

Testimony of

Lauren Saunders, National Consumer Law Center

On behalf Americans for Financial Reform

And the following AFR members:

ACORN

ACORN Housing

Americans for Fairness in Lending

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

Sargent Shriver National Center on Poverty Law

SEIU

U.S. PIRG

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Safeguarding Consumer Protection and the Role of the Federal Reserve

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I. INTRODUCTION

A. Summary

Thank you Chairman Watt, Ranking Member Paul and members of the committee for inviting me to testify today. I am the Managing Attorney of the National Consumer Law Center's Washington, DC office. I am pleased to offer this testimony on behalf of Americans for Financial Reform¹ and the following AFL members: ACORN,² ACORN Housing, Americans for Fairness in Lending,³ Consumer Action,⁴ Consumer Federation of America,⁵ Consumers Union,⁶ Demos,⁷ National Association of Consumer Advocates,⁸ National Consumer Law Center (on behalf of its low-income clients),⁹ National Fair Housing Alliance,¹⁰ National People's Action,¹¹ Public Citizen,¹² Sargent Shriver National Center on Poverty Law,¹³ SEIU,¹⁴ and U.S. PIRG.¹⁵

¹ **Americans for Financial Reform** is a coalition of nearly 200 national, state, and local organizations working to reform and restore oversight, accountability, and transparency to the nation's financial system. The coalition represents organizations and members in every state committed to reforming the regulatory system through policy, legislation, communications and field operations around the country.

² **ACORN**, the **Association of Community Organizations for Reform Now**, is the nation's largest community organization of low- and moderate-income families, working together for social justice and stronger communities.

³ **Americans for Fairness in Lending** works to reform the lending industry to protect Americans' financial assets. AFFIL works with its national Partner organizations, local ally organizations, and individual members to advocate for reform of the lending industry.

⁴ **Consumer Action**, founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles and Washington, DC. For more than two decades, Consumer Action has conducted a survey of credit card rates and charges to track trends in the industry and assist consumers in comparing cards.

⁵ The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

⁶ **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about goods, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with more than 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

⁷ **Demos** is a New York City-based non-partisan public policy research and advocacy organization founded in 2000. A multi-issue national organization, Demos combines research, policy development, and advocacy to influence public debates and catalyze change.

⁸ The **National Association of Consumer Advocates, Inc.** is a nonprofit 501(c) (3) organization founded in 1994. NACA's mission is to provide legal assistance and education to victims of consumer abuse. NACA, through educational programs and outreach initiatives protects consumers, particularly low income consumers, from fraudulent, abusive and predatory business practices. NACA also trains and mentors a national network of over 1400 attorneys in representing consumers' rights.

⁹ The **National Consumer Law Center**, Inc. is a non-profit corporation, founded in 1969, specializing in

This testimony describes why we recommend that consumer protection for financial products and services be consolidated within a new federal Consumer Financial Protection Agency.

A review of the history of consumer protection by the Federal Reserve and the other banking agencies demonstrates consistent inattention, at best, and opposition, at worst, to the needs of consumers. These failures transcend many years and many different subject areas, and show that the problems are institutional, not occasional lapses that have been corrected by experience or that can be fixed by tinkering with the existing framework.

low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes and regularly updates a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, Cost of Credit, Consumer Banking and Payments Law, Foreclosures, and Consumer Bankruptcy Law and Practice, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws.

10 Founded in 1988, the **National Fair Housing Alliance** is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

¹¹ **National People's Action** is a national network of metro and statewide organizations that builds grassroots power to create a society in which racial and economic justice are realized.

¹² **Public Citizen** is a national nonprofit membership organization that has advanced consumer rights in administrative agencies, the courts, and the Congress, for thirty-eight years.

¹³ Founded by Sargent Shriver in 1967, the mission of the **Sargent Shriver National Center on Poverty Law** is to provide national leadership in identifying, developing, and supporting creative and collaborative approaches to achieve social and economic justice for low-income people. The Community Investment Unit of the Shriver Center advances the mission of the organization through innovative and collaborative public policy advocacy to enable low-income people and communities to move from poverty to prosperity.

¹⁴ With 2 million members in Canada, the United States and Puerto Rico, **SEIU** is the fastest-growing union in the Americas. Focused on uniting workers in healthcare, public services and property services, SEIU members are winning better wages, healthcare and more secure jobs for our communities, while uniting their strength with their counterparts around the world to help ensure that workers—not just corporations and CEOs—benefit from today's global economy.

¹⁵ The **U.S. Public Interest Research Group** serves as the federation of and federal advocacy office for the state PIRGs, which are non-profit, non-partisan public interest advocacy groups that take on powerful interests on behalf of their members.

Our testimony describes why we believe that a new CFPB would do better. First, it will give consumer protection the attention and clear focus it deserves. Second, by consolidating functions that are now in seven different agencies, it will provide consistent protection no matter who offers the product or service, will be able to take a holistic view, and will be able to act quickly to prevent harm. Finally, the agency will be set up to ensure regulatory independence and freedom from regulatory arbitrage.

We also describe the powers that the new agency should have, the role that the Federal Reserve and the other agencies should retain, and how the various agencies will consult and coordinate. In short, we agree with the President and Chairman Frank that, in order to ensure robust consumer protection, the new agency should have the full set of tools to protect consumers: data collection and research, supervision and examination, rule-writing and enforcement. These responsibilities should be moved away from the Federal Reserve and other banking agencies and be given exclusively to the CFPB, in order to ensure effectiveness and avoid conflicts that can paralyze action, though the banking agencies and the Federal Trade Commission should retain backup enforcement powers for their regulated entities.

Properly implemented, a Consumer Financial Protection Agency will encourage innovation by financial actors, increase competition in the marketplace and lead to better and safer choices for consumers.

We look forward to working with you and committee members to enact a strong Consumer Financial Protection Agency bill to restore the faith and confidence of American families that the financial system will protect their homes and their economic security.

B. About Americans for Financial Reform

Americans for Financial Reform is a coalition of nearly 200 national, state, and local organizations working to reform and restore oversight, accountability, and transparency to the nation's financial system. The coalition represents organizations and members in every state committed to reforming the regulatory system through policy, legislation, communications and field operations around the country.

The campaign is organized around the principles originally outlined in the “Special Report on Regulatory Reform,” by the Congressional Oversight Panel chaired by Professor Elizabeth Warren to monitor the bailout and to help ensure that aid to the financial sector is accompanied by meaningful market reforms.

The coalition’s platform and activities can be seen at www.ourfinancialsecurity.org.

C. The Experience of the National Consumer Law Center and Other Consumer Advocates in Working with the Federal Reserve Board and the Other Banking Agencies

This testimony draws on the long experience of the National Consumer Law Center in particular, and consumer advocates in general, in working with the Federal Reserve Board (FRB) and the other banking agencies, and observing their consumer protection activities.

For over 40 years, NCLC has provided a source of consumer law expertise to poverty law programs, consumer advocates, and policymakers around the country working to protect low income consumers.

Of particular note here, we publish an 18-volume series of legal treatises, each of which runs several hundred to 1,000 or more pages, that detail the interpretation, regulations under, and use of most of the “enumerated statutes” that are proposed to be transferred to the Consumer Financial Protection Agency,¹⁶ as well as the federal laws that preempt state consumer protections and the federal and state laws against unfair and deceptive practices.¹⁷ NCLC attorneys and other consumer attorneys who help write these treatises read every single case under each of these statutes, and every volume is updated annually.

Together with many other consumer and civil rights groups, we have commented in excruciating detail in response to requests for comments from the FRB in particular, but other banking agencies as well, virtually every time regulations are proposed. In just the past year, NCLC has filed hundreds and hundreds of pages of comments with the Federal Reserve and other agencies on credit card, mortgage, foreclosure rescue scams, overdraft fees, and many other topics.

For decades, NCLC attorneys and other consumer advocates have also participated on the Federal Reserve’s Consumer Advisory Council and have had the opportunity to talk directly to Board Governors about our concerns. We have also met and interacted with Board staff formally and informally in many other settings.

We have uniformly found the Federal Reserve’s consumer protection staff, and the Governors, to be intelligent, knowledgeable, experienced, and respectful of our views. Indeed, one of the

¹⁶ We cover the Alternative Mortgage Transaction Parity Act, Electronic Funds Transfer Act, Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, Secure and Fair Enforcement for Mortgage Licensing Act, Truth in Lending Act, and Truth in Savings Act. The only major statutes that we do not cover in depth are the Community Reinvestment Act and the Gramm-Leach-Bliley Act.

¹⁷ Unfair and Deceptive Acts and Practices (2008 7th ed.); Truth in Lending (2007 6th ed. and 2008 Supp.); The Cost of Credit: Regulation, Preemption, and Industry Abuses (2005 3d ed. and 2008 Supp.); Consumer Banking and Payments Law (2005 3d ed. and 2008 Supp.); Foreclosures (2007 2d ed. and 2008 Supp.); Credit Discrimination (2005 4th ed. and 2008 Supp.); Fair Debt Collection (2008 6th ed.); Student Loan Law (2006 3d ed. and 2008 Supp.); Access to Utility Service (2008 4th ed.); Fair Credit Reporting (2006 6th ed. and 2008 Supp.); Collection Actions (2008 1st ed.); Consumer Class Actions (2006 6th ed. and 2008 Supp.); Consumer Bankruptcy Law and Practice (2006 8th ed. and 2008 Supp.); Consumer Law Pleadings (Website and 2008 Index Guide); Consumer Arbitration Agreements (2007 5th ed. and 2008 Supp.); Automobile Fraud (2007 3d ed. and 2008 Supp.); Repossessions (2005 6th ed. and 2008 Supp.); Consumer Warranty Law (2006 3d ed. and 2008 Supp.).

strengths of the proposal to create a new Consumer Financial Protection Agency is that it will not attempt to re-create divisions that already exist, but will transfer the relevant divisions of the Federal Reserve and other agencies to the new agency and will retain the experience and knowledge that they have. We have also observed occasional successes, with the Federal Reserve and other agencies taking action to address significant consumer protection problems.

But overall, our experience has not been so positive. Year after year, in area after area, and agency after agency, we have generally found that consumer protection rarely wins the day and has simply not been a priority. The needs of consumers have usually been trumped by a deregulatory bias and faith in the free market, an antipathy to taking significant consumer protection measures that are opposed by industry, an excessive reliance on fine print disclosures when the agencies have acted, and just plain inertia.

II. History is Replete with Areas Where the Federal Reserve and the Other Bank Regulators Have Failed to Protect Consumers

The various federal consumer protection statutes proposed to be moved to the CFPB, as well as the sweeping authority in the FTC Act to stop unfair and deceptive acts and practices, could have been used to address many of the abuses directed at consumers over the years. Though there have been examples where the banking agencies have issued important rules or otherwise acted to protect consumers, those examples are the exception rather than the rule. Below I summarize the history of several of the failures of consumer protection.

A. For Well Over a Decade, All of the Federal Agencies Ignored Requests to Address Mortgage Abuses

The Federal Reserve Board was granted sweeping anti-predatory mortgage regulatory authority by the 1994 Home Ownership and Equity Protection Act (HOEPA). Final regulations were issued on 30 July 2008 only after the world economy had collapsed due to the collapse of the U.S. housing market triggered by predatory lending.¹⁸ Even then, the FRB ignored pleas to address unfair and deceptive practices in the entire market, not just in subprime loans.

Advocates for consumers badgered the federal banking agencies, particularly the Federal Reserve Board, to address predatory mortgage lending steadily since HOEPA passed. The Board did little, despite numerous and repeated requests to

a) improve Truth in Lending to make mortgage disclosures more meaningful and relevant, and

b) specifically address and prohibit abusive mortgage practices under its HOEPA¹⁹ and unfair practice authorities.

¹⁸ 73 FR 147, Page 44522, Final HOEPA Rule, 30 July 2008.

¹⁹ 15 U.S.C. ' 1629(1)(2).

1. *The FRB Would Not Improve Disclosures*

For several decades, advocates told the FRB that disclosures must be improved considerably to make them meaningful and truly helpful to consumers as a shopping tool.

- In the mid-nineties, advocates pushed the FRB to close loopholes to make APR comparisons more meaningful to help consumers protecting themselves in the mortgage market.²⁰ The FRB and HUD actually agreed and recommend with advocates on this point and recommended in its Joint Report to Congress in 1998 that the finance charge definition be amended to encompass all of the costs of credit.²¹ However, in the face of heavy industry opposition, these efforts were abandoned.²²
- During the same period, consumer advocates encouraged the FRB to improve the confusing and meaningless disclosures for variable rate mortgages.²³ Advocates recommended, among other things, that the information provided be based on the consumer's actual loan, rather than the fictitious one currently required by TILA.²⁴
- Advocates efforts to improve the disclosures have continued over the past decade. However, neither the Federal Reserve Board nor the other federal banking supervisory agencies responded with anything more than minimal improvements in either the definition of the finance charge, or disclosures related to the risks of variable rate mortgages.²⁵

²⁰For example, NCLC and other groups participated in a series of dockets before the Federal Reserve Board relating to improving TILA's disclosures. *See, e.g.* "How the Finance Charge Can More Accurately Reflect the True Cost of Credit" R-0969 (June 17, 1997).

²¹Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (July 1998).

²²*See, e.g.* Margot Saunders, Testimony before the Subcommittees on Housing & Community Opportunity and Financial Institutions & Consumer Credit House Committee on Banking and Financial Services regarding the Rewrite of Truth in Lending Act and Real Estate Settlement Procedures Act, September 16, 1998, available at http://www.consumerlaw.org/issues/predatory_mortgage/testimony.shtml.

²³*See, e.g.* Federal Reserve Docket on How to Improve Variable Rate Disclosures, R-0960, Feb 28, 1997.

²⁴*See, e.g.* Margot Saunders, Testimony before the Senate Committee on Banking, Housing and Urban Affairs regarding S. 1405 The "Financial Regulatory Relief and Economic Efficiency Act of 1997" March 10, 1998, available at http://www.consumerlaw.org/issues/predatory_mortgage/content/1998_MS_test-regword.pdf.

²⁵*See, e.g.* Comments On RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers Department of Housing and Urban Development 24 CFR Part 3500, [Docket No. FR-4727-02] RIN 2502-AH85, November, 2002, available at http://www.consumerlaw.org/issues/predatory_mortgage/content/final_RESPA.pdf; Letter from the National Consumer Law Center to the Board of Governors, Federal Reserve Board, regarding Variable Rate Disclosures, January 17, 2006, available at http://www.consumerlaw.org/issues/predatory_mortgage/content/2006ARMproposal.pdf; National Consumer Law Center and others, Comments to the Federal Reserve Board, Docket No. R-1267, regarding the Proposed

2. The Agencies Failed to Adopt Substantive Prohibitions Against Predatory Mortgage Terms

HOEPA went into effect in 1995. Advocates immediately recognized that was inadequate to stop predatory mortgages and continued bringing new problems to the attention of both banking agencies and Congress. The Agencies were well aware of problems, issuing a variety of fairly meaningless pronouncements telling the industry to “clean up their act.”

Between 1996 and 1998, there had been ongoing discussion with both the Federal Reserve Board and HUD to convince both agencies to make serious changes to rules dealing with predatory mortgages as part of TILA/RESPA reconciliation efforts that began in 1996. Advocates repeatedly pointed out that comprehensive rules were necessary to address the continuing and growing predatory features of mortgage loans.²⁶

The report issued by HUD and Treasury jointly in 2000 reflected the wide-spread recognition of the problem of predatory lending. Yet it was absent of any clear prohibitions that would address or reduce the problems.²⁷ Little – if anything – was included in their 2000 report that actually stopped abusive practices. Federal agencies responded with simply more studies and, worse, more regulations that exacerbated the problems rather than addressed them (such as the OCC’s issuance of the preemption regulations allowing national banks and their subsidiaries to ignore state consumer protections).²⁸

In 2000, OTS acknowledged that it may have gone too far in preempting state prohibitions against prepayment penalties in its AMTPA regulations. Overcoming tremendous and vehement opposition from the mortgage industry (including litigation in federal court), the OTS succeeded in amending its own rules to remove the preemptive effect on prepayment penalties and late

Illustrations of Consumer Information for Nontraditional Mortgage Products Home Equity Lending Market, November 28, 2006, available at http://www.consumerlaw.org/issues/predatory_mortgage/content/nontradillustrationscomments.pdf; National Consumer Law Center and others, Comments to Office of the Comptroller of the Currency (Docket No. OCC-2007-0013), Federal Reserve Board (Docket No. OP-1292), Office of Thrift Supervision (Docket No. OTS-2007-0016), Federal Deposit Insurance Corporation, Proposed Illustrations of Consumer Information for Subprime Mortgage Lending, @October 15, 2007, available at http://www.consumerlaw.org/issues/predatory_mortgage/content/subprime_illustrations_comments.pdf.

²⁶See *record* in Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, July, 1998.

²⁷Curbing Predatory Home Mortgage Lending, HUD, TREASURY, June 20, 2000. See, <http://www.treas.gov/press/releases/ls719.htm>.

²⁸For an analysis of the devastating consequences of as well as the mistaken basis for the OCC preemption rule, see Elizabeth Renuart and Margot Saunders, *Banking Activities and Operations; Real Estate Lending and Appraisals*, OCC Docket No. 03-16, October 6, 2003. Available at http://www.consumerlaw.org/issues/preemption/10_6_occ.shtml.

fees.²⁹ This action was hailed as a great consumer victory, but it merely reinstated existing state protections. OTS itself did nothing to directly address the abuses.

HOEPA mandated the Federal Reserve Board to hold regular hearings to gather information about ongoing problems. More importantly, it mandated that:

The Board, by regulation or order, *shall* prohibit acts or practices in connection with:

- (A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this (HOEPA) section; and
- (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the borrower's interest.³⁰

The Federal Reserve Board held hearings across the country in 2000³¹ at which droves of homeowners and advocates testified,³² beseeching the Board to use its authority under HOEPA and make significant changes to *stop* the abuses in mortgage lending. Our testimony, which was *typical of the requests of most advocates before the Board*, sought, among other items:³³

- Coverage of many more loans under the protections of HOEPA;
- Changing the Swiss cheese approach of determining which fees charged on a mortgage loan should be included in the trigger for HOEPA loans;
- Elimination of the current incentives for originators to increase the price of mortgage loans by limiting the amount of points and fees that could be financed;
- Elimination of financing of credit insurance premiums;
- *Clear guidelines for lenders to determine the borrower ability to repay loans under all scenarios;*
- Prohibition of refinancing low-rate mortgages (such as those provided by Habitat for

²⁹See, National Consumer Law Center and others, Comments Regarding the "Advance Notice of Proposed Rulemaking, OTS Docket Number RIN 2550-AB37, 12 C.F.R. Part 560, No. 2000-34, July 5, 2000. Available at http://www.consumerlaw.org/issues/predatory_mortgage/NCLC_CFA_comments.shtml.

³⁰Pub. L. No. 90-321, *as added* Pub. L. No. 103-325, 108 Stat. 2191 (Sept. 23, 1994), 15 U.S.C. ' 1639(l)(2).

³¹See, e.g. Elizabeth Renuart, Testimony before the Board of Governors of the Federal Reserve regarding Home Equity Lending and HOEPA, August 4, 2000. Available at, http://www.consumerlaw.org/issues/predatory_mortgage/hoepa_f1.shtml.

³²Typically legal services attorneys brought multiple clients to the hearings, allowing the clients to explain their own cases; and following the clients=testimony with explanations of how the stories told by the homeowners were **B** unfortunately **B** simply typical of hundreds more cases in that community.

³³National Consumer Law Center, *Comments to the Federal Reserve Board s Proposed Revisions to Regulation Z Truth In Lending regarding Proposals to Address Predatory Mortgage Lending B* Docket No. R-1090 March 9, 2001. Available at http://www.consumerlaw.org/issues/predatory_mortgage/comments_frb.shtml.

- Humanity); and
- Elimination of deceptive practices relating to variable rate loans.

As a result of these HOEPA hearings, the Federal Reserve Board made minor but important adjustments to HOEPA. The most significant of these changes were:³⁴

- Including premiums for credit insurance in the trigger for HOEPA, and
- Tightening the requirements for verification of repayment ability for HOEPA loans.

The inclusion of single payment credit insurance premiums in the HOEPA points and fees trigger had the dramatic impact of effectively banning the sale of these exorbitantly priced products from the entire mortgage market. This change impacted all home loans, not just the high cost loans governed by HOEPA.

The new rules for verification of income for HOEPA loans exclusively applied to the tiny fraction of the mortgage market covered by HOEPA, but at least established a federal policy of the minimum activity necessary to truly evaluate a borrower's ability to pay the loan.

After OTS's salutary amendments to its AMTPA rules in 2000 and the 2001 HOEPA changes, consumer protection activity stopped. Consumer advocates continued asking the agencies to address the escalating problems of predatory lending.³⁵ At one 2003 Consumer Advisory Council meeting with FRB Governors – illustrative of many comments made on many occasions – one consumer advocate pleaded for the Board to listen:

And, you know, I hate to be this kind of – you know, as I say, you know, consumer advocates are from Mars, and bankers are from Venus. (Laughter)

I sometimes feel that way. But, you know, we are – you know, there are parts of the country where we are going to – I really feel it's going to be a nightmare. I think the horse it out the barn door. And, you know, I hope I am wrong. I really hope I am wrong. But I think it's in the interest of the financial institutions to figure out how to fix this problem, which some unregulated institutions created, but which then the financial institutions went and purchased.³⁶

³⁴Other changes were also made to Regulation Z §§ 226.32 and 226.33. These two changes were the only ones that could be said to truly impact the entire mortgage market.

³⁵. See, e.g. Comments of the National Consumer Law Center and the Consumer Federation of America to Federal Deposit Insurance Corporation re FDIC Draft Staff Guidance "How to Avoid Purchasing or Investing in Predatory Mortgage Loans" January 31, 2001. Available at http://www.consumerlaw.org/issues/predatory_mortgage/fdic.shtml.

³⁶ Transcript of the Consumer Advisory Council Meeting at 66 (June 26, 2003) (statement of Ruhi Maker, attorney with Empire Legal Services).

until 2006, when the five federal banking agencies dipped their collective big toes in the regulatory waters by issuing the Interagency Guidance on Nontraditional Mortgage Products in March 29, 2006.³⁷

The 2006 Interagency Guidance was hailed as a great consumer victory. It indicated that prudent lenders making the new types of loans (like Payment Option ARM loans and Interest Only loans) should at least to evaluate the borrower's ability to repay the loan on the fully indexed rate.³⁸ But the excesses of the mortgage market continued unabated for over a year and a half, showing that the Guidance did little to actually rein in the industry.

NCLC and other advocates recommended that lenders be *required* to verify that borrowers have the ability to repay their loans based on the maximum payments possibly due under the loan and that lenders be prohibited from steering borrowers into costlier loans.³⁹ The industry objected vigorously, saying that such stringent prohibitions would inappropriately stifle the availability of credit.⁴⁰

The five federal banking regulators bowed a bit to consumers but mostly responded to the industry's fears of constricting credit. The Guidance did not prohibit stated income loans. The regulators did not require full underwriting of the maximum payments under the loans. The regulators did not establish any clear prohibitions; these were just guidelines. No remedies or enforcement for consumers was hinted at; the regulators even attempted to provide some cover for industry players who had previously engaged in the circumscribed behavior.⁴¹ This Guidance, as well as the Statement on Subprime Lending issued a year later by the same agencies, was simply not strong enough to make the industry behave.⁴²

³⁷71 Fed. Reg. 58,609, 58,613-58,614 (Oct. 4, 2006).

³⁸*Id.* 18The fully indexed rate is the interest rate that would be in effect at the time of origination, based upon the index identified in the loan note plus the listed margin, absent a teaser rate. Even the fully indexed rate does not reflect the possible risk that interest rates will increase; it is not the maximum rate that can be charged under the note. It is only the rate that would be charged on the note had the interest rate calculations under the note been imposed at the outset.

³⁹Alys Cohen and Margot Saunders, Comments of the National Consumer Law Center to the Office of the Comptroller of the Currency Docket No. 05-21, Office of Thrift Supervision No. 2005-56, Federal Reserve System Docket No. OP-1246, Federal Deposit Insurance Corporation, National Credit Union Administration, Interagency Guidance on Nontraditional Mortgage Products, March 29, 2006. Available at http://www.consumerlaw.org/issues/predatory_mortgage/content/NontraditionalMortgageComments.pdf.

⁴⁰Examining the Role of Securitization, Hearings Before the S. Comm. on Banking, Hous., & Urban Dev., 110th Cong. (2007) (statement of Sandor Samuels, Executive Managing Dir., Countrywide Fin. Corp.) (60% of borrowers from Countrywide could not qualify at the fully indexed rate), available at <http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=256>; Steven Sloan & Joe Adler, How Freddie Cutbacks in Hybrids May Reverberate, *Am. Banker*, Feb. 28, 2007 (quoting Wright Andrews, a lobbyist for nonbank lending institutions, as saying that most subprime borrowers cannot afford the fully indexed rate and requiring underwriting to the fully indexed rate would prevent adjustable rate mortgages from being made).

⁴¹*Id.*

⁴²Statement on Subprime Lending, 72 Fed. Reg. 16 37,569 (July 10, 2007).

The loans written after the Guidance are expected to default at a greater rate than those written before.⁴³ All indications are that the loans issued *after* the Guidance and the Statement on Subprime Lending will default at a much higher rate than the loans issued in the years previous to these regulators' meager attempts to address the issues.⁴⁴

3. The Final HOEPA Rules Are Helpful But Are Too Little, Too Late

In June 2007, at a hearing on Improving Federal Consumer Protection in Financial Services, Chairman Barney Frank gave the Federal Reserve an ultimatum:

I am going to make a statement with regard to your rulemaking authority: use it or lose it.... And I think I speak here probably for the majority of this committee. If the Fed doesn't start to use that authority to roll out the rules, then we will give it to somebody who will use it. You reinforce my sense that the Fed is not the best place to do consumer protection.⁴⁵

Under pressure of losing its authority, the Board in 2008 finally issued proposed amendments to two of the HOEPA protections (ability to repay and prepayment penalty provisions) and two sets of proposed rules addressing a larger part of the mortgage market.⁴⁶ Relatively quickly thereafter, the Board finalized these changes to Regulation Z on July 30, 2008.⁴⁷

One set applies to loans – now scarce – with points and fees that meet HOEPA triggers:⁴⁸

- The prohibition against prepayment penalties for high-cost loans covered by the Home Ownership and Equity Protection Act was broadened.
- The pattern and practice requirement in the HOEPA repayment ability rule was

⁴³ See, e.g., American Home Mortgage Assets, LLC Prospectus supplement (August 29, 2006) (supplement to prospectus dated April 21, 2006), American Home Mortgage Assets Trust 2006-4; Issuing Entity: American Home Mortgage Servicing, Inc.; Servicer: American Home Mortgage Corp. at 9 (showing that the lender underwrote these POA loans only for the first year's payments and that 73% of the loans covered by this prospectus were refinance loans).

⁴⁴ Nearly 61% of option ARMs originated in 2007 will eventually default, according to studies by Goldman Sachs and Countrywide, as reported in the Wall Street Journal earlier this year. Ruth Simon, *Option Arms See Rising Defaults*, Wall Street Journal, January 30, 2009.

⁴⁵ Improving Federal Consumer Protection In Financial Services, Hearing Before The Committee On Financial Services, U.S. House Of Representatives, One Hundred Tenth Congress, First Session, Serial No. 110-40 at 37-38 (June 13, 2007), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:37556.pdf.

⁴⁶ 73 Fed. Reg. 1,672 (Jan. 9, 2008).

⁴⁷ 73 Fed. Reg. 44,522 (July 30, 2008). The Board also amended the advertising rules for home equity lines of credit (Reg. Z § 226.16) and for closed end credit generally and closed-end loans secured by a dwelling (Reg. Z § 226.24).

⁴⁸ Proposed Reg. Z §§ 226.35.

removed.

The other set regulates “higher priced” loans, above an APR trigger but likely below HOEPA triggers.⁴⁹ These rules cover all higher-priced loans secured by the consumer’s principal dwelling, *including* purchase loans:⁵⁰

- First, the creditor must evaluate the consumer’s ability to repay using the same standards that appear in the revised rule applicable to HOEPA loans.
- Second, a higher-priced loan may not include a prepayment penalty unless certain tests are met.
- Third, creditors before consummation must establish escrow accounts for the payment of property taxes and premiums for *required* mortgage-related insurance, insurance covering the loss or damage to the home, or insurance protecting the creditor against the consumer’s default or other credit loss for all covered first lien loans.
- Fourth, as with HOEPA loans, the creditor cannot structure a home-secured loan as an open-end plan to evade the higher-priced loan protections.⁵¹

While these rules will no doubt have some salutary effect, they will by *no means* address the serious problems in the mortgage marketplace. Many consumers are still unprotected because *the rule excludes prime loans and home equity lines of credit*.

One – and probably the most serious – example of the serious limitations of the Board’s new rule is that the ability to repay rule and other higher-cost restrictions do not apply to the many borrowers with nontraditional prime mortgages and other abusive bank loan products and the increasingly sizeable pool of homeowners with HELOCs. Failure to consider a borrower’s ability to repay has been endemic in parts of the prime and Alt-A market not covered by the rule.

Even in the midst of the most serious crisis in credit underwriting in this nation’s history, neither the Federal Reserve nor any other agency has proposed or promulgated effective regulations that will truly address the abuses in the mortgage marketplace.

⁴⁹ Proposed Reg. Z §§ 226.36.

⁵⁰ Excluded are loans to finance the initial construction of a home, a temporary or bridge loan with a term of twelve months or less, and a home equity line of credit. A first lien loan secured by the consumer’s principal dwelling meets the APR trigger if its annual percentage rate exceeds the average prime offer rate for a comparable transaction by 1.5% or more percentage points. The APR on a subordinate lien loan must exceed the average prime offer rate for a comparable transaction by 3.5% or more percentage points. Unlike HOEPA loans, there is no points and fees trigger.

⁵¹ Reg. Z § 226.35(b).

B. Until Pushed by Congress, the Federal Reserve Board Responded to Pleas to Address Credit Card Abuses with Fine Print Disclosures

The new credit card rules adopted by the banking agencies in 2008 are one of the exceptions that prove the rule. The rules are a significant, though not complete, step forward in consumer protection and address several abuses in the credit card market.

But the rules were a break from the historic pattern of responding to evidence of abuses with only more fine print disclosures. As with the HOEPA rules, only after Congress threatened the banking agencies in 2007 to “use it or lose it” regarding their power to address unfair and deceptive practices, and only after it became clear that Congress intended to address credit card abuses itself, did the agencies react to preserve their turf. In the meantime, the abuses contributed hundreds of millions (if not billions) of dollars in interest and fees to consumers’ credit card debt.

The need for credit card protections was especially acute because of the ever-expanding scope of federal bank preemption. The Supreme Court first preempted state interest rate caps in 1978,⁵² and the OCC later expanded that preemption to permit national banks to ignore state laws regulating fees such as late payment, over-limit, and cash advance fees. After the *Smiley* decision,⁵³ the average late fee soared from \$12.83 in 1995 to over \$33.64 in 2005, and over-limit fees similarly jumped from \$12.95 in to over \$30.81 in 2005.⁵⁴ By the end of 2008, credit card debt was over \$960 billion.⁵⁵

The preemption of state law encouraged credit card issuers to devise abusive tricks and traps to increase rates, impose fees and make inordinate profits from beleaguered consumers. From the 1990s to the early 2000s, consumer advocates⁵⁶ and academics⁵⁷ repeatedly documented the horrific abuses by credit card companies against consumers. A limited list of these practices included:

⁵² *Marquette National Bank of Minneapolis v. First of Omaha Service Corp*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

⁵³ *Smiley v. Citibank (South Dakota), N.A.*, 7 U.S. 735 (1996) (upholding OCC regulations).

⁵⁴ Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 20/ -/21* (Sept. 2006) (GAO-06-929), available at www.gao.gov/new.items/d06929.pdf.

⁵⁵ Federal Reserve Board, Statistical Release No. G.19, *Consumer Credit* (Feb. 2009), available at www.federalreserve.gov/releases/G19/20090206.

⁵⁶ For example, Consumer Action issued regular Credit Card Surveys documenting the abuses *du jour*. See also USPIRG, *The Credit Card Trap: How to Spot It, How to Avoid It* (April 2001), available at www.truthaboutcredit.org.

⁵⁷ Elizabeth Warren and Amelie Warren Tyagi, *The Two-Income Trap: Why Middle-Class Mothers and Their Families Are Going Broke* (2003), Ch. 6.

- Skyrocketing penalty rates of 30% APR or more, often triggered without a violation of the card agreement.
- Unjustified late and over-limit fees of \$25 to \$35.
- Hair trigger excuses for imposing these penalty rates and fees, such as being a day or even an hour late
- Rate increases imposed on existing balances
- Shrinking time periods to pay a credit card bill
- Setting payment cut-off times early in the morning
- Manipulating how payments were applied to increase interest charges;
- Double cycle billing
- Failing to properly underwrite so that consumers (especially college-age consumers) took on more debt than they could afford

Advocates repeatedly urged Congress and regulators, such as the Board, to take strong, substantive steps to regulate credit card abuses.

In December 2004, the Board announced it was undertaking a major overhaul of the credit card disclosures. Consumer advocates responded by submitting extensive, detailed comments discussing the enormous problems with credit card abuses and the burden they placed on American consumers.⁵⁸ In the comments, we urged the Board to issue strong, substantive regulations regulating credit cards. We explained that simply revising the disclosures under TILA would not be adequate to protect American consumers.

Two years passed. During that time, consumer advocates met with the Federal Reserve staff to urge strong protections. The Government Accountability Office issued a landmark report confirming the credit card abuses that consumer advocates and academics had long complained about.⁵⁹ Congress held repeated hearings.⁶⁰ Hundreds of media articles were written about the tricks and traps of credit cards.

On June 14, 2007, the Board responded with its solution: it issued a proposal rule that exclusively focused on revamping the disclosures for credit cards under TILA.⁶¹ While the rule

⁵⁸ See, e.g., National Consumer Law Center, et al, *Comments to the Federal Reserve Board's Advance Notice of Proposed Rulemaking - Review of the Open-End (Revolving) Credit Rules of Regulation Z*, Docket No. R-1217, March 28, 2004, at 40-41, available at www.consumerlaw.org

⁵⁹ Government Accountability Office, *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 20/ -/21* (Sept. 2006) (GAO-06-929), available at www.gao.gov/new.items/d06929.pdf.

⁶⁰ Hearings were held in both the Senate, Committee On Homeland Security And Governmental Affairs, Permanent Subcommittee On Investigations Regarding Credit Card Practices: Fees, Interest Rates, and Grace Periods, 110th Cong. (March 7, 2007); Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers: Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs, 110th Cong. (2007), and in the Financial Services Committee of the House of Representatives, see, e.g. Credit Card Practices: Current Consumer and Regulatory Issues (Apr. 26, 2007); Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives (June 7, 2007).

⁶¹ 72 Fed. Reg. 32948 (June 14, 2007).

made significant improvements to the formatting and understandability of these disclosures, the Board did *nothing* about fundamental abusiveness of credit card tactics. In fact, the Board even proposed eliminating a key disclosure for credit cards – the “effective APR,” which is specifically mandated by TILA.⁶²

The next day, June 15, 2007, Chairman Barney Frank gave the Federal Reserve the ultimatum quoted above: that it would lose authority over unfair and deceptive practices if it did not use it.

Consumer advocates once again sent extensive comments urging the Board to substantively address abusive credit card practices.⁶³ We proposed that the Board to use its authority to ban unfair and deceptive practices under the Federal Trade Commission Act, or in some cases under TILA itself. Consumer advocates were not the only ones to submit comments to the Board. Over 2,000 consumers sent in their stories about how they had been victimized by credit card abuses.

The drumbeat of complaints, media articles and studies on credit card abuses continued. Key members of Congress continued to hold hearings, organize summits, and introduced bills to regulate credit cards.⁶⁴

In the fall of 2007, the Office of Thrift Supervision finally heeded the threat from Congress and opened its own rulemaking on prohibiting abusive or deceptive practices under its independent authority under the FTC Act.⁶⁵ In May 2008, the Federal Reserve, joined by the OTS and NCUA, issued a proposed rule addressing some, but not all, of the most serious abuses in credit card practices. The rule prohibits retroactive rate increases unless the consumer misses a payment; requires a reasonable time to pay a credit card bill; prohibits double cycle billing; and requires that payments be applied proportionally to high APR and low APR debt.

The rules were a significant step forward. But they omitted some profitable abuses that Congress was forced to address, including crushing, punitive rate increases on consumers who have missed one payment; tricks that induce consumers to incur over limit fees; fees that eat up half of the credit limit (Congress lowered the FRB’s cap from 50% to 25%); and excessive penalty fees. More importantly, the regulators acted only after threats from Congress and a huge amount of pressure.

⁶² The Board did indeed eliminate the effective APR in the final regulation.

⁶³ *See, e.g.*, National Consumer Law Center, et al, Comments to the Federal Reserve Board’s Notice of Proposed Rulemaking - Review of the Open-End (Revolving) Credit Rules of Regulation Z, Docket No. R-1286, available at www.consumerlaw.org.

⁶⁴ Hearings in the House Financial Services Committee include The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers (March 13, 2008); The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers (April, 17, 2008); Problem Credit Card Practices Affecting Students: The Need for Legislative Action (June 26, 2008).

⁶⁵ 72 Fed. Reg. 43,570 (August 6, 2007).

C. The Federal Reserve Permitted Overdraft Fee Abuses to Take Off and Grow into a Huge Profit Center

Overdraft loans, or “courtesy pay” as the banking industry euphemistically likes to call them, are one of, perhaps the only, form of involuntary credit imposed unknowingly on consumers. Like many of the other abuses discussed in this testimony, overdraft fee abuses took off after the Supreme Court in 1996 upheld the OCC’s regulation declaring that state laws against unfair and deceptive practices are preempted and do not apply to bank fees.⁶⁶

Overdraft fees used to be a penalty for something that only the consumer, not the bank, could prevent: paying for a good or service with a check that later bounces. With the advent of electronic banking in the form of debit cards and ATM cards, it became possible for banks to deny the transaction instantaneously, enabling the consumer to choose another payment method. In the early days, that is exactly what happened, with no fee to the consumer.

But in the late 1990s and early 2000s, bank consultants started promoting services to banks and credit unions that would *encourage* consumers to overdraw their accounts so that the banks could increase their overdraft fee income. Essentially, the banks added a hidden line of credit that allow overdraft transactions to be approved, even at point of service and ATM terminals where they were formerly denied. One website promised that banks would raise overdraft fee income by “100%, 200%, 300% or more!”⁶⁷

Sadly, little has changed in a decade. Specialized Bank Services continues to boast: “Courtesy Pay® is the leading overdraft program. It can increase your NSF fee income up to 400%, and you can rest assured of compliance.”⁶⁸

Banks can “rest assured of compliance” because, over the years, the Federal Reserve and the other banking regulators have chosen to allow these programs to continue. Overdraft fees have been, or have the potential to be, governed or impacted by several statutes administered by the Fed: the Truth in Savings Act (TISA), the Truth in Lending Act (TILA), the Electronic Funds Transfer Act (EFTA), and the Federal Trade Commission Act’s (FTC Act) ban on unfair and deceptive acts and practices. The other banking agencies enforce those statutes with respect to their regulated entities.

In addition to being unfair and deceptive, overdraft loans violate TILA by extending credit without consumer consent or providing disclosures required of other credit. But banks claimed that the programs fell into a loophole in TILA that allowed banks to pay overdrawn paper checks as an occasional, discretionary courtesy. One member of industry admitted that overdraft plans

⁶⁶ Smiley v. Citibank (S.D.), N.A., 517 U.S. 735 (1996).

⁶⁷ See NCLC & CFA, BOUNCE PROTECTION: HOW BANKS TURN RUBBER INTO GOLD BY ENTICING CONSUMERS TO WRITE BAD CHECKS: An Examination of Bounce Protection Plans at 6 n. 33(January 2003), available at http://www.nclc.org/issues/bounce_loans/appendix.shtml.

⁶⁸ See <http://specializedbankservices.com/sbs3.htm> (visited July 11, 2009).

were supposedly designed to “slip through” regulatory requirements by stating that bounce protection is discretionary.⁶⁹

Some state banking departments, including those in Alabama and Iowa, initially rejected this ruse.⁷⁰ But abuses continued.

On August 3, 2001, the OCC sent an interpretive letter to one bank consultant about its program. The letter noted a number of regulatory and policy concerns, including the lack of safeguards for consumers, and the fact that the banks “will, in essence, entice their customers to write NSF checks more frequently and on purpose in order to generate fee income.”⁷¹ But the letter stopped short of telling consultant that the program was unlawful or should be discontinued.

In January 2003, NCLC and several other groups sent detailed comments making a number of recommendations to the Federal Reserve,⁷² including:

- Require TILA disclosures, including the finance charge and Annual Percentage Rate.
- Prohibit banks from claiming that overdraft is “discretionary” when they promote it as credit.
- Prohibit banks from imposing overdraft protection plans on consumers without their consent.
- Require banks to inform consumers about more reasonable alternatives, such as overdraft lines of credit and transfers from savings accounts.
- Prohibit banks from seizing Social Security, SSI and veteran’s benefits, which are protected exempt income under federal law, to repay bounce protection loans.

But the FRB refused to take any of these measures, and merely issued regulations under the Truth in Savings Act requiring the fees to be disclosed in bank account fine print.

The other regulators played their part in encouraging overdraft abuses. Banks began manipulating the order in which debits are deducted from an account, so that the account will be overdrawn sooner and incur more bounce check fees. CFA and other national consumer groups wrote to the Comptroller and other federal bank regulators in 2005 regarding the unfair trade practice of banks ordering withdrawals from high-to-low, while at the same time unilaterally permitting overdrafts for a fee.

⁶⁹ Charles Cheatham, Legal Briefs “Overdraft Plans,” Oklahoma Bankers Association, August 2000.

⁷⁰ The Alabama Banking Department advised banks that charging a \$2 daily fee on overdrawn accounts was considered a finance charge under Alabama law. V. Lynne Windham, Associate Counsel, Alabama State Banking Department, letter to redacted company (August 14, 2001); See also Iowa Consumer Credit Code Administrator, Informal Advisory # 88, “Per Diem Charge on Honored NSF Checks As A Finance Charge Under the ICCA and Iowa Common Law” (August 12, 1999).

⁷¹ OCC Interpretive Letter #914 (August 3, 2001), available at <http://www.occ.treas.gov/interp/sep01/int914.pdf>.

⁷² NCLC et al, Comments on Open End Credit and HOEPA Triggers and Solicitation for Comments on Bounce Protection Products, Docket No. R-1136 (January 27, 2003) available at http://www.nclc.org/issues/bounce_loans/frb.shtml.

When banks began to face court challenges, the OCC issued guidelines that allow banks to use this dubious practice, as long as review various “considerations,” none of which relates to consumer protection.⁷³ The OTS, by contrast, advised thrifts that transaction-clearing rules should not be administered unfairly or manipulated to inflate fees.⁷⁴ The guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies.⁷⁵ CFA’s survey of the sixteen largest banks earlier this year found that all of them either clear transactions largest first or reserve the right to do so.⁷⁶

The FRB watched these overdraft fee programs from their early days, and could have stopped them before they became entrenched. Instead, they allowed them to take off and spread throughout the bank and credit union world, to the point where they are an important profit center that is now much harder to attack. As a result, American consumers spend at least \$17.5 billion per year on cash advances from their banks.

In 2007, Representative Carolyn Maloney introduced legislation to address overdraft fee abuses and began holding hearings on the problem.⁷⁷ At the same time, lawmakers were pressuring the banking agencies to use or lose their authority to ban unfair and deceptive practices.

In fall of 2007, the OTS opened a rulemaking into various potentially unfair and deceptive practices, but did not list overdraft fees among them.⁷⁸ Consumer groups responded with voluminous comments documenting the unfair and deceptive nature of overdraft fees.

When the time came for proposed rules, the OTS, now joined by the FRB and NCUA punted on overdraft fees. They proposed banning unfair and deceptive credit card practices, but decided to postpone deciding what to do with overdraft fees. Instead of using their authority to address unfair and deceptive practices, the Federal Reserve opened a rulemaking under its authority to regulate electronic transactions under the Electronic Funds Transfer Act.

Eventually, the FRB made two alternative proposals, both dealing only with overdraft credit extended at ATMs and point-of-service debit card terminals. One would allow unsolicited overdraft loans and overdraft fees on approved transactions unless the consumer “opts out” of automatic overdraft “protection.” The other would require that consumers “opt in” before overdraft credit could be extended, for a fee, on an ATM or debit card transaction.

⁷³ 12 C.F.R. 7.4002(b).

⁷⁴ Office of Thrift Supervision, Guidance on Overdraft Protection Programs, February 14, 2005, p. 15.

⁷⁵ Dept. of Treasury, Joint Guidance on Overdraft Protection Programs, February 15, 2005, p. 13.

⁷⁶ Consumer Federation of America, Comments to Federal Reserve Board, Docket No. R-1343, Reg. E, submitted March 30, 2009.

⁷⁷ H.R.946, Consumer Overdraft Protection Fair Practices Act (introduced Feb. 8, 2007); House Financial Services Committee, Hearing on: Congress Overdraft Protection: Fair Practices for Consumers (July, 11, 2007).

⁷⁸ 72 Fed. Reg. 43,570 (August 6, 2007).

Neither proposal gives consumers TILA disclosures that enable the consumer to compare “courtesy pay” overdraft loans to other forms of overdraft protection, such as an overdraft line of credit or a linked savings or credit card account. Neither of the FRB’s proposals gives consumers opt-in, opt-out, or TILA disclosures for overdraft loans extended for checks or electronic transfers, which would provide an impetus for the consumer to consider better options.

More than a decade after abusive overdraft practices began, consumers are still waiting to see whether the banking agencies will give them any protection.

D. The Banking Agencies Refused to Deal with Student Loan Abuses

For years, lenders fought and clawed to get into the largely unregulated world of predatory private student lending. During this time, a particularly unholy alliance developed between unlicensed and unaccredited schools like Silver State Helicopters – which recently shut down and filed for bankruptcy – and mainstream banks and lenders. The creditors didn't just provide high-interest private loans to students to attend unscrupulous schools; they actually sought out the schools and partnered with them, helping to lure students into scam operations. They then turned around, and like subprime mortgage providers, made big money on these loans by securitizing them and shifting the risky debt onto unsuspecting investors.

Lenders got away with this because no one was paying attention. Regulatory agencies simply ignored their responsibility to stop unfair lending practices.

The FTC Holder Rule (more accurately referred to as the Federal Trade Commission Preservation of Claims Rule), puts lenders on the hook when they have “referring relationships” with trade schools that defraud students or shut down unexpectedly. The rule requires these lenders to put a “holder notice” in the contract. Under the provision, students are entitled to recover any payments they have made and to have their remaining indebtedness canceled.

But most private student loan providers flaunt the rule. In a March 2008 report surveying 28 private loan agreements, we found that 40 percent didn't include the holder notice in them at all. Nearly all the rest contained the notice but undermined it by including contradictory clauses - saying, for example, that students would be responsible for repaying the loans in full no matter how dissatisfied they were with the schools.

A favorite tactic of national banks is to simply ignore the holder rule, saying that it doesn't apply to them. Among other arguments, they claim that they are outside the reach of FTC enforcement. The main problem is that the FTC can only enforce the law only against schools that fail to include the notice, not the lenders.

Advocates have asked the Federal Reserve and other banking agencies to adopt the FTC Holder Rule themselves and to enforce it against the lenders they regulate.⁷⁹ But they have refused.

⁷⁹ See Transcript of Federal Reserve Board Consumer Advisory Council Meeting at 63-64 (Oct. 23, 2003) (statement of NCLC staff attorney Elizabeth Renuart).

In the meantime, thousands of students at Silver State Helicopters have been harmed and left in the cold trying to figure out how to get out from under incapacitating debt for worthless educations.

E. The Federal Reserve and Other Banking Agencies Have Failed to Ensure that Financial Institutions Furnish Accurate Data to Credit Reporting Agencies

Consumers face considerable frustration trying to fix the significant numbers of errors in credit reports.⁸⁰ Many of those errors are caused by the deficiencies of furnishers, such as re-aging of stale debts, failing to update accounts discharged in bankruptcy, and reporting authorized users as liable on the debt.

Under the Fair Credit Reporting Act, many of the provisions that regulate furnishers cannot be enforced by consumers harmed by their violation, including the all-important accuracy requirements. These furnishers requirement can only be enforced by federal regulators, including the banking regulators for banks.

The banking regulators have almost entirely ignored their enforcement responsibilities with respect to this critical function. We do not know of any FCRA enforcement actions that federal banking regulators have taken with respect to banks under their supervision. If there have been any such actions, they have not been made public. The banking regulators are the sole entities capable of enforcing the accuracy requirements of the FCRA against bank furnishers, which include almost all of the major credit card lenders. They have abandoned this responsibility, leaving consumers unprotected against inaccurate and even deliberate misreporting by bank furnishers.

Enforcement is not the only function for which the banking regulators have failed to adequately protect consumers. They have also failed to write vigorous regulations to ensure the accuracy and completeness of information furnished to credit reporting agencies. For example, the Fair and Accurate Credit Transaction Act of 2003 required the Federal Trade Commission and banking regulators to develop guidelines for accuracy and integrity. The FTC and banking regulators did not issue a proposed rule until the end of 2007, four years later.

Part of the delay was due to disagreements between the FTC and banking regulators over how strong the regulations and guidelines would be, with the banking regulators presumably urging less stringent provisions. We know that the FTC and banking regulators could not agree on a definition of "integrity" or whether to place that definition in regulations or guidelines, because this disagreement could not be resolved prior to the issuance of the Notice of Proposed Rulemaking. This disagreement was openly reflected in the Federal Register notice, which included two competing versions of the proposal.⁸¹ Ultimately the FTC and banking regulators

⁸⁰ See Chi Chi Wu, National Consumer Law Center, *Automated Injustice: How A Mechanized Dispute System Frustrates Consumers Seeking To Fix Errors In Their Credit Reports* (January 2009), available at http://www.nclc.org/issues/credit_reporting/content/automated_injustice.pdf.

⁸¹ See 72 Fed. Reg. 70,944 (Dec. 13, 2007).

reached a compromise⁸² – a compromise that would not have been necessary if the banking regulators had not objected to stronger, more protective provisions.

F. The Banking Agencies' Track Record on Payday Loan Abuses Reveal One Significant Success (An Exception That Proves the Rule) and Several More Recent Failures

1. Years of Campaigns Against Bank Regulators Were Needed to Stop Rent-a-Bank Payday Loan Abuses

Payday loans are small loans until the next paycheck. They typically cost \$15 to \$20 per \$100 for a 2-week loan, which translates to 390% to 520% APR. The borrower gives the lender a post-dated check or electronic access to the bank account for the loan amount plus the fee. The loans trap borrowers in a cycle of debt. A borrower who does not have \$100 today likely will not have \$120 in 2 weeks, forcing a new loan for an additional fee. The initial debt of a few hundred dollars can explode into thousands of dollars of debt they cannot escape.

In the 1990s, payday lenders began to circumvent state laws by partnering with banks to make high cost loans and piggyback on the bank's preemption abilities. Eventually all of the federal banking regulators, through supervision and guidance, put a stop to the practice. But it took numerous enforcement actions by state regulators, private litigation on behalf of consumers, and a protracted campaign aimed at the regulators by national and state level consumer groups.

Beginning in 1998, advocates at the Virginia Poverty Law Center and CFA wrote to the OCC's New York and national offices, respectively, about Eagle National Bank's partnerships with an unaffiliated nonbank check cashing organization in Virginia engaged in abusive lending. The letters asked for a Community Reinvestment Act examination. The OCC replied that the bank's payday lending did not have a negative effect on the CRA rating since the loans were made outside the bank's assessment area.

Lawsuits against rent-a-bank operations began in 1999.⁸³ Soon, class action lawsuits were filed by consumers in Maryland, Texas and Indiana attacking the rent-a-bank arrangements between Ace Cash Express and Goleta National Bank. State regulators in several states took enforcement or other actions to stop rent-a-bank payday lending in their states. Seventeen state attorneys general filed *amicus curiae* briefs in support of Ohio's motion to dismiss Goleta National Bank's challenge to its authority.⁸⁴

⁸² See 74 Fed. Reg. 31,484 (July 1, 2009).

⁸³ Complaint, Phanco v. Dollar Fin. Group, Clearinghouse No. 53,034 (C.D. Cal. Filed Feb. 8, 1999).

⁸⁴ See generally National Consumer Law Center, *The Cost of Credit: Regulation, Preemption, and Industry Abuses* at 116 (3d ed. 2005 and Supp.)

Consumer groups engaged in extensive efforts to urge federal regulators to prevent banks from undermining states' abilities to enforce small loan and usury laws against storefront lenders. CFA, NCLC and several other groups wrote to the Comptroller of the Currency in mid-1999 to protest the "Satisfactory" CRA rating given by the OCC despite Eagle National Bank's 400 to 500 percent APR payday lending with Dollar Financial Group check cashing stores.⁸⁵ The Comptroller's initial reply on November 30, 1999 was that "In the final analysis, there may, practically speaking, be little that bank regulators can do to eliminate abusive payday lending practices that comply with existing law."

Groups also met with the Chairman of the Federal Deposit Insurance Corporation in 2002 and with other FDIC staffers in 2003, with the Comptroller of the Currency, and raised payday lending issues with the Federal Reserve Board's Consumer Advisory Council. National groups protested rent-a-bank lending by First Bank of Delaware to a Federal Reserve Governor.⁸⁶ Those are just a few of the efforts directed at the bank regulators. Consumer groups also sought Congress's help in curbing the misuse of federal bank powers by payday lenders and their partner banks to evade state consumer protection laws.⁸⁷

The Federal Reserve, OTS and OCC, in a change of course, all began cracking down on rent-a-bank operations. But the rogue banks started switching charters. First Bank of Delaware initially said it would withdraw from payday lending due to Federal Reserve requirements, but then decided to stop being a Federal Reserve member bank in order to switch to FDIC supervision. CFA and other groups protested the FDIC's decision to permit First Bank of Delaware to switch regulators to avoid the Federal Reserve's scrutiny of its payday loan operation.⁸⁸

In November 2003, national and state consumer organizations staged a walk-out and forum at the National Press Club during an FDIC conference on serving unbanked consumers. The Community Reinvestment Association of North Carolina conducted a Financial Freedom Tour to protest along with New York advocates outside the FDIC building in Manhattan and at County Bank in Rehoboth Beach, Delaware.

The North Carolina group also protested the role of the FDIC in permitting rent-a-bank payday lending by staging a 2004 protest outside the FDIC headquarters in Washington. The group handed out toy sharks to FDIC staff and held a basketball game between the "peeps" (consumers) and the "sharks" (payday lenders) which was refereed in favor of the sharks by the

⁸⁵ California Reinvestment Committee, Consumer Federation of America, Consumers Union, Greenlining Institute, National Community Reinvestment Coalition, National Consumer Law Center, U.S. Public Interest Research Group, Woodstock Institute, Letter Re: Eagle National Bank and "Payday Loans," Address to The Honorable John D. Hawke, Jr., Comptroller of the Currency, July 27, 1999.

⁸⁶ CFA et al letter to Federal Reserve Board Governor Gramlich, April 14, 2003, www.consumerfed.org/FRB_letter_rent_a_bank041503.pdf

⁸⁷ Letter from national and state organizations to Congress (October 2, 2002), available at <http://www.consumerfed.org/pdfs/paydayletter100802.pdf>.

⁸⁸ <http://www.consumerfed.org/pdfs/fdicletter10-2003.pdf>

“Chairman” who kept his head buried in the FDIC guidelines and refused to call fouls on the “sharks.”⁸⁹

Chicago-based Woodstock Institute, Illinois’s Monsignor John Egan Campaign for Payday Loan Reform, and North Carolina groups protested the FDIC’s CRA rating for Brickyard Bank after the Illinois bank partnered with Check ‘n Go to make payday loans in North Carolina. A protracted campaign of leafleting, protests, and media outreach by community groups eventually ended that partnership.

Finally, in February 2005, the FDIC reportedly sent letters to all the remaining rent-a-bank payday lenders, asking the banks to consider terminating their arrangements. Since this was not an enforcement action, the FDIC did not issue the letters publicly, but payday lenders and banks impacted filed notices with the SEC and issued press releases making it clear that the FDIC had lowered the final curtain on rent-a-bank payday lending. Rent-a-bank payday lending ceased by mid-2006.

2. OCC and OTS Preemption Rules are Allowing Bank and Prepaid Account Advance Payday Loans to Spread and Perhaps Become the Next Widespread Abuse, Replacing Overdraft Loans

For several years, Wells Fargo and U.S. Bank have offered payday loan products through their bank accounts. The newest is Fifth Third Bank’s Early Access loan, which the bank developed in response to pressure against abusive overdraft fees.⁹⁰

Bank account advance payday loans may well spread like wildfire if the Federal Reserve cracks down on overdraft fees by requiring consumer consent before overdraft credit is extended. Fifth Third boasts that consumers “overwhelmingly accept” payday advances and see them as “value add.”⁹¹ But consumer approval seems to be judged by the fact that “80% of those trying it becom[e] repeat users.... [The fees] have been the gift that just keeps giving.”⁹² In the traditional payday loan context, frequent rollovers are seen as a problem that turns a small loan into a huge debt, not an indication of approval. But state payday loan laws will not be able to touch them because of preemption.

The fee structure for all three bank account advance payday loans is similar to traditional payday loans: \$2 per \$20 advanced, automatically repaid with the next deposit. The banks claim an APR of 120%, but the true APR is 520% if the advance is taken a week before payday. All three banks are able to take advantage of rules preempting state usury and payday loan laws.

⁸⁹ Community Reinvestment Association of North Carolina, Newsletter “Melee Breaks Out at Game: Outcome Unresolved,” March 11, 2004.

⁹⁰ See Heather Landy, “Turning Fee Revenue into Customer Opportunities,” *American Banker* (June 24, 2009).

⁹¹ *Id.* (quoting Terry Zink, executive vice president at Fifth Third Bancorp).

⁹² *Id.*

The recent move by Ohio-based Fifth Third is particularly distressing because the state's residents recently succeeded after years of struggle in passing a payday loan law capping rates at 28%. Payday lenders have complained about the bank's ability to ignore that law while they must comply with it.

Meta Bank, a federally chartered savings association, has developed a similar predatory payday loan feature – iAdvance -- on its Visa- and MasterCard-branded prepaid cards that receive direct deposit of wages and government benefits.⁹³ The loans cost \$25 per \$200 and are automatically repaid by the next deposit. The disclosed APR is 150%, but the rate is closer to 650% because the loans are likely taken out late in the month when money runs out, not a full 30 days before payday. They have the similar problem of repeat renewals and escalating fees that traditional payday loans have.

Because MetaBank's home state has no interest rate caps, the bank can and does ignore state laws limiting payday loan interest rates in other states where the card is offered. The loans are only available to those who sign up to have their paycheck or public benefit check directly deposited onto the prepaid card. The loans are automatically deducted from income before food or other necessities and escape laws against garnishing Social Security and other benefits and laws that protect a minimum amount of income. An iAdvance official boasts that demand for the line of credit is "insatiable and not price sensitive" and that its regulator – the OTS – has been very "flexible" with them and "understands" this product.

3. Other Banking Agency Failures on Payday Loans and Telemarketing Schemes

The Federal Reserve also enables payday loans by failing to close other loopholes in consumer protection.⁹⁴

- Since at least 2005, consumer groups and state officials have asked the FRB, without success, to address abusive uses of remotely created checks, which are used by telemarketing scams and by payday lenders seeking to circumvent the right to stop checks and electronic transfers.⁹⁵

⁹³ See NCLC, "Bank Payday Loans ... They're Baaaaaaaack" (June 2009), available at http://www.nclc.org/issues/payday_loans/content/Bank_Prepaid_Payday_Loans.pdf.

⁹⁴ These problems are discussed at greater length in Testimony of Travis Plunkett, Consumer Federation of America, and Edmund Mierzwinski, U.S. PIRG, Before the Committee on Financial Services, U.S. House of Representatives, Hearing on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation (June 24, 2009).

⁹⁵ See, e.g., NCLC et al., Comments: regarding Proposed Amendment to Regulation J and Regulation CC Regarding Remotely Created Checks (May 2005), available at <http://www.nclc.org/issues/banking/content/RCCCommentsFed5.pdf>; Press Release, "Massive Telemarketing Scheme Affected Nearly One Million Consumers Nationwide; Wachovia Bank to Provide an Additional \$33 Million to Suntasia Victims," Federal Trade Commission, January 13, 2009, viewed at <http://www.ftc.gov/opa/2009/01/suntasia.shtm>

- In 2006, consumer groups met with Federal Reserve staff, and sent a follow up letter in 2007, to urge them to take regulatory action to protect consumers whose accounts were being electronically accessed by internet payday lenders, who often ignore state payday laws. Nothing has happened.
- The Federal Reserve has failed⁹⁶ to close loopholes in the Truth in Lending Act that have allowed payday lenders and federal credit unions to dramatically understate the annual percentage rate (APR) in order to avoid usury caps.⁹⁷ The Nevada Federal Credit Union – which is subject to an 18% usury cap – claims a 0% APR for its day payday loans, but the nonrefundable “application” fee brings the true annual rate to 222% to 1,820%, depending on the size of the loan and repayment period.

G. Banking Agencies Have Acted as Anti-Consumer Protectors by Preempting State Laws

As reflected in many of the problems discussed above, Prof. McCoy’s testimony today, and in earlier testimony before Congress,⁹⁸ the banking agencies have often gone beyond inaction to affirmatively oppose consumer protection. The OCC and the OTS, in particular, which have authority to interpret the National Bank Act and the Home Owner’s Loan Act, respectively, have used that power to wipe out state consumer protection laws with nothing to replace them at the federal level. The OCC’s efforts began with interpretative letters stopping state enforcement and state standards in the period up to 2004, followed by OCC’s wide-ranging preemption regulations in 2004 purporting to interpret the National Bank Act. Though the National Credit Union Administration has been less aggressive, it too has preempted a number of important consumer protections.

The preemption actions of the banking agencies reinforce the view that they see their mission primarily as protecting industry *from* consumer protection, not as protecting consumers from industry abuses.

H. The Current System Has Not Promoted Fair Lending

The Federal Reserve has responsibility for writing rules under the Equal Credit Opportunity Act, and each of the banking agencies, as well as the Department of Justice, has enforcement authority over ECOA for the institutions they regulate. Of course, rules to ensure consumer protection generally can also be used to address fair lending.

⁹⁶ NCLC has pointed out many gaps that undermine the APR in

⁹⁷ Payday lender Advance America charged a \$150/month “participation fee” on top of 6% interest to avoid Pennsylvania’s usury cap. That scam was finally shut down under state law, not federal. *See* Pennsylvania Dept. of Banking v. NCAS of Delaware, LLC, 948 A.2d 752 (Penn. May 29, 2008).

⁹⁸ Testimony of Kathleen Keest, Travis Plunkett, Consumer Federation of America, and Edmund Mierzewski, U.S. PIRG, Before the Committee on Financial Services, U.S. House of Representatives, Hearing on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation (June 24, 2009).

The latest, most blatant example of the disregard for civil rights is the OCC's regulation prohibiting states from enforcing their own fair lending statutes. Even after the failures of consumer protection became evident with the collapse of the financial system, the OCC continued *this year* to cling to an extreme view of preemption under which a state cannot even enforce state civil rights laws that are *not* preempted – a position opposed by all 50 attorneys general. Even the Supreme Court, which is typically very deferential to the banking agencies, found that the OCC went too far, though it did uphold the OCC's view that the states are not allowed to ask for information ahead of time from banks about potential violations – a significant crimp on the states' enforcement authority.

Overall, the current system clearly has not promoted fair lending. Predatory lending practices and the ensuing crisis have had a particularly harsh impact on communities of color. African Americans and Latinos suffered the brunt of the predatory and abusive practices found in the subprime market. While predatory and abusive lending practices were not exclusive to the subprime market, because of lax regulation in that sector, most abuses were concentrated there. Several studies have documented pervasive racial discrimination in the distribution of subprime loans. One such study found that borrowers of color were more than 30 percent more likely to receive a higher-rate loan than White borrowers even after accounting for differences in creditworthiness.⁹⁹ Another study found that *high-income* African-Americans in predominantly Black neighborhoods were three times more likely to receive a subprime purchase loan than *low-income* White borrowers.¹⁰⁰

African-Americans and Latinos receive a disproportionate level of high cost loans, even when they qualify for a lower rate and/or prime mortgage. Fannie Mae and Freddie Mac estimated that up to 50 percent of those who ended up with a subprime loan would have qualified for a mainstream, “prime-rate” conventional loan in the first place.¹⁰¹ According to a study conducted by the Wall Street Journal, as much as 61% of those receiving subprime loans would “qualify for conventional loans with far better terms.”¹⁰² Moreover, racial segregation is linked with the proportion of subprime loans originated at the metropolitan level, even after controlling for percent minority, low credit scores, poverty, and median home value.¹⁰³ The resulting flood of high cost and abusive loans in communities of color has artificially elevated the costs of homeownership, caused unprecedented high rates of foreclosures, and contributed to the blight

99 See Bocian, D. G., K. S. Ernst, and W. Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, May 2006.

100 *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (Washington, D.C.: HUD, 2000).

101 See the Center for Responsible Lending's Fact Sheet on Predatory Mortgage Lending at <http://www.responsiblelending.org/pdfs/2b003-mortgage2005.pdf>, and *The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities*, ACORN, August 15, 2006, available at www.acorn.org.

102 See “Subprime Debacle Traps Even Very Creditworthy,” *Wall Street Journal*, December 3, 2007.

103 Squires, Gregory D., Derek S. Hyra, and Robert N. Renner, “Segregation and the Subprime Lending Crisis,” Paper presented at the 2009 Federal Reserve System Community Affairs Research Conference, Washington, DC (April 16, 2009).

and deterioration of these neighborhoods. It is estimated that communities of color will realize the greatest loss of wealth as a result of this crisis, since Reconstruction.

The Federal Reserve has been helpful in increasing the amount of information collected under the Home Mortgage Data Act and in identifying and referring to the other banking agencies institutions whose HMDA data warrant a closer examination. But not one case has been brought at a result.

In fiscal year 2007-08, the Federal Reserve Board referred only eight cases of lending discrimination to the Justice Department in fiscal year 2007: four based on discrimination against unmarried people; two based on mortgage discrimination against minorities, one based on racial discrimination in auto loans, and one based on an institution's loan policies that discriminated on the base of race, in the case of one policy, and on Native American lands, in the case of the other.¹⁰⁴

In recent years, the Department of Justice has received few referrals of alleged ECOA violations from any federal agencies. In 2005, the Department received thirty-eight referrals and, in 2006, it received thirty-four.¹⁰⁵ The downward trend continued in 2007, when it received only twenty-seven referrals.¹⁰⁶ Most referrals have been from the FDIC, and most have been returned to the respective agency for administration resolution. The referrals that the Department kept for review from 2007 included cases alleging discrimination on the basis of race, national original, marital status, age, and the exercise of rights under the Consumer Credit Protection Act.

With numbers this low, and devastation across communities of color, one has to wonder whether the banking agencies are looking at all.

I. Other Failures of Consumer Protection

In earlier testimony before the Financial Services Committee,¹⁰⁷ witnesses described other instances in which the Federal Reserve and the other banking agencies have failed to protect consumers, including:

¹⁰⁴ See Board of Governors of the Federal Reserve System, 93d Annual Report: 2007 126-27 (Apr. 2008), available at <http://www.federalreserve.gov/boarddocs/rptcongress/annual07/pdf/AR07.pdf>.

¹⁰⁵ See The Attorney General's 2005 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act Amendments Of 1976 (Mar. 7, 2006), available at www.usdoj.gov/crt/housing/documents/ecoa2005.htm; The Attorney General's 2006 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act Amendments Of 1976 (Mar. 13, 2007), available at www.usdoj.gov/crt/housing/documents/ecoa2006.pdf.

¹⁰⁶ The Attorney General's 2007 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act Amendments Of 1976 (Apr. 2, 2008), available at www.usdoj.gov/crt/housing/documents/ecoa2007.pdf.

¹⁰⁷ See Testimony of Travis Plunkett, Consumer Federation of America, and Edmund Mierzwinski, U.S. PIRG, Before the Committee on Financial Services, U.S. House of Representatives, Hearing on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation (June 24, 2009)

- The Federal Reserve is allowing a *shadow banking system, prepaid debit cards*, to develop for the unbanked and immigrants. Except for narrowly defined payroll cards, the Board has rejected requests to extend protections for wages, unemployment and other benefits, and other funds deposited on those cards against unauthorized charges, billing errors, stop payment rights, and other protections given to other forms of debit cards.
- The regulators have failed to enforce the *Truth In Savings Act* requirement that banks provide account disclosures to prospective customers. A 2008 General Accounting Office study found that 22% of banks visited by secret shoppers did not give consumers access to the detailed schedule of account fee disclosures required by federal law. TISA is one of the few consumer protection statutes that is not privately enforceable.
- The Federal Reserve actively campaigned to eliminate a Congressional requirement that it publish an *annual survey of bank account fees*.

III. A NEW APPROACH: THE CONSUMER FINANCIAL PROTECTION AGENCY

The old system has failed; we need a new approach. We believe that the proposed Consumer Financial Protection Agency corrects the errors of the past and is needed for several reasons. First, it will give consumer protection the attention and clear focus it deserves. Second, by consolidating functions that are now in seven different agencies, it will provide consistent protection no matter who offers the product or service, will be able to take a holistic view, and will be able to act quickly to prevent harm. Finally, the agency will be set up to ensure regulatory independence and freedom from regulatory arbitrage.

A. Consumer Protection Needs More Focus and Attention

A CFPA, with consumer protection as its sole mission, will be able to focus much-needed attention on the needs of consumers, the pitfalls of the marketplace, and the protections needed for both consumers and honest competitors. The agency will not be distracted from this paramount role by other duties, or have its perspective warped by other missions. It can direct its research, data collection and various activities in a consistent direction: determining the impact of products and services on consumers and the best ways to ensure that they can achieve financial stability and are protected from abuses. The CFPA's focus on ensuring safe and sustainable credit and banking products for all borrowers would ensure that these products are offered in a transparent, uniform, nondiscriminatory manner.

The Federal Reserve has far too much on its plate and comes from a very different perspective. Though the agency certainly could have done better, in retrospect it may simply have been unfair to expect the FRB to play so many different roles. Its governance structure, the role of the regional banks, its focus on the profitability and health of the institutions it supervises, and its macro role in monetary policy all leave consumer protection as an afterthought. With so much of its time, energy and budget focused on entire portfolios, large institutions, and indeed on the state of the entire economy, the needs of individual families and the ins and outs of how products work one-on-one are simply not part of the agency's mindset.

The marginal role of consumer protection is already true under the FRB's current mission, but it will become even more so if the Board becomes the systemic risk regulator. Two former Board Governors agree. Their perspectives are relevant whether or not greater systemic risk authority is given to the Board.

Last week, former Fed Gov. Frederic Mishkin testified:

*I believe that the Federal Reserve should give up its role as a consumer protection regulator. My reasoning for this conclusion is as follows. The skills and mindset required to operate as a consumer protection regulator is fundamentally different from those required by a systemic regulator. Protecting consumers involve setting and then enforcing the appropriate rules under a transparent legal framework. The orientation of an effective systemic regulator must be different from that of a rule-enforcing consumer protection or conduct of business regulator. A regulator charged with both enforcing rules and managing systemic risk may end up devoting too much of its attention to rule enforcement.*¹⁰⁸

Lawrence Meyer, another former Fed governor, agreed, even though he does not believe that adding systemic risk increases the Board's responsibilities significantly:

*[I]f something is to be given up, the most obvious choice is consumer protection and community affairs. These are not seen around the world as core responsibilities of central banks. The case for giving up consumer protection and consumer affairs is strengthened by the Treasury's proposal to unify these responsibilities in a single agency.*¹⁰⁹

For all of the banking agencies, the present regulatory system is institution-centered, rather than consumer-centered. At the federal level, major agencies are funded by the institutions they oversee, giving them inordinate influence within the agency.

The agencies' bank-centric focus on the health of the institution has led to an exclusive reliance on a collaborative and secretive bank examination and supervision to protect consumers. Though supervision is definitely one part of the picture, it lacks transparency and accountability, fails to set clear rules for others to follow, and gives bank regulators a high degree of discretion to decide what types of lending are harmful to consumers, a process that involves negotiating behind-the-scenes with bank officials.¹¹⁰ Secret deals do not have the same impact on consumer protection as public enforcement actions or rules, which act as a deterrent for other providers.

¹⁰⁸ Testimony Of Frederic S. Mishkin To United States House Of Representatives Subcommittee On Domestic Monetary Policy And Technology at 2 (July 9, 2009) (emphasis added).

¹⁰⁹ Testimony Of Laurance H. Meyer To United States House Of Representatives Subcommittee On Domestic Monetary Policy And Technology at 2 (July 9, 2009) (emphasis added).

¹¹⁰ "Findings made during compliance examinations are strictly confidential and are not made available to the public except at the OCC's discretion. Similarly, the OCC is not required to publish the results of its safety-and-soundness orders....Thus, the OCC's procedures for compliance examinations and safety-and-soundness orders do not appear

Regulators have often treated consumer protection as less important than their safety and soundness mission or even in conflict with that mission. The examples above describe in detail how regulators failed time and again to protect consumers. Because regulators apparently decided that their overriding mission was to ensure that the short-term balance sheets of the institutions they regulated were strong, they were less likely to perceive that questionable products or practices were harmful to consumers. Moreover, the relative resources that agencies devoted to the two goals and the priorities they articulated frequently minimized consumer protection, and were more likely to focus on *reducing* regulatory restrictions on the institutions they oversaw.¹¹¹

As we've learned in the current crisis, focusing exclusively on consumer and civil rights protection would often be positive for lenders' stability and soundness over the long term. However, the agency would be compelled to act in the best interest of consumers even if measures to restrict certain products affected bank products. The leadership of a CFPB would be held to account based on its ability to inform consumers and help protect them from unsafe products. In order to function effectively, the leadership would need to show expertise in and commitment to consumer protection.

B. Consolidate Consumer Protection Functions of Seven Agencies in One Place for a Consistent, Holistic View of Consumer Protection

Right now, four federal regulatory agencies are required both to ensure the solvency of the financial institutions they regulate and to protect consumers from lending abuses.¹¹² Jurisdiction over consumer protection statutes is scattered over several more agencies, with rules like RESPA and TILA, which both regulate mortgage disclosures, in different agencies.

The Administration's plan consolidates rule-making authority for the existing consumer protection laws related to the provision of credit in one agency, including the Truth in Lending Act (TILA), Truth in Savings Act (TISA), Home Ownership and Equity Protection Act (HOEPA), Real Estate Protection Act (RESPA), Fair Credit Reporting Act (FCRA), Electronic

to provide any public notice or other recourse to consumers who have been injured by violations identified by the OCC." Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, April 26, 2007.

¹¹¹ For example, in 2007 the OTS cited consumer protection as part of its "mission statement" and "strategic goals and vision." However, in identifying its eight "strategic priorities" for how it would spend its budget in Fiscal Year 2007, only part of one of these priorities appears to be directly related to consumer protection ("data breaches"). On the other hand, OTS identified both "Regulatory Burden Reduction" and "Promotion of the Thrift Charter" as major strategic budget priorities. Office of Thrift Supervision, "OMB FY2007 Budget and Performance Plan," January 2007.

¹¹² The Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) charter and supervise national banks, and thrifts, respectively. State chartered banks can choose whether to join and be examined and supervised by either the Federal Reserve System or the Federal Deposit Insurance Corporation (FDIC). The FTC is charged with regulating some financial practices (but not safety and soundness) in the non-bank sector, such as credit cards offered by department stores and other retailer.

Fund Transfer Act (EFTA), and Fair Debt Collection Practices Act (FDCPA). 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. As cited in several places in this testimony, federal regulators dithered for years in implementing regulations to stop unfair and deceptive mortgage and credit card lending practices. One of the reasons for these delays has often been that regulators disagree among themselves regarding what regulatory measures must be taken. The course of least resistance in such cases is to do nothing, or to drag out the process.

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. As the New Foundation document continues:

The core of such an agency can be assembled reasonably quickly from discrete operations of other agencies. Most rule writing authority is concentrated in a single division of the Federal Reserve, and three of the four federal banking agencies have mostly or entirely separated consumer compliance supervision from prudential supervision. Combining staff from different agencies is not simple, to be sure, but it will bring significant benefits for responsible consumers and institutions, as well as for the market for consumer financial services and products.¹¹³

Given that multiple regulators oversee similar institutions, the process has also resulted in different standards for different types of financial institutions. As discussed above, reordering a consumer's checks to increase overdraft fees is or is not considered unfair depending on what type of institution holds the account.

A 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 CFPA 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. This includes the flexibility to set standards that are adequate to address rapid evolution and changes in the marketplace. 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. 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.

¹¹³ The Obama Administration, Financial Regulatory Reform: A New Foundation p. 57

C. Prevent Regulatory Arbitrage and Ensure Regulatory Independence.

The ability to “charter shop” – change regulators to avoid strict supervision – and the banking agencies’ fear of losing fee revenue have undeniably led regulators like the OTS to compete to attract financial institutions by keeping regulatory standards weak. Institutions were able to increase their leverage over regulators by taking a significant chunk of the agency’s budget away when it changed charters and regulators.

Two of the most notorious examples are Washington Mutual and Countrywide,¹¹⁴ which became infamous for promoting dangerous sub-prime mortgage loans on a massive scale.¹¹⁵ Both switched their charters to become thrifts regulated by the Office of Thrift Supervision (OTS). The threat of charter shopping has also encouraged the OTS and OCC to expand their preemptive authority and stymie efforts by the states to curb predatory and high-cost lending. The OCC in particular appears to have used its broad preemptive authority over state consumer protections and its aggressive legal defense of that authority as a marketing tool to attract depository institutions to its charter.¹¹⁶

Although the credit card rule adopted late last year by federal regulators was ultimately finalized over protests from the OCC, these objections were likely one of the reasons that federal regulators delayed even *beginning* the process of curbing abusive credit card lending practices until mid-2008.

Charter shopping is not confined to the OCC and OTS. As described above, in the early 2000s rogue banks switched to charters supervised by the FDIC to escape enforcement actions aimed at ending rent-a-bank payday lending.

The “charter shopping” problem would be directly addressed through the creation of a single CFPB with regulatory authority over all forms of credit. Federal agencies would no longer compete to attract institutions based on weak consumer protection standards or anemic enforcement of consumer rules.

The CFPB will not have to fear retaliation if it takes action against an abusive product. It will be able to focus on the safety of credit products, features and practices, no matter what kind of lender offered them.

¹¹⁴ Of course, following their stunning collapses, Countrywide was acquired by Bank of America and Washington Mutual by Chase, both in regulator-ordered winding-downs.

¹¹⁵ Arthur E. Wilmarth, Jr., “The OCC’s Preemption Rules Threaten to Undermine the Dual Banking System, Consumer Protection and the Federal Reserve Board’s role in Bank Supervision,” Proceedings of the 42nd Annual Conference on Bank Structure and Competition (Fed. Res. Bank of Chicago, 2006) at 102, 105-106.

¹¹⁶ For a detailed analysis, see brief amicus curiae of Center for Responsible Lending et al in the Supreme Court case *Cuomo v. Clearinghouse and OCC* (08-453) available at http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/08-453_PetitionerAmCu10ConsumerProtectionOrgs.pdf (last visited 21 June 2009) at pages 20-39.

IV. THE TOOLS THE CONSUMER FINANCIAL PROTECTION AGENCY NEEDS AND ITS INTERACTION WITH THE FEDERAL RESERVE AND THE OTHER AGENCIES

A. The CFPA Needs Full Data Collection, Rule-writing, Supervision and Examination, and Enforcement Capabilities

In its work to protect consumers and the marketplace from abuses, the CFPA needs a full set of enforcement and analytical tools, as reflect in H.R. 3126 and President Obama's white paper.

1. *Data Collection and Information Gathering*

The first tool is the ability to gather information about the marketplace, institutions and consumers so that the agency itself can understand the impact of emerging practices in the marketplace. The agency could use this information to improve the information that financial services companies must offer to customers about products, features or practices, to identify risks, and to tailor its rules and enforcement proceedings. For many products, features or practices, the agency might determine that no regulatory intervention is warranted. For others, this information about the market will inform what tools are used. Without adequate information, the agency would simply be operating blind, and its consumer protection activities will be cruder and less effective.

2. *Rule-writing*

A second tool is rule-writing. The historical description above shows that rule-writing by Federal Reserve and other banking agencies has failed to protect consumers. Rules have focused on narrow, technical compliance with disclosure statutes. The banking agencies completely failed to use their broader authority to address unfair and deceptive practices except when under the recent gun of Congress to "use it or lose it." The OCC admits that it was not until 2000 that *ever* invoked the long-dormant consumer protection authority provided by the 1975 amendments to the Federal Trade Commission Act.¹¹⁷

The CFPA can ensure that the various consumer protection statutes passed by Congress will get appropriate periodic updating to address new issues, technology, holes and evasions. In addition, the agency will have more flexible authority under its enabling statute to address unfair, deceptive or abusive practices that Congress has not anticipated. In some cases, these rules will focus on disclosures, though hopefully with greater emphasis on simple, understandable disclosures and not more fine print. On other occasions, the rules will ensure that consumers have the option of choosing a more simple, safer "plain vanilla" product. And occasionally, the agency will feel the need to restrict or ban specific product features or even entire products that

¹¹⁷ See Julie L. Williams & Michael L. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1244, 1246 & n.25, 1253 (2003) (citing authority from the early 1970s indicating that OCC had the authority to bring such an action under Section 8 of the Federal Deposit Insurance Act, noting that OCC brought its first such case in 2000, and conceding that "[a]n obvious question is why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act").

are harmful or not suitable in some circumstances, or that don't meet ordinary consumer expectations. 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. We can only wonder how much less pain would have been caused for our economy if a regulatory agency had been actively exercising that power during the run up to the mortgage crisis.

The CFPA should have exclusive rule-writing authority. Giving other agencies authority will only lead to inconsistent rules and conflicts. It may also encourage the banking agencies to act quickly, to pass weak rules, in the hopes of preempting the CFPA from addressing a subject.

3. Supervision, Examination and Guidance

A third tool necessary to give the agency the full range of flexible options is supervision and examination. Though the banking agencies placed too much exclusive reliance on supervision in the past, they are right that it can be a useful approach in some circumstances. As former FRB Governor Randall Kroszner explained:

Where Federal Reserve examiners observe weaknesses or compliance failures by supervised institutions, examiners document them in a report to bank management. The required corrective actions are stated in the examination report. We find that in the overwhelming majority of cases, management voluntarily addresses any violations or weaknesses that we have identified without the need for formal enforcement actions. In those rare instances where the bank is not willing to address the problem, we have a full range of enforcement tools at our disposal and use them to compel appropriate corrective action.¹¹⁸

Supervision is also a useful tool to ensure that guidance is appropriately followed. In some circumstances, the CFPA will issue clear, binding rules, but in other instances it might decide to issue more flexible guidance. As Governor Kroszner explained,

Principles-based guidance is particularly useful when dealing with practices that may be inappropriate in some circumstances but appropriate in others.... Through the issuance of principles-based guidance, backed-up with regular examinations, the federal depository institution regulators are able to have a significant impact on institutions' practices.¹¹⁹

Comptroller of the Currency John Dugan has made similar points:

In short, we believe that the OCC's comprehensive approach to consumer protection regulation – integrating guidance, supervision, enforcement, and complaint resolution – is

¹¹⁸ Testimony of The Honorable Randall S. Kroszner, Governor, Federal Reserve Board before the Committee on Financial Services - U.S. House of Representatives on Improving Federal Consumer Protection in Financial Services at 12 (June 13, 2007).

¹¹⁹ *Id.* at 14.

effective in achieving the objectives established by Congress.... Such guidance also advises national banks on emerging and significant risks; on our expectations for bank practices for managing those risks and preventing problems from arising; and on likely areas of focus by bank examiners. The OCC's strategy is to prevent problems before they arise, and because we can issue supervisory guidance expeditiously, we can address issues quickly as they surface.¹²⁰

The CFPA should have this tool and should not be forced to use enforcement alone. As described above, the rent-a-bank payday preemption abuses of the past were addressed through supervision.

Supervision cannot bear the entire weight of consumer protection, but it can be more efficient and less heavy handed than enforcement actions when problems do not deserve more public or severe measures. Supervision can be used to address problems early on, to work with the institution to develop a more subtle approach that takes into account the institution's legitimate concerns while addressing consumer protection issues.

Supervision and examination also supplements the agency's data collection activities and allows the CFPA to see problems of which it is unaware. Preventing the agency from looking inside institutions to see what is really going on would leave it with a "catch me if you can" mandate. The agency could not act unless it had the evidence that a punitive enforcement action was warranted – evidence it would have difficulty obtaining.

Consumer protection supervision should also be an exclusive power of the CFPA. There is no reason to duplicate this supervision at the federal level. Of course, when consumer protection issues present safety and soundness considerations, they will be examined in the traditional safety and soundness examinations.

4. *Enforcement*

Finally, where appropriate, the agency will have the ability to engage in administrative or judicial enforcement actions. 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 warranted. Under H.R. 3126, the agency will have the full range of enforcement powers, including subpoena authority; independent authority to enforce violations of the statutes it administers; and civil penalty authority. The bill also enables states to supplement the agency's resources to bring enforcement actions. States routinely receive consumer complaints and see local violations first.

¹²⁰ Testimony of the Honorable John C. Dugan, Comptroller of the Currency, Office of the Comptroller of the Currency before the Committee on Financial Services - U.S. House of Representatives on Improving Federal Consumer Protection in Financial Services (June 13, 2007), available at <http://www.house.gov/financialservices/hearing110/htdugan061307.pdf>.

The proposal should also be strengthened by giving individual consumers remedies when rules are violated.¹²¹ Expecting consumers merely to complain to a federal, or even a state, agency and hope that someone will attend to their individual case will not achieve full consumer protection. Full accountability and compliance are best promoted by making wrongdoers answer to those who they harm.

Enforcement is the one place where it makes sense to give the banking agencies back-up authority. H.R. 3126 wisely provides that if the CFPA fails to act 120 days after a referral from another agency, that other agency is free to take an enforcement action against entities within its jurisdiction if it feels one is warranted. This back-up authority acts as a check on the CFPA and ensures that serious problems are not placed solely in the hands of a single agency.

Another key feature to enforcement needs to be empowering frontline financial employees. They need whistle blower protections and an end to compensation schemes that pressure them to sell at any cost. They know the products they are directed to push are often harmful to their customers, they have no alternative other than to be fired. With whistle blower protections and proper compensation systems, these workers can provide the regulation from below that we will need when banks begin to try to find their way around new regulations.

B. The CFPA Will Consult and Coordinate with the Banking Agencies; The Scope of Conflicts Has Been Overstated.

The financial industry, and to a lesser extent the banking agencies, have raised concerns about how the CFPA will coordinate its work with the banking agencies, and how conflicts will be resolved if consumer protection and safety and soundness supervision are separated. The Administration's carefully thought-out blueprint for the new agency, which is reflected in H.R. 3126, contains several features that will ensure that the agency will consult with other federal regulators to promote consistency with prudential, market, and systemic objectives. Moreover, the potential for significant conflicts is overstated.

1. One of the CFPA's Five Board Seats Will Belong To A Prudential Regulator.

The most direct measure to ensure coordination is actually putting the views of the prudential regulators *inside* the CFPA as part of the CFPA's own decision-making process. The importance of this measure cannot be overstated. The prudential regulator will have the full authority of any other commissioner to ensure that the board itself, and the work of the agency overall, take into account any appropriate safety and soundness or other prudential considerations. As the CFPA embarks on its new mission, it will undoubtedly work for consensus among its board members whenever possible, and it can be expected that the prudential regulator will have significant

¹²¹ The importance of giving consumers remedies when rules are violated is described in greater length in the Testimony of Travis Plunkett, Consumer Federation of America, and Edmund Mierzwinski, U.S. PIRG, Before the Committee on Financial Services, U.S. House of Representatives, Hearing on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation (June 24, 2009).

influence (some might fear too much influence) within the agency. Dissent among board members will not be good for the agency, and the prudential regulator can be expected to have particular influence with Congress, the President, and other important players. It is highly unlikely that the views of that board member will be disregarded.

2. The CFPA Is Directed To Consult With Prudential Regulators.

Throughout the bill, the CFPA is directed to consult and coordinate with the banking agencies and other agencies as appropriate. The CFPA will take this statutory mandate seriously. Agencies throughout government routinely coordinate on overlapping areas of authority, and there is no reason to expect that this agency will do any less. Consultation is the norm rather than the exception.

The critical fact is that other agencies should *not be given a veto* over the CFPA's rules. The GAO, for example, has identified time delays in interagency processes as a contributor to the mortgage crisis.¹²² Similarly, the requirement for joint rulemaking under the Fair and Accurate Credit Transactions Act has been a nightmare that has only led to paralysis. Similarly, one can imagine that if the OCC had a veto over the credit card rules, it would have used it, to stop rules that not only achieved consensus among FRB, the OTS and the NCUA, but also were overwhelmingly endorsed by strong bipartisan votes in both houses of Congress.

In fact, the bill should also be improved to make clear that industry players who are dissatisfied with CFPA rules cannot use the consultation requirements as a basis for challenging those rules. The consultation requirements exist to give the Agency statutory direction, and to provide a framework for consideration of various viewpoints within the federal government. Industry should not be able to drag that consultation process into court for judicial review as an excuse for challenging a rule. New York University Law Professor Rachel Barkow testified last week that the consultation requirements, as currently written, could “make any rules that the CFPA does pass vulnerable to innumerable legal challenges on the ground that the CFPA did not adequately consider a competing agency's objectives. This is the kind of sweeping substantive standard that allows industry participants to tie up agency rules for years with challenges.”¹²³

¹²² “As we note in our report, efforts by regulators to respond to the increased risks associated with the new mortgage products were sometimes slowed in part because of the need for five federal regulators to coordinate their response.” “Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System, Testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, February 4, 2009, pages 15-16.

¹²³ Statement of Rachel E. Barkow, Professor of Law, Faculty Director, Center on the Administration of Criminal Law, New York University School of Law on The Proposed Consumer Financial Protection Agency: Implications for Consumers and the FTC Before the House Subcommittee on Commerce, Trade, and Consumer Protection at 7 (July 8, 2009) (“Barkow Testimony”), available at http://energycommerce.house.gov/Press_111/20090708/testimony_barkow.pdf.

3. The CFPA and Prudential Regulators Will Share Examination Reports

The bill requires the CFPA to share confidential examination reports with the prudential regulators and vice versa. This confidential exchange of information will give the CFPA greater insight into any significant safety and soundness concerns expressed by prudential regulators, and will also help the banking agencies to understand consumer protection concerns exposed by CFPA examinations.

4. Congress will have Oversight over the Agency

Congress will also have the ability to oversee the CFPA and to ensure that appropriate consultation and coordination is occurring between the agencies. It is likely that at least part of the Agency's funding will come from appropriations, as a backup to fees, giving Congress regular input into the functioning of the Agency. Congress of course also has the ultimate ability to amend the statute and to restrict the Agency's authority if it is used inappropriately.

The CFPA will be well aware of the history of the FTC, which incurred the wrath of Congress and had its powers severely curtailed when it got out in front of congressional expectations. The agency will be forewarned about the importance of consulting with the banking agencies and considering safety and soundness concerns, and Congress can ensure that it does so.

5. The Seriousness of Potential Conflicts is Overstated

These measures, built into the structure of the CFPA, will ensure that significant safety and soundness and other concerns of prudential regulators are taken into serious consideration.

But equally important, the likelihood of significant conflicts between safety and soundness and consumer protection, or between the CFPA and the banking agencies, is exaggerated. As should be fully apparent today, consumer protection can actually bolster safety and soundness. Indeed, consumer regulators – who approach the issue differently – may be more attune to the risks of dangerous products at an earlier point in time than prudential regulators, when they are only affecting a handful of families and not entire portfolios.

Though the link between consumer protection and safety and soundness is now obvious, the two functions are not the same, and do lead agencies to have different perspectives. In some circumstances, such as with overdraft loans, a financial product might well be profitable, even though it is deceptively offered and has a financially devastating effect on a significant number of consumers.¹²⁴ A prudential regulator, who sees the role those profits play in the balance sheet, may resist changes that require restructuring the product.

But ending or correcting profitable but abusive practices will *rarely* affect the overall safety and soundness of an institution. If it does, that institution is probably unsustainable over the long run

¹²⁴ Testimony of Travis Plunkett, Legislative Director, Consumer Federation of America and Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, Before the Subcommittee on Financial Institutions and Consumer Credit of the U.S. House of Representatives, Committee of Financial Services, March 19, 2009.

in any event, as evidenced by the collapse of numerous subprime lenders. *The mere fact that prudential regulators see the industry's perspective and take their side does not mean that a consumer protection rule hurts the health of an institution.*

Consumers themselves have an interest in seeing that safety and soundness concerns are taken seriously. If the rules go too far, they could backfire and harm consumers themselves. Consumers and financial institutions share a common interest in seeing that financial products and services are made in a sound, fair and sustainable basis. If access to credit is shut off, that will harm consumers too. But more typically, access to credit is a red herring trotted out any time that a bank wants to preserve a profitable activity, even one that is predatory and destructive.

Contrary to the arguments of opponents of the CFPA, protecting consumers from traps and tricks when they purchase credit, savings or payment products should encourage confidence in the financial services marketplace, spur innovation, and ultimately create a win-win situation good for everyone. As Nobel Laureate Joseph Stiglitz has said:

There will be those who argue that this regulatory regime will stifle innovation. However, a disproportionate part of the innovations in our financial system have been aimed at tax, regulatory, and accounting arbitrage. They did not produce innovations which would have helped our economy manage some critical risks better—like the risk of home ownership. In fact, their innovations made things worse. I believe that a well-designed regulatory system, along the lines I've mentioned, will be more competitive and more innovative—with more of the innovative effort directed at innovations which will enhance the productivity of our firms and the well-being, including the economic security, of our citizens.¹²⁵

C. Congress Should Consider Making the CFPA a Fully Independent Agency

In last week's testimony before a Commerce subcommittee, New York University Professor of Law Rachel Barkow noted that the bill as drafted appears not to make the CFPA a fully independent agency, but rather to subject it to review by the President's Office of Management and Budget and to the requirements of executive orders.¹²⁶ Thus, the CFPA will have *less independence* than these independent agencies, including the FTC and the CPSC after which the CFPA is modeled:

Board of Governors of the Federal Reserve System
Commodity Futures Trading Commission
Consumer Product Safety Commission
Federal Communications Commission
Federal Deposit Insurance Corporation

¹²⁵ "Too Big to Fail or too Big to Save? Examining the Systemic Threats of Large Financial Institutions," Joseph E. Stiglitz, April 21, 2009, page 10.

¹²⁶ Barkow Testimony at 13-15.

Federal Energy Regulatory Commission
Federal Housing Finance Agency
Federal Maritime Commission
Federal Trade Commission
Interstate Commerce Commission
Mine Enforcement Safety
Health Review Commission
National Labor Relations Board
Nuclear Regulatory Commission
Occupational Safety and Health Review Commission
Postal Regulatory Commission
Securities and Exchange Commission¹²⁷

As Professor Barkow testified:

The more susceptible an agency is to presidential oversight, the more likely the agency's policies will shift as new administrations take power. Dramatic shifts hinder business planning and create legal uncertainty, which can be damaging to any market, including the one for financial products and services. In addition, [the OMB's Office of Information and Regulatory Affairs (OIRA)] has traditionally had a deregulatory bias. Although many urge OIRA to take a more aggressive role in policing agency inaction as well, OIRA's history is to the contrary. There remains the risk, then, that OIRA review could put pressure on the CFPB to be less ambitious in its regulatory positions. The potential for OIRA to delay the implementation of regulations in the future is also a possibility.¹²⁸

Professor Barkow cited a recent Government Accountability Office (GAO) finding that OIRA review expands the President's influence over an agency's substantive policies, frequently leading to significant and material modifications in the agency's regulations.¹²⁹

OMB review could be one method of ensuring that the banking agencies views are seriously considered before a CFPB rule is adopted. Professor Barkow did note advantages to OMB review, including the coordination of policies across the executive branch and the requirement of cost benefit analysis.¹³⁰

¹²⁷ The term "independent regulatory agency," which entitles to agency to independence from executive orders, is contained in the Paperwork Reduction Act, 44 U.S.C. § 3501(5).

¹²⁸ Barkow Testimony at 14 (footnote omitted).

¹²⁹ Barkow Testimony at 13; U.S. Gov't Accountability Office, Report to the Chairman, Committee on Oversight and Government Reform, House of Representatives, Federal Rulemaking: Improvements Needed to Monitoring and Evaluation of Rules Development as Well as to the Transparency of OMB Regulatory Reviews 30 (April 2009) (reviewing 12 rules submitted to OIRA and finding that OIRA review led to significant or material changes for eight of them).

¹³⁰ Barkow Testimony at 14.

But given that the CFPA's own Board membership and consultation requirements ensure coordination from the start, and that consideration of costs and benefits is built into the Agency's unfairness authority by statute, Congress should consider whether this additional review is worth the costs.

Moreover, it is noteworthy that it is *the Paperwork Reduction Act* that defines the term "independent regulatory agency." Agencies that do not fall within that term might be expected to be subject to greater paperwork and review requirements, with resulting delays in implementation of their rules. Congress might want to consider this possibility.

V. CONCLUSION

The nearly 200 organizations that are members of American for Financial Reform, along with many other consumer, community, civil rights, and labor groups, and Americans of every stripe, believe that restoring consumer protection should be a cornerstone of financial reform. It will reduce risk and make the system more accountable to American families. We recognize, however, that other reforms are needed to restore confidence to the financial system. Our coalition ideas on these and other matters can be found at the website of Americans For Financial Reform, available at ourfinancialsecurity.org.

Thank you for the opportunity to testify. Our organizations look forward to working with you to move the strongest possible Consumer Financial Protection Agency through the House of Representatives and into law.