financial institutions and markets. Recent history demonstrates that we cannot count on these markets to police themselves. We need [CFPA] to ensure that the basic terms of consumer credit transactions will be transparent, understandable, and reasonable."

"I urge you to preserve and enhance the ability of the state securities regulators to protect investors."

Past preemptions of state authority should be reversed. "Investors and consumers have been particularly harmed when the states have been preempted from protecting their interests. This includes the preemption of state usury laws, predatory mortgage lending laws, and state securities laws. It is exactly the areas where state laws have been preempted from regulating that have been focus points of the current financial crisis."

"The states remain the regulators that are closest to the investing public and they have demonstrated they can respond quickly and effectively to help investors….The states have added value precisely because they are independent of other agencies and self-regulatory organizations. The states have been another set of eyes watching the markets. The states have also served as a regulatory backstop or circuit breaker, protecting investors in cases when other regulators have not taken action."

"Based on the principle of federalism, we urge the Congress not to make the state securities agencies subject to the authority of any federal body, [including CFPA]. The independence of the states means that they are less likely to yield to pressure from regulated entities, and the states agencies therefore are much less likely to be 'captured' by the firms and industries that they regulate."

"We urge that any new legislation should not curtail the states' ability to: [r]equire that firms, persons, or offerings register with the states; [p]olice and inspect firms and persons; and [b]ring enforcement actions for violations of securities laws and industry rules."

"The states will cooperate and coordinate with the Consumer Financial Protection Agency. However, it is crucial that the states not be put under the CFPA's authority. The states' independence is vital, and it is the key to our record of success."

The testimony calls for Congress to give the states additional regulatory tools with respect to securities regulation and for further securities-related reforms.

Statement of Ellen Seidman, Senior Fellow at the New America Foundation and former Director of the Office of Thrift Supervision

"The Administration's recognition of the seminal importance of consumer protection in financial services is a critical reversal of the trends of the last several decades…. [T]he time has come to create a well-funded single federal entity with the responsibility and authority to receive and act on consumer complaints about financial services and to adopt consumer protection regulations that would be applicable to all providers of financial services…."

"The Administration has also focused on the importance of the CRA. As the Administration's proposal recognizes, access to high quality financial products, at fair terms and reasonable prices, is an essential element of consumer protection. When well-regulated entities do not provide quality services that meet needs and are well-marketed, expensive and sometimes predatory substitutes will move in. Avoiding that result requires both leveling the playing field by having consistent regulations, well-enforced, across all entities providing similar products and encouraging financial institutions to serve all communities and consumers."

"I am….concerned about two elements of the Administration's proposal, as discussed below….I believe that prudential supervisors, in particular the federal and state banking regulatory agencies, should retain primary supervisory responsibility for consumer protection, as well as for safety and soundness, over the entities they regulate. I suggest…that Congress make some changes to the organic banking statutes to emphasize the importance of consumer protection, elevating it to a higher place in the supervisory system….I am [also]concerned, that what has been in many ways the most consistently successful element of the CRA, namely investment in community development finance (such as affordable rental housing, community facilities, small business lending both with and through Community Development Financial Institutions) may get lost in an agency devoted to consumer protection. This could hurt the communities in which many of those consumers most in need of protection live."

"I believe the bank regulators, given the proper guidance from Congress and the will to act, are quite capable of effectively enforcing consumer protection laws. Moreover, because of the system of prudential supervision, with its on-site examinations, they are also in a good position to do so efficiently and in a manner that benefits both consumers and the safety and soundness of the regulated institutions."

"The current crisis has many causes, including an over-reliance on finance to 'solve' many of the needs of our citizens….Consumers were harmed by both the proliferation of bad products and practices and the sale of hard-to-understand credit and investment products to customers for whom they were not suitable, and by the lack of high quality products that meet consumer needs, well priced and effectively marketed, especially in lower income communities."

'[There were] three basic regulatory problems. First, there was a lack of attention, and often unwillingness, to effectively regulate products and practices even where regulatory authority existed….This is not just an issue at the federal level….Second, … there were, and are, holes in the regulatory system, both in terms of unregulated entities and products, and in terms of insufficient statutory authority. The clearest case relates to mortgage brokers, where there was no federal regulation at all, no regulation beyond simple registration in many states, and ineffective regulation even in most of the states that actually asserted some regulatory authority. But there are other examples-payday lending is prohibited in some states, regulated

more or less effectively in others, and pretty much allowed without restriction in still others. And then of course there is the question of what kind of responsibility sellers of financial products have to customers… Finally, there is and was confusion, for both the regulated entities and consumers and those who work with them. Consumer protection comes in many forms, from substantive prohibitions like usury ceilings and payday lending prohibitions, through required terms and practices, to disclosures and marketing rules. Multiple regulators exacerbate the confusion….”

“The system clearly could be improved. But as we do so, we should not be lulled into thinking the solutions are obvious or easy…..Just try describing [, for example,] whether a payday loan or a bounced check is more expensive. Many products, especially loans and investments, involve both uncertainty and difficult math over a long period of time, which is hard for even the most educated consumer. And the differences between a good product and a bad one can be subtle, especially if the consumer doesn't know where to look…Finally, different consumers legitimately have different needs. …”

“… I suggest three guiding principles [on how to regulate]. First, to the maximum extent possible, products that perform similar functions should be regulated similarly, no matter what they are called or what kind of entity sells them. For example,… payday loans and bounced check protection have a good deal in common, and probably should be regulated in a similar manner. Second, we should stop relying on consumer disclosure as the primary method of protecting consumers. While such disclosures can be helpful, they are least helpful where they are needed the most, when products and features are complex…. The Administration's proposal recognizes the principle that disclosure may be helpful, but is unlikely to be sufficient when products are complex, and moreover would require the CFPA to test and evaluate disclosures to make them reasonable and understandable…Third, enforcement is important. Rules that are not enforced, or not enforced equally across providers, generate both false comfort and confusion, and tend to drive, through market forces, all providers to the practices of the least well regulated…
[I]t is not just that some entities were not subject to the same rules as others, but also that the rules were not enforced consistently across entities. The Administration proposes to accomplish this by transferring primary federal supervision and enforcement for consumer protection with respect to all depositories into the CFPA….[W]hile this could improve consistency, on balance I think it may not be the most effective result. The Administration's proposal appears to contemplate that the CFPA would also engage in prudential supervision, i.e., on-site examinations, of state-regulated non-depository institutions, although ‘the states should be the first line of defense’ Especially if it means that entities not now subject to prudential supervision would be, it could be very large undertaking, given the number and type of institutions involved, but it could also lead to substantial improvements for consumers of the services of non-depositories.”

“The time has come to elevate the consistent consideration of consumer protection with respect to financial instruments to the same level of concern as the financial stability of the financial system. Indeed, as the current crisis demonstrates, failure to do so leads to financial instability. As the Administration notes in its proposal, elevating consumer protection requires understanding what consumers need; how products are marketed and sold; how

consumers get information about, understand and use products; and the benefits and risks of various products to different consumers…"

"I support the creation of a new, independent Consumer Financial Protection Agency, with rulemaking, enforcement and complaint-collection responsibilities…"

"There has only been limited focus on the treatment of complaints, but centralizing the consumer complaint function at a single agency is important. While the Administration proposes centralizing complaints related to federally-regulated entities, we would do well to think more broadly. A nationwide complaint function, covering state-regulated, as well as federally-regulated entities would have sufficient scale and focus to make it possible to create a world-class system, easy to use, and effective in serving individuals, helping providers resolve problems, and finding systemic problems. It would provide consumers a single point of contact, rather than requiring them to navigate the complex world of financial services providers and regulators when they have a problem or concern about a financial service or product, and also provide some consistency in response. It addition, the agency would have the tools to recognize, research and respond to developing problems before they threaten the economy-or large numbers of consumers."

"[T]he mortgage situation has shown that a base level of regulations that all providers must adhere to is a precondition to keeping the market at the level of those engaged in best practices-or at least the practices condoned by the regulators-not the worst."

"The Administration proposes to unite responsibility for all federal consumer protection laws relating to consumer financial products other than investment products in the new entity. This will ensure regulatory consistency and thus enhance innovation. Moreover, bringing all financial consumer responsibilities together will help provide the scale and scope of regulatory authority to develop expertise and give the CFPA the gravitas and power to attract high quality talent and be taken seriously. Establishing the CFPA while not shifting regulatory responsibility for existing statutes to it might well reduce the interest of current regulators in the field, thus potentially reducing, rather than enhancing, overall consumer protection."

"The CFPA would be not just be about protection in the 'thou should not' sense of the word; indeed, there is emphasis in the Administration's proposal on the affirmative, on consumers having access to the financial products they need to live their lives fully and that those products are transparent, simple and fair….Access is a concept that extends beyond fair lending and the CRA. It covers issues like understanding how consumers actually use financial products and what kinds of protections and notice consumers value and use….The Administration envisions the CFPA having strong research capacity, using data both it and the industry collects to enable it to become expert in consumer understanding and behavior. This can help it regulate effectively without necessarily having a heavy hand."

".... CFPA would not be required to pre-approve products, although 'no action' letters would be available to producers and developers of new products who wanted to be sure their product disclosures met the CFPA's 'reasonableness' standard. I agree that requiring product pre-

approval would be a mistake. Financial products are almost infinitely variable, and small variations can make a big difference in safety and effectiveness. Moreover, financial activities consist of practices and processes, as well as products-and sometimes the delivery channel matters more than the product. In addition, technology is generating new opportunities, which can work to consumers' benefit as well as their detriment, at a very fast pace. In this atmosphere, requiring pre-approval would be a drain on resources and a bar to useful innovation. In addition to the ‘no action’concept, an alternative to pre-approval that might be useful, especially as to products, would be to require providers to file product descriptions with the new agency, at least with respect to a specified group of products and terms. This could enhance the agency's ability to stay up-to-date on innovations in the market and potentially to respond to troublesome products or terms before they become widespread.”

“The CFPA should have the authority to enforce its regulations-and the responsibility to do so. That responsibility should, however, be secondary to the supervisory responsibility of the regulators of financial services providers, and should be shared with state entities with authority to enforce consumer protection laws and regulations….[T]he prudential supervisors can be highly effective in enforcing consumer protection laws, and moreover, responsibility for enforcing consumer protection laws can generate safety and soundness benefits. Regulators who engage in prudential supervision (federal and state), with on-site examinations, should be expected to exercise that authority. Retaining primary supervisory and enforcement authority with the prudential supervisors makes use of existing structures and resources, keeps consumer protection and service to all communities integrated into the prudential regulatory framework, and reduces the possibility of duplicative examinations. At the same time, keeping backup enforcement authority in the CFPA would provide the means for any reluctance of prudential supervisors to engage in effective enforcement to be effectively backstopped.”

“….The likelihood that consumer protection would in fact be integrated into prudential supervision could be enhanced by amending the organic statutes that establish banking and other financial services regulators to (i) make consumer protection an explicit responsibility of regulators on a par with safety and soundness, and make clear that responsibility extends to non-bank subsidiaries and affiliates of banks; (ii) require that at least one member of the governing body of agencies that have governing boards have knowledge and experience concerning consumer finance; (iii) require that each agency have a separate division devoted to consumer protection, with examination staff trained in the field; (iv) set examination cycles for compliance examinations that are similar to the cycles for safety and soundness examinations; and (v) require regular reports to Congress on the topic.”

“A critically important concern in creating any new agency, especially a regulatory agency whose primary constituency is a diffuse public of consumers of financial services, is how to fund it. The two major options, which can be used in tandem….are appropriations and some sort of special tax or user fee. Appropriations have the advantage of being subject to the normal budget process, in which national priorities are reflected in funding levels. However, as the rather depressing history of funding…has demonstrated, consumer safety agencies do not always come out of this process with sufficient funds to meet their responsibilities. User fees also have their problems. Although all agencies that deal repeatedly and primarily with a

relatively small group of private firms are subject to regulatory 'capture, in which the interests of the regulated diminish the zeal for regulation, the situation is particularly difficult when the agency is funded by those it regulates. For the CFPA, a possible solution would be to use appropriated funds to get the agency-including the consumer complaint function-up and running and to fund the research and analytical and other functions that are not purely regulatory. However, long-term reliance on funding the regulatory function through the general budget (even if ultimately funds are appropriated) would fly in the face of the experience with other regulatory agencies. And although regulatory capture is a potential problem with user fees, since all providers of consumer financial services will be subject to the agency's jurisdiction, the issue of charter choice is not present….One possibility would be require entities in major groups (depository institutions) and (non-depository credit institutions) of the Standard Industrial Classification to pay a fee, preferably based on transaction volume, not assets, to support the agency. While this would not cover entities that were not 'primarily engaged' in providing these services (e.g., a retailer that extends credit), it is likely to reach all major providers, and others could be added as gaps become apparent."

"A final question that needs to be faced is the relationship between the regulations promulgated by the CFPA and those of other regulators. This is primarily an issue relating to state laws and regulations, and raises the issue whether we are content with a low ceiling (i.e., federal preemption with relatively low standards) or whether we have learned from the recent crisis that a high floor (high federal standards, but with states allowed to supplement) is more effective for both consumers and the economy. Financial institutions are understandably concerned about having to follow multiple sets of rules, especially if they are in conflict. But the Administration's proposal may actually enhance the likelihood of consistency. If the federal government-either by statute or regulation-sets a relatively high bar with respect to consumer product regulation, states have little interest in adding regulation. On the other hand, there may be local conditions or circumstances in which problems are more apparent or apparent earlier and more appropriate for response at the state level than at the federal, and I believe that door should remain open. States should not, however, be able to adopt laws or regulations in conflict with federal rules."

"I would like to say a special word about the inclusion of the Community Reinvestment Act in the President's proposal. The proposal states …. 'The [CFPA] should enforce fair lending laws and the Community Reinvestment Act . . . [and] . . . have sole authority to evaluate institutions under the CRA.' [I]t is time for explicit recognition that government regulation and oversight are what enable private financial services companies to operate profitably at high levels of leverage. In return, those companies must be held to an affirmative mandate to fairly and equitably serve all communities, sectors and constituencies. . . .The case for doing so revolves around four observations: mainstream financial institutions have a long history of neglecting lower income and minority communities; [s]uch neglect degrades the impact of significant government expenditures at the federal, state and local levels; [t]he dislocation of financial institutions from local communities limits the capacity of these communities to marshal civic resources; [and] [r]egulated industries and their regulators are inherently conservative (notwithstanding recent excesses) and overestimate the risks involved in serving these communities."

“Nevertheless, I am not convinced that the CFPA is the best place to locate CRA, especially if the CRA obligation is not extended beyond banks and thrifts….First, CRA explicitly and appropriately states that the affirmative obligation to serve is to be exercised ‘consistent with safe and sound operation.’ This will be harder to accomplish if CRA evaluation is separated from the entity responsible for evaluating safe and sound operation. Second, possibly the most consistently effective part of CRA over the past thirty years has been its support for community economic development-affordable multifamily housing; community facilities such as clinics, schools and community centers; shopping centers and other economic anchors; pre-bankable small business lending; support of Community Development Financial Institutions. These are not consumer protection functions, although there certainly is a correlation between communities in need of economic development and consumers most in need of consumer protection. But they are different concepts, using different tools, for different purposes. Finally, the current enforcement mechanism for CRA-consideration of CRA evaluation at the time of a merger, acquisition or certain other actions-must, as the Administration's proposal recognizes, remain with the prudential supervisor. This mechanism is outdated in a world in which 4% of banking institutions (those with assets of more than $10 billion) already hold 77% of the system's assets.[23] Moreover, it is counterproductive in that the permission to merge that a high CRA rating facilitates also has a tendency to dilute service to the very communities previously well served. Nevertheless, unless and until that mechanism is changed, separating the rating from the enforcement seems unwise.”

“If the decision is made to move CRA to the CFPA, I suggest three safeguards to mitigate some of the problems cited above. First, there should be a statutory requirement for a separate division of the CFPA devoted explicitly to all parts of CRA, including in particular community economic development and the affirmative obligation to serve all communities….Second, the prudential supervisors should be given an opportunity to participate in CRA examinations and also to review and comment on CRA evaluations before they are issued. Finally, the CFPA should be required to report to the Administration and Congress within a year with recommendations for updating, expanding and improving CRA.”

“[In conclusion,] while the current crisis has many causes, the triggering event was almost certainly the collapse of the sub-prime mortgage market. That is an event that need never have happened if both our regulatory system and regulators had been more completely and effectively focused on protecting consumers. For many years, many of us have been pointing out that bad consumer practices are also bad economic practices. Not only because of the damage they do to consumers, but also because when the music stops, we all get hurt. The current state of affairs provides a golden opportunity to make significant improvements in the regulatory system and the Administration has made a bold start. If we do not act now, when will we?”

Statement of Travis Plunket & Ed Mierzwinski

on behalf of 13 leading consumer advocacy organizations[2]
(55 pages & appendices)

A major cause of worldwide economic crisis has been failure of federal regulators to stop abusive lending, especially unsustainable mortgages.

CFPA would target underlying causes of the regulatory failure.

Federal agencies did not make protecting consumers top priority and sometimes competed against each other to keep standards low; agencies also had cumbersome and time-consuming process and often didn't stop abuses until too late; regulators were not independent of influence of institutions they regulated.

Problems with sustainability of credit products keep getting worse.

"One in two consumers who get payday loans default within the first year, and consumers who receive these loans are twice as likely to enter bankruptcy within two years as those who seek and are denied them."

Federal banking agencies did not use the regulatory authority granted them to stop unfair and deceptive mortgage practices before foreclosure crisis got out of control.

"Less well known are federal regulatory failures that have contributed top the extension of unsustainable consumer loans, such as credit card, overdraft and payday loans, which are now imposing a crushing financial burden on many families….failures to rein in abusive types of consumer loans were in areas where federal regulators had existing authority to act, and either chose not to do so or acted too late to stem serious problems in the credit markets."

Combining safety and soundness supervision which focuses on bank profitability in same regulator for consumer protection "magnified an ideological predisposition or anti-regulatory bias by federal officials that led to unwillingness to rein in abusive lending practices before it triggered the…. crisis."

The structural flaws in the regulatory agencies (e.g., narrow safety and soundness focus, conflict due to reliance on assessments on regulated institutions to pay regulatory costs; balkanization of authority between agencies; lack of transparency and accountability) caused them to compete against each other to weaken standards, etc.

CFPA would elevate importance of consumer protection, prompt action to prevent abuse, end regulatory arbitrage and guarantee regulatory independence.

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[2] ACORN, Americans for Fairness in Lending, Center for Digital Democracy, Consumer Action, Consumer Federation of America, Consumers Union, Demos, National Association of Consumer Advocates, National Consumer Law Center (on behalf of its low-income clients), National Fair Housing Alliance, National People's Action Public Citizen, U.S. PIRG.

Regulatory authority currently is too spread out; agencies often treat consumer protection as less important or in conflict with safety and soundness mission.

"Occasionally, safety and soundness concerns have led regulators to propose consumer protections, as in the eventually successful efforts by federal banking agencies to prohibit 'rent-a-charter' payday lending, in which payday loan companies partnered with national or out-of-state banks in an effort to skirt restrictive state laws. However, from a consumer protection point-of-view, this multi-year process took far too long. Moreover, the outcome could have been different if the agencies had concluded that payday lending would be profitable for banks and thus contribute to their soundness." (Footnote 21, p. 5)

If regulators had acted to prevent abusive terms/practices, they would have greatly improved institutions' financial stability.

However, the statement notes that consumer protection and safety and soundness are different functions and sometimes do conflict.

The banking supervisory process lacks transparency and has resulted in different standards for products offered by different types of financial institutions.

Predatory lending practices and the resulting economic crisis have had especially harsh impacts on minorities.

CFPA would ensure all credit products are safe and not discriminatory and would enforce standards in a uniform and transparent manner; it also would ensure products are offered in fair and sustainable manner and the suitability of products for various types of borrowers.

"….[T]he agency would be compelled to act in the best interest of consumers even if measures to restrict certain types of loans would have a negative short-term financial impact on financial institutions"

Current regulatory structure is institution-centered, rather than consumer-centered and structured on type of company instead of type of product offered to consumers.

Agencies have been slow to regulate, often disagreeing on what actions to take.

"Charter-shopping" for the weakest regulator can be overcome by CFPA and it would regulate on type of product, not on type of institution, thus providing minimum national standards, but states could add further regulations.

States would be less likely to regulate more if CFPA sets high standards to begin with, thus ensuring greater uniformity.

States could still serve as an early warning system and testing ground for new solutions.

CFPA would provide an independent regulatory process, avoiding charter chopping and being structured so it would not be totally dependant on assessments from the regulated institutions.

Various examples are cited of alleged errors/failures by the federal bank regulators (e.g., FRB's failure for years to use HOEPA authority to regulate mortgage lending; credit cards; bank overdraft programs).

"While the FRB issued a staff commentary clarifying that TILA applied to payday loans, the Board refused to apply the same rules to banks that make nearly identical loans. As a result, American consumers spend at least $17.5 billion per year on cash advances from their banks without signing up for the credit and without getting cost-of-credit disclosures or a contract that the bank would in fact pay overdrafts ….consumers unknowingly borrow billions of dollars at astronomical interest rates. A $100 overdraft loan with a $35 fee that is repaid in two weeks costs 910 percent APR. The use of debit cards for small purchases often results in consumers paying more in overdraft fees than the amount of credit extended. The FDIC found last year that the average debit card point of purchase overdraft is just $20, while the sample of state banks surveyed by the FDIC charged a $27 fee. If that $20 overdraft loan were repaid in two weeks, the FDIC noted that the APR came to 3,520 percent."

"The OTS is allowing bank payday loans (which preempt state laws) on prepaid cards."

"The Fed's failure to protect this shadow banking system is also disturbing as prepaid cards are becoming a popular product offered by many predatory lenders, like payday lenders."

"One positive effort by the banking agencies in the past decade was the successful effort to end rent-a-bank partnerships that allowed payday lenders to partner with depositories to use their preemptive powers to preempt state payday loan laws. (footnote comment -
"Payday lending is so egregious that even the Office of the Comptroller of the Currency refused to set storefront lenders hide behind their partner banks' charters to export usury.") But more recently, one prepaid card issuer, Meta Bank, has developed a predatory, payday loan feature---iAdvance---on its prepaid cards that receive direct deposit on wages and government benefits. At a recent conference, an iAdvance official boasted that Meta Bank's regulator---the OTS---has been very 'flexible' with them and 'understands' this product."

"The Federal Reserve has supported the position of payday lenders and telemarketing fraud artists by permitting remotely created checks (demand drafts) to subvert consumer rights under the Electronic Funds Transfer Act."

"Remotely created checks are also used by high cost lenders to remove funds from checking accounts even when consumers exercise their right to revoke authorization to collect payment through electronic funds transfer. CFA first issued a report on Internet payday lending in 2004 and documented that some high-cost lenders converted debts to demand drafts when consumers exercised their EFTA right to revoke authorization to electronically withdraw money from their bank accounts. CFA brought this to the attention of the Federal Reserve in 2005, 2006 and 2007. No action has been taken to safeguard consumers' bank accounts from unauthorized unsigned checks used by telemarketers or conversion of a loan payment from an

electronic funds transfer to a demand draft to thwart EFTA protections or exploit a loophole in EFTA coverage."

"The structure of online payday loans facilitates the use of demand drafts. Every application for a payday loan requires consumers to provide their bank account routing number and other information necessary to create a demand draft as well as boiler plate contract language to authorize the device. The account information is initially used by online lenders to deliver the proceeds of the loan into the borrower's bank account using the ACH system. Once the lender has the checking account information, however, it can use it to collect loan payments via remotely created checks per boilerplate contract language even after the consumer revoked authorization for the lender to electronically withdraw payments."

"The use of remotely created checks is common in online payday loan contracts. ZipCash LLC 'Promise to Pay' section of a contract included the disclosure that the borrower may revoke authorization to electronically access the bank account as provided by the Electronic Fund Transfer Act. However, revoking that authorization will not stop the lender from unilaterally withdrawing funds from the borrower's bank account. The contract authorizes creation of a demand draft which cannot be terminated. 'While you may revoke the authorization to effect ACH debit entries at any time up to 3 business days prior to the due date, you may not revoke the authorization to prepare and submit checks on you behalf until such time as the loan is paid in full.'"

"The Federal Reserve has taken no action to safeguard bank accounts from Internet payday lenders."

"In 2006, consumer groups met with Federal Reserve staff to urge them to take regulatory action to protect consumers whose accounts were being electronically accessed by Internet payday lenders. We joined with other groups in a follow up letter in 2007, urging the Federal Reserve to make the following changes to Regulation E:

- Clarify that remotely created checks are covered by the Electronic Funds Transfer Act.
- Ensure that the debiting of consumers' accounts by internet payday lenders is subject to all the restrictions applicable to preauthorized electronic funds transfers.
- Prohibit multiple attempts to "present" an electronic debit
- Prohibit the practice of charging consumers a fee to revoke authorization for preauthorized electronic funds transfers.
- Amend the Official Staff Interpretations to clarify that consumers need not be required to inform the payee in order to stop payment on preauthorized electronic transfers."

"While FRB staff was willing to discuss these issues, the FRB took no action to safeguard consumers when Internet payday lenders and other questionable creditors evade consumer protections or exploit gaps in the Electronic Fund Transfer Act to mount electronic assaults on consumers' bank accounts."

"As a result of inaction by the Federal Reserve, payday loans secured by repeat debit transactions undermine the protections of the Electronic Fund Transfer Act, which prohibits basing the extension of credit with periodic payments on a requirement to repay the loan electronically. Payday loans secured by debit access to the borrower's bank account which cannot be cancelled also functions as the modern banking equivalent of a wage assignment – a practice which is prohibited when done directly. The payday lender has first claim on the direct deposit of the borrower's next paycheck or exempt federal funds, such as Social Security, SSI, or Veterans Benefit payments. Consumers need control of their accounts to decide which bills get paid first and to manage scarce family resources. Instead of using its authority to safeguard electronic access to consumers' bank accounts, the Federal Reserve has stood idly by as the online payday loan industry has expanded."

The CFPA to be effective must be structured so that it is strong and independent "with full authority to protect consumers."
The CFPA should have "a full set of enforcement and analytical tools."

- The first tool would be the ability to gather information about the marketplace so it could understand the impact of emerging practices.
- A second would be the ability to "rein in deceptive marketing practices or to require improved disclosures of terms."
- A third would be "the identification and regulatory facilitation of 'plain vanilla' low risk products that should be widely offered."
- A fourth would be the ability "to restrict or ban specific product features or terms that are harmful or not suitable in some circumstances or that don't meet ordinary consumer expectations."
- Finally, would be "the ability to prohibit dangerous financial products."

The consumer groups support the Administration's proposal that the CFPA "govern the sale and marketing of credit, deposit and payment products and services and related products and services, and….ensure that they are being offered in a fair, sustainable and transparent manner" because "credit products can have different names and be offered by different types of entities, yet still compete for the same customers in the same marketplace. Putting the oversight of competing products under one set of minimum federal rules regardless of who is offering that product will protect consumers, as well as promote innovation, [and will] promote innovation, and [provide] consumers with valuable options and [spur] vigorous competition."

The consumer groups recommend that "CFPA have jurisdiction over investment products, like mutual funds, and insurance products like credit insurance that are sold in connection with credit transactions. The United States has never sufficiently addressed the problems and challenges of lending discrimination and redlining practices, the vestiges of which include the present day unequal, two-tiered financial system that forces minority and low-income borrowers to pay more for financial services, get less value for their money, and exposes them to greater risk. It is therefore, imperative that the Consumer Financial Protection Agency also focus in a concentrated way on fair lending issues. To that end, the Agency must have a comprehensive Office of Civil Rights which would ensure that no federal agency perpetuated unfair practices and that no member of the financial industry practices business in a way that

perpetuates discrimination…..A more detailed description of the civil rights functions that must be undertaken at the CFPA and at other regulatory and enforcement agencies can be found in the Civil Rights Policy Paper available at www.ourfinancialsecurity.org."

CFPA should "have broad rule-making authority to effectuate its purposes, including the flexibility to set standards that are adequate to address rapid evolution and changes in the marketplace. Such authority is not a threat to innovation, but rather levels the playing field and protects honest competition, as well as consumers and the economy."

"The Administration's plan also provides rule-making authority for the existing consumer protection laws related to the provision of credit would be transferred to this agency …..Current rule-writing authority for nearly 20 existing laws is spread out among at least seven agencies. Some authority is exclusive, some joint, and some is concurrent. However, this hodge-podge of statutory authority has led to fractured and often ineffectual enforcement of these laws. It has also led to a situation where federal rule-writing agencies may be looking at just part of a credit transaction when writing a rule, without considering how the various rules for different parts of the transaction affect the marketplace and the whole transaction. The CFPA with expertise, jurisdiction and oversight that cuts across all segments of the financial products marketplace, will be better able to see inconsistencies, unnecessary redundancies, and ineffective regulations. As a market-wide regulator, it would also ensure that critical rules and regulations are not evaded or weakened as agencies compete for advantage for the entities they regulate."

"Additionally the agency would have exclusive 'organic' federal rule-writing authority within its general jurisdiction to deem products, features, or practices unfair, deceptive, abusive or unsustainable, and otherwise to fulfill its mission and mandate. The rules may range from placing prohibitions, restrictions or conditions on practices, products or features to creating standards, and requiring special monitoring, reporting and impact review of certain products, features or practices."

"A critical element of a new consumer protection framework is ensuring that consumer protection laws are consistently and effectively enforced. As mentioned above, the current crisis occurred not only because of gaps and weakness in the law, but primarily because the consumer protection laws that we do have were not always enforced. For regulatory reform to be successful, it must encourage compliance by ensuring that wrongdoers are held accountable."

"A new CFPA will achieve accountability by relying on a three-legged stool: enforcement by the agency, by states, and by consumers themselves.

- First, the CFPA itself will have the [enforcement] tools, the mission and the focus necessary to enforce its mandate…..But unlike the banking agencies, whose mission of looking out for safety and soundness led to an exclusive reliance on supervision, the CFPA will have no conflict of interest that prevents it from using its enforcement authority when appropriate.
- States must be allowed "to enforce federal consumer protection laws and CFPA's rules ….. [S]tates are often closer to emerging threats to consumers and the

marketplace… They routinely receive consumer complaints and monitor local practices which will permit state financial regulators to see violations first, spot local trends, and augment the CFPA's resources.

- Finally, consumers themselves are an essential, in some ways the most essential, element of an enforcement regime. Recourse for individual consumers must, of course, be a key goal of a new consumer protection system."

"Consumers must have the ability to hold those who harm them accountable for numerous reasons:

- No matter how vigorous and how fully funded a new CFPA is, it will not be able to directly redress the vast majority of violations against individuals. The CFPA will likely have thousands of institutions within its jurisdiction. It cannot possibly examine, supervise or enforce compliance by all of them.
- Individuals have much more complete information about the affect of products and practices, and are in the best position to identify violations of laws, take action, and redress the harm they suffer. An agency on the outside looking in often will not have sufficient details to detect abusive behavior or to bring an enforcement action.
- Individuals are an early warning system that can alert states and the CFPA of problems when they first arise, before they become a national problem requiring the attention of a federal agency. The CFPA can monitor individual actions and determine when it is necessary to step in.
- Bolstering public enforcement with private enforcement conserves public resources. A federal agency cannot and should not go after every individual violation.
- Consumer enforcement is a safety net that ensures compliance and accountability after this crisis has passed, when good times return, and when it becomes more tempting for regulators to think that all is well and to take a lighter approach.
- The Administration's plan rightly identifies mandatory arbitration clauses as a barrier to fair adjudication and effective redress. We strongly agree -- but it is also critically important….that consumers have the right to enforce a rule."

"Private enforcement is the norm and has worked well as a complement to public enforcement in the vast majority of the consumer protection statutes that will be consolidated under the CFPA, including TILA, HOEPA, FDCPA, FCRA, EFTA and others."

"Conversely, the statutes that lack private enforcement mechanisms are notable for the lack of compliance. The most obvious example is the prohibition against unfair and deceptive practices in Section 5 of the FTC Act."

"The CFPA will have the ability to craft its rules and enforcement regime to protect those who comply. The agency can define 'plain vanilla,' safe products that are presumptively in compliance. The agency will also be able to craft exemptions from its regulations. But products outside parameters determined to be safe may be subject to principles that carry the risk of significantly higher penalties for violations. Where the agency promulgates a rule addressing features or practices in certain products, private enforcement will be one tool to see that the rule is followed, benefiting both the individuals who use the product and the honest competitors who follow the rules."

"This three-legged stool of federal, state, and individual enforcement is critical to making the consumer protection regime work in practice. It ensures that there are no gaps in protections and that lagging attention in one location does not bring down the system. This tripartite approach ensures a friendly competition, a race to the top, not a dangerous scheme of eggs all in one basket."

CFPA "would have significant enforcement and data collection authority to revaluate and to remove, restrict or prevent unfair, deceptive, abusive, discriminatory or unsustainable products, features or practices. The agency could also evaluate and promote practices, products and features that facilitate responsible and affordable credit, payment devices, asset-building and savings. Finally, the agency could assess the risks of both specific products and practices and overall market developments for the purpose of identifying, reducing and preventing excessive risk, (e.g. monitoring longitudinal performance of mortgages with certain features for excessive failure rates; and monitoring the market share of products and practices that present greater risks, such as weakening underwriting.)"

The consumer groups "recommend that the agency take the following approach to product evaluation, approval and monitoring:

- "Providers of covered products and services could be required to file adequate data and information to allow the agency to make a determination regarding the fairness, sustainability and transparency of products, features and practices. This could include data on product testing, risk modeling, credit performance over time, customer knowledge and behavior, target demographic populations, etc. Providers of products and services that are determined in advance to represent low risk would have to provide de minimus or no information to the agency.
- 'Plain vanilla' products, features or practices that are determined to be fair, transparent and sustainable would be determined to be presumptively in compliance and face less regulatory scrutiny and fewer restrictions.
- Products, features or practices that are determined to be potentially unfair, unsustainable, discriminatory, deceptive or too complex for its target population might be required to meet increased regulatory requirements and face increased enforcement and remedies.
- In limited cases, products, features or practices that are deemed to be particularly risky could face increased filing and data disclosure requirements, limited roll-out mandates, post-market evaluation requirements and, possibly, a stipulation of pre-approval before they are allowed to enter or be used in the marketplace….
- The long-term performance of various types of products and features would be evaluated, and results made transparent and available broadly to the public, as well as to providers, Congress, and the media to facilitate informed choice.
- The Agency should hold periodic public hearings to examine products, practices and market developments to facilitate the above duties, including the adequacy of existing regulation and legislation, and the identification of both promising and risky market developments. These hearings would be especially important in examination of new market developments, such as, for example, where credit applications will soon be

CFPA should have a stable funding base for robust enforcement and "that is not subject to political manipulation by regulated entities." The groups suggest funding from a variety or mixture of sources including appropriations, user fees or industry assessments, filing fees, and transaction-based fees.

"[T]he agency should receive, analyze and work to resolve all federally-directed complaints regarding credit or payment products, features or practices under the agency's jurisdiction. Ideally, the agency should be the sole repository of consumer complaints on products, features or practices within its jurisdiction, and should ensure that this is a role that is readily visible to consumers, simple to access and responsive. The agency should also be required to conduct real-time analysis of consumer complaints regarding patterns and practices in the credit and payment systems industries and to apply these analyses when writing rules and enforcing rules and laws."

"[T] the agency should establish minimum standards within its jurisdictions. CFPA rules would preempt weaker state laws, but states that choose to exceed the standards established by the CFPA could do so. The agency's rules would preempt statutory state law only when it is impossible to comply with both state and federal law.

"[F]ederally chartered institutions [should] be subject to nondiscriminatory state consumer protection and civil rights laws to the same extent as other financial institutions. A clear lesson of the financial crisis….is that protections should apply consistently across the board, based on the product or service that is being offered, not who is offering it. Restoring the viability of our background state consumer protection laws is also essential to the flexibility and accountability of the system in the long run. The specific rules issued by the CFPA and the specific statutes enacted by Congress will never be able to anticipate every innovative abuse designed to avoid those rules and statutes. The fundamental state consumer protection laws, both statutory and common law, against unfair and deceptive practices, fraud, good faith and fair dealing, and other basic, longstanding legal rules are the ones that spring up to protect consumers when a new abuse surfaces that falls within the cracks of more specific laws."

"[T]he CFPA should have the authority to grant intervener funding to consumer organizations to fund expert participation in its stakeholder activities. The model has been used successfully to fund consumer group participation in state utility ratemaking. Second, a government-chartered consumer organization should be created by Congress to represent consumers' financial services interests before regulatory, legislative, and judicial bodies, including before the CFPA. This organization could be financed through voluntary user fees such as a consumer check-off included in the monthly statements financial firms send to their customers. It would be charged with giving consumers, depositors, small investors and taxpayers their own financial reform organization to counter the power of the financial sector,

and to participate fully in rulemakings, adjudications, and lobbying and other activities now dominated by the financial lobby."

"Proactive, affirmative consumer protection is essential to modernizing financial system oversight and to reducing risk. The current crisis illustrates the high costs of a failure to provide effective consumer protection. The complex financial instruments that sparked the financial crisis were based on home loans that were poorly underwritten; unsuitable to the borrower; arranged by persons not bound to act in the best interest of the borrower; or contained terms so complex that many individual homeowners had little opportunity to fully understand the nature or magnitude of the risks of these loans. The crisis was magnified by highly leveraged, largely unregulated financial instruments and inadequate risk management."

"Opponents of reform of the financial system have made several arguments against the establishment of a strong independent Consumer Financial Protection Agency. Indeed, the new CFPA appears to be among their main targets for criticism, compared with other elements of the reform plan. They have basically made six arguments. They have argued that regulators already have the powers it would be given, that it would be a redundant layer of bureaucracy, that consumer protection cannot be separated from supervision, that it will stifle innovation, that it would be unfair to small institutions and that its anti-preemption provision would lead to balkanization. Each of these arguments is wrong."

"Opponents argue that regulators already have the powers that the CFPA would be given. This argument is effectively a defense of the status quo, which has led to disastrous results. Current regulators already have between them some of the powers that the new agency would be given, but they haven't used them. Conflicts of interest and missions and a lack of will have worked against consumer enforcement."

"[For example, F]ederal bank regulators currently face at least two conflicts. First, their primary mission is prudential supervision, with enforcement of consumer laws taking a back seat. Second, charter shopping in combination with agency funding by regulated entities encourages a regulatory race to the bottom as banks choose the regulator of least resistance."

"The new CFPA would *not* be a redundant layer of bureaucracy. To the contrary, the new agency would consolidate and streamline federal consumer protection for credit, savings and payment products that is now required in almost 20 different statutes and divided between seven different agencies."

"The current regulatory consolidation of both of these functions has led to the subjugation of consumer protection in most cases, to the great harm of Americans and the economy. Nevertheless, trade associations for many of the financial institutions that have inflicted this harm claim that a new approach that puts consumer protection at the center of financial regulatory efforts will not work."

"[T]he new agency should have full rulemaking authority over all consumer statutes. The checks and balances proposed by the Administration, including the consultative requirement and the placement of a prudential regulator on its board and its requirement to share

confidential examination reports with the prudential regulators will address these concerns. In addition, the Administration's plan provides the CFPA with full compliance authority to examine and evaluate the impact of any proposed consumer protection measure on the bottom line of affected financial institutions. While collaboration between regulators will be very important, it should not be used as an excuse by either the CFPA or other regulators to unnecessarily delay needed action. The GAO, for example, has identified time delays in interagency processes as a contributor to the mortgage crisis. This is why it is important that the CFPA retain final rulemaking authority, as proposed under the Administration's plan. Such authority, along with the above mentioned mandates, will ensure that both the CFPA and the federal prudential regulator collaborate on a timely basis."

"For most of the last twenty years, bank regulators have shown little understanding of consumer protection and have not used powers they have long held. OCC's traditional focus and experience has been on safety and soundness, rather than consumer protection. Its record on consumer protection enforcement is one of little experience and little evidence of expertise. In contrast, as already noted, the states have long experience in enforcement of non-preempted state consumer protection laws."

"Opponents argue that a single agency focused on consumer protection will 'stifle innovation' in the financial services marketplace. To the contrary, protecting consumers from traps and tricks when they purchase credit, savings or payment products should encourage confidence in the financial services marketplace and spur innovation."

"Opponents argue that the CFPA would place an unfair regulatory burden on small banks and thrifts. [But, s]mall banks and thrifts that offer responsible credit and payment products should face a lower regulatory burden under regulation by a CFPA….[T]he CFPA would promote fewer restrictions and less oversight for 'plain vanilla' products that are simple, straight-forward and fair. However, it is also important to note that some smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA. [For example, s]maller banks have also been leaders in facilitating high-cost refund anticipation loans, in helping payday lenders to evade state loan restrictions and in offering deceptive and extraordinarily expensive 'fee harvester' credit cards."

"Opponents argue that the agency's authority to establish only a federal floor of consumer protection would lead to regulatory inefficiency and balkanization….In fact, this approach is likely to lead to a high degree of regulatory uniformity (if the CFPA sets high minimum standards,) greater protections for consumers without a significant impact on cost or availability, increased public confidence in the credit markets and financial institutions, and less economic volatility."

"[T]he long campaign of preemption by the OTS and OCC, culminating in the 2004 OCC rules, contributed greatly to the current predatory lending crisis." Under the proposal, critical authority will be returned to those attorneys general, who have demonstrated both the capacity and the will to enforce consumer laws. In addition to losing the states' experience in enforcing

such matters, depriving the states of the right to enforce their non-preempted consumer protection laws raises serious concerns of capacity."

"…Federal law should always be a Floor. Consumers need state laws to prevent and solve consumer problems. State legislators generally have smaller districts than members of Congress do. State legislators are closer to the needs of their constituents than members of Congress. States often act sooner than Congress on new consumer problems. Unlike Congress, a state legislature may act before a harmful practice becomes entrenched nationwide…..U.S. consumers should not have to wait for a persistent, nationwide abuse by banks before a remedy or a preventative law can be passed and enforced by a state to protect them. States can and do act more quickly than Congress, and states can and do respond to emerging practices that can harm consumers while those practices are still regional, before they spread nationwide….States and even local jurisdictions have long been the laboratories for innovative public policy, particularly in the realm of environmental and consumer protection…. [Even] in the area of financial services, where state preemption has arguably been the harshest and most sweeping, examples of innovative state activity are still numerous."

"A key principle of federalism is the role of the states as laboratories for the development of law. State and federal consumer protection laws can develop in tandem. After one or a few states legislate in an area, the record and the solutions developed in those states provide important information for Congress to use in deciding whether to adopt a national law, how to craft such a law, and whether or not any new national law should displace state law."

"It is certainly not the case that states always provide effective consumer protection. The states have also been the scene of some notable regulatory breakdowns in recent years, such as the failure of some states to properly regulate mortgage brokers and non-bank lenders operating in the sub-prime lending market, and the inability or unwillingness of many states to rein in lenders that offer extraordinarily high-cost, short term loans and trap consumers in an unsustainable cycle of debt, such as payday lenders and auto title loan companies. Conversely, federal lawmakers have had some notable successes in providing a high level of financial services consumer protections in the last decade, such as the Credit Repair Organizations Act and the recently enacted Military Lending Act.[100] This is why it is necessary for this new federal agency to ensure that a minimum level of consumer protection is established in all states."

"Nonetheless, as these examples show, state law is an important source of ideas for future federal consumer protections. …A state law will not serve this purpose if states cannot apply their laws to national banks, who are big players in the marketplace for credit and banking services. State lawmakers simply won't pass new consumer protection laws that do not apply to the largest players in the banking marketplace."

"Efficient federal public policy is one that is balanced at the point where even though the states have the authority to act, they feel no need to do so. Since we cannot guarantee that we are ever at that optimum, setting federal law as a floor of protection as the default—without

also preempting the states—allows us to retain the safety net of state-federal competition to guarantee the best public policy."

"[In conclusion,] a strong federal commitment to robust consumer protection is central to restoring and maintaining a sound economy. The nation's financial crisis grew out of the proliferation of inappropriate and unsustainable lending practices that could have and should have been prevented. That failure harmed millions of American families, undermined the safety and soundness of the lending institutions themselves, and imperiled the economy as a whole. In Congress, a climate of deregulation and undue deference to industry blocked essential reforms. In the agencies, the regulators' failure to act, despite abundant evidence of the need, highlights the inadequacies of the current regulatory regime, in which none of the many financial regulators regard consumer protection as a priority….[E]stablishment of a single Consumer Financial Protection Agency is a critical part of financial reform…[I]ts funding must be robust, independent and stable. Its board and governance must be structured to ensure strong and effective consumer input, and a Consumer Advocate should be appointed to report semi-annually to Congress on agency effectiveness. [R]estoring consumer protection should be a cornerstone of financial reform. It will reduce risk and make the system more accountable to American families."

[See further ideas from consumer groups at the website of Americans for Financial Reform, ourfinancialsecurity.org..]

The consumer groups' testimony also contains 4 appendices relating to (1) abusive lending practices by smaller banks and thrifts; (2) private student loan regulatory failures and reform recommendations; (3) rent-a-bank payday lending; and (4) information relating to the income sources of major financial regulatory agencies.

"[S]ome smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA."

"[For example, p]ayday lenders partnered with small banks based in states with deregulated interest rates in order to make loans in states that retained usury laws, small loan rate caps, or had slightly restrictive payday loan laws. Through enforcement action, the Comptroller of the Currency stopped four small national banks from renting their charters to payday lenders. The Federal Reserve put regulatory pressure on the only state-chartered member bank involved in rent-a-charter lending and the bank withdrew from payday lending. The Office of Thrift Supervision prevailed on a small thrift in Ohio to stop."

"For years, about a dozen very small state banks 'rented' their charters to enable payday lenders to evade state usury and small loan protections. These banks ended this abusive practice only after state regulators and consumer attorneys initiated litigation, the National Association of Attorneys General sent a stern letter, consumer groups launched a multi-year advocacy campaign by across the country, key Congressional leaders sent letters, and new leaders at the FDIC used all the enforcement tools at their disposal. By the time bank

regulators deprived payday lenders of willing bank partners, state consumer protections had been undermined."

The statement attacks small banks bank overdraft loan programs, refund anticipation loans, and third-party direct deposit arrangements for social security and benefits checks in the context of check cashers and loan companies, but does not expressly mention payday lenders in this regard.

"Smaller banks also issue high fee, low limit credit cards to consumers with impaired credit. These 'fee-harvester' cards are marketed to the most vulnerable consumers, and come with loaded high fees that use up most of the card's capacity, leaving consumers with minimal credit at an exorbitant price." The statement references enforcement actions brought by regulators and notes entities involved "included payday lender Check 'n Go Online, CashCall, Inc., ThinkCash (TC Loan Service LLC), Fortris Financial, LLC, and several prepaid card providers. First Bank & Trust was ordered by the Office of Comptroller of the Currency in 2003 to stop partnering with payday lenders and to set aside $6 million to reimburse credit card customers impacted by deceptive lending practices."

"[S]tarting in the 1990s and early 2000s, many smaller banks partnered with payday lenders to pass on their preemptive powers to avoid state payday loan laws. Though those rent-a-bank partnerships have ended, preemptive bank payday lending has not."

"MetaBank, a federally chartered savings association headquartered in South Dakota, offers the iAdvance line of credit on prepaid cards, including payroll cards. The loan operates exactly like a payday loan. The loans are small, short term credit with a flat fee ($25 per $200); require that the borrower have a regular paycheck (direct deposit of wages or government benefits onto the prepaid card); and lead to frequent rollovers and a triple digit APR. The disclosed APR is 150%, but that assumes that the loan is outstanding for 30 days. That is highly unlikely, as the loans are most likely taken out toward the end of the pay cycle. The APR is 650% if the loan is taken out a week before payday."

"But in several respects the loans are worse than payday loans. First, the bank is able to preempt state usury, small loan, and payday loan laws."

"Second, unlike a payday lender, which must cash a check that can be stopped (at least in theory), the bank has immediate access to offset the loan against the next payment of the consumer's wages or benefits, even benefits that are exempt from garnishment."

"Third, the cost can be much higher because the loan is not even necessarily outstanding the full two weeks that a typical payday loan is. It might only be a few days. Some larger banks also have payday-loan products. Wells Fargo, Fifth Third Bank, and U.S. Bank have direct deposit account advances, which operate just like Meta Bank's iAdvance loans except that they offset a bank account not a prepaid card account."

Appendix 3: Rent-A-Bank Payday Lending

"Federal regulators also fueled the explosive growth of payday lending during the late 1990s and early 2000s by allowing banks to partner with loan companies to evade state protections**.** Payday lenders solicit consumers to write unfunded checks for immediate cash loans that are due in full on the borrower's next payday, in order to keep the check from bouncing. By claiming the right to 'export' weak regulations from the states where their bank partners were based, payday lenders charged interest rates of 400 percent and higher in states with stronger laws."

"The payday loan industry used its 'National Bank Model' as a two-edged sword in state legislative debates, urging state legislators to legalize payday loans to 'keep out' the out-of-state banks and provide 'competition' for banks that brokered payday loans. Then, when industry friendly laws were enacted, some payday lenders continued to partner with out-of-state banks to by-pass the limits in the new payday loan law. For example, ACE Cash Express was a leader in enacting the Colorado payday loan law but dropped its state license, claiming that its loans were made by a national bank. It is widely believed that payday loan authorizing legislation was enacted in Virginia because rent-a-bank payday lenders had entered the state and a state law was the only way legislators thought they could impact the market."

"Payday lenders also used bank partners to stay in business when the North Carolina legislature permitted the payday loan law to sunset in 2001. Instead of closing up shop, payday lenders with about five hundred branches affiliated with national banks to continue making loans. By late 2001, the North Carolina Banking Commissioner reported that seven banks were partnering with payday lenders, including Peoples National Bank of Paris, Texas; First National Bank, Brookings, SD; First Bank of Delaware; Brickyard Bank, Illinois; County Bank of Rehoboth Beach, DE; Eagle National Bank, PA; and Goleta National Bank, CA. Eventually, the North Carolina Attorney General settled cases against the remaining 'rent-a-bank' lenders to exit the state. Class action litigation against the same lenders continued."

"To combat the explosion of triple-digit interest lenders in states with usury or small loan caps, state regulators and Attorneys General brought enforcement actions, filed litigation, and sought legislation to close loopholes being exploited. For example, the Massachusetts Banking regulators shut down a retail outlet that partnered with County Bank of Rehoboth Beach, DE for violating the Massachusetts usury and small loan act.[115] Other state regulators that went to court to stop rent-a-bank payday lending include Colorado, Georgia, North Carolina, New York, Oklahoma, and Ohio."

"By partnering with banks located in states with no usury cap, payday lenders were able to charge consumers much higher rates than state laws permitted and use other loan features that trapped borrowers in debt. For example, a 2001 CFA/USPIRG survey found that ACE Cash Express (Goleta National Bank) and Advance America (BankWest, SD) charged Virginia consumers 442 percent APR for payday loans despite Virginia's 36 percent small loan rate cap. The same survey noted that Money Mart (Eagle National Bank) charged 455 percent APR and loan servicers for County Bank of Rehoboth Beach, DE charged 780 percent APR for two-week loans had authorized this product. ACE Cash

Express partnered with Goleta National Bank and Dollar Financial Group partnered with Eagle National Bank to make loans up to $500 in California, a state that limited payday loans to $255 (if a lender charged the maximum fee). Colorado's payday loan law prohibited loan renewals but rent-a-bank lenders "rolled over" loans three or four times, charging borrowers the fee each payday without paying off the loan. While it is difficult to quantify the cost of rent-a-bank payday lending to consumers, the Center for Responsible Lending wrote to the FDIC Board of Directors in 2004 that 3,000 payday loan stores were at that time partnering with FDIC-supervised state banks. CRL estimated that over one million borrowers annually were trapped in a cycle of borrowing at a cost of about $750 million in fees per year that would otherwise be illegal under state law….

"The campaign to stop banks from renting their charters to enable payday lenders to evade state usury, small loan, and payday loan laws stretched over a decade. Below are noted key regulatory developments that eventually stopped this tactic. This list does not include numerous class action lawsuits, advocacy campaigns, and state law enforcement cases that were also instrumental in curbing usury by banks through payday lending outlets……[list omitted]."

Statement of Kathleen Keest
On behalf of the Center for Responsible Lending

(24 pages & appendices)

"Over the past decade, federal bank regulators looked the other way as responsible loans were crowded out of the market by aggressively marketed, tricky financial products carrying hidden costs and fees. Dangerous products, whose most 'innovative' feature was their ability to obscure their true costs and risks, led a race to the bottom that stifled true innovation, deprived consumers of meaningful choice of products, stripped away billions of dollars in hard-earned wealth from millions of Americans, and ultimately led to today's foreclosure crisis and economic meltdown."

"The key lesson of this experience is that strong consumer protections are essential to financially sound banks and a healthy economy. For too long, consumer protection has been entrusted to regulators whose primary mission and focus has been prudential ('safety and soundness') regulation. Because abusive practices often produce short-term profit, these regulators have typically viewed consumer protections as nothing more than a constraint on bank activity and revenues, rather than as an integral part of the safety and soundness of the system. These regulators' failure to restrain the abuses that led to today's credit crisis demonstrates the need for an agency solely focused on the rigorous consumer protection needed to ensure that financial institutions can flourish in a sustainable way."

"For this reason, we strongly support a vibrant, innovative, state-of-the-art consumer protection agency for financial products, such as has been introduced by the Administration and in both Houses of Congress, provided that it is strong, well resourced, independent of the companies it regulates, and fully transparent and accountable to the public. An independent consumer protection agency, dedicated and empowered to keep the markets free of abusive

financial products, committed to transparency, and fully accountable to the public and Congress, would help to restore consumer trust and confidence, stabilize the markets, and put us back on the road to economic prosperity."

"In other areas of economic life, American markets have been distinguished by the standards of fairness, safety and transparency of the products marketed to consumers. Financial products should not be the exception. Despite the years of rhetorical threats that more regulation would dry up credit, we now know that what dries up credit – and a great deal more – is a failure of consumer and investor confidence."

"You have asked us to focus on three areas of inquiry:

> **1. Whether the agency should be independent or integrated with the prudential supervisors of depository institutions.** We believe it should be an independent, standalone regulator with the primary mission of consumer protection. An independent agency is necessary to counteract the forces that drive regulators to put concerns about consumer protection on the back burner.
> **2. The scope of rule-making, examination and enforcement authority of the agency and the types of financial products that should be within its regulatory purview.** The agency should have rule-making, supervision and enforcement authority over all providers of consumer credit, deposit, and payment systems (as well as over ancillary goods and services). At the same time, this authority should not displace the right of the states' to protect their citizens from abuses within their border, so federal law, including this agency's rules, should set the floor rather than the ceiling on state consumer protection. The agency should coordinate with the states to ensure robust state and federal enforcement.
> **3. The importance of, and the potential methods for, funding the agency.** It is essential that the agency be funded in a way that ensures its capacity, strength and independence. We recommend that the agency be funded through a combination of appropriations, user fees, and assessments to minimize the risks that attend each option as a stand-alone mechanism."

"[W]e do not automatically equate either structural or substantive regulatory reform with extra and undue costs and burdens. Technology has made compliance evaluations relatively easy and cost effective … For common-sense products, the Act's common-sense requirements do not impose significant extra burdens. Furthermore, viewed from a societal perspective, compliance costs are a bargain when compared to the cost of recklessness."

"The regulators' collective failure to rein in the abuses stifled the development of safe, sustainable loan products that would have provided consumers with real choice….In the long run, competition among loan originators to attract investors, coupled with the regulatory failure to ban the abuses had the unintended consequence of severely reducing consumer choice through the major credit crisis we are now experiencing."

"For these reasons, we reject the assertion that an independent agency charged with protecting consumers – keeping the field swept of landmines, as it were – will stifle innovation. It is a false dichotomy to say that a market that is safe for consumers is bad for business. Again, to

look at the experience of the last decade or so, we found that 'Gresham's Law' is a strong force in the financial marketplace: bad money drives out good money, setting competition on a downward trajectory that hurts honest, ethical and efficient businesses. Natural experiments with state laws show that pruning out bad practices makes room for good ones to develop and flourish. Balanced and objective regulation thus stimulates productive innovation."

"We also do not believe that this Agency would impose untenable burdens on smaller financial institutions. Indeed, it may actually create a more level playing field. How could a small community bank offering a 5.5% 'plain vanilla' fixed-rate mortgage compete with Ameriquest's exploding 2/28 loan when Ameriquest's Super Bowl ads were reaching millions of households? If one of the biggest lenders in the country is offering brokers twice as much to deliver a risky payment option ARM to it pays for a fixed-rate loan, how can that small bank compete for broker channel loans? That competition for the middlemen is called 'reverse competition,' and it gravely distorted the market."

"An independent agency is necessary to assure adequate, impartial, and fully informed oversight that is market wide**.** The lesson of the current crisis is that responsibility and accountability for sound, balanced, and evidence-based consumer protection and fair lending regulation and enforcement must reside in an independent agency whose primary mission is consumer protection. This agency must have jurisdiction over the entire market, not just pieces of it, and it must be structured to minimize conflicts of interest.

- A single independent agency avoids regulator shopping and the race to the bottom for weak rules and weak enforcement. The current system allows regulated depository institutions to shop for their own regulator. They can choose between state and federal regulators, and they can choose among federal regulators. With that choice, they can also choose what laws apply, or – given the federal regulators' aggressive preemption of state laws – whether any law applies at all…The result has been the unseemly behavior of federal regulators out shopping for 'customers' (as they call their supervisees), and unashamedly using the preemption as a marketing tool. These regulators have an extremely poor record of treating consumer protection and fair lending as integral to prudential supervision….[T] the OCC's fair lending and consumer protection enforcement has been abysmal. Leaving consumer protection and fair lending oversight with the prudential supervisors would be simply to retread the failed path taken after the S&L crisis…As they did once the S&L crisis had passed, the prudential regulators will revert to norm, and forget the lessons learned….It was not simply in its rule-making that the OTS failed consumers. Its failure to adhere to consumer protection principles integral to safety and soundness led to the failure of large institutions under its watch. …There is no reason to believe that the same regulators performing the same mix of duties would work any better this time. Our analysis would not change if the OTS were to be merged into the OCC for a single federal charter regulator, as the consumer protection performance of both agencies was severely substandard. While an OTS/OCC merger would eliminate that particular charter competition, the OCC would still have incentive to compete for charter share with states unless we make absolutely sure with this and other legislation that federal consumer protection and fair lending laws are a floor, not a ceiling. What's more, there is still the incentive structure posed by the fees that fund its existence…..The

litany of the federal financial supervisors' failures is long …Suffice it to say that the prudential supervisory agencies have not earned the confidence that they are up to the task that we hope Congress will set for this new agency.

- A single regulator eliminates the regulatory gaps and the uneven playing field. The model of 'functional regulation' recognizes that similar products are offered by a wide array of providers, and the products and services should be consistently regulated. Today, [for example,] national banks compete with payday lenders for triple-digit interest rate, short-term small loans….Leaving consumer protection in the hands of the safety and soundness regulator raises the question of what entity would regulate non-depository institutions that are not subject to safety and soundness supervision. The same standards and protections should apply to all consumer products, regardless of the nature of the originating lender. Creating a single consumer protection agency to cover all products would ensure a level playing field among lenders and consistency of regulation.
- A single, independent market-wide regulator can mitigate the risk of regulatory capture. The phenomenon of close relationships between the regulator and the regulated is not a new one, nor is it limited to the financial services industry. The risk of regulatory capture is always present, and it can undermine rigorous rule-making and enforcement. Thus, in reforming the consumer protection function, it is important to include structures that will minimize the risk where possible. An agency tied to one segment of the market, over time, almost inevitably will try to assure that its supervisees have a competitive edge. An agency that covers the entire market will be able to work toward a fair, competitive, playing field for all players."

"The agency should have regulatory, supervisory, and enforcement jurisdiction over providers of credit, deposit, and payment systems (and ancillary goods and services).

- Covered products and services should cover the full range of traditional banking services, their non-banking counterparts, and ancillary goods and services….[T]he scope of products and practices that should be subject to the Agency's jurisdiction falls broadly into the categories of credit, deposit/savings, and payment systems, including stored value cards, plus closely related products and services….Ancillary products and services would include, for example, loan brokering, mortgage servicing, loan modification and foreclosure prevention services, debt collection, and payment processing. The agency should also have jurisdiction over additional products that are linked, intrinsically or by practice, to a credit transaction, such as credit insurance, gap insurance, and debt cancellation agreements.
- The agency should have the rule-making authority relating to these subject matter areas that are currently scattered among at least half a dozen agencies, sometimes overlapping and sometimes leaving gaps. The fragmented system of identity-driven silos of regulation is compounded by fragmentation of rule-writing authority among at least half a dozen agencies. This rule-making authority is even more fragmented than the supervision structure, and compounds the "silo" problem that precludes anyone from training a clear eye on the market as a whole. Part of the impetus for a single-mission consumer protection agency comes from the recognition that no one has been looking at the full picture, keeping an eye on

the overall market trends on products and practices, and evaluating their overall impact. A consolidated rule-writing authority in this Agency would make it more likely that rules could be harmonized, made more consistent, and evaluated for their usefulness. If the statutes themselves need revision, this agency could freely suggest consolidation, changes, or elimination of some requirements that serve no purpose, without fear of losing "turf." Thus by streamlining rules and grounding them in real-world behaviors, this consolidation into a single agency may ultimately *reduce* the level of "regulatory burden" on providers rather than increase it.

- "The agency should have authority to collect and evaluate data to ensure that regulation and enforcement are informed by empirical, real-world information….The agency should test the performance of new products and practices under real-world conditions. The ability and willingness of an agency like this to test the real-world function and performance of products in the marketplace is almost alone worth the effort of its creation. One of the most puzzling aspects of the run-up to the crisis is the absence of empirical scrutiny of the products and practices that dominated the market. Red flags abounded, but faith among the regulators was unshaken. Assertions justifying both the safety and value of practices were relied upon, when those practices could have and should have been tested. Warnings came for years from community groups, lawyers representing homeowners, and counseling agencies that there were serious structural problems in the subprime market, and later, in the non-traditional market as that one grew. The disparate impact on borrowers of color has been a major theme of those warnings for nearly twenty years, since the early days of that market. Yet although these warnings came from all parts of the country, over a number of years, about many different providers in the subprime and non-traditional market, they nonetheless were discounted as 'anecdotes.'…The agency should have authority and responsibility to obtain data necessary to understand how products and practices work in the real world and what their impact is on customers. Data collection, market monitoring and evaluation functions are key to effective regulation. Right now, the financial services industry controls the data. Access is rationed and controls are placed on its use, making it extraordinarily difficult to bring transparency to the way these transactions work in the real world….If there is concurrent supervisory authority, the agency must have the same access to the data as the prudential regulator. Furthermore, since providers typically collect a great deal of data for their own business purposes, data reporting requirements should not be opposed as an additional cost burden.
- A procedure for reviewing new products and practices will provide an opportunity for review and realistic risk assessment, with streamlined systems for safe harbor products. For some products or features, there is a point before sufficient data has been accumulated to give concrete results. What then? Most proponents of this consumer protection agency model recommend that there be some reasonable "safe harbor" for products that do not present obvious concerns. For truly new products and practices (and there are fewer of them than we like to think in this field) some simple, common-sense questions may be all

> that's needed." [In a footnote to support the claim that there are fewer truly new products than most think, the testimony notes:
> " Today's payday market, for example, is the old-salary-lending business from the turn of the 20th century, only slightly tweaked."]

"The agency should have supervision and enforcement authority over laws in its jurisdiction. We believe that the Agency's rule-making authority must be bolstered by supervisory and enforcement authority over matters within its jurisdiction. However, the market is too vast for exclusive enforcement to rest with the agency, so States should have concurrent enforcement authority. …[C]onsumers [also] should be able to enforce their own rights…The agency should have supervisory jurisdiction….Supervision, when the will and capacity is there, can catch problems early, before they spread, and the agency is not doomed to trying to put out fires that started yesterday. Without supervisory authority, that is, in effect, what will happen. It is simply not reasonable for the current financial supervisory agencies to retain exclusive supervisory authority….The size and nature of the market makes it unrealistic to envision supervision in the same way that bank examiners do. A wide array of methods might be used to accomplish that. Routine filings, similar to call reports, but better designed, might be required for some kinds of products. Mystery shoppers might be used to test sales practices. Workable plans will evolve, but the key thing now is to ensure that the Agency can implement them. There should be concurrent enforcement, but structured so that the Agency retains the capacity to assure that there is consistency among federal agency enforcement. The record of the financial supervisory agencies on enforcement of consumer protection and fair lending laws is far too weak to make a credible case that exclusive enforcement authority should rest with them. Moreover, most of the enforcement violates one of the central tenants of effective reform: transparency. Finally, enforcement by silos would still leave the regulators in the dark as to overall market impact. The ability of the agency to monitor market-wide trends and their impact on communities of color is another area where it could bring great value. The evidence is that across the spectrum, from small dollar loans to payment services to mortgage lending, the products and services offered to these communities more often focus on wealth extraction rather than asset building. Unlike the current regulatory model, which focuses on one provider at a time, a market-wide agency with strong supervision and enforcement authority is better positioned to identify the cause and facilitate market-based solutions."

"The states should be partners: the agency's rules should be a floor, not a ceiling, and states should have concurrent enforcement authority. Federal rules must be a floor, not a ceiling. One clear lesson of the meltdown is that overly aggressive and over-broad preemption helped spread the virus that affected the market…..[O]ne reason more states have not acted is that they do not want to put their own institutions at a competitive disadvantage with banks that can ignore their law. Again, the result is a race to the bottom…..The time has come to recognize the vital role that states must play. They have their fingers closer to the pulse of the market and they can act more quickly to address problems – for both the consumers and providers. States should have concurrent enforcement authority. This is a vast country with over a hundred million households, and about $13 trillion just in household credit outstanding. It is unrealistic to suggest that the federal enforcement alone is adequate. Consumer protection is a traditional state function, and states have considerably more experience in enforcement than the federal financial regulators. This should be an essential

feature of this reformed system. Private enforcement must also be available. Public enforcement, even with state concurrent enforcement, will never have adequate resources. That means that many consumers would never get relief at all, or not when needed. The existing foreclosure crisis is a prime example. Public enforcement officials cannot defend individuals in foreclosures. To deny private enforcement is to deny a homeowner the benefit of these consumer protection and fair lending rules at precisely the time when it is most important that they be vindicated."

"The agency should be funded with a mix of sources. The last question we were asked to address is how the agency should be funded. Single source funding from each of the sources suggested comes with some inherent problems. Funding by supervisees can lead to conflicts of interest at one end of the spectrum, while appropriations alone may lead to funding inadequate to permit the Agency to do its job right."

"[In conclusion,] meaningful, substantive consumer protection is the foundation of a sustainable market for financial products, for the soundness of its institutions, and for the stability of the capital markets that provide its liquidity. Effective consumer protection requires a strong, properly-resourced, independent regulator whose mission is devoted to this purpose. In terms of specifics, separating the consumer protection function from the 'safety and soundness' function will help to guard against the tendency of prudential regulators to regard consumer protection as conflicting with lender profits, and ensure that conflicting interests do not relegate consumer protection to the background. Giving a single regulator authority over all consumer financial products, whether or not originated by depository institutions, will ensure a level playing field across the market. And ensuring that federal regulation and enforcement set the floor, not the ceiling, will allow states to continue their important role in innovating regulatory improvements, and protecting their citizens from the particular abuses that arise within their borders."

Appendix "A" relating to the Federal Trade Commission

- This appendix briefly highlights why the consumer advocacy groups believe that the FTC would be "less than [an] optional choice" to use as an alternative location for placing consolidated federal consumer protection and lending responsibilities. In essence, they argue: (1) it has multiple missions; (2) even its consumer protection bureau covers hundreds of thousands of businesses in all types of commerce; (3) it does not cover the entire market of financial services providers; (4) it does not have all regulatory tools needed by a regulator; and (5) because the agency has multiple missions, its leadership does not always have a background in financial practices. Thus, in the advocacy groups' view, the FTC would have to be significantly changed and even then there would be funding issues.

Appendix "B" details current rule-writing jurisdiction of federal agencies under various federal financial consumer protection laws.

Statement of Ed Yingling
On behalf of the American Bankers Association

"Changes are certainly needed, but the pros and cons and unintended consequences must be carefully evaluated before dramatic changes – affecting the entire structure of financial regulation – are enacted."

"We believe that a separate consumer regulator should not be enacted, and, in fact, is in direct contradiction with an integrated, comprehensive approach that recognizes the reality that consumer protection and safety and soundness are inextricably bound. Consumer protection is not just about the financial product, it is also about the financial integrity of the company offering the product. Simply put, it is a mistake to separate the regulation of an institution from the regulation of its products."

"Banks can only operate safely and soundly if they are treating customers well. Banks are in the relationship business, and have an expectation to serve the same customers for years to come….Satisfied customers are the cornerstone of the successful bank franchise. The proposal for a new consumer regulator, rather than rewarding the good banks that had nothing to do with the current problems, will add an extensive layer of new regulation that will take resources that could be devoted to serving consumers and make it more difficult for small community banks to compete."

"Certainly, there were deficiencies under the existing regulatory structure; and banks, bank regulators, non-bank overseers, and policymakers all share some responsibility for the financial and economic problems that developed. Creating a new consumer regulatory agency, however, is not the solution to these problems. It would simply complicate our existing financial regulatory structure by adding another extensive layer of regulation. There is no shortage of laws designed to protect consumers. Making improvements to enhance consumer protection under the existing legal and regulatory structures – particularly aimed at filling the gaps of regulation and supervision of nonbank financial providers – is likely to be more successful, more quickly, than a separate consumer regulator."

The statement argues that community banks would have a disproportionate regulatory burden under a CFPA.

"While the non-banks – the shadow banking industry which includes those who are most responsible for the crisis – are covered, at least in part, by the new agency (and that is positive), their regulatory and enforcement burden is, based on history, likely to be much less."

"The new agency, according to the Administration proposal, will rely first on state regulation and enforcement, and yet we all know that the budgets for such state regulation and enforcement are completely inadequate to do the job."

Under the Administration's plan, CFPA would "have vast and unprecedented authority to regulate in detail all bank consumer products and services. The agency is even instructed to create its own products and services – whatever it decides is 'plain vanilla' – and mandate that banks offer them. Even further, the agency is basically urged to give the products and services it designs regulatory preference over the bank's own products and services. The agency is even encouraged to require a statement by the consumer acknowledging that the consumer affirmatively was offered and turned down the government's product first. The proposal goes beyond simplifying disclosures – which is needed – to require that all bank communication with consumers be 'reasonable.' This is a term so vague that no banker would know what to do with it."

"We share the vision that greater transparency, simplicity, accountability, fairness and access can be achieved by establishing common standards uniformly applied that reflect how consumers make their choices among innovative products and services. But this vision cannot be achieved by ignoring the experience of our recent financial crisis and failing to directly address those deficiencies that led to it. It is now widely understood that the current economic situation originated primarily in the largely unregulated non-bank sector. For example, the Treasury's plan noted that 94% of high cost mortgages were made outside the traditional banking system. Many of these providers had no interest in building a long-term relationship with customers but, rather, were only interested in profiting from a quick transaction without regard to whether the mortgage loan or other financial product ultimately performed as promised. Thus, an important lesson learned is that certain unsupervised non-bank financial service providers and their unregulated financiers – the so-called shadow banking system – undermined the entire system by abusing consumer and investor trust with impunity."

"[C]onsumer protection and financial system safety and soundness are two sides of the same coin. The lack of good underwriting, and in some cases fraudulent underwriting, by mortgage brokers, which failed to consider the individual's ability to repay, set in motion an avalanche of loans that were destined to default. Good underwriting is the essence of both good consumer protection and good safety and soundness regulation. Loans that are based on the ability to repay protect the institution from losses on the loans and protect consumers from taking on more than they can handle. Thus, what is likely to protect both the lender and the customer cannot be, nor should it be, separated."

"[U]niform regulation and uniform supervision of consumer protection performance must be applied to non-banks as rigorously as it has been applied to the banking industry. ….[R]egulatory policymakers for consumer protection should not be divorced from responsibility for financial institution safety and soundness. Separating the safety of the institution from the safety of its products means each agency only has half the story.

The ABA believes the CFPA proposal contains serious flaws as it: "Severs the connection between consumer protection and safety and soundness – forcing each to attempt to work independently and freeing each to contradict the valid goals of the other – to the detriment of consumer choice and safety and soundness; [s]ubjects banks to added enforcement, but leaves the 'first line of defense' for the supervision and examination of non-banks to the states, which suffer from a lack of resources for meaningful enforcement…there would be perverse

incentives for financial products to flow out of the closely examined banking sector to those who will skirt the meaning, and even the language, of regulations; [e]xcludes competitor financial products from its reach – including securities and money market funds, and possibly insurance – thus further belying the promise of uniform or systemic oversight and creating incentives for development of products outside the scope of the CFPA that may be risky for consumers; [i]mposes government designed one-size-fits-all products – so-called plain vanilla products – over services that are designed for an increasingly diverse customer base…. [t]hese products would be given regulatory preference over the products designed by the individual banks, and consumers could even be required to sign a notice that they have first turned down the government's product; [r]equires communications with consumers to be 'reasonable', an incredibly vague and unworkable standard; [b]asically ends uniform national standards, eventually creating a patchwork of expensive and contradictory rules that will create uncertainty, increase consumer costs, and lead to constant litigation; [and] [s]addles consumers and providers with a new regime of fees to fund yet another agency."

"To be successful in the regulation of, examination of, and enforcement on non-banks, the agency will have to be very large and have a significant budget."

"Consumer regulation should not be separated from safety and soundness regulation. Consumer regulation and safety and soundness regulation are two sides of the same coin. Neither one can be separated from the other without negative consequences; nor should they be separated. An integrated and comprehensive regulatory approach is the best method to protect consumers and protect the safety and soundness of the financial institution. While certainly improvements can be made, the current regulatory structure applied to banks provides an appropriate framework for effective regulation for both consumer protection and bank safety and soundness. [T]hat same framework was virtually non-existent for non-bank providers of financial products."

"Attempts to separate out consumer protection from safety and soundness will lead to conflicts, duplication and inconsistent rules, which will likely result in finger pointing as inevitable problems arise. What are banks to do when the consumer and safety and soundness regulators disagree, as they inevitably will?"

"Almost every bank product or service has both consumer issues and safety and soundness issues that need to be balanced and resolved."

"And what are we to do about employee training? Banks spend billions of dollars training employees to comply with the heavy regulations to which banks are subjected. Examiners examine banks for their training programs. Front-line employees must have training in numerous consumer, safety and soundness, and anti-money laundering regulations…. How would such training be effectively coordinated between agencies with differing views and objectives? Is the new agency going to examine banks and non-banks equally for compliance training? It cannot be left to the states, where there is little precedent for extensive examining for compliance training outside banking."

"Finally, we are very concerned about conflicts over CRA lending. The banking industry has worked hard in serving its communities and in complying with CRA. We agree that CRA has not led to material safety and soundness concerns, and that bank CRA lending was prudent and safe for consumers. That is not to say that there is no debate about individual CRA programs and loans as to the right balance between outreach and sound lending. However, that debate – that tension – is resolved now in a straightforward manner because the same agency is in charge of CRA and safety and soundness. To separate the two is a recipe for conflicting regulatory demands, with the bank caught in the middle."

"[T]wo different regulators – one focused on consumers and another focused on safety and soundness – will almost certainly come up with two different and conflicting answers. However, another problem is that they may agree philosophically and still come up with two different answers: two different but similar rules that, when added together, only create an untenable situation for the financial institution."

"The key focus of change should be on closing existing gaps in regulation, not on adding yet another bureaucratic layer. The biggest failures of the current regulatory system, including consumer protection failures, have not been in the regulated banking system, but in the unregulated or weakly regulated sectors. ..[T] the extent that the system did work, it is because of prudential regulation and oversight of banking firms. While improvements within the banking regulatory process can certainly be made, the most pressing need is to close the regulatory gaps outside the banking industry through better supervision and regulation – both on the consumer protection and safety and soundness sides of the coin."

"In stark contrast to the weakness of oversight or examination of consumer compliance issues for most other financial service providers, bank regulators have an extraordinarily broad array of tools at their disposal to assure both consumer protection and safety and soundness. Banks are regularly examined for compliance with consumer regulations, and regulators devote significant resources to supervision and training in consumer compliance issues. While certainly improvements can be made to make this process more effective, the structure, rules, supervision and examination are already in place at banks. The need is for the same bank-like structure, supervision and examination to be applied to non-bank financial service providers."

'[R]egulation without enforcement can be worse than no regulation in that it gives rogue institutions a veneer of legitimacy. All evidence tells us that the states will not have the resources to enforce all these regulations. We have, frankly, little confidence that the CFPA will force equal examination and enforcement on non-bank lenders and others, or that it will have the resources to do so."

"The proposal gives the CFPA unprecedented authority to control the products and services offered by banks. As stated earlier, the agency is encouraged to design products and services, mandate that banks offer them, regulate the non-agency products more heavily, and require consumers to sign a document that they do not want the government-designed product. All communications to consumers about products and services would have to be 'reasonable,' a vague and unworkable standard if there ever was one. This would appear to give the agency an incredible amount of control over banks' and others' products without any real legislated

standards. It also would very much undermine incentives for innovation and better customer choice. Certainly banks and non-banks would be less likely to create new products or consumer enhancements. Any deviations from the government-designed product would be subject to additional regulation and clearances. In many cases, the government product might not fit with the institution's business plan."

"The undermining of national standards will increase costs and cause tremendous litigation and uncertainty."

"[I]t is hard to imagine that a national system can function effectively if all national bank consumer products are subject to fifty different state laws. As we have noted, the safety and soundness regulator will not be able to function well if it has no authority over consumer laws, much less if that authority is held by not only the federal consumer regulator, but every state regulator, legislature, and attorney general as well."

"The multitude of rules – and do not underestimate how incredibly complex they would be – would subject banks to tremendous legal costs in order to comply, and also to constant litigation. Every product, form, and customer communication would have to be checked and rechecked regularly for compliance with changing laws in all fifty states. Customers will move to other states regularly, and the bank would have to assume its customers could be in any state. Costs to consumers would increase as banks try to address all the different rules. Innovation would be discouraged as any changes would have to be tested against all the different state rules."

The testimony also raises questions regarding how the new agency would be funded, and notes "[t]o be remotely effective, this new agency will have to be very large. It will need to regulate, and in many cases examine, not just banks, but credit unions, finance companies, pay-day lenders, mortgage brokers, mortgage bankers, and many others – maybe even pawn shops."

"ABA agrees that improvements can and should be made to protect consumers. The great majority of the problems, as has been noted by both Democrats and Republications on the committee, occurred outside the highly regulated traditional banks, but there are legitimate issues relating to banks as well."

The ABA suggests the following concepts be considered in making improvements in consumer financial protection: expanded and enhanced use of federal unfair and deceptive practices (UDAP) authority, including having the FTC apply this authority "much more aggressively" to non-banks;" improving disclosures; a centralized call center for receiving and routing consumer complaints; reviewing and strengthening consumer regulation within existing agencies; empowering the systemic regulator to look at consumer issues that could cause systemic problems to to require regulatory agencies to address such issues.

In conclusion, CFPA "will result in a huge regulatory burden, particularly for community banks, while non-banks, which are primarily responsible for the crisis, will have ineffective enforcement. As outlined above, we believe that separating safety and soundness regulation

from consumer regulation would be a mistake. Nevertheless, there are important improvements that can and should be made in the consumer arena, and we will work with members of this committee to make such improvement….”

Statement of Alex Pollock, Resident Fellow, American Enterprise Institute

“….[W]e can all agree as a matter of objective interpretation that the ‘CFPA’ as proposed would be a highly intrusive, large, very expensive bureaucracy, with broad, rather undefined, and potentially arbitrary powers, which would impose large costs on consumer financial services, while also imposing requirements which would be likely to conflict with those of other regulatory agencies. Where we differ is that some of us like the idea of having such a bureaucracy, and some of us, including me, do not.”

“…[T]he proposed CFPA would not only ‘define standards for *plain vanilla* products’—that is, define products—but would ‘be authorized to require all providers and intermediaries to offer these products.’ All ‘providers and intermediaries’—a vast jurisdiction apparently unrelated to any chartering definitions—would have part of their business dictated by this agency. That is a truly amazing assertion.”

“Moreover, CFPA should ‘be authorized to place tailored restrictions’—that is, restrictions—‘on product terms and provider practices.’ ‘Terms’ presumably includes pricing. Does it include credit standards, such as required down payments? A more sensible proposal would have been to define certain financial products as ‘plain vanilla,’
and require disclosure that ‘This is—or is not—a plain vanilla financial product suitable for an unsophisticated customer.’ But this idea, which strikes me as reasonable, would not require a new agency.”

“The CFPA is to have ‘sole’ authority, for example, to define the meaning of ‘reasonable.’ This is by no means an easy legal or philosophical project. It would also have supervisory, examination, and ‘a full range of enforcement powers’” For financial institutions, it would be an additional, parallel regulatory system representing a major burden, a potentially punitive approach, and significant regulatory risk; this is likely to be quite at odds with the intense desire of the government to attract additional capital into the banking system.”

CFPA would place disproportionate regulatory burdens on smaller community financial institutions, and they should be exempted from its requirements.

“The Administration’s proposal emphasizes one very good idea: insuring clear, simple, straightforward, informative disclosures. Of course, we do not need a CFPA to achieve this.”

“[T]he indubitably best consumer protection is the ability to exercise personal

responsibility in making informed decisions about underwriting yourself for the credit and about how much risk you wish to take. This is the best reason to have clear and straightforward disclosures: not just to get understandable information, but to act on it."

"[I]t seems remarkable to me that the idea of enabling and building personal responsibility on the part of consumers does not seem to appear anywhere in the Administration's proposal."

The testimony notes that the Administration's proposal also does not address, as it should, the relationship between Fannie and Freddie and the CFPA.

"The CFPA is proposed to have 'sole authority to evaluate institutions under the CRA' and to 'promote community development investment,' taking these responsibilities away from the existing regulators. I believe this is a truly bad idea. The proposal believes that there is a 'conflict' between CRA and safety and soundness responsibilities. On the contrary, I believe that whenever credit risk and investment risk are involved, it is absolutely necessary to have to balance between 'community investment' and safety and soundness. Thus, it is imperative for such responsibilities to be combined in one regulatory agency. The alternative, to have credit and investment being 'promoted' by people with no responsibility for safety and soundness, appears to me worse than dubious."

"What happens when the safety and soundness regulator disagrees with the CFPA? It seems to me such disagreements are inevitable. The question is simply unaddressed in the proposal. Sitting, as we are, in the wake of a credit collapse, it should be readily concluded that the superior authority should be placed with responsibility for safety and soundness. A more straightforward solution to this issue, if one wants to keep the idea of centralizing consumer protection and disclosure responsibilities, is to make use of a logical existing organization, and just drop the notion of the CFPA. My suggestion would be to use the Federal Reserve."

"[A]ny proposals which substantially increase regulatory burden and regulatory risk [also] must be considered in the light of the government's intense need to attract very large amounts of additional private equity capital into the banking system."

<u>Opening Statement of Congressman Andrew Carson (D-IN)</u>

"I am particularly interested in how this Consumer Financial Protection Agency can protect my constituents from predatory mortgage origination and payday loan traps.

During these tough economic times, consumers are seeking out payday loans just to make ends meet. As my constituents increasingly rely on these products, their credit is being eroded. I want to work with the Committee and the Administration to encourage banks to offer safe, small dollar loans as an alternative to payday lenders. I hope that this important

component will be included as we move forward with this piece of regulatory reform legislation."