REGULATORY RESTRUCTURING: ENHANCING CONSUMER FINANCIAL PRODUCTS REGULATION

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JUNE 24, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–49

U.S. GOVERNMENT PRINTING OFFICE

52–406 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIÉRREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, Jr., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

WITNESSES

Wednesday, June 24, 2009

APPENDIX

Page

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

REGULATORY RESTRUCTURING: ENHANCING CONSUMER FINANCIAL PRODUCTS REGULATION

Wednesday, June 24, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:07 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Gutierrez, Watt, Sherman, Moore of Kansas, Capuano, Clay, Baca, Miller of North Carolina, Scott, Green, Cleaver, Ellison, Klein, Wilson, Foster, Carson, Speier, Minnick, Kosmas, Himes, Maffei; Bachus, Castle, Royce, Lucas, Manzullo, Biggert, Miller of California, Hensarling, Garrett, Neugebauer, Bachmann, Marchant, McCarthy of California, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order. I apologize for being late. Let me make a request of my colleagues. I guess we will go to the opening statements. I will begin. We have 10 minutes each. One of my frustrations as the ranking member, as the chairman and even previously has been the problem of getting adequate response to consumer complaints. It has been my experience that when you have an ongoing responsibility for broad systemic issues, consumer complaints can get crowded out. It is also the case that when you, and it has been my experience, have bank regulators whose primary role is the health and safety and soundness of the banks, consumer regulation, again, tends to get crowded out. We certainly have the history of the Federal Reserve previous to the co-chairman, who has been a great improvement, literally ignoring their consumer responsibilities.

So I think the proposal that has come forward for a separate entity charged with protecting consumers from abuse is a very good one. The fear that this will be some out of control entity ravaging the financial sector is unsupported by anything in American history. There is no pattern of overregulation that I can see in the consumer area, and I don't see one here. So I am very pleased that the Administration sent us this recommendation.

I am glad that we have with us one of the original authors of it, if not the original author, Professor Warren from Massachusetts. And I will just say as a matter of schedule, we will be spending a good deal of time between now and the rest of this congressional session dealing with the question of financial regulation. This is an important piece of it. It is my intention that following this hearing, we will be moving in July when we return to a mark-up on this. Ultimately, the financial regulation is going to be one bill, in part because of the United States Senate. Let me say, I was invited to speak on a project involving an entity that is going study the Senate.

And I said, I thought that was going to be both important and fairly easy because it is a very significant institution with very few moving parts, which makes it somewhat easy to study it. But I do believe in the interest of this committee's doing its job the best it can that we should mark these up individually. So I do want to announce that this is a hearing that will lead to a mark-up in the period between the 4th of July and the recess at the end. So I urge members to pay very close attention. With that, I now recognize the gentleman from Alabama for 2 minutes.

Mr. BACHUS. I thank the chairman. Mr. Chairman, today we are having a hearing on the creation of an independent consumer protection, or Consumer Financial Protection Agency. And there is no question that consumer protection is a legitimate government responsibility. However, there is and needs to be a serious dialogue over how that function should be properly undertaken to be effective. The proposal that was outlined in the Administration's White Paper proposes very fundamental and profound changes to the current financial regulatory regime. We have to ask ourselves whether those changes have the potential to reduce consumer choice, limit innovation, and exacerbate the credit crunch that consumers and small businesses are currently facing. When you tell people that they cannot make certain loans, then it always has the potential to restrict credit.

The House Republicans have offered a consumer protection plan that closes gaps in the enforcement of our present consumer protection laws by consolidating the regulatory enforcement and consumer protection functions in a single agency and streamlining the complaint process for consumers and investors. It would also strengthen antifraud enforcement by giving regulators more investigative and enforcement tools. The Republican consumer protection proposal is built on the premise that the best way to protect consumers is not through creation of another bureaucracy accountable to no one, but by consolidating the regulatory system in place today and holding regulators accountable for both consumer protection and safety and soundness.

Probably my main question early on is the wisdom of bifurcating consumer protection and safety and soundness regulation as is suggested in the Administration's proposal. I am not the only one who has raised these concerns. A Virginia Democrat, Mark Warner of the Senate Banking Committee said, "I need some more convincing of the creation of this Consumer Protection Agency. Will this new consumer agency have the knowledge because it won't have the kind of day-to-day exposure to financial products or the industry if this agency was actually housed inside the day-to-day prudential regulator."

Mr. Chairman, I look forward to working with you and the Administration to develop a consumer protection framework that fosters innovation in financial products, and benefits and protects consumers without creating unintended potentially adverse consequences for consumers and the financial services industry. I also thank Congressman Delahunt for his work on the issue.

The CHAIRMAN. I will next recognize the chairman of the Financial Institutions Subcommittee, Mr. Gutierrez, for 2 minutes.

Mr. GUTIERREZ. Thank you, Mr. Chairman. I am pleased the committee is beginning the process of evaluating regulatory restructuring legislation with a hearing that focuses on protecting consumers. I strongly support the concept of an independent agency that concentrates solely on consumer financial services issues, and I am especially excited by the prospect of having an agency that focuses on the Community Reinvestment Act enforcement and approaches the issue solely from a consumer's perspective. But my support for such an independent agency is contingent upon its serving as the primary Federal regulator for nonbank institutions. The Administration's White Paper outlines the Consumer Financial Protection Agency's jurisdiction as encompassing both banks and nonbanks. But I will be seeking confirmation from the Administration that it intends for the CFPA to be the primary Federal consumer regulator for payday lenders, money remitters, and other money services businesses. And that the White House commit that the CFPA will aggressively use its supervisory and enforcement powers to regulate these industries.

In addition, I have several questions and concerns about some of the provisions that are in the Administration's White Paper on this topic. Specifically from a banking perspective, I am concerned about how the Consumer Financial Protection Agency's board authority will mesh with the authority of the safety and soundness regulators. There is a real potential here for conflicting regulations from different bank regulatory bodies. I thank the chairman for the time.

The CHAIRMAN. The gentleman from Texas, Mr. Neugebauer, for 2 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Like everyone here, I support consumer protection. I also support protecting consumers' ability to choose financial products and services that best fit their needs. Action we take in Congress shouldn't harm consumers by reducing their choices and increasing the cost and fees. Certainly the information consumers receive can be disclosed better. I have been a strong advocate of better disclosure, clearer disclosure, and shorter disclosure. But the government's role here is not to decide what products and services are available; the government is here to ensure transparency and integrity in the marketplace. Our Republican plan calls for a simplification of consumer protection, not duplication and creation of a new bureaucracy. We need to keep safety and soundness regulators and consumer protection regulation in the same house because these two missions are connected and because this helps hold the regulators accountable.

We have had some regulators quite honestly who didn't do their job, and this Administration plan does not hold them accountable. We had consumers who made poor decisions and lenders who made poor decisions. We had regulators who didn't do their job, didn't see that some of these products were curtailed. But one of the things we know is that the government's role here, and we need to be very careful as we start to throw this big regulatory blanket over the marketplace, is to send a signal to the American investors or people using financial products that the government will keep things from going up or keep them from going down, but it will not keep people from losing their homes. That is not the role of the government; the government cannot do that. When we say that we are going to regulate safety, I think sometimes we can send a signal there that somehow the government is going to make all of these investments safe. But what we do not need to do is start taking away the choices that the American people have for financial products. And I look forward to a debate where we can do something that is good for the American people but not reduce their choices.

The CHAIRMAN. Next, the prime sponsor of the bill here on the committee, the gentleman from North Carolina, Mr. Miller, for 2 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. One of the issues arising from the financial crisis that this committee must address is how compensation in the financial industry created incentives for taking immediate profits while ignoring only slightly less immediate risk. We will consider how to adjust compensation to ally the long-term interests of companies with the interest of those who work for them. The issue before us today is more difficult and more important, how to ally the interests of the financial industry with those of society. The financial industry has defended every consumer credit practice, regardless of how predatory the practice appeared to those unsophisticated in finance, like me, as an innovation that made it possible to extend needed credit to those who were excluded from traditional lending.

And the industry's innovations resulted in inflating the housing bubble, evading existing consumer protections, trapping the middle class in unsustainable debt, and creating risk for financial companies that were dimly understood by regulators, by investors, and even by the investors and CEOs of the companies that created them. And it plunged the country and the world into the worst recession since the Great Depression. The regulatory system we are considering is less restrictive than the regulation of many industries that have done much less damage. At bottom, the question is this: Are consumer lending practices that the industry celebrates as innovation actually useful to society, or are they just a way to make more and more money by betraying the trust of the American people? Other regulators don't just take the regulated industry's word for it that their products are beneficial, and neither should the regulation of the financial industry. I yield back my time.

The CHAIRMAN. The gentleman from California, Mr. Royce, for 2 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. Well, beyond the problems with bifurcating consumer protection and solvency protection, a fundamental question remains. And that is, would a consumer financial products agency have stopped the issuance of subprime mortgages to consumers or Alt-A mortgages to consumers? I think it is fair to say the regulators we had in place, many of whom were responsible for consumer protection, were assisting in rather than hindering the proliferation of these subprime products, the proliferation of what are now called "liar loans." In fact, it was because of regulators in Congress that these various products came into existence and thrived in the manner that they did. Subprime mortgages came out of CRA regulations, according to a former Fed official.

And Fannie Mae and Freddie Mac purchased subprime and Alt-A loans to meet their affordable housing goals set by their regulators and by Congress. They lost $1 trillion doing that. The consumers frequently lost their homes as a result of the collapse of the boom and bust that was thus created. Instead of adding another government agency, and unwisely separating solvency protection from consumer protection, we should take a step back and look at the artificial mandates we place on financial institutions that inevitably distort the market which ends up in the long-term walloping the consumer and creating the kind of housing problem that we have today. Thank you, and I yield back, Mr. Chairman.

The CHAIRMAN. Next, the gentlewoman from California, Ms. Waters, for 2 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman, for holding this hearing. Judging from the proliferation of all kind of exotic products such as the no-doc loans, option ARMs, and other subprime mortgages and payday loans, our current regulatory framework inadequately protects consumers. One of the issues is jurisdiction. There are several types of consumer financial products which because they are offered by nonbanks fall into what may be classified as the shadow banking industry. These products and institutions escape Federal regulation yet often lead to Federal problems such as our current economic and foreclosure crisis.

A prime example of this is mortgage servicing. Mortgage servicing is an important part of the housing market and consumers often have more contact with their mortgage servicers than they do with their mortgage broker, real estate agent, or bank combined. However, lately many services have been unable to properly assist consumers for all kinds of reasons. There are liability issues and basic lack of capacity. There is currently no Federal agency with specific jurisdiction over the mortgage servicing industry, and therefore no mechanism for anyone to address this pressing issue.

Keeping this in mind, an agency that merely examines up-front disclosure will not offer adequate protection to consumers who enter into transactions for financial products only to find that those products lack proper servicing and support. I am of the firm belief that if we are to truly protect consumers, we must go beyond the mere questions of disclosure in plain language and also investigate whether interactions between consumers and financial services providers are efficient and sound. That is why any Consumer Financial Protection Agency must have broad authority to examine both products and practices. Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. The gentlewoman from Illinois is recognized for 3 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman. Today's hearing really is about consumers. And there is no question that Federal financial regulators dropped the ball on many fronts. But the Administration's plan to strip the authority to protect consumers from the functional regulator and instead create a whole new bureaucracy jeopardizes the safety and soundness of financial institutions, promotes risky behavior, puts taxpayers on the hook, and threatens our economy. Instead of strengthening our current system and improving communication among regulators, holding regulators regularly accountable for their existing mandates to protect and empower consumers, I am afraid the Administration's proposal sets up an additional layer of Federal regulation that will have the power to dictate what products businesses offer and tell consumers what products they can or cannot have.

If that is not big government, I don't know what is. I think the Administration's proposal takes us down a slippery slope. On the other hand, to protect consumers against fraud and help consumers make informed decisions, I think the Republican proposal empowers consumers. Our proposal also puts taxpayers first and points towards smarter stronger regulators and regulations that promote transparency, accountability, and competition.

Specifically, our plan streamlines the complaint process for consumers and enhances consumer information, it maximizes restitution for fraud victims, and makes it easier for financial regulators to assist in investigating and prosecuting violations of financial laws. I think we have a lot of discussion that needs to take place on this issue and I look forward to hearing from the witnesses. I yield back.

The CHAIRMAN. The gentleman from North Carolina for 2 minutes.

Mr. WATT. Thank you, Mr. Chairman. Mr. Chairman, a number of my colleagues have pointed out that this discussion takes place against the backdrop of a financial meltdown in which the regulators actually were in charge of consumer protection. And so, in addition to today's hearing that will focus on the Administration's proposal to address that failure in our system, we intend to provide one of the regulators, the Fed, which had primary jurisdiction to protect consumers in one part of our industry with an opportunity to explain to us how they can both provide this consumer protection that is expected and pick up additional responsibilities in the newly proposed regulatory framework at the same time.

So this hearing is not disconnected from another hearing that will be taking place in the subcommittee with jurisdiction over the Fed to give them an opportunity to explain how, if they think they could do it better, how they both failed and how they could do it better going forward.

So I just wanted to take an opportunity to point out that in addition to this hearing, which is an important way to move us forward, we do want to give at least one of the regulators the opportunity to evaluate where and how they failed, and if they believe it should be done a different way, how they would do it better going forward. I thank the chairman and I yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling, for 3 minutes.

Mr. HENSARLING. I thank you, Mr. Chairman. The subject matter of today's hearing is disappointing to me. The goal should not be enhancing regulation; the goal ought to be enhancing consumer protection. The hearing title assumes that the magic elixir to our Nation's economic woes is simply more regulation and more regulators. Regulators who now apparently will be given sweeping powers to decide which financial products are best for ourselves and our families. The underlying legislation essentially says that when it comes to financial products if we will only yield our freedoms, if we will only yield our consumer choices, if we will only yield our market-driven innovations to a group of unelected philosopher kings, they will undoubtedly rule us with wisdom and justice.

Forgive me, but I do not buy it. The way to protect consumers is to ensure competitive markets, effective disclosure, consumer choice, innovation, and a modicum of personal responsibility. Now, the underlying legislation tells us that this unelected group of people to form this Commission will have full powers to unilaterally and subjectively ban a product from the market that it deems unfair or anti-consumer. Unelected bureaucrats will now decide for us what mortgages we can have, they will decide what bank accounts we can open, they may even decide whether or not we can be trusted with a credit card.

To that I say, if you do not know the Rodriguez family of Mesquite, Texas, do not presume to choose their bank account for them. If you do not know the Laird family of Athens, Texas, do not believe that you can decide what mortgage is best for them. If you don't know the Shane family of Coffman County, Texas, please don't deign to decide whether or not they can use a credit card to meet their family's needs to find their version of the American dream.

Now, to those who say the Administration's financial reform plan lacked any originality, they are clearly wrong. To functionally create a commission of consumer punishment, not consumer protection, this is an original idea, it is an originally bad idea. And for those who say that, well, we have an economic crisis therefore we must act, you cannot point to any other consumer product but a subprime mortgage as having anything connected to the economic crisis, yet the Federal Reserve has acted, Congress has acted. You can also not point to any lack of regulatory authority. You may not believe that the regulatory authority was exercised properly, maybe not aggressively, it is not a lack of regulatory authority. We need better enforcement, smarter enforcement, but we must preserve economic liberty and consumer choice, and I yield back the balance of my time.

The CHAIRMAN. The gentlewoman from California, Ms. Speier, for 3 minutes. There will be one more 3-minute on the other side and then we will get to our witness.

Ms. SPEIER. Thank you, Mr. Chairman. When the Consumer Product Safety Commission was proposed in 1972, toaster manufacturers, toy companies, and car makers all screamed foul, much like the financial services industry is screaming about the Consumer Financial Protection Agency that we are discussing today. But thank God for the CPSC. It has resulted in safer and more consumer-friendly products and boosted American confidence that the products that they bring into their homes will not kill them.

The proposal for a Consumer Financial Protection Agency that we are talking about today is, I believe, one of the most important reforms to come out of this economic meltdown. A landscaper in my district who works for the City of San Francisco and earns $60,000 a year got a $600,000 mortgage. He now has an $800,000 balance because his "pick a payment" loan allowed him to short his monthly payment and feed the balance back onto the principal. At this point, his yearly mortgage is $51,000 a year, more than his take-home pay. How did he get a loan like this, a bank gave it to him. It is far too generous to say that financial institutions were simply opportunistic for selling exotic mortgages to working people and pushing credit cards on students who were unlikely to be able to repay. Amazingly, many in the financial services industry argue that a consumer protection agency is unnecessary. Not only should consumers just trust their bankers, they also argue that the financial services industry is too complex for a consumer protection agency to understand. Really? Does anyone really want to make the argument that the status quo works. Let's be clear, existing regulators could have stopped the liar loans, the subprime steering, the option ARMs that nearly brought our economy down. The status quo could have jumped in at any time but it didn't. If a product is marketed with total disregard for a consumer's ability to repay, if it is purposefully written so you need to hire a lawyer to understand the terms, if it is manipulated so its customer is more apt to be in a costly product than in one they are entitled to, you can't blame that on the complexity of the system.

Regulators stood by while credit card companies used clever tricks to draw customers into even deeper debt with cheaper rates and balance transfers and "convenience checks" all the while burying the real credit terms on page 30 in fine type. Now, more than 50 million American families can't pay off their credit cards every month. It is essential that this new agency have real power, that they have flexible rulemaking authority, that it be adequately funded, not subject to the starvation by Congress, and that it have real enforcement authority. Financial institutions will say that they cannot possibly function in the kinds of restrictions proposed here, to which I ask them why are you afraid of letting consumers understand the terms of their mortgages and credit cards. We have spent hundreds of billions of dollars taking care of the largest banks in our country. It is time to do something for the 117 million American families as well. I yield back.

The CHAIRMAN. The gentleman from New Jersey for 3 minutes.

Mr. GARRETT. I thank the chairman, I thank the ranking member for holding this hearing, I thank the members of this panel, and I thank the other members of the panel after that as well for coming out today. You know, the Administration claims that its proposal seeks to address and reform the main areas in our financial system that are responsible for the credit crisis and the recession. When you think about it, I don't see anything in the proposal to stop the Federal Reserve, their very loose monetary policy, nor is there anything in there to address the conflicts of interest in the Fed in their dual roles as monetary policy czar and safety and soundness regulator.

I don't see anything in their proposal to prevent the misallocated credit decisions by the government through Fannie Mae and Freddie Mac and CRA. In fact, and this is important, as with the CRA a goal of the proposal before us today, and if you look at the President's proposal, it is out on page 55, it says, "it is to ensure traditionally underserved consumers in communities have access to lending, investment and financial services."

So just like the CRA, its meeting such a goal could possibly exacerbate systemic risk by requiring firms to engage in practices that are risky in the name of consumer protection, something that basically brought us here in the first place. And finally, I don't see anything that will avert human error in the regulatory agencies tasked with that responsibility of overseeing financial institutions. And when you think about that, think of all the panels and experts that we have had come here to say uniformly that it was not for lack of authority but merely human error when such things as the SEC missed the Madoff situation and didn't listen to the information when the regulators over at AIG didn't look deep into it and looked at the Financial Products situation.

They admitted human error there rather than lack of authority. And so here the subject of a hearing today would be a creation of yet another regulator, again with human error actually encouraged by separating regulatory decision. And this point also is important; you are going to be separating the regulator's decision, you are going to create duplication from an already limited expertise found at prudential regulators. In other words, you are potentially working at cross purposes. It was a policy by the government that largely got us into these problems and I don't believe that creating more government agencies, perhaps those even with an Orwellian, heavy-handed, government bureaucrat knows best mentality will ultimately misallocate credit is the appropriate solution. The Republicans, on the other hand, have often an alternative reform package that takes steady aim ensuring no more bailouts by ending the government's practices of picking winners and losers, reducing counter government participation in private markets, appropriately streamlining and restructuring government oversight and restoring market discipline and consumer empowerment. I really think that is the change that people are asking for. I yield back.

The CHAIRMAN. We will now begin the hearing with my colleague from Massachusetts, Mr. Delahunt, who has been a long time advocate for this position. And as a former law enforcement official of great distinction in the Commonwealth of Massachusetts, he is someone who is very well versed in how rights are protected and laws are enforced. Mr. Delahunt?

STATEMENT OF THE HONORABLE WILLIAM DELAHUNT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. DELAHUNT. Thank you, Chairman Frank and Mr. Bachus, for allowing me to testify today. There should be no doubt that we need a new regulatory framework and as importantly sustained supervision of the financial system. The current system failed us and we must avoid a repeat. While the near collapse of the financial system began on Wall Street, it quickly spread to Main Street, taking a devastating toll on families everywhere. Consumers have lost trillions in investment income and home equity. Investors both domestically and internationally have lost confidence. But I am confident that with your leadership and the excellent work of this committee, coupled with the commitment from the White House, we can extricate ourselves from this mess and move forward.

Let me speak to the proposed Consumer Financial Protection Agency in the President's plan. It creates a consumer watchdog and in many respects reflects a proposal put forth by my friend and colleague from North Carolina and a member of this committee, Brad Miller. It is charged with ensuring that financial products sold to consumers are safe, responsible, accountable, and transparent. I also want to acknowledge the presence of the intellectual author of this concept, Harvard Professor Elizabeth Warren, who will testify on the next panel.

There are currently 10 different Federal regulators that have some responsible for protecting consumers from predatory or deceptive financial products, but none have consumer protection as their simple sole primary objective. As a consequence, debt instruments have become increasingly risky. American families have been steered often deceptively into overpriced credit products including credit cards, car loans, and subprime mortgages. And as a result, Americans are overwhelmed with debt. These levels of personal debt have not only played a significant role in the financial crisis, but represent a significant impediment to full economic recovery.

Today, one in four families are worried about how they will pay their credit card bill each month and nearly half of all credit cardholders have missed payments in the past year. There are more than 2 million families who have missed at least one mortgage payment and one in seven families are currently dealing with a debt collector. Like other government agencies, the Consumer Financial Protection Agency would seek to shield the consumer from unreasonable risk. The Agency would review financial products for safety, modify dangerous products before they hit the market, establish guidelines for consumer disclosure, and collect and report data about different consumer loans. I am sure Professor Warren will outline the specific provisions of the proposal. Undoubtedly credit helps dreams come true. Consumers can buy homes, cars and pay for a college education. But when seeking a loan consumers should not have to understand the nuances of complex financial instruments just as they don't need to understand how a toaster works, how a drug acts in our bodies or whether the food they eat is safe. By creating an agency whose primary role is to help the consumer people can again borrow with confidence that they are protected from fraudulent unsafe credit products. This will increase overall consumer confidence, will create demand, and stimulate the markets and spur investments.

It is a win-win, not just for the consumer, but I believe will accelerate the recovery that is our common goal. Let me conclude with this: The Congress has attempted to enact reforms in the past but to no avail. Sensible reforms were thwarted by special interests and some will come before this committee to say that our regulations go too far, that this is simply too much. I say to them, give me a break. Just look at what has occurred. For too long, we have frankly let the American people down by failing to create a prudent regulatory regiment to protect the consumer from dangerous financial products. And we have seen the results. We can't let it happen again. And the consequences are simply too profound. Thank you, Mr. Chairman.

[The prepared statement of Representative Delahunt can be found on page 78 of the appendix.]

The CHAIRMAN. I thank the gentleman. I would just note that after 22 years as a district attorney, being able to say to somebody else, give me a break, probably is a role reversal for you.

Mr. DELAHUNT. I used to hear that frequently, Mr. Frank.

The CHAIRMAN. We are going to break. Now, there has only been one vote. So instead of waiting, let's get over and get back quickly. I intend to vote, come right back and start right away with our witnesses, so let's move quickly.

[recess]

The CHAIRMAN. The hearing will reconvene. We will begin with Professor Elizabeth Warren, who is a Leo Gottlieb Professor of Law at Harvard University. By the way, without objection, any documents that any of the witnesses wish to submit will be made a part of the record today. And if, after the hearing, you decide you have some supplemental material, we will take that as well. Professor Warren?

STATEMENT OF ELIZABETH WARREN, LEO GOTTLIEB PROFESSOR OF LAW, HARVARD UNIVERSITY

Ms. WARREN. Thank you, Chairman Frank, for inviting me here. Thank you, Ranking Member Bachus. I also want to thank Congressman Delahunt and Congressman Miller who were able to put together the first version of this and introduce it in this House. I appreciate the invitation to appear. I should note, I speak only for myself, not on behalf of any other group or as a lobbyist for anyone. I am here to deal with a problem that can be explained in blunt words: the consumer credit market is broken. This is not about people who went to the mall and charged up what they couldn't afford to pay, and this is not about people who bought five bedroom houses that they can't make the payments on. Those people should deal with the consequences. This is about people who get trapped by credit agreements themselves.

Everyone in this room recognizes the problem. Consumers cannot compare financial products because the products have become too complicated. Make a comparison between four credit cards, put the papers on the table, and you would have more than 100 pages of dense, fine-print text to work through. And, quite frankly, even if you invested the hours to do it, I don't know if you would be able to understand it. I say that only because I teach contract law at Harvard Law School, and I can't understand many of the terms.

You can't tell which card is cheaper, which card is safer. That is not choice. Companies compete today by offering nominal interest rates and free gifts and then loading tricks and traps in the fine print where nobody else can see them. The result is that bad cards produce more profits than good cards and the market can't drive consumers toward cheaper, lower-risk products. Healthy markets thrive with information and level playing fields, not with tricks and traps. Broken credit markets also tilt the playing fields between big and small lenders. Local banks and credit unions may offer better products, but when the customers can't make easy comparisons the smaller banks, the ones with the smaller advertising budgets lose out. Broken credit markets also feed excessive risk into the system. Bad products carry very high default rates. And this is true across-the-board. Aggregated together, this can bring down families, bring down banks, bring down retirement funds, and ultimately bring down our whole economy.

Systemic risk regulation starts by not feeding high risk products into the system. A Consumer Financial Protection Agency can fix a broken market. An agency that focuses on transparency can promote, for example, a plain vanilla product. Consider if we had a Consumer Financial Protection Agency, 2-page plain vanilla, credit card agreement. You could put four of them on the table, the differences between them, the interest rates, the penalties, what causes the penalties, even the free gifts can be put out there in bold. That means that in less than a minute, you can tell which one is cheaper, which one is riskier and how much those free gifts actually cost you. That is choice, that is a meaningful choice made possible by regulation that repairs a broken market. Agencies can also reduce overall regulatory burdens for lenders.

I think everyone in here agrees we should remove the layers of contradictory and inefficient regulation. By putting things in a single place and by promoting plain vanilla safe harbor mortgages, credit cards and other products that automatically pass regulatory muster, we make it very cheap for issuers to issue these products. They are already through the regulatory process. Banks can offer something else, but they have to show that what they offer meets basic safety standards, which in this case means a customer can read it and understand it in 5 minutes or less.

Regulatory agencies are not perfect, but they can do a lot of good. In the 1920's, anyone with a bathtub and some bottles of chemicals could sell drugs in America. The FDA put a stop to that. Dirty meat could be sold to families. The Department of Agriculture put a stop to that. In the 1960's, babies' car seats collapsed on impact, 8-year old boys shot out their cousins' eyes with BB guns, and infants chewed on toys covered in lead paint. The Consumer Protection Safety Commission put a stop to that. We have tried for 70 years to combine consumer protection with other financial service regulatory functions. This structure has not worked.

To talk about keeping these two together is to say we are satisfied with the system and want it to go on as it has before. I think it is time for change. We need someone in Washington who cares primarily about families, who cares about consumers, who looks at the products not from the point of view exclusively of bank profitability but who looks at these products in a much larger sense about what they mean to the family, what they mean to communities, what they mean to the economy as a whole. This is an historic moment. You can repair a broken market, you can take the first steps in preventing the next financial crisis, and most of all, you can put a Consumer Financial Protection Agency in place to stop the tricks and traps that are robbing American families every day. Thank you, Chairman Frank.

[The prepared statement of Professor Warren can be found on page 199 of the appendix.]

The CHAIRMAN. Next, we have the Honorable William Francis Galvin, Secretary of the Commonwealth of Massachusetts, who, for people not familiar with the intricacies of the laws of the State of Massachusetts, he is the securities regulator for the State of Massachusetts, so has been deeply involved in regulation. Mr. Galvin.

STATEMENT OF THE HONORABLE WILLIAM FRANCIS GALVIN, SECRETARY, THE COMMONWEALTH OF MASSACHUSETTS

Mr. GALVIN. Thank you, Chairman Frank, Ranking Member Bachus, and members of the committee. I want to thank you for this opportunity to testify on these important issues of consumer and investor protection. As Secretary of the Commonwealth, as has been noted, I am the chief securities regulator. The Congress is now considering an array of initiatives to improve consumer and investor protection. These include proposals in the White House, a White Paper on financial regulatory reform, as well as bills proposing the creation of the Consumer Financial Protection Agency. I commend and support the President's plan to strengthen and rationalize financial regulation, to provide greater protection against systemic risk in the financial markets, and to create a Federal agency to protect consumers in credit transactions.

I support the proposal to strengthen the U.S. Securities and Exchange Commission that will enable the SEC, along with the States, to oversee the securities markets and to protect consumers. I also applaud other elements of the White House plan that would directly improve investor protection such as making securities brokers fiduciaries. True consumer protection requires that financial firms be fiduciaries for their consumers whether they are licensed investment advisors or brokers. We need to act now on the issue of mandatory arbitration. The documented problems in that area should be an indication that this should be optional for investors rather than mandatory. Too many investors have faced a stacked deck in arbitration. Most especially hedge fund registration, whereas that both hedge fund managers and the funds themselves should register with the SEC.

Hedge funds are often low visibility but high impact participants in the financial markets. Hedge funds have also been the source of abusive trading in the commodities and securities markets, including trades that have distorted the oil and food markets. Wild speculation in these basic commodities during the past year has robbed millions of Americans of billions of dollars at the gas pump and the supermarket. I urge Congress to protect our now fragile economy from further damage. We support the creation of a Consumer Financial Protection Agency to enhance the protection of consumers when they enter into credit savings and payment transactions.

Sadly, this hearing on the creation of this agency is necessary because existing regulatory agencies dropped the ball. While some proposals have slipped through the cracks—some problems have slipped through the cracks of existing rules too often regulators fail to maintain their independence in the industries they regulate and they fail to use their powers to promulgate and enforce rules to protect the public. Massachusetts and other States have a distinguished record of protecting retail investors and consumers. As financial regulation is redesigned, I urge you to preserve and enhance the abilities of the States and State regulators to protect investors and consumers. There is an acute need for this protection. Retail investors and savers have been forced into the risk market to meet their basic financial goals.

Investors and consumers are particularly harmed when the States have been preempted from protecting their interests. These include the preemption of State usury laws, predatory mortgage lending laws, and security law preemption. The National Securities Markets Improvement Act of 1996 preempted State authority in key areas where the States protected investors. NSMIA removed the State's ability to require enhanced disclosure in mutual funds. NSMIA created a regulatory blind spot for hedge funds selling securities pursuant to the Rule 506 exemption. And NSMIA prevented a State enforcement action against large investment advisors even when the violation involved unfair or deceptive practice. Massachusetts and other States have taken the lead in bringing enforcement actions and recovering funds for investors. These include auction rate securities, illegal market timing of mutual funds, and false security analyst reports and pyramid and Ponzi schemes.

The States are close to the investing public and have time and time again demonstrated that they can act quickly and effectively to help investors. The States have added value but precisely because they are independent of other agencies and self-regulatory organizations. States have been another set of eyes watching the market. States have also served as a backstop, protecting the interest of investors in important cases when other regulators have not taken action. We urge the Congress not to make the States subject to the authority of the Financial Services Oversight Council or the Federal Reserve. Similarly we urge the States not be made subject to the Consumer Financial Protection Agency. The independence of the States means that they are less likely to yield to pressure from regulated entities and they are much less likely to be captured by the firms and the industries that they regulate.

In this regard, I must emphasize the record that States have of cooperating with the SEC and FINRA and this record will continue. The States will cooperate and coordinate with the Consumer Financial Protection Agency that is proposed. However, it is crucial the States not be under the CFPA's authority. The States' independence is vital and it is the key to our record of success. To be effective, the States need the tools we need to regulate effectively. We need to restore States' authority over nonpublic offerings, particularly hedge funds, which are particularly sold pursuant to the exemption under Rule 506. We need to permit the States to police larger federally registered investment advisors for unethical and dishonest practices. The rights for investors to sue for violations of State and Federal securities laws is also a powerful tool that should be reconsidered. I urge the Congress to review the impacts of the private security litigation reforms. We need to strengthen, not weaken, investor remedies. Thank you, Mr. Chairman.

[The prepared statement of Secretary Galvin can be found on page 81 of the appendix.]

The CHAIRMAN. Next, we will hear from Ellen Seidman, who is a senior fellow at the New America Foundation and a former Federal regulator.

STATEMENT OF THE HONORABLE ELLEN SEIDMAN, SENIOR FELLOW, NEW AMERICA FOUNDATION

Ms. SEIDMAN. Thank you. Thank you Chairman Frank, Ranking Member Bachus, and members of the committee. I appreciate your inviting me here this morning. In addition to being a senior fellow of New America Foundation, I am also executive vice president at ShoreBank Corporation, the Nation's largest community development financial institution. My views are informed by my current experience, although they are mine alone, not those of New America or ShoreBank, as well as by my years at the Treasury Department, Fannie Mae, the National Economic Council, and as Director of the Office of Thrift Supervision.

The Administration has proposed creation of a very broad-based and powerful Consumer Financial Protection Agency that would have regulatory, supervisory and enforcement authority over consumer protection in the financial services sector and also over the Community Reinvestment Act. The Administration's recognition of the seminal importance of consumer protection financial services is a critical reversal of the trends over the last several decades and builds on the work this committee has done. I agree with the Administration that the time has come to create a well-funded single Federal entity with the responsibility for authority over consumer protection and financial services. The Administration has also focused on the importance of CRA.

Access to high-quality financial products at fair terms and reasonable prices is an important element of consumer protection that requires both leveling the playing field by having consistent regulations across all entities providing similar products and encouraging financial institutions to responsibly serve all communities and consumers. I am concerned, however, about two elements of the Administration's proposal. First, I believe that prudential supervisors, in particular, the Federal and State banking regulatory agencies, should retain primary supervisory responsibility for consumer protection as well as for safety and soundness over the entities they regulate.

I suggest, however, that Congress make changes to the organic banking statutes to emphasize the importance of consumer protection, elevating it to a higher place in the supervisory system. Second, I am concerned that what has been in many ways the most consistently successful element of CRA, namely investment and community development finance, such as affordable rental housing, community facilities and lending both with and through CDFIs, may get lost in an agency devoted to consumer protection.

In my written statement, I suggest some ways to increase the likelihood that if CRA is part of the CFPA, service to all communities and community development will be a robust part of its mandate.

The current crisis has many causes, including an overreliance on finance to solve many of the needs of our citizens. Those needs require broader social and fiscal solutions, not financial engineering.

Nevertheless, there were three basic regulatory problems. First, there was a lack of attention and sometimes unwillingness to effectively regulate products and practices even where regulatory authority existed. Second, there were and are holes in the regulatory system, both in terms of unregulated entities and products and in terms of insufficient statutory authority.

Finally, there was and is confusion for both the regulated entities and consumers and those who work with them. The solutions are not easy. Financial products, even good ones, can be extremely complex. Many, especially loans and investments, involve both uncertainty and difficult math over a long period of time. The differences between a good product and a bad one can be subtle, especially if the consumer doesn't know where to look. And different consumers legitimately have different needs.

The regulatory framework, of course, involves both how to regulate and who does it. With respect to how, I suggest three basic guiding principles that I believe are fully consistent with the Administration's proposal. First, products that perform similar functions should be regulated similarly no matter what they are called or what kind of entity sells them.

Second, we have to stop relying on consumer disclosure as the primary method of protecting consumers. While such disclosures can be helpful they are least helpful where they are needed the most, when products and features are complex. Third, enforcement is important. While much attention has been given in the week since the President's proposal was announced to enforcement and depository institutions, the fact that the proposal would make fairly stunning changes and improvements in consumer protection for nondepositories has largely been left unsaid.

With respect to who should regulate, it is time to establish a single Federal entity dedicated to consumer protection. If properly funded and staffed, this agency will be more likely to focus on problems that are developing, to take action before they get out of hand. This is not separating regulation writing more than it currently is. Most banking consumer protection regulations are written solely by the Fed. The other prudential regulators enforce someone else's regulations. That is exactly the system that there would be in this case.

Centralizing the complaints function will give consumers and those who work with them a single point of contact and the regulatory body early warning of trouble. The CFPA will also have the opportunity to become expert in consumer understanding and behavior to regulate effectively without necessarily having a heavy hand, and it could also become a focus for the myriad of Federal efforts surrounding financial education.

How will the new regulator be funded and at what level?

It is essential that this entity be well-funded. If it is not, it will do more harm than good as those relying on it will not be able to count on it. This almost certainly requires a dedicated revenue source in addition to general fund appropriations.

What will be the regulator's supervisory and enforcement authority?

I believe that the prudential supervisors can do this. Regulators who engage in prudential supervision with on-site examinations should be expected to exercise that authority. Retaining primary supervisory and enforcement authority with the prudential supervisors makes use of existing structures and resources, and keeps consumer protection and safety and soundness together, but having backup authority in the CFPA would be extremely important.

In my testimony, I explain that I think that there are revisions to the organic banking statutes that could make an enormous difference in making sure that this works better than it has. The current crisis is an enormous opportunity to make a big difference that will benefit consumers, financial institutions, and the economy.

The President has put forth a bold proposal, and now is the time to act. Thank you.

[The prepared statement of Ms. Seidman can be found on page 179 of the appendix.]

The CHAIRMAN. We are going to be having a lot of votes. Members can go and vote. I may or may not go. After 53 votes last week, I think I can miss an adjournment vote or two, so I may well keep going. If members want to go and come back, we are going to keep going.

Mr. Mierzwinski.

STATEMENT OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Mr. Chairman.

I am Ed Mierzwinski with the U.S. Public Interest Research Group. Along with Travis Plunkett on the next panel, of the CFA, we are submitting joint testimony, written testimony, on behalf of over a dozen community and civil rights organizations in support of the Consumer Financial Protection Agency as first proposed by Professor Warren, then introduced by Mr. Brad Miller and Mr. William Delahunt, and now part of the President's comprehensive blueprint to reform our financial system.

In our written testimony, we went into great detail as to why this new agency will protect consumers from unfair credit payment and debt management products no matter what company or bank sells them and no matter what agency may serve as their primary regulator.

I want to also point out that our coalition recognizes that there are a number of other problems that your committee will be addressing over the next year and that those problems, including systemic risk, including the bad incentives for executive pay, including the shadow banking system, and other issues, are all covered in our Americans for Financial Reform platform, which is available at ourfinancial security.org, and we intend to work closely with the Congress to make sure that as strong as possible recommendations are enacted.

The idea of a Federal financial consumer protection agency is a critical part of the President's plan, and we urge you to recognize that it must be given authority to make the rules, to supervise compliance with the rules, and to finally to enforce those rules.

In the area of enforcement of the rules, we are very appreciative that the President has proposed that not only will this agency enforce the rules but that State supervisory regulators and the State Attorney General will be able also to enforce the rules. We will reinstate Federal law as a floor, not as a ceiling, also that private rights of action will be allowed, that consumers will be able to enforce the consumer laws. The provision also provides the President's provision that arbitration, forced arbitration clauses in banking contracts, be eliminated as a way to make it easier for private enforcement of the consumer laws. We also propose, in the writing of the legislation, that you ensure that consumers be allowed to enforce the rules, not only the laws.

I want to start out by saying that we have a system that is broken, and what we are trying to do is fix it. The current system does not work. It is possible to create a new system that will work. Let me look really quickly at some of the failures of the current financial system.

First, the Fed had 15 years in which it did not write rules about HOEPA. Second, the OCC spent most of its time and energy preempting the States for 15 years instead of enforcing the laws. By the way, there is one law that the States still are allowed to enforce, which are fair lending laws, and before the Supreme Court now is the case where the OCC has sued New York because it tried to enforce those fair lending laws.

On credit cards, we know the answer to that one. They slept while the credit card problem got worse, and Congress had to step in and solve the problem. The Fed has allowed a shadow banking system of prepaid cards outside of the current financial protection laws that target the unbanked and immigrants. The OTS allows bank payday loans to continue on prepaid cards. The Fed has refused to speed up check availability. The list goes on and on. The Fed has supported the position of payday lenders and telemarketing fraud artists by promoting and permitting remotely controlled checks to subvert consumer rights under the banking laws. These regulators do not look at consumer protection as something that they should be doing.

There are basically six arguments that the other side will use against this agency. They will argue the regulators already have the power. Well, they have the power, but they do not use it, partly because of their culture, partly because of charter shopping, and partly because safety and soundness trumps consumer protection. That is why they must be separated. They will argue it will be a redundant layer of bureaucracy, that it will take away bureaucracy. We have 7 regulators enforcing 20 different laws. That is the wrong way to go.

I have already discussed that we can separate consumer protection from supervision. The proposal from the President talks about a council of regulators with a prudential regulator on the board of the new agency. The President also talks about making sure that there is the sharing of information. We are looking for a new system. We are not looking to take this agency and to cut it off at the knees. We can separate the two.

The agencies will argue and the banks will probably argue that small banks will be hurt. We have a detailed appendix in our testimony. Small banks are actually part of the problem. They promote payday loans. They do a lot of things that are not good.

Finally, as I already discussed, the opponents of the proposal will argue that taking away Federal uniformity is somehow the wrong thing to do. We think it is the right thing to do.

Thank you very much.

[The joint prepared statement of Mr. Mierzwinski and Mr. Plunkett can be found on page 118 of the appendix.]

The CHAIRMAN. Next is Mr. Edward Yingling, who is the president and chief executive officer of the American Bankers Association.

STATEMENT OF EDWARD L. YINGLING, PRESIDENT AND CEO, AMERICAN BANKERS ASSOCIATION

Mr. YINGLING. Thank you, Mr. Chairman, Mr. Bachus, and members of the committee for inviting me to testify on behalf of the banking industry.

Members of this committee are looking at this consumer agency proposal from the point of view of consumers, who should be paramount in your deliberations, but today I would also ask you to take a look at this issue from an additional point as well. While banks of all sizes would be negatively impacted, please think of your own local community banks. These banks never made one subprime loan, and they have the trust of their local consumers. As this committee has frequently noted, these community banks are already overwhelmed with regulatory costs that are slowly but surely strangling them.

Yet last week, these community banks found the Administration proposing a potentially massive new regulatory burden. While the shadow banking industry, which includes those most responsible for the crisis, is covered by the new agency, their regulatory and enforcement burden is, based on history, likely to be much less. The proposed new agency is to rely first on State regulation and enforcement. Yet we all know that the budgets for such State enforcement will be completely inadequate to do the job. Therefore, the net result will be that the community banks will pay greatly increased fees to fund a system that falls disproportionately and unfairly on them.

The new agency would have vast and unprecedented authority to regulate in detail all bank consumer products. The agency is even instructed to create its own products, whatever it decides is plain vanilla, and mandate that banks offer them.

Further, the agency is urged to give the products it designs regulatory preference over the bank's own products. The agency is even encouraged to require a statement by consumers that the consumer was offered and turned down the government's product first. Thus, community banks, whether it fits their business model or not, would be required to offer government-designed products, which would be given a preference over the bank's own products.

On disclosure, the proposal goes beyond simplification, which is badly needed to require that all bank communication with consumers be "reasonable." This term is so vague that no banker would know what to do with it, but not to worry. The proposal would allow, even encourage, thousands of banks and others to preclear communications with the agency. So, before a community bank runs an ad in the local newspaper or sends a customer a letter, it would apparently need to preclear it with the regulator to be legally safe.

CRA enforcement is also, apparently, to be increased on these community banks, although they already strongly serve their communities, and that is not to mention the inherent conflicts that will occur between the prudential regulator and the consumer regulator with the banks caught in the middle.

Please recognize that all of this—cost, conflicting requirements, and uncertainty—would be placed on community banks that in no way contributed to the financial crisis. More generally, the fundamental flaw in the proposal is that consumer regulation and safety and soundness regulation cannot be separated. You cannot separate a business from its product.

A good example is check hold periods. Customers would like the shortest possible holds, but this desire needs to be balanced with the complex operational issues in clearing checks and with the threat of fraud, which costs banks, and ultimately consumers, billions of dollars.

Another example is the Bank Secrecy Act, which protects against money laundering and terrorist financing. These critical regulations must be coordinated with consumer and safety and soundness regulation. Take the account opening process. A consumer regulator would focus on simplicity in disclosures, while the prudential regulator would also want to consider the potential for fraudulent activity and for implementing the Bank Secrecy Act to protect against terrorist financing. What is the bank in the middle supposed to do? What about conflicts over CRA lending?

We agree that CRA has not led to material safety and soundness concerns, but that is because it is under one regulator. There is often debate about individual CRA loans as to the right balance between outreach and sound lending. However, that debate, that tension, is resolved in a straightforward manner because the same agency is in charge of CRA and of safety and soundness. To separate the two is a recipe for conflicting demands, with the bank again caught in the middle.

The great majority of consumer problems, as has been noted by both Democrats and Republicans on this committee, occurred outside the highly regulated traditional banks, but there are legitimate issues relating to banks as well. In that regard, my written testimony outlines some concepts that we hope you will consider to address the banking side of it.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Yingling can be found on page 235 of the appendix.]

The CHAIRMAN. Next, Mr. Alex Pollock, who is a resident fellow of the American Enterprise Institute.

STATEMENT OF ALEX J. POLLOCK, RESIDENT FELLOW, AMERICAN ENTERPRISE INSTITUTE

Mr. POLLOCK. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee.

I have both experienced and studied many cycles of financial bubbles and busts, including the political reactions which inevitably follow, and this forms my perspective on today's questions.

I think we can all agree that the Consumer Financial Protection Agency, as proposed, would be a highly intrusive, large, very expensive bureaucracy with broad, rather undefined and potentially arbitrary powers, which would impose large costs on consumer financial services while, as Mr. Yingling just said, also imposing requirements which would be highly likely to conflict with those of other regulatory agencies. We differ on whether we like this idea or not.

When it comes to so-called plain vanilla products for all providers and intermediaries, a vast jurisdiction apparently unrelated to any charter in definitions, the proposed agency would be able to dictate part of the business across this wide jurisdiction. This strikes me as an amazing assertion. A more sensible proposal would be to define certain financial products as plain vanilla and require disclosure that this is or is not a plain vanilla financial product suitable for an unsophisticated customer. This idea, which strikes me as reasonable, would not require a new agency.

For financial institutions, the CFPA would be an additional parallel regulatory system, representing a major burden, a potentially punitive approach and significant, undefinable regulatory risk. This is quite at odds with the intense desire of the United States Government to attract additional capital into the banking system.

Discussions that I have read about the formation of this agency make me think a lot of those that preceded the Sarbanes-Oxley Act. I see Mr. Oxley smiling down at me up there. That was the first major regulatory overreaction of the 21st Century, and the Sarbanes-Oxley Act has proved highly successful at generating costs and bureaucracy while apparently having no influence at impeding the build-up of risk, as we see from the result. It created and still creates disproportionate burdens on small and venture businesses, and I believe we would see a similar pattern for the CFPA.

Professor Warren and Mr. Yingling both mentioned the special role of community financial institutions, and I think in any kind of body of this kind, should it be created, it would be reasonable to exempt community financial institutions.

The Administration's proposal, in my view, emphasizes one extremely good idea—ensuring clear, simple, straightforward, informative disclosures.

In congressional testimony in the spring of 2007, while sitting at this table, I proposed a one-page mortgage form so borrowers could easily focus on what they really need to know. It remains my opinion that something like that would be a huge improvement in the way the American mortgage system works.

By far the most important reason for good disclosures is for borrowers to be able to decide for themselves whether they can afford the debt service commitments they are making. In my view, that is much more important than choosing among products. The key is: Can you afford the commitments you are making? In the ideal case, the borrowers would be able to complete the one-page form on their own.

In this context, it seems remarkable to me that the idea of building personal responsibility on the part of consumers seems to be missing from the Administration's proposal, which seems to me to be a major failure.

The Administration's White Paper gets to Fannie Mae and Freddie Mac, and it seems to lose courage. As everybody knows, Fannie and Freddie made a huge contribution to inflating the mortgage bubble. They plunged into low-quality mortgage credit, and pushed the top of the market much higher, and the bust subsequently became much worse, of course, including their own insolvency. Without addressing Fannie and Freddie, we cannot address the mortgage market.

The new agency is proposed to have sole authority to evaluate institutions under CRA and to "promote" community development investment. As others have said, I believe this is a truly bad idea. Whenever credit risk and investment risk are involved, it is necessary to balance community investment and safety and soundness. Thus, in my view, it is imperative for these to be combined in one regulatory agency. To have credit risk and investment risk being promoted by people with no responsibility for safety and soundness would be an obvious mistake.

Others have suggested that the idea of centralizing consumer protection is still a good idea. I think it probably is, along with these disclosure responsibilities. We can make use of a logical existing organization. My vote would be to use the Fed and to just drop the notion of the CFPA.

As a final thought, I would like to repeat that any proposals which substantially increase the regulatory burden and undefinable regulatory risk must be considered in the light of the government's intense need to attract very large amounts of additional private equity capital into the banking system.

Thanks very much for the chance to share these views.

[The prepared statement of Mr. Pollock can be found on page 174 of the appendix.]

The CHAIRMAN. Thank you.

Let me say at the outset to my former colleague, Secretary Galvin, that I do not think there is any likelihood that we are going to increase any preemption. In fact, many of us on both sides were opposed to the breadth of the OCC's preemption of all State banking laws, and I believe we will address that. I had previously spoken to the Secretary of the Treasury, and we had initiated conversations with the Comptroller of the Currency, with the State attorneys general and with State bank supervisors. I think we will have resolved that. I know there is a pending court case, but I think we may moot the case by dealing with it.

Next, Mr. Yingling, I just want to say that I welcome and appreciate your comments. I am going to talk about the CRA issue, which is an interesting one, as to how we deal with it. I want to start at the bottom of page 7 of your written testimony. You said it orally, and I think it is very important:

"We agree that CRA"—"we" is the American Bankers Association because there has been this effort to blame CRA for many of the ills of the world in terms of lending. "We agree that CRA has not led to material safety and soundness concerns and that bank CRA lending was prudent and safe for consumers." That doesn't mean every loan made there was right, but I think that is a very impressive reputation of those who would say CRA was a major part of the crisis.

It is also important when you say, "Bank CRA lending was prudent and safe for consumers." The relevance to that is that there is no non-bank CRA lending, because CRA explicitly, by its terms, only applies to banks. So this is a very impressive statement on your part.

Let me now ask others. Ms. Seidman also had this, and I do think that raises an important issue about CRA. I understand you say that is because it is within the current context.

Let me ask Mr. Mierzwinski and Professor Warren: What is your view about the notion of moving CRA? Is there a problem there? You do have this issue where CRA is enforced, to the extent that it is—and it is not exactly the toughest enforcement mechanism. It is enforced by the regulators in terms of denying a right of a change of ownership. How do you make these two work together? That is the one conflict which I do think needs to be addressed.

Professor Warren?

Ms. WARREN. Well, I would make one point about it. It surprised me to see this particular proposal, but there is something to be said for having someone who worries about how financial products are read and understood by consumers looking at CRA. No one is helped if what happens under CRA is that bad loans are made that ultimately cause families to lose their homes.

So to the extent that this injects in the CRA some element of the quality of the loan-making, the quality of the financial decisions that the families are making who were at least supposed to be benefited. I like that aspect of it.

The CHAIRMAN. You were surprised that this was not part of your original proposal?

Ms. WARREN. No, Congressman.

The CHAIRMAN. Let me ask Mr. Mierzwinski.

Mr. MIERZWINSKI. Mr. Chairman, I think that Ellen Seidman's testimony makes some very good points about some of the issues that are framed with moving the agency. The consumer groups and the other community groups are looking at making sure—

The CHAIRMAN. I appreciate it.

Professor Warren, I think you are right. It is possible to have input from this agency without the kind of transfer. I will say that I met yesterday with the community bankers, and they had that same issue. It does seem to me that there is a legitimate issue here about how best to improve CRA. I do, again, say that in the context of thanking you, Mr. Yingling. I know you will hear complaints about your evaluation of CRA and how it was not a major cause of the problem, but I thought I would thank you for it before you get criticized for it.

Let me ask as to one last issue. I invited Secretary Galvin even though he is the securities regulator because he has been a staunch supporter of not having preemption, and we did go through that in a number of cases. The premise here is that we will leave securities enforcement to the SEC. Correct me in the sense that I do think that investor protection is a bigger part of the SEC's mission than consumer protection is of the OCC's.

Does anyone dissent from the notion of—it is my own view that we might want to try and beef up the SEC. Does anyone dissent from the recommendation to focus just on bank products and not on the SEC, banks and others?

Mr. Yingling?

Mr. YINGLING. We dissent in the sense that you have products that compete with each other, and we think that they ought to be subject to the same type of regulatory issues.

The CHAIRMAN. That is a reasonable point for you to raise. Any other comments?

Mr. GALVIN. Mr. Chairman, the only thing I would point out is there are a number of products that sort of fall into multiple categories. Annuities come to mind. Mutual funds products come to mind.

The CHAIRMAN. Well, let me just say on annuities, the insurance issue also comes up, and that is why I decided that we needed a separate panel. So we will be talking about that. That is another issue. I think Mr. Yingling makes a reasonable point. So you get a couple, but I do think that those are things we will work on.

I thank the panel, and it is a busy day. So let me now recognize the gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman.

Professor Warren, I have been reading your interviews with different news organizations, and you said sometimes that one of the first things you will do—and just tell me of these different things what you see as maybe priorities.

Now, you testified you want to eliminate the most destructive practices, you know, high-risk products. You want to establish minimum safety standards; is that correct? Are those two of the different things you want to do?

Ms. WARREN. Yes, Congressman.

Mr. BACHUS. Then, I think, one of the third ones was to require lenders to make pure vanilla, or standardized financial products, available.

Ms. WARREN. Actually, Congressman, no. I have never suggested requiring anything of anyone.

Mr. BACHUS. Oh, okay.

Ms. WARREN. What I have suggested is an agency that offers plain vanilla products that provide a safe harbor on regulation. That is, if you will use an off-the-shelf, page-and-a-half credit card agreement or a one-page mortgage agreement, then you have met all regulatory obligations at that point, making it cheap for you and easy for the consumer to understand.

Mr. BACHUS. What are some of the most destructive high-risk practices or products that you see?

Ms. WARREN. Well, actually, I found it interesting that you listed those as separate entities. The real point, in my view, is when customers cannot follow what you are doing, I regard it as extremely destructive, as high-risk, when you dump 30 pages on a customer and you call that a credit card contract and when only after the customer has used the credit card, discovers terms in it when those terms are charged against the customer.

I think that is extremely destructive. I think it is destructive to show up at a mortgage closing and be handed literally hundreds of pages with stickers saying, sign here, sign here, sign here, and the advice, "you cannot read it." I think that is destructive. I think it is destructive when there are changes over time—when you are quoted one price on a mortgage, but when you show up after you have already sold your house and after you have already gotten all the furniture in the moving truck and are told that the interest rates will be different or that there are prepayment penalties. I think those are very destructive practices.

Mr. BACHUS. Well, other than disclosing them, though, would you stop some of those practices?

Ms. WARREN. The point, Congressman, as I see it, is that it is all about disclosing them. That is really the whole point here. We have now played the game over and over and over of, add 10 more paragraphs, 4 more pages, 20 more pages. That is not disclosure.

Mr. BACHUS. Well, I understand what you are saying, but would you actually choose the terms—

Ms. WARREN. No.

Mr. BACHUS. —or would you just require—

Ms. WARREN. I am not interested in picking terms. What I am interested in is putting terms out where customers can see them and compare products.

Mr. BACHUS. But sometimes it would be destructive. Some practices would be destructive.

Ms. WARREN. Well, you know, let me put it this way, Congressman: I was testifying a year-and-a-half ago in the Senate when one of the Senators asked the principal officer testifying for one of the major banks to explain double-cycle billing. The person from the bank started, stopped, moved over, started again, stopped. He finally laughed and said, "I cannot do it." Well, my view is, if you cannot explain it, then you probably should not sell it to customers. I think that is destructive.

Mr. BACHUS. So that would be one of the principles?

Ms. WARREN. Yes, that would be a key principle for me.

Mr. BACHUS. But what about some of these high-risk products? What if you could explain it, but what if the terms were bad? Would you prevent those?

Ms. WARREN. Well, you know, my view is we used to do this by usury laws. We simply said, there is a cap. There it is.

Mr. BACHUS. Right. Is that sort of what you want to return to?

Ms. WARREN. No. That is exactly what I am talking about. There was no reason to develop a business model that put tricks and traps in back and you pretended to compete on things that were not real. So we have two choices going forward. One alternative is you could return to a day of usury caps. The second way we can do it is we can do it through an agency. I have also sat in these hearings time after time—

Mr. BACHUS. What would the agency do?

Ms. WARREN. Well, this is what we just talked about.

The agency could say if you will issue a page-and-a-half credit card contract that is readable, a one-page mortgage that is readable and make the blanks clear—the interest rate, the penalty rate, what triggers the penalty, and how you get your free gift—if you will put those in bold where someone could read them, you are relieved of other regulatory obligations.

Now the consumer can make a good choice. That is meaningful choice, I believe, Congressman.

Mr. BACHUS. So you are not going to want to set anything. You are just going to want to require—

The CHAIRMAN. We only have time for the gentleman to make a final comment. So without repeating the question, do you have a final comment? We are over the time.

Mr. BACHUS. Well, this would apply to consumer loans. How about bank fees? As long as they reveal those—

The CHAIRMAN. We are way over time. We cannot get into a new dialogue. I just said the gentleman could wrap up.

Mr. BACHUS. Oh, okay.

The CHAIRMAN. Professor Warren, if you want to answer the question, we will find some opportunity to do so later on within her allotted time.

The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

I would like to start with kind of a basic question about oversight and regulation. I sincerely believe that there are some products. They have often been referred to, because of this subprime meltdown that we have had, as "exotic products" that were offered in the markets, such as Alt A loans and option adjustable rate mortgage, etc.

There appears to be a feeling or an understanding or a basic way that the financial services community works that says you cannot deny products, that you can regulate them, no matter what someone decides to market that it is no so bad that it could be banned, that it could be stopped, that it could be disallowed, but whatever comes on the market, we will regulate it.

How many of these products can reasonably be regulated?

We discovered that there was very little regulation going on with these exotic products that came on the market. There was no real oversight. Nobody seems to have had to introduce them to any agency to say, you know, this is what we are about to do. They did not seem to know what was going on.

What about that? Are there any products that are so bad that there needs to be some way to stop them altogether or do we go along with the idea that, well, if new products come on the market—1,000 of them or 2,000 of them—it does not matter, and we will regulate them?

I would like someone to speak to that. Let me ask Ms. Seidman what you think about that?

Ms. SEIDMAN. Thank you, Congresswoman Waters.

You know, I think one of the questions that we have to ask is: What is a "product" and what is a "term?"

So, clearly, no one would ban mortgages or credit cards. On the other hand, I think we have a system that recognizes that banning terms is very much within the power of the regulator. In fact, interestingly enough, the Fed actually banned double-cycle billing, which Professor Warren just described.

Are there some products that are so bad they should not be allowed? You know, I think there are, but I also think it is incredibly important that we understand what the needs of the population are and how those needs are going to be met.

I do not happen to like payday lending. When I was at OTS, we made sure that the institutions we regulated did not do that. On the other hand, in a world in which we have discouraged savings, in a world in which we do not make saving easy, in a world in which there are a lot of people, immigrants and nonimmigrants, who do not have easy access to our mainstream financial institutions, we need to figure out something else so that they can have access to well-priced, well-structured, short-term credit. There are both mainstream institutions, credit unions in particular, some banks and some non-banks that are doing that.

So the question is: What is the function that needs to be served, and how can that function be served in a responsible way? That is the question that this new agency is going to have to answer, and I think it is a creative way and a really important way to think about consumer protection.

Ms. WATERS. Thank you.

Mr. Yingling, we are being told—and it is being whispered and talked about in the back rooms and in other places—that the bankers are going to have a big pushback on this agency as to what it stands for and what it is supposed to do.

What is it about the agency that would cause the bankers, one, not to have a consumer protection agency as you understand it?

Mr. YINGLING. Thank you, Ms. Waters.

First, let me say that I agree with you. There are products that should be banned. Part of the answer to your question is to point out that there are currently authorities within the regulatory agencies that could have addressed and that can address in the future those types of products.

I testified earlier before this committee, and the chairman and I had a dialogue in which he pointed out very clearly that the Fed was not aggressive enough on HOEPA and should have been more aggressive, that HOEPA could have addressed a lot of this. Now, with the new authorities that are being implemented under UDAP, Unfair and Deceptive Practices, the regulators have even more authority. We support what this committee approved in the last Congress, which is to extend the UDAP authority to all of the bank regulators.

Our major concerns are twofold. One is that we really do not believe you can separate the business from its products and that to have these two regulators will put banks in the middle or they will be pushed and pulled, and we gave a number of examples about that.

The other is that this authority from the Administration, as they have proposed it, goes well beyond just setting up an agency. I was interested that Professor Warren said she did not believe that you should mandate products. Let me read from page 66 of the Administration's proposal:

"We propose that the regulator be authorized to define standards for plain vanilla products. The CFPA should be authorized to require all providers and intermediaries to offer these products prominently."

So, basically, they design standards. We think that goes too far.

Ms. WATERS. Thank you very much.

The CHAIRMAN. The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Professor Warren, I want to just kind of follow up on that same line of questioning because when I look at the Administration's proposal and when I listen to you talk and when I listen to Ms.

Seidman talk, I get to thinking that you do not agree with the Administration's proposal because you are talking more about transparency and integrity and not about regulation.

You know, I think many of us believe that the American people are pretty smart and that if they understand what product they are buying and they understand the principles and the contractual rights that they have and the person providing the credit that they are very, very able to make that choice.

So would you think that maybe a better road to go down then is, let's work on disclosure, and then let's make sure that the regulatory agencies that oversee these entities are, in fact, enforcing that disclosure?

Ms. WARREN. Well, Congressman, that sounds like a good plan except that is what we have been doing for the last 70 years, and it has not worked very well. We have done it specifically since 1994. The real point is there is no one who wants to make disclosure effective. Congressman Delahunt talked about 10 different agencies that have pieces of this. The Fed has had the power to move in.

What I really think is that it is time to talk about disclosure in a way that means something. It is not disclosure to add more pages of incomprehensible text. I will tell you about my own credit card. On the pricing term, there are 47 lines to explain how the price will be calculated on my credit card. The very last line says: "Notwithstanding the foregoing, the company reserves the right to charge any amount at any time for any reason."

I assumed the 46 lines that preceded that line were simply there as camouflage in the hopes I would never see the last one.

Mr. NEUGEBAUER. Let me interrupt you there.

I agree. What I am talking about is, let's do the simplified. I have supported—and I know Mr. Pollock and I have had this conversation—a one-page disclosure. If you cannot get the big terms, as I call it, on one page, then, you know, possibly you have a product that people ought to be concerned about. If it takes 40 pages to explain your product, then maybe people would not sign up for it.

Yet you admit and everybody admits here that we have had a regulatory failure. The question is: If we have had regulatory failure, how is adding more regulation going to fix it? What we ought to be doing is putting people in place who are regulators, and we need to make sure they do their jobs. The government always says, well, gosh, if we have people who are not doing their jobs, let's go get some more people who will not do their jobs, and that will fix it. I am tired of that.

Ms. WARREN. I am tired of it, too. So here is how I see the problem. Why is it that for 70 years we have had power and no action? Indeed, we have had the kind of inaction that has brought us into a crisis. My view is we have a structural problem, and the structural problem is when the Fed has monetary policy and consumer protection it cares about monetary policy. When the OCC has profitability of the banks and consumer protection, it cares about profitability of the banks.

The problem we have is that these agencies are conflicted internally. The people who are attracted to these agencies—I do not mean this in a bad way. We need people like this, but if you want to do—who goes to the Fed? People who want to do M–1, M–2. Who goes to the OCC? People who are bankers and who really want to engage in the banking process. If you really care about consumers and the economic health of the American consumer, you tell me, where do you go in Washington? There is no home.

We built an Environmental Protection Agency, and now we have people who care about environmental law, and they have a place to go to develop nuanced, healthy, smart responses. That is what we need for consumers.

Mr. NEUGEBAUER. Well, I think if you will look at the plan we have laid out, we agree with you. We think the Fed ought to focus on monetary policy, and we think we ought to streamline the regulatory process, and we think that the financial institutions ought to have one person who is sitting down and who is having dialogues. Within the organization, you have the consumer part. You have the safety and the soundness part. You have to make sure that—and for example, in the Administration's plan, it does not eliminate anybody looking at consumer products. The States still look at it. Other Federal agencies do that, and so now you have all of these different opinions on what is a safe product. Why isn't it better to keep all of that under one roof? If those folks are not going to do their jobs correctly, we will take action here in this committee to encourage them to do that.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. I want to address only one question to Mr. Yingling and to Mr. Pollock, I think, but I want to do a little background here.

On March 31, 2008, before all of the meltdown, Secretary Paulson at that point issued a Blueprint for Regulatory Reform. In that, he said that he was proposing three kinds of situations—a model that would have three regulators: a regulator focused on market stability across the entire financial sector; a regulator focused on the safety and soundness of those institutions supported by a Federal guaranty; and a regulator focused on protecting consumers and investors. He went to some length to describe his consumer-investor-regulator role, very similar to the one that is on the table now, by the way, and he outlined it in some detail.

On July 10, 2008, this committee had a hearing at which Secretary Paulson testified, and it was supposed to be about his blueprint, but he did not mention the word "consumer" but one time in his testimony. When I had the opportunity to ask questions, I asked him: How can these regulators do what they are supposed to do—protect safety and soundness and whatever else they are supposed to do—without making consumer protection a second-rate obligation? It was the same question that Ms. Warren was just asked, by the way, in response to a question.

Now, the Administration is talking about giving more authority to the Fed and to the regulators in addition to the authority that they already had. What I am trying to figure out is, if they could not do the consumer protection part of what they were supposed to do when they did not have this increased authority, how can we reasonably expect them with new authority and with new responsibilities to do the consumer protection? How can we get somebody to put consumer protection over and above all of the other things that are going on in the financial system without doing this proposal?

Can you explain that to me?

Mr. POLLOCK. Thanks, Congressman. I was not a supporter of Secretary Paulson's plan at the time, and I am not now.

Mr. WATT. Nobody seems to be.

Mr. POLLOCK. I think he is, at best, one for three. I think the so-called—

Mr. WATT. Please do not spend my time talking about Secretary Paulson. Just talk about the question I asked, please.

Mr. POLLOCK. Well, I am just putting it in the context of your question, Congressman.

The systemic risk regulator is a bad idea. I think the separate agency, as we are talking about today, is a bad idea. Potentially, it is a good idea to think about putting all of the consumer protection and disclosure requirements in one place. I do agree with that.

Mr. WATT. Okay. Well, that is good.

Mr. Yingling, it sounds like you agree with Secretary Paulson at least on that theoretical proposition.

Go ahead, Mr. Yingling.

Mr. YINGLING. Well, again, we disagree with much of the Paulson proposal. I think it is a good question. I think it is a good question as to how you get more focused on consumer issues in the regulators.

Our problem is that, if you have separate regulators, you have separated the business from its product, and we do not think that it is the way to go. We think you ought to go more directly at—

Mr. WATT. My question is: How do you make the product, the consumer part of it, as important as the product part of it?

Mr. YINGLING. I think you do that, one, by whom you appoint. Who did the previous Administration appoint? Maybe they appointed people with a certain philosophy that you would not agree with. I think you can do it by beefing-up coordination. I think you can do it by writing laws on plain disclosure. I think you can do it by having regular reports to this committee, like the Humphrey-Hawkins report, where they would have to come before you and say what they have done on consumer regulation.

I think there are a lot of things you could do, but it is really hard to put a bank in the middle where they have regulators who will be pulling them in different directions. I have given a number of examples of that where you are going to have the banker in the middle with one regulator saying go this way and the other regulator saying go that way.

Mr. WATT. Thank you, Mr. Chairman.

The CHAIRMAN. At this point, I will insert into the record statements from: the Property Casualty Insurers Association of America; the National Association of Federal Credit Unions; Jonathan Mintz, who is commissioner of the New York City Department of Consumer Affairs; and the Independent Community Bankers Association.

Next, we have Mrs. Biggert from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman.

You know, one of the things that I really care about is financial literacy and education, and we have worked with the Federal agencies and with the private sector through our caucus with Mr. Hinojosa.

Ms. Warren, shouldn't we concentrate on improving financial education and regularly reviewing consumer testing and improving product disclosures which would result in an efficient and innovative market instead of so much government control?

Mr. Pollock mentioned personal responsibility, and I think that he is right and that nobody has really mentioned that. There is a role for the consumer to really take responsibility when they are getting into a product and to really do the research. Are we just saying, well, the government can do it for us? Should we mandate financial literacy in the schools?

You know, we have tried to stay away from that while really going forward with it. Is this something that should actually be a course in the schools?

Ms. WARREN. Well, Congresswoman, I actually would like to say I also talked about personal responsibility in my direct testimony. I will make the point that this is not about people who go to the mall and charge up thousands of dollars that they cannot afford or who buy five-bedroom houses that they never had a hope of paying for. This is about people who get trapped by the products themselves.

I am completely in favor of making these products transparent enough that people can read them, understand them, and make smart financial decisions. Literacy is not going to solve the problem of reading a 30-page credit card contract.

Congresswoman, I have assigned these contracts in the past to my own classes at Harvard Law School. Everyone in the room has a college diploma, at least 2 years of law school, and has me as a reason that they had better read carefully, and they cannot figure out the terms.

Mrs. BIGGERT. In Illinois, though, lawyers are at the closings and really work with their clients, and part of their responsibility is to explain that. Maybe it is all legalese. We have already suggested so many times to have a one-page disclosure, to have RESPA as a one-page or as a three-page so that people can understand that.

So just to make a whole new agency based on that because—well, it is kind of like we kid around here that sometimes we have our staff, and we call this assisted living for Members of Congress. You have to take the responsibility yourself.

Maybe, Mr. Pollock, could you say a little bit more about personal responsibility?

Mr. POLLOCK. As I said in my testimony, Congresswoman—

Mrs. BIGGERT. I am sorry. I missed it because we had to go vote.

Mr. POLLOCK. —the best reason to have really good disclosure—and I completely agree with you, Professor Warren, about good disclosure—is that it enables personal responsibility. The main question, in my opinion, which should be addressed by all credit disclosures is to the customer: Can I afford the debt service commitments I am making? How much risk can I take?

I am not against people deciding to take risks, but they ought to know and understand what risks they are taking.

Mrs. BIGGERT. Thank you.

Then, Ms. Seidman, you state in your testimony that the CRA should be left with the prudential regulator. Why is that when it seems like part of that was really the problem? You know, we have 92, 93, 94 percent of people paying their mortgages on time, and they really did not have a problem with this. We had the CRA and the pressure on the banks to loan to people who maybe should not have even been in the market yet, and you take that out of what could have had a regulator for a consumer protection and leave that with the other regulator.

Ms. SEIDMAN. Congresswoman, I think you are asking two questions. One is the question of whether CRA caused the problem.

Mrs. BIGGERT. That is right.

Ms. SEIDMAN. As Mr. Yingling testified, the answer to that is no. I also believe the answer to that is no. A good deal of recent research by the Federal Reserve has demonstrated just how little effect CRA actually had in generating high-cost loans in low-income communities, which is the only thing that CRA counts.

The second question that you are raising, though, is whether CRA belongs in this agency. In my testimony, I suggest that it may not be. A piece of CRA is, indeed, the whole issue of access to good-quality consumer financial products, which the CFPA would deal with. But a very big and very important piece of CRA is community financial investment—the charter schools, the affordable rental housing, the community centers. All of those kinds of investments are really not a consumer protection issue.

I also agree with Mr. Yingling that CRA is written very appropriately to say that these actions must be taken in a manner that is consistent with safe and sound operation. That is what the prudential supervisors do.

Thank you.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman, and thank you, Professor Warren, for your leadership as Chair of the Congressional Oversight Panel for TARP.

I appreciate the points you make in your testimony, including the need for personal responsibility, the need for fixing broken markets for hardworking and play-by-the-rules families, and for noting that this new agency should be putting consumers in a position to make the best decisions for themselves. I also appreciate your point that we are not looking for more disclosures. We just need to make disclosures and make sure that those are written so people can understand them.

I believe many of our constituents may not have a good understanding of several parts of the financial regulatory reform package Congress considers; for example, systemic risk, derivatives or resolution authority; but this proposed consumer protection agency is an idea that everyone can easily understand the need for.

Professor Warren, you point out that regulatory costs can put enormous financial pressure on a small institution. For the small banks in Kansas and in other parts of the country that did the right thing and did not make irresponsible loans and were not overleveraged, what will this Consumer Financial Protection Agency mean to them? Will it help level the playing field?

Ms. WARREN. Thank you very much, Congressman.

I think that that is the most critical question here as we move forward. I see it helping the smaller banks—the community banks, the regional banks, who, as you rightly point out, were often not the cause of the problem but are now being forced to pay for it. I see it helping them in two principal ways.

The first one is in the direct cost of compliance. Our complex structure right now, while it is ineffective for consumers, is nonetheless very expensive for financial institutions. Now, if you are a huge financial institution, you can hire a team of lawyers and spread that cost across millions of credit card products or home mortgage products, and it will come out okay for you. For small institutions, I believe the current burdens can be crippling. So the idea here is to slim these down, to make them effective for consumers but much cheaper for the financial institutions.

The second way I think it is helpful for the smaller banks, for the community banks, is that it is my belief that often, not always but often, they offer cleaner products. They offer better products, but in a world in which all of the products are 20-, 30-pages long—the home mortgages are stacks and stacks—we do not create the appropriate functioning market so that the good products get rewarded and the bad products get driven out. Instead, the folks who can afford the multimillion dollar advertising campaign can drive consumers to the more expensive, high-risk products. Ultimately, that is not only to the injury of the consumer; it is to the injury of the small financial institutions.

So, I see this as leveling the playing field, not just between the customer and the bank but between the really big banks and the smaller banks.

Mr. MOORE OF KANSAS. Thank you very much.

Ms. Seidman or Mr. Yingling, do you have any comments?

Ms. SEIDMAN. I agree with Professor Warren. I think that this is one of those situations where the immediate reaction is, oh, no, another regulator; but in fact, when you look a whole lot deeper, you realize that what can happen here is a combination of consolidation and consistency in regulation that does not exist now, and it is providing a preference for quality products, which are the products that most of the community banks do in fact provide.

Mr. MOORE OF KANSAS. Thank you.

Sir, do you have any comments?

Mr. YINGLING. Yes. I would say there is not a community banker in the country who believes that. I have talked to dozens of community bankers since this proposal came forward. They all think it will be additional regulation. They think it means another examiner will be in. For example, right now, they have an examiner who comes in and looks at all of their compliance training. The ABA offers dozens of courses that are compliance training for frontline people in banks, but those are coordinated. They have to take sometimes a dozen different courses, but they are coordinated with one regulator.

Now we are going to have two regulators coming and saying, I do not like what your other regulator told you. I want you to offer these other courses. When they go to account openings, you are going to have one examiner who comes in and says, the way your frontline people are opening accounts, from my point of view, should be this way because I am the consumer regulator. You are going to have another examiner who comes in and says, the way you are opening accounts should be the other way because I am a safety and soundness examiner. I am worried about fraud, and I am worried about the Bank Secrecy Act.

Mr. MOORE OF KANSAS. Ms. Seidman, do you have a comment very quickly?

Ms. SEIDMAN. Yes.

As my testimony points out, I actually agree with Mr. Yingling on this second point. On the first point, the reason the ABA has all of those courses is there are too many regulations, many of which are not consistent with each other.

Mr. MOORE OF KANSAS. Thank you.

Mr. MIERZWINSKI. Could I add a quick comment?

The CHAIRMAN. The time has expired.

The gentleman from Texas.

It is another adjournment resolution. Members can come and go as they wish. For now, I am going to keep the hearing going.

Mr. HENSARLING. Thank you, Mr. Chairman.

Listening to a lot of the testimony, I kind of had deja vu all over again. I was invited to the White House, that doesn't happen often in my case, to hear the President unveil his capital markets reform plan. And I was struck by the fact that I could have given 80 percent of the President's speech, and I agree with about 20 percent of his legislation.

So, as I listened to the testimony here, I find myself in agreement with the overwhelming majority of the testimony, but when I look to at the underlying legislation, H.R. 1705, the Durbin companion bill in the Senate, there just seems to be a big disconnect.

Number one, I want to agree with most of the panel; consumer disclosure is broken. I think there is a fairly unanimous opinion about that. Now, there is a debate as to the causes. And I believe there is certainly merit in the idea of gaining better expertise about consumer marketing, consumer understanding, even happy to propose that in one, in a new agency. But as I read H.R. 1705, I see something that goes way beyond simply empowering a consumer with more effective disclosure.

I mean, again, what I see is an unelected body granted the legal authority to ban from the marketplace any consumer financial product, practice, or features it considers, "unfair" or "anti-consumer." And then, in section 10 of the bill, both civil and criminal penalties may apply to officers, directors, and employees of firms that produce products that are judged "unfair" or "anti-consumer." I mean, this just strikes me as incredibly draconian and a disconnect from the testimony that I hear.

So my first question is—first, can I safely assume that all are familiar with Mr. Delahunt's bill, H.R. 1705? If you are not, could you raise your hand?

Seeing no hands, I assume people have familiarity with the bill.

Ms. WARREN. It depends what you mean by familiarity. I am somebody who gives out pop quizzes, and I can say right now I don't want to take a pop quiz on that bill.

Mr. HENSARLING. Professor Warren, if you were here for Congressman Delahunt's testimony, he gave you credit for being the mother of the idea. Have you abandoned your child?

Ms. WARREN. I don't want to be cross-examined on a particular provision. I am saying I didn't read it before I came in here this morning.

Mr. HENSARLING. Fair enough. The others seem to have familiarity.

For those who are familiar with the bill, do you support it?

Mr. Pollock?

Mr. POLLOCK. I think you are absolutely right, Congressman, and I don't.

Mr. HENSARLING. Mr. Mierzwinski, do you support the legislation?

Mr. MIERZWINSKI. The consumer group is strongly supportive of it.

Mr. HENSARLING. Okay. I thank you.

Mr. MIERZWINSKI. I just want to say quickly that it is not just consumer disclosure that is broken; it is consumer protection that is broken.

Mr. HENSARLING. Forgive me, I have a short amount of time.

Ms. Seidman, do you support the legislation?

Ms. SEIDMAN. Yes, I do. And I also—

Mr. HENSARLING. Let me ask this question then, if I could, for those particularly who support the legislation. I want to talk about a few financial products and ask if you believe they are unfair or anti-consumer. And if you would raise your hand if you believe they are unfair or anti-consumer. If you don't believe or you don't have an opinion, you can leave your hand down.

Negative amortization ARMs, does anybody believe those are unfair or anti-consumer? Okay. We have a couple of hands there.

Subprime mortgages, the entire universe of subprime mortgages?

Ms. WARREN. Congressman, I can't understand this without seeing what the paperwork is that accompanies them and what the disclosure is that is given to the consumer.

Mr. HENSARLING. That is fine, Professor.

So, again, you are saying some you would support; some you wouldn't.

ATM fees, does anybody believe they are per se unfair or anti-consumer? We have one hand.

Ms. SEIDMAN. A $30 fee for a $5 overdraft is unfair.

Mr. HENSARLING. I am asking for your opinion.

Noninterest bearing checking accounts, does anybody believe they are unfair or anti-consumer?

Unfortunately, my time is waning, but again, among this body of ostensibly studied people, very intelligent people, people who know a lot about this subject, clearly the terms "unfair" and "anti-consumer" are most subjective. And now people are advocating legislation to turn over this incredible power to these people to potentially ban products.

I mean, there is no grandfathering that I can find in this clause, under my reading of this then. Does anybody believe that this panel would not have the legal authority, for example, to ban ATM fees?

Has anybody interpreted the bill otherwise?

Mr. Yingling, if the panel banned ATM fees, would we have fewer ATM machines available to consumers, in your opinion?

Mr. YINGLING. Well, you would have almost none in airports and places like that.

I would say you don't need to get there. You have unfair and deceptive practices. This committee passed a bill last Congress to spread that over all the regulators. And if you look at the way the Fed interpreted that in the credit card area, the authority is there. You don't need this new vague open-ended authority.

The CHAIRMAN. The gentleman from California.

Mr. BACA. Thank you very much, Mr. Chairman.

Thank you very much for holding this hearing. I would like to follow up on the last question. I don't think the question is in reference to the products we are banning. It is about fairness and knowledge. I think this is what we are talking about.

I think you have to be fair in terms of letting the consumer know exactly what they are getting. I think that is really the issue here. It is not about banning a product. It is not about the ability to provide assistance. It is letting the consumer know exactly what they are getting into in a simplified form. And I think that is what we need to do right now.

And so my question is, in reference to compliance, monitoring and criteria that has to be, and then the funding aspect; we have to make sure that the funding is there if we are going have oversight, regulators and others. Because other than that, we can come up with any kind of legislation, but if the funding to monitor exactly what goes on; what are the penalties for individuals who violate the law in terms of not complying with another mandate?

And here, again, we all talk about mandates; do we fund a mandate, or do we come up with another mandate without the funding dollars that are necessary? And how do we hold them accountable? How do we begin to hold them accountable? What kind of oversight or regulations do we need to implement?

Ms. Warren, could you please respond to that?

Ms. WARREN. I will give my own thoughts on funding. I think that this is an area where a per account fee makes a lot of sense. So, for example, if we said it will be a nickel a year for every open credit card account that a financial institution has that has to go to this agency, a penny a year for open car loans, maybe a dime a year for open mortgages, because they take more regulatory oversight, that gives the agency an independent source of funding. It doesn't push up costs. It keeps it low and keeps this agency funded based on how much it has to supervise, how much is going on out there. I advance it at least as one option.

Mr. BACA. Because remember that the American people trust what we are doing and what we are coming up with. And that was part of the problem, I guess, that we had with Alan Greenspan, is that he assumed that people were going to do the right thing, but people didn't do it, and it got into a greed, how much profit can we make. And so then the consumer ended up having to pay for it, not knowing what was in the document itself. So people took advantage of that.

And I think that is what we are trying to stop right here, right now, is to try to find a balance or a means where it is still profitable but at least people know exactly what they are getting into.

Mr. Yingling, would you want to answer that?

Mr. YINGLING. I would just like to say I agree with your introductory comments. And this may come as a surprise, but we are concerned that the agency might be funded in a way—and Mr. Gutierrez just came back in, and I want to pick up on a point he raised in his introductory remarks.

A major problem for us is going to be how this agency would interact with State regulated, and in some cases unregulated, entities. The great, great, great majority of the subprime problem was outside the regulated banking industry. It was primarily mortgage brokers and others.

And we are concerned that this agency stops at the State line and says, initially at least, we are going to trust that to State regulation. Well, we don't think the State regulation is going to deal with it, so we think our banks, our community banks, are going to be regulated hard on it, and we will be right back where we were with the unregulated, the less regulated, sector doing bad things which draw us all into the fire.

So one of our questions, Mr. Gutierrez, as you correctly raised it in my opinion, is, how would such an agency or how would the Federal Government interact with all these unregulated or less regulated entities that, while banks are not perfect, are the major cause of the problem?

Mr. BACA. Ms. Warren, you were going to respond?

Ms. WARREN. Thank you.

I want to say, the introductory paragraphs to the paper I first wrote about what was then the Consumer Financial Product Safety Commission, I think, I have forgotten the name, was about this very question, and made the point that regulation must shift in the financial services area from who issued it to what the product is. So there is level regulation across-the-board for mortgages, for credit cards, for payday loans, for whatever, student loans.

Mr. BACA. I believe that we all want a fair level playing field for everyone, and we believe that unions, community banks and others shouldn't have been to pay for what somebody else committed. And it seems like they are being put into a category because someone else took advantage of that greed and then passed it on to the consumer, and the consumer didn't know exactly what they are getting into in a document that you needed a thesis to determine what it said.

The CHAIRMAN. The gentleman's time has expired.

We will finish with Mr. Posey.

Mr. POSEY. Thank you very much, Mr. Chairman.

I was a little bit confused, Professor Warren, by a couple of your answers or discussions with Mr. Bachus. And so I am going to ask a series of questions, because we have a lack of time, and if we run out of time, you can respond to them in writing, if you would be kind enough. You don't have to. If we have time left, we will go down the row, but I don't think we are going to have that kind of time left.

If I heard you correctly, you mentioned banning certain products, and I was wondering specifically what products you recommend to be banned. You indicated that some products are complicated to understand, but agree that complicated disclosures are ineffective. I am not sure if you oppose the high risk or if you oppose the way they have been described, and if you could clarify that, please.

You mentioned a safe harbor for pure vanilla, and I was just wondering where you draw the line on what is pure vanilla and what is not with the wide variation of experiences and knowledge that the citizens of this great country have. Some people seem to be asserting that our citizens are incapable of managing their own risk, and it makes one wonder, who will decide on our behalf what is an acceptable range? And who is going to tell me what risk I am allowed to take and what risk I am not allowed to take, what I can pay and what I can't pay?

Much of the complicated disclosures that everybody has been beating to death today are a result of congressional or State regulations that were as well intended as what is before us now. And the result is, you tell a company they have to disclose something, and if it takes 45 lines to do it, they are going to do it. They don't particularly care if you like it or not. You told them to do it, and that is what it takes to keep them out of court with the lawyers that you are training up there.

You know, it sounds like we are talking about an agency that we should probably change their name to; we should probably be talking about a Federal Department of Reward Without Risk or a Guaranteed Reward Without Risk, which is kind of an oxymoron since that is the principle upon which our financial system was built on and the free enterprise system seems to evolve on.

And then if that doesn't work, maybe we can have a Federal Department of Prosperity Without Risk or Work. One wonders where this is all going to stop if we continue trying to think the government is going to solve everything by taking responsibility away from people to make their own decisions.

I think we all want them to make informed decisions, but where do you draw the line about intruding into my ability to decide what kind of a mortgage I want, what kind of a fee is acceptable to me. There are people who get better credit deals than I do because they have more money, and there are people who have maybe less opportunity because they don't pay their bills. I mean, are you going to take that latitude away from a lender to make those kind of decisions, and ultimately, what kind of consequences do you think the market is going bear? And do you think there are going to be no consequences in the overall cost of the consumer?

When we talk about the consumer, first and foremost, before we talk about a single credit card holder or we talk about a person taking out an individual mortgage, I look at a consumer's—400 million people in this country, they are all consumers. They are consumers of what we make here. Some of what we make here is good for them. Some of what we make here is bad for them, but they are all different. And the typical government approach that one size fits all, this is the way you have to do it, and everybody has to live with this, doesn't seem to be a real service, I don't think, to our consumers most of the time.

Ms. WARREN. Thank you, Congressman.

I will start by saying the person who was talking about banning products actually wasn't me; it was Mr. Yingling who embraced that notion.

Mr. YINGLING. I was quoting the Administration's proposal.

Ms. WARREN. I thought you said that you believed in banning certain products, certain credit products.

Mr. YINGLING. All right. I am sorry, I agree with that.

Mr. POSEY. But it is in your proposal as well.

Ms. WARREN. Well, and he said he embraced banning certain products.

You asked about complicated disclosures. That was exactly my testimony. Complicated disclosures don't work. We have a problem now, and part of the problem is brought on by a bad regulatory structure.

Mr. POSEY. I heard that. My question to you was, you said that some of these products are very complicated, and so obviously, the disclosure of them is going to be very complicated. Oftentimes, you can't simplify a disclosure of a complex equation. And so my point is, were you talking about disallowing the complex items themselves or the complex—

The CHAIRMAN. The gentleman's time has expired. There won't be time to answer the question.

I am going to excuse this panel now. We are going to impanel the second panel. We are going to begin where we left off in the questioning.

The gentleman from California has a quick question.

Mr. MILLER OF CALIFORNIA. Did I miss the panel by voting?

The CHAIRMAN. Well, if you can do it quickly. We do have a second panel.

Mr. MILLER OF CALIFORNIA. Thank you very much.

Professor Warren, I really enjoyed your comments on the transparency and disclosure and simplified forms. Is somebody other than an attorney going to draft these?

Ms. WARREN. I am sorry, is someone other than an attorney—

Mr. MILLER OF CALIFORNIA. Well, I really enjoyed, you talk about transparency and disclosure and simplified forms. But a fair question is, is somebody other than an attorney going to draft these?

Ms. WARREN. Well, I think, at least what I hope, is this will be done in consultation with the industry and with consumers.

Mr. MILLER OF CALIFORNIA. So we are going to put attorneys on it, so we can understand what they are saying.

Ms. WARREN. So part of the point here is so that we understand that we have products that consumers can understand. If consumers can't understand them, then they don't meet regulatory muster.

Mr. MILLER OF CALIFORNIA. If you look at GSEs, they have various programs, and then they constantly evolve different products in that program. They might evolve products daily to meet the consumer demands. And I am concerned about how what you are going to do might impact that. And I guess the most important question I have, have you ever read legislation that comes out of Congress?

Ms. WARREN. I am sorry.

Mr. MILLER OF CALIFORNIA. Have you read the legislation that comes out of Congress and how we mandate and regulate the financial services industry in banks?

Ms. WARREN. Yes, sir, I teach it.

Mr. MILLER OF CALIFORNIA. How do you apply that to a simplified form?

Ms. WARREN. Well, I think the point is—

Mr. MILLER OF CALIFORNIA. Now, give consideration to RESPA, mortgage closings, and then you have State law to deal with. I am not trying to argue. Just having been a Realtor and a builder and a State legislator, you are going to have the States involved here, too; how is all this going to work in a simplified form?

Ms. WARREN. Congressman, as I see it, what this agency does is it picks up all of those regulatory burdens that are there now. It puts them into one agency, and it comes up with a slimmer, more effective set of regulations that apply across-the-board wherever the product is issued, regardless of who issues it.

Mr. MILLER OF CALIFORNIA. How does a lender deal with the reality of their having to draft some form of a contractual loan document agreement that covers them as a lender and covers the consumer who is getting a loan? And I am looking at all the mandates and all the laws and all the requirements that we place on them where they have to safeguard themselves and safeguard the consumer.

Ms. WARREN. That is the point, Congressman. We are really trying to change the legal mandates. We are trying to say that more legal mandates of ineffective disclosure is not helping the consumer, is driving up costs for the financial institutions, and is a bad idea.

So what we want is a new agency that has the power to say, we are going to slim these down. We are going to make the disclosures work for consumers and frankly be far cheaper for the financial institutions. Where that difference will be felt of course will be for the financial institutions who cannot afford to hire a team of lawyers in order to figure out the current regulatory compliance.

Mr. MILLER OF CALIFORNIA. And you are establishing a floor, am correct?

Ms. WARREN. I'm sorry?

Mr. MILLER OF CALIFORNIA. You establish a floor for Federal regulations.

Ms. WARREN. That is right, that is what is proposed.

Mr. MILLER OF CALIFORNIA. How do you deal with the ceiling when you have to deal with the States? I know California, and we regulate the heck out of anything that walks, talks, breaths or ever moved. So what are you going to do with the States when, all of a sudden, these State legislators who think they are more brilliant than you and a committee that you might form, how do you deal with them? I am not being sarcastic.

Ms. WARREN. Congressman, I know you are not. This creates a floor, and it creates a floor—we really have to be clear here. In response to the fact that the OCC in particular has used its Federal power to protect the financial institutions from any effective regulation, including preventing the States from enforcing their own laws on fraud—

Mr. MILLER OF CALIFORNIA. So we have an override over State regulation for the first time in this type of a form. So RESPA and the way Realtors have to form closing statements and those type of things that the States actually mandate, we are going to supersede that.

Ms. WARREN. So this is going to bring all of the Federal rulemaking, all of the Federal disclosure responsibilities into one place.

And I want to make one important point about preemption. It is my own view. If we get this right, if we get the plain vanilla forms right and they work for the community banks and they work for the customers, if we get that right, the need for the States to write additional regulations, in my view, becomes much less.

Mr. MILLER OF CALIFORNIA. But it won't happen in reality.

One last question. This is very, very important, and this raises a huge red flag. You said good products will be rewarded, and bad products will be driven out. Who is to determine what the good product is and—I mean, it is a matter of apples and oranges. I like apples; he likes oranges.

Ms. WARREN. No. It is the customer who will make that decision. That is the whole point behind this. When I can take a 2-page credit card agreement and I can look at four of them and tell instantly what the costs are, what the risks are, and how I get my free gifts, then I can make the decision as a customer. This is about making markets work. That is the point behind it.

Mr. MILLER OF CALIFORNIA. I guess I am going to have to buy you lunch to discuss this because I am out of time.

This such a complex industry driven by government regulations and mandates and requirements; I don't know how you just forego everything we have done in the past, and we mandate on lenders, and just make it simple without firing all the attorneys.

Thank you. I yield back.

Mr. GUTIERREZ. [presiding] I am not in that big of a hurry. You could continue going.

Let me just make a statement about what is kind of going on, what my perspective on what is going on here.

So I was here, I think it was in 1994, when we passed legislation to deal with mortgages to make it clearer to people, and then it took the Federal Reserve until this year to pass the rules and the regulations. So, you know, there have been people saying no regulations, no regulations, no regulations, and guess what happened, a lot of people got caught up. And now they passed some nice rules, obviously.

Mr. MILLER OF CALIFORNIA. Would the gentleman yield for one second?

Mr. GUTIERREZ. Sure.

Mr. MILLER OF CALIFORNIA. I want to make myself clear so you don't misunderstand me.

I think that the problem we faced in recent years was we failed to define predatory versus subprime. And lenders went out and acted, and some individuals acted as if there were no underwriting standards necessary that should apply to a loan.

Mr. GUTIERREZ. I understand that perfectly.

My only point is, look, we need to re-look at how we do things because obviously they are not working real well. So we do have a consumer protection agency, and it was kind of the Federal Reserve, and they didn't do it. And we finally got rules and regulations. We were happy to adopt them. We were applauding them when they came here, and then we expanded them when we did the credit card bill of rights. We actually expanded on some of them. Some people said, why are you doing it; they have already issued rules. So we do those things.

And I think that we really need to—the public is really hungry for someone to be on their side, and they rightfully don't feel. I just want for public disclosure—I mean, I got home. I went to the—I am usually not here when we are not in session, but I stuck around because, in all the years I have been here in 17 years, I have never been to a bill signing. At least maybe it was the first time I was relevant to a bill signing because I am a subcommittee Chair.

So I show up, I go down to the White House, get my pen, and it is the credit card bill of rights. I get my pen, and I get home. Do you know what I found out when I got home, no kidding, three changes from three different credit card companies, two of which I had forgotten about. So I promptly called them and said, you changed the rules; I don't want your card. I figured that was a better reason than just saying I had forgotten I had a card. But the card that I did use—and then I buy a ticket on a foreign airline, and all of a sudden, there is this new charge that I had never seen before.

So, look, that is why we need rules, because even when we pass rules, they kind of rush to change the rules. So I think it is a very good time for all of us. We are going to take some time in July. We are going to go through this stuff. We are going to have some hearings. We are all going to work together.

But I think they are good men and women on both sides of the aisle here that we can get together and do what I believe the public is really yearning for us to do. They know we are good at approving hundreds of billions of dollars to bail out—we are the socialists. The socialists bail out the capitalists. I love this. We bailed out Wall Street, the socialists, Democrats. Do you remember? It was kind of ironic, but that is what we did. That is all I am going to say. We are going to move on to the next panel.

Mr. SHERMAN. Mr. Chairman, I would like to ask questions of this panel.

Mr. GUTIERREZ. The gentleman is recognized for 5 minutes.

Mr. SHERMAN. Thank you. Just when you thought that America does not torture, the chairman decides that you have to stay here for 5 more minutes.

To me, one of the key issues here is whether—

Mr. GUTIERREZ. I was going to say I actually like everybody on this panel, so I didn't keep you here for that reason.

Mr. SHERMAN. One of the key issues for me is whether we are creating a law enforcement agency or a law-making agency. A study of U.S. history over the last 60 years reflects an effort by the Executive Branch, sometimes abetted by the Legislative Branch, to turn Congress into an advisor body rather than a legislative body. I have seen this in all areas. It is perhaps most pronounced in foreign affairs.

And at the extreme, what we could do is: have the Fed take over control of making sure the economy is protected; have this new agency make sure the consumer is protected; and then we could save a lot of time and money by not having a Financial Services Committee.

And I guess I will address this to Professor Warren: Is the goal here to create a law enforcement Executive Branch agency or to create a law-making agency that would decide all the issues that I have spent 13 years on this committee arguing about? For example, should we have interest rate caps on this product or that product, would be a good specific. God knows I have spent 13 years arguing that on a dozen different products. What do you have in mind here?

Ms. WARREN. Well, Congressman, there is no doubt the authority resides with Congress, and it appropriately does. Congress will set the standards for this agency, and then ask the agency to go and use its rulemaking authority to put that into specific terms on any given form of disclosure or other activities they engage in. But that certainly doesn't preempt Congress, and it should not preempt Congress, not only from its continued oversight of the agency itself, but its continued involvement in this area. It is only Congress that should make the big changes. But this is about an agency that makes the financial product market work better for consumers.

Mr. SHERMAN. We certainly all want to make things work better for consumers. And certainly nothing that would be constitutional would completely deprive Congress of the right to pass future statutes. The closest we could get would be to create a new agency and basically say, you guys do whatever you think is in the consumer's interest, and from time to time, we will have oversight hearings.

Are you talking about going that far at the other—the more traditional administrative law approach is Congress writes the big rules, and then the little—you know, whether it has to be on yellow paper or blue paper, we let the administrative agency decide. And I address this specifically as to rate caps just as a good example. Would this new agency have the right to say, for this kind of product or for that kind of product, the maximum interest rate is "X?"

Ms. WARREN. I have to say I am not someone who heads in the direction with this agency for rate caps. It seems to me if we were talking about rate caps, that would be an appropriate place for Congress to set the larger policy question.

Mr. SHERMAN. Absolutely. And we have had a lot of hearings in this room about rate caps, and sometimes they seem like a good idea, and sometimes they don't. But do you envision an agency that would have within its power the ability to say, well, Congress hasn't decided on rate caps for credit cards. We just passed a big credit card bill; we left that out. Therefore, our agency will impose rate caps.

Ms. WARREN. I have to say, Congressman, I am afraid in this sense you are asking the wrong person. Ultimately—

Mr. SHERMAN. I see one of the other witnesses—

Mr. POLLOCK. We have the same point, Congressman.

Ms. WARREN. I am sure there are those who would like to say you are going to give it too much power and therefore we shouldn't do this at all. I think it is ultimately Congress's decision how much power you think it needs to get the job done. What I am focused on is the job it needs to get done and the structure it needs to do that.

Mr. SHERMAN. The only thing perhaps more important than protecting consumers is protecting the Constitution.

I yield back.

Mr. GUTIERREZ. The gentleman is recognized for 5 minutes.

Mr. MANZULLO. Thank you.

The basic facts about your mortgage loan, a 1-page document, it is simple. It is easy, perhaps too simple and too easy for Congress to pass, editorialized by the Washington Post as being the best statement that the consumer understands. When I practiced law, I went through probably at least a couple thousand real estate closings before RESPA, which screwed up America. It has done more harm. We used to close in 20 minutes, and now that you have documents like this, you close in 2 hours. No one reads the dang thing because if you don't sign everything there, you don't get the keys to your house.

Mr. Pollock, why hasn't your 1-page form been adopted, and what is wrong with the city that insists upon screwing everything up? How do you like that question?

Mr. POLLOCK. Thank you, Congressman.

Mr. MANZULLO. And if you have some time, let Mr. Yingling try to, or Mr. Mierzwinski has an answer to that, too. Go ahead.

Mr. POLLOCK. Thank you. I have asked myself that question a lot of times because it seems like such an obviously good idea. We did get bills introduced in this committee and in the Senate, where Senator Schumer introduced a 1-page mortgage form bill. They didn't get passed, but we had a little debate about whether the consumer should have to sign the form.

That was my view, of course—and the counter-argument was, well, if the consumer signs, it means they are taking responsibility. My point was, yes, that is the idea. But we didn't get them passed.

I am happy to say that Bank of America has introduced voluntarily a 1-page mortgage form. And we know that the Department of Housing, in looking at their new couple of page forms, studied the one-page idea. I think we need to keep working on it. It should certainly be doable.

Mr. MANZULLO. Anybody else want to try—Mr.—how do you pronounce your last name?

Mr. MIERZWINSKI. "Mierzwinski," sir. I would just say briefly the consumer groups think that the new agency would cut through the red tape. There are 20 or so consumer laws; currently there are 7 or 9, depending on how you count them, agencies that have authority over various parts of the law. RESPA and TILA are in these interagency negotiations.

Mr. MANZULLO. Why don't we just eliminate all that crap?

Mr. MIERZWINSKI. But if we had one agency that could cut through all of that, that would be a solution.

Mr. MANZULLO. But that is another layer.

Mr. MIERZWINSKI. No. It is going to take away from the other agencies.

Mr. MANZULLO. No, it won't. It will just add to it.

The Federal Reserve had the authority to do two things that could have stopped this collapse in America. Number one, they could have required to have written proof of a person's income before that person could have bought a home. And number two, they could have eliminated the outrageous 3/27 and the 2/28 mortgages with the teaser rates upfront. One agency had the authority to do it. They didn't do anything, and the Nation collapsed economically because of that.

So why should we create another agency to come in, create brand new products, oversee what these other people already are not doing. How do we know the new agency would do its job?

Mr. MIERZWINSKI. Very briefly, because I know Ms. Seidman and Professor Warren want to speak. But I think that if you have safe consumer products, you have less risk in the system.

Mr. MANZULLO. That is the job of the Fed.

Mr. MIERZWINSKI. The Fed has two jobs. Monetary policy conflicts with consumer protection and prompts this.

Mr. MANZULLO. No, it doesn't. Not if it is done correctly.

Mr. MIERZWINSKI. It is the way that it has been done is the problem with that.

Mr. MANZULLO. Who else wants to get in this argument?

Professor Warren, did you raise your hand?

Ms. Seidman?

Ms. WARREN. I am glad to yield, but that is the problem. The people who go to the Fed want to do monetary policy. They have demonstrated in as many ways as one can humanly demonstrate that they are not interested in—

Mr. MANZULLO. So you need another agency to do their job, right?

Ms. WARREN. Excuse me, Congressman. They are not interested in consumer protection.

Mr. MANZULLO. Yes, they are. Mr. Bernanke is interested in consumer protection.

Ms. WARREN. Then why hasn't he done anything?

Mr. MANZULLO. Well, you might want to ask him that question. Mr. Pollock?

Mr. POLLOCK. Congressman, I just would like to underline the point you made that a lot of extremely complex and confusing disclosure that we have, as you pointed out, is the result of regulation.

Mr. MANZULLO. That is right.

Last word, Ms. Seidman.

Ms. SEIDMAN. Yes, the Administration's proposal, actually in contrast to some of the pending legislation, would move the authority from the Fed, from HUD, to the new agency.

Mr. MANZULLO. So another bureaucracy.

Ms. SEIDMAN. It would not put it on top of it.

Mr. MANZULLO. How do you know they will do their job with another layer of bureaucracy on top?

Ms. SEIDMAN. First of all, it is not another layer. It is a different agency.

Mr. MANZULLO. But these are layers of agencies.

Ms. SEIDMAN. No. The old layer is being taken away.

Mr. MANZULLO. So who is the old layer being taken away?

Ms. SEIDMAN. The Fed would no longer have—

Mr. MANZULLO. But then the Fed would have no responsibility for taking a look at instruments and determining whether or not those are safe instruments.

Ms. SEIDMAN. It would be moved over to the new entity.

Mr. MANZULLO. More Federal jobs, Mr. Chairman.

Mr. GUTIERREZ. The time of the gentleman is expired. We did invite these people to come and address us and answer questions, and we might want to treat them as such.

Mr. MANZULLO. Well, we did.

Mr. GUTIERREZ. Please, please. We might want to treat them as such. They are our guests here in the People's House. We might want to treat them at least with some modicum of respect for their answers.

Now, Mr. Ellison you have one question, right?

Mr. ELLISON. Just one. And I really mean that.

Thank you all for being here. My one question is, could you, perhaps Professor Warren, describe the limits of disclosure? In your testimony, you did a phenomenal job at talking about effective disclosure. But I am curious to know if in your view there are limits to that and if the consumer products board could help address some of those limitations?

A quick illustration of what I mean. When I was a trial lawyer, I went and cross-examined witnesses every single day. I don't care if you were a police officer or a professor, you weren't there in that courtroom more than me, and I was going to make you look like you were lying even if you were telling the truth.

People who do financial regulation, they do this every single day, even if you have a 1-pager. I mean, are there limits to disclosure, and could the board help address some of those limits in terms of just basic fairness? That is my only question.

Ms. WARREN. Thank you, Congressman.

I want to say two things because I think you are exactly right. We have been talking about layers of complexity and how this would take out some of the complexity, but there is another point. If we make the real point about disclosure, can the consumer accurately understand what you have just done? Then the whole game shifts. So this is not about how many things can I write that make you look over here while I am really socking it to you over there. This is about someone who says, now, did you get it straight across the middle what it is that you are trying to accomplish?

And you put your finger on a key point that no one has talked about, and that is expertise. You know, the largest financial institutions in this country hire literally thousands of people to play with the design of their products. I sat next to someone from Bank of America who described the number of people and the number of experts they hire. They ran 500 experiments internally on their own customers in order to determine what maximizes profits for the bank.

There is no expert on the side of the consumers. And so this agency is about is leveling the playing field just a little by saying there is someone who is going to be an expert, who is going to get smart, who is going to learn to read this and be able to say, when you make a disclosure, it has to be a disclosure that is effective so that the consumer can make a real choice at the end of the day.

Mr. ELLISON. Thank you.

Mr. GUTIERREZ. For my own protection, the chairman is going to be back pretty soon and he is going to see the same panel he left that he thought he had discharged. So Mr. Ellison had his question, and I thank Professor Warren.

Mr. Paulsen, you are recognized for 5 minutes.

Mr. PAULSEN. Thank you, Mr. Chairman.

And we have had some discussion about the different layers of regulatory environment and the bureaucracy. But for those who are not watching and those who aren't aware, there is a plethora of regulation right now that goes on with banks and other institutions. And this new agency would seek to regulate some additional regulations obviously.

And so if you are a national bank, right now, your regulator is the Office of the Comptroller of the Currency. If you are a thrift, your regulator is the Office of Thrift Supervision. All banks are overseen by FDIC, of course, because of deposit insurance. Bank holding companies are supervised by the Fed. State-chartered banks are regulated by their State banking supervisor. And if you are not a member of the Fed, then the FDIC has additional oversight of that bank.

Bank subsidiaries have functional regulators, such as the FCC when they regulate securities. State commissions regulate insurance, subs, etc. Banks are also subject to the IRS, to OSHA, pension oversight, and every other Federal regulator that regulates any aspect of a business.

SBA regulates the function of SBA lending that a bank does, and HUD gets into RESPA and other housing related issues, and it goes on and on and on.

So my question, and I am a big proponent of having a focus on a regulation for safety and soundness, and it is really important that we have transparency, especially on the customer side. But my concern, and I want to ask Mr. Yingling because everyone else kind of went around the circle there, but Mr. Yingling in particular, do you see this new regulatory, this new proposal on the consumer side, as offering any additional value to your customers, or is it just adding to the mix of the alphabet soup?

Mr. YINGLING. Well, I think there are two issues.

One is just the structure. And as I testified earlier, as banks look at this, they just see another layer. Now, I recognize the argument that you are taking it out of other agencies and putting it over here. But look at it from the point of view of a bank, what it means is, you are going to have an examiner from another institution come in. And that examiner is going to look at the same thing in many cases that your prudential regulator looks at and come to different conclusions. Even if they have the same philosophy, they are going to come to different conclusions.

So the account operating process, I will use this as an example, at banks is heavily regulated, and it is regulated on a bunch of sides. You have to have the right disclosures. You have to have the right signatures. You have to do things that relate to antifraud protection to make sure you know your customers. We have a product at the ABA where the bank takes whatever name they get and the information, and it runs it through a computer, and it tells them, is that really Ed Yingling? Is Ed Yingling really 5-foot 9 and 35-years-old with blue eyes? No, I am not. And it regulates also for the Bank Secrecy Act, very important to stop money laundering and terrorist financing.

Now we are going have two regulators come in and give us different views of that account-opening process. We train our employees, our front-line employees, extensively with all of these rules, but they are reporting to one regulator. Now all that will be reporting to two regulators. We have to take the exams that they take, the front-line compliance exams that they take, and show them to the regulator, and the regulator has to say yes, those exams are okay. Now we are going to have two different regulators. So from the bank's perspective, it is an additional layer.

Mr. PAULSEN. And just to follow up. One of the concerns I have, and I just spoke yesterday to a community banker in my district, and he said he is going through an audit process right now. And the folks who are in his building are looking at—just a small community bank. I thought maybe he would have 3 or 4 regulators who are going through the books and the audit; 17 people are in there going through the books from top to bottom. And that is a huge drain on resources. Obviously regulation is important, but 17 people. And to think that we potentially are going to add another layer on top of that is of a concern to me.

And I guess it is important to focus again on safety and soundness, but at a time I think in the market right now we need innovative products, we need to allow the financial community to provide for innovation, I am really concerned that this may hamstring that ability.

Ms. SEIDMAN. Can I raise an issue? I don't think anybody would create our bank regulatory system if they were starting from scratch for many of the reasons you just described.

But Mr. Yingling listed all of the different rules that you have to go through with respect to account opening. Those rules are generated by a whole bunch of different agencies. One of the points of this proposal is to have them generated by one agency.

Mr. YINGLING. No, they aren't. They are three different—

Ms. SEIDMAN. The rules will be consistent—

Mr. YINGLING. How can they be generated by one agency? One is the Bank Secrecy Act. One has to do with account opening and truth in lending, and one has to do with antifraud. They are different rules.

Ms. SEIDMAN. They could be harmonized much better if one agency is harmonizing them instead of many of them.

Mr. YINGLING. But the consumer agency will not have jurisdiction over all those rules.

Mr. GUTIERREZ. Hold it. One at a time.

Mr. PAULSEN. I will point out, the devil is going to be in the details, Mr. Chairman.

I yield back.

Mr. GUTIERREZ. The time of the gentleman has expired on that question.

So I just wanted to say to Professor Warren, Ms. Seidman, and the others, I would like to put a floor on payday lending, a national one, so that at least we have some minimum standard. I would like for the remitters to have somebody nationally, you know a Federal regulator, I would like to see people maybe not buy an $800 TV and 3 years later pay $2,400 for it, or people to kind of, I don't know, escape to installment loans at 500 and 600 percent. Some people might be surprised that happens. It happens.

So not to take any time here, if you have any ideas about how that fits into what we are doing now in terms of setting floors and doing something now versus dealing with all of those things, you know, while we have the public's attention and the Congress' attention, I would love to hear from you later.

And now to close, the sponsor, Mr. Miller, is recognized for 5 minutes.

Mr. MILLER OF NORTH CAROLINA Thank you, Mr. Chairman.

Several witnesses and members have referred to the need for personal responsibility. I agree with that, but I have noticed that no one seems to use the term personal responsibility or call for personal responsibility when they are actually taking personal responsibility. It always seems to be when they are pointing out that someone else is responsible and that other person is not taking personal responsibility.

Mr. Yingling used or said that a variety of products was valuable and the products would compete, and that is the way I would like to see the market work, too. I am perfectly happy where there is some rough equality of bargaining power, some rough equality of information, or information symmetry, as economists would say, that we leave the parties to a transaction to their own devices.

The way economic theory says that should work is that when one competitor introduces a new product or does something different and it proves profitable, others will mimic what they are doing, and they will compete with each other, and they will be forced to contain their costs, and the prices will come down, and it will benefit the consumer. And the result is that all the competitors make an honest living, and the consumers actually get the benefits of their innovation.

What we have seen in the financial sector, though, is beginning around 1980, after bouncing for decades between 5 and 15 percent of all corporate profits, the profitability of the financial sector went up steadily, dramatically, consistently, up until a couple of years ago, to more than 40 percent of all corporate profits. And compensation of the industry, about which we have heard a great deal, went from about what other Americans made beginning in 1982, about 1.8 times what most Americans made.

Mr. Yingling, if the market were working properly, if there were competitive forces that were containing costs and limiting profits, how do you account for that level of profitability and that compensation level by the financial sector?

Mr. YINGLING. Well, you are asking me a question that is broader than your local community banks in North Carolina. You are asking a question about Wall Street. A fair question. I just want to point that out, that I don't represent all those people in hedge funds and that type of thing.

I think your analysis of the way it is supposed to work is correct. I think it is quite clear there were problems. I think, for example, and we have testified to this, that the compensation systems were not properly calibrated. And I don't mean to use that as a technical term. Compensation did not include enough consideration of the risk that, say, traders were putting on the system. I think it also shows that there was way too much leverage in the system. It also raises questions about monetary policy, quite frankly.

So I would certainly say that there were severe problems, including gaps in regulation, that led us to this problem. The great majority of it outside the traditional banking industry.

Mr. MILLER OF NORTH CAROLINA. Well, and I recognize the financial sector includes more than just the banking industry and more than just consumer credit. But consumer credit is actually the bulk of all transactions one way or the other. You don't think that consumer credit and the failures of the market to limit profitability and prices in a consumer credit transaction was part of the problem?

Mr. YINGLING. I don't know about the word profitability, particularly with respect to banks. I think that there were severe, terrible problems in the subprime lending market. In the President's proposal, it points out that 94 percent of that took place outside the traditional regulated banking market. There were terrible problems with mortgage brokers who were giving loans to people that never should have been made. There were problems with the fact that those loans went over the banking system to Wall Street where they were given AAA.

Mr. MILLER OF NORTH CAROLINA. My time is about to expire, and I haven't really gotten much on that.

But the second question, there have been several mentions of protecting consumer choice. And I am very perplexed at what consumers appeared to have chosen in financial products in the last few years. Can you get me the names of some consumers that I can talk to who would explain why they chose a double cycle billing for credit card transactions, or consumers who qualified for a prime mortgage but instead asked for a mortgage that had an initial rate that started at about prime; after 2 or 3 years, the rate adjusted, their monthly payment went up 30 to 50 percent, and they had a prepayment penalty? Could you give me the names of consumers who went into one of your member institutions and asked for those products, so I could somehow fathom how they made those choices?

Mr. YINGLING. I think that is a rhetorical question, and I won't try to answer it.

Mr. GUTIERREZ. Thank you very much.

It is wonderful to have you all here.

Mr. Pollock, good to see you again, although you did come as a witness for the minority side, but we will still be friendly with one another.

And it is good to have you all here. We are going to try to get it right this time. I thank this wonderful panel, all of you, for being here. And I look forward to talking to you all once again. Thank you so much.

I ask unanimous consent that written statements by the American Financial Services Association and the Insurance Marketplace Standard Association be entered into the record.

Without objection, it is so ordered.

Thank you so much.

Well, I am going to work really hard on this, because I want to get everybody's name right. We now have our third panel.

We welcome you all: Mr. Travis Plunkett, legislative director, Consumer Federation of America; Ms. Kathleen E. Keest, senior policy counsel, Center for Responsible Lending; the Honorable Ralph Tyler, commissioner, Maryland Insurance Administration, on behalf of the National Association of Insurance Commissioners, welcome; Mr. Gary E. Hughes, executive vice president and general counsel of the American Council of Life Insurers, we are happy to have you here; Ms. Catherine J. Weatherford, president and chief executive officer, NAVA, the Association of Insured Retirement Solutions; and Mr. Cliff F. Wilson, Southeast Arizona Insurance Supervisors, on behalf of the National Association of Insurance and Financial Advisors.

We welcome you all, and we will start with Mr. Travis Plunkett for 5 minutes please.

STATEMENT OF TRAVIS PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA (CFA)

Mr. PLUNKETT. Good afternoon, Mr. Chairman, and members of the committee, and Ranking Member Bachus.

My name is Travis Plunkett, and I am the legislative director at the Consumer Federation of America. I really appreciate the opportunity to speak with you again.

CFA strongly supports creating a Federal consumer protection agency focused on credit and payment products because it targets the most significant underlying causes of the massive regulatory failures that have harmed millions of Americans. In particular, combining safety and soundness supervision with its focus on bank profitability in the same regulatory institution as consumer protection authority magnified an ideological predisposition or antiregulatory bias by Federal officials and contributed to an unwillingness to rein in abusive lending before it triggered the housing and economic crises.

Structural flaws in the Federal regulatory system compromise the independence of banking regulators and encourage them to overlook, ignore, or minimize their mission to protect consumers. A consumer financial protection agency would correct many of the most significant structural flaws that exist, realigning the regulatory architecture to, first, put consumer protection at the center of financial services regulation; second, end regulatory arbitrage; and third, create a truly independent regulatory process.

Towards that end, I want to talk about funding quickly. It should be a priority to provide the agency with a stable funding base that is sufficient to support robust enforcement and is not subject to political manipulation by regulated entities. Funding from a variety of sources, as well as a mix of these sources, should be considered, including congressional appropriations, user fees or industry assessments, filing fees, priced services, such as for compliance exams and transaction-based fees.

Another authority that this agency should have that has been the subject of much discussion is the process for overseeing products, features, and services that are offered. Where credit products represent a significant risk to borrowers, we think this agency could require providers to file additional data and information to allow the agency to assess the fairness, sustainability, and transparency of products, features, and practices.

As we have heard a lot of discussion about plain vanilla products that are determined to be fair, transparent, and sustainable should be presumptively in compliance and face less regulatory scrutiny and fewer restrictions. Those that are riskier need to have stronger oversight. That could include a variety of remedies related to increased regulatory requirements, including prohibition.

And for those who think this is an unusual idea, let me just point out that Congress does this frequently and has recently done so regarding certain abusive credit card practices that consumers simply can't understand and that Congress has determined to be just outright abusive.

We have been asked by the committee to consider whether this agency should have some jurisdiction over insurance as well. This is certainly an excellent question. With a few notable exceptions, State insurance consumer protections and market conduct examinations are generally very weak.

CFA testified last month before Chairman Kanjorksi's subcommittee in support of bringing safety and soundness regulation under Federal control in part because effective systemic regulation of insurance, which we support, is not really possible unless the regulator has a thorough knowledge of and control over safety and soundness.

However, consumer protection regulatory weaknesses that exist at the State level should be strengthened without undermining the excellent regulatory practices in a few States, such as the remarkably successful rate regulation regime in California. Any Federal efforts to assist insurance consumers must be as a supplement to, not a replacement for, consumer protection efforts by State insurance regulators.

There are several things in our testimony that we throw out as possibilities for this agency regarding insurance regulation. Most significantly, given the core mission of the agency, which is to protect consumers in the credit markets, it makes a lot of sense to consider granting the agency minimum standards jurisdiction over insurance products that are central or ancillary to a credit transaction such as credit, title, mortgage and forced place insurance.

Mr. GUTIERREZ. [presiding] The time of the gentleman has expired.

Mr. PLUNKETT. Okay. Thank you.

[The joint prepared statement of Mr. Plunkett and Mr. Mierzwinski can be found on page 118 of the appendix.]

Mr. GUTIERREZ. You are very welcome.

Ms. Keest, you are recognized for 5 minutes.

STATEMENT OF KATHLEEN E. KEEST, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. KEEST. Thank you to the chairman and to Ranking Member Bachus, although, I guess he is not here anymore. Thank you very much for inviting us to testify.

The Center for Responsible Lending brings a unique perspective to the question of how to structure a regulatory system that best serves the public, the institutions, and the financial needs of American households. Ours is a research-based policy organization, but it is affiliated with a financial institution that is directly affected by regulations and the regulatory system.

I, myself, am a former credit code administrator and assistant attorney general in Iowa, so we bring three perspectives to this proposal. From all of these perspectives, we wholeheartedly welcome the proposal of a separate, independent regulator that is focused on the bottom lines of both the providers and of the households who are their customers.

Today's crisis has many origins, but a big one is a fatally flawed regulatory system that has led to where we are today. There were flawed regulators in not seeing what they were doing, but the structure, itself, has made it unlikely that any of the current lessons that today's regulators may have learned will have any staying power.

The OTS is a good example of that. They were created after the savings and loan industry self-destructed 20 years ago. Yet, today, when OTS' full-time, on-site safety and soundness examiners were at WaMu, they failed to notice that half of the real estate loans that WaMu was making from 2004 to 2006 were inherently risky, badly underwritten loans.

It is a little bit difficult to understand why we are talking about vesting these agencies with the consumer protection fair lending compliance, calling them "prudential regulators" when they have been no more prudent than the customers of those agencies, which is what they call their supervised institutions.

Financial autopsies by inspectors general have pointed to regulatory failures in both the OCC and the OTS for not doing their jobs, and the attitude of those regulators who consider their supervisees their customers is at the heart of the problem. For the market to work as intended, we need to have a level playing field. We need rules of the game and we need referees. We need referees, not cheerleaders, but the charter competition and the legal systems for sales structure that we have now inevitably led to the so-called "prudential regulators" being cheerleaders.

That is why we believe that this needs to be an independent regulator. That regulator needs to have all three tools that a regulator's toolbox should have. It needs to have the authority to set standards, the ability to monitor them in real-time, and the ability to enforce those standards. As a former regulator, I can tell you that, if you are not able to be onsite and monitoring things in real-time and are left to dealing with them when they become big enough to become a law enforcement problem, then the damage has already been done, and at the velocity that today's market moves, that does not take very long.

The second question that I would like to address is that about insurance. One of the things that we think is key is that insurance products that are inextricably linked with the financial products have to be there. We have proposed a "but for" test, which is to say, if this insurance product would not exist except for the underlying transaction and if it is intrinsically intertwined with it, then it should be there. We think that it is important to remember that credit insurance was one of the key tools used by predatory mortgage lenders 10, 15 years ago, and it was used to strip billions of dollars of equity out of people's homes when they still had some equity to steal.

Fifteen years ago, Congress had a chance to nip it in the bud then by making it a HOEPA trigger fee, but you did not. You did give the Fed the authority to do so later, but it was about 5 years later after billions of dollars of equity had been lost and after State legislatures, law enforcement and the FRB all clamped down on it.

So we would simply like to remind you that we think it is important to have learned both from the lessons of the S&L crisis 20 years ago and from the predatory lending problem 15 years ago and to say, let's learn from those mistakes and not do the same thing over again.

Thank you for the opportunity to testify, and I will look forward to your questions.

[The prepared statement of Ms. Keest can be found on page 94 of the appendix.]

Mr. GUTIERREZ. Thank you.

Commissioner Tyler, please, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE RALPH S. TYLER, COMMISSIONER, MARYLAND INSURANCE ADMINISTRATION, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. TYLER. Thank you, sir. Good afternoon.

Mr. Chairman, my name is Ralph Tyler. I am the Maryland Insurance Commissioner, and I appear today on behalf of the National Association of Insurance Commissioners. My comments will be directed to the question posed by the committee regarding the applicability of this proposed new agency to insurance.

While separating consumer protection from financial oversight may be an appropriate structure for other sectors, not so with insurance. Insurance is a promise to pay in the future if a covered loss occurs. Thus, solvency is the bedrock consumer protection. With an insurance contract, consumer protections are embedded in the product design, and product design directly affects solvency. As a result, we do not think the supervision of these areas should be separated or shared with a competing regulator.

There is currently a continuum of interaction between the insurance regulator and the insurance industry. It extends from licensing a company or a producer through product design and financial assessment to market conduct and claims payment. Breaking apart the links in that process will create gaps and inconsistencies, and it will do nothing to address the problems we collectively seek to resolve.

In the area of insurance regulation, the States have developed a wide range of consumer protection tools, which are detailed in my written testimony, all of which are designed around complex products and unique interactions between insurers and policyholders. The basic purpose of market regulation is to protect consumers by identifying and correcting practices that are in conflict with contract provisions and State law requirements.

For example, all States have unfair trade practices laws and unfair claims settlement protections based on models developed through the National Association of Insurance Commissioners. These laws provide a framework of consumer protection that gives States broad authority to intervene on behalf of policyholders.

The first link in the insurance regulatory chain is licensing an insurer to do business in the State. This process begins by examining the insurer's financial solvency, management capacity, expertise, and other factors. We also assess insurance producers through examinations, background checks, and continuing education requirements to ensure that consumers are protected at the point of sale.

Regulators then ensure the adequacy and appropriateness of the products offered to consumers. Insurance policies are complicated contracts, so insurance departments review policy forms to ensure that consumers are getting the coverage for which they have paid and that the policy provisions comply with the law. Likewise, because insurance is a product whose ultimate value is not known at the time of purchase and is dependent on risk assumptions that are difficult for a consumer to verify, States have some form of rate review to assure that rates are adequate but not excessive or discriminatory.

Additionally, 36 States, including Maryland, from where I come, are now part of the Interstate Insurance Product Regulation Commission, which allows an insurer offering life insurance, annuities, long-term care, and disability products to get product approval directly through the Commission, using one set of uniform standards while leaving market conduct enforcement and consumer protection to the States.

In total, the States have approximately 1,600 consumer service personnel monitoring the marketplace, handling in the aggregate 2.3 million consumer inquiries and 370,000 formal consumer complaints each year. To deal with criminal activity related to insurance, there are over 1,200 State personnel devoted to these activities.

The States have developed a sophisticated system of consumer protection, and we would respectfully urge the committee not to change that system in the name of consumer protection. Simply put, federalizing insurance regulation in the name of consumer protection would weaken consumer protection.

Thank you very much.

[The prepared statement of Mr. Tyler can be found on page 189 of the appendix.]

Mr. GUTIERREZ. You are very welcome.

Mr. Hughes, you are recognized for 5 minutes.

STATEMENT OF GARY E. HUGHES, EXECUTIVE VICE PRESIDENT & GENERAL COUNSEL, AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

Mr. HUGHES. Thank you, Mr. Chairman, and members of the committee.

I think there is some risk of having an industry witness come before you, talking about consumer issues and saying we strongly support enhancing consumer protections, and then we say, "however," and offer you a lot of reasons of why we do not support the protections that are being discussed.

In point of fact, life insurance companies do, indeed, support strong consumer protections. It is good business: Led by a group of CEOs, we have been working for over 2 years with State and Federal regulators to provide annuity consumers with more relevant and more clearly understandable disclosure. And we are continuing to work with State regulators to have all jurisdictions adopt uniform annuity standards on suitability, sales to seniors, and producer credentialing; but we do believe there are right ways and wrong ways to strengthen consumer protections in the context of insurance, and I think much of what I am going to say is going to echo what Commissioner Tyler has just said.

So why don't we support placing insurance products under the jurisdiction of an agency like the CFPA?

If you consider the stated purpose of the Agency as articulated by the Administration, we see references to products that are unregulated, lightly regulated or regulated by agencies with conflicting agendas and that were a cause of or contributed in some way to the financial crises. Life insurance products are not any of those things.

Our products are more heavily regulated than most. States typically have a prior approval process for new products, so if a company does business on a national basis, it will make 51 separate product filings. It will have 51 separate reviews, and it will wait for 51 separate approvals. Frankly, we do not see the wisdom or justification in making that number 52. Just to be clear, heavy product regulation is not the same thing as efficient product regulation or regulation in the best interests of consumers. In fact, one of the principal reasons we have been pressing for a Federal charter is due to the redundant, costly, and very time-consuming State product approval process.

Placing life insurance products under the CFPA would be a step backwards in terms of achieving more efficient and effective insurance regulation. Frankly, the last thing that our industry needs is more fragmented regulation. In that same vein, we note that the Administration proposes to exempt SEC and CFTC regulated products from the purview of the CFPA. The rationale, presumably, is that these agencies adequately regulate products under their jurisdictions. We believe that the even heavier regulatory oversight of life insurance products suggests that they should be afforded a similar exclusion.

A lack of necessity is not the most compelling factor arguing against placing life insurance products under the CFPA. As the Commissioner said, life insurance product regulation is an integral part of life insurance solvency regulation, and there is no more important consumer protection in our world than solvency. Our products involve promises to pay, extending outwards of 40 years or more, and the solvency standards governing the design of these products assure that these promises will be kept.

Life insurance product regulation involves, among other things, how premiums received from the sale of the products must be invested, the nature, level and duration of guarantees that are made, what risk classification criteria are used, what assumptions on product lapses are made, the appropriate level of surrender charges, the adequacy of reserves, what nonforfeiture limitations are applicable, what mortality rates are assumed, and what pricing assumptions are involved.

Failure to regulate any of these product attributes correctly puts consumers at risk over the long haul, and it jeopardizes the solvency of the issuing life insurance company. So divorcing product regulation from the balance of life insurance solvency regulation—and by that, we mean assigning these responsibilities to more than one regulator—weakens rather than strengthens consumer protections, and increases rather than decreases systemic risk in the insurance market.

This brings me to the last point I would like to make. It should be clear that anyone presuming to regulate life insurance products must be intimately familiar with the technical underpinnings of these products as well as with how product design relates to overall solvency. Put differently, life insurance company product regulation requires in-depth insurance regulatory expertise.

As this committee well knows, that sort of expertise is absent at the Federal level, although that is a gap in the overall regulatory framework that we would like to see remedied through the creation of a Federal functional insurance regulator. But it is unrealistic to expect that the CFPA would ever have the degree of expertise necessary to handle insurance product regulation effectively.

The centerpiece of the Administration's proposal with respect to insurance is the creation of an Office of National Insurance, and if it becomes a reality, the ONI would be the appropriate Federal agency to coordinate with State functional regulators concerning insurance product issues. Unless and until Congress establishes a Federal functional regulator with full solvency authority, we believe that the role of any Federal body with respect to insurance regulation should be advisory only.

In conclusion, we urge this committee to consider carefully the points we have raised because we do firmly believe that the best interests of consumers would not be well served by giving the CFPA jurisdiction over insurance products.

Thank you.

[The prepared statement of Mr. Hughes can be found on page 87 of the appendix.]

Mr. GUTIERREZ. Ms. Weatherford, you are recognized for 5 minutes, please.

STATEMENT OF CATHERINE J. WEATHERFORD, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NAVA, THE ASSOCIATION FOR INSURED RETIREMENT SOLUTIONS

Ms. WEATHERFORD. Thank you.

Mr. Chairman, Ranking Member Bachus, and members of the committee, thank you very much for this opportunity, and I commend you for holding this important hearing to examine gaps in and overlapping of financial regulation and their products.

I have over 30 years of regulatory experience, much of that time as an elected insurance commissioner and as CEO of the National Association of Insurance Commissioners. Since I have built my career protecting consumers, I fully understand the necessity for sound and effective regulation. NAVA's members are insurers, broker-dealers, banks, and asset management firms, and they are represented by hundreds of thousands of registered Financial Advisors across the country who help millions of Americans build sound retirement plans.

Congress' long-time focus on incentivizing retirement savings has shown to be wise foresight, especially in these turbulent economic times. Consistent with our new mission, which will be fully reflected in our new name, which will be announced later next month, I would like to make a few key points today.

Retirement savings is even more critical now as boomers' nest eggs are shrinking due to the economic crisis. At the same time, they are living longer due to rapid advances in medicine. Americans no longer fully rely on traditional retirement programs. So guaranteeing a lifelong income through an annuity is an option more and more Americans are choosing. In 2007, life insurers held $2.6 trillion in annuity reserves with 23 million variable contracts in force, representing over $2 trillion in assets under management. This truly demonstrates the value of variable annuities, especially in these down markets. When compared to other financial products, VA's have delivered guaranteed benefits to consumers in this down market better than others.

NAVA supports important consumer protection principles—transparency, suitable sales and education and training. Therefore, we urge uniform passage of the NAIC suitability, disclosure, and senior designation models. We also support the adoption of a summary prospectus by the SEC for annuity purchasers, which has already been adopted for mutual funds. We are also partnering with FINRA to deliver education both for consumers and for FINRA members.

Our consumers are protected by a comprehensive regulatory structure consisting of the SEC, FINRA, and 50 State regulators. These regulators perform comprehensive examinations of numerous consumer protection laws as often as every year, and at the State level, it is common for most large insurance companies to undergo 5 to 10 examinations, if not more, by different State insurance departments simultaneously in any given year.

Variable products, because they are securities, must be also approved by the SEC. Then, on the State level, the products must contain legally required contractual provisions, and must be approved by every State insurance regulator in the Nation where the product will be sold—a very arduous process that can take well over a year to obtain approvals of these types of products in all States.

Given the current regulatory protections, adding yet another layer of regulation to the insurance industry is unnecessary. It has already been stated that separating financial regulation and consumer protection regulation is not prudent and would present significant risks to consumers. It could also prevent the best products from reaching consumers in a timely fashion. To this end, we do support the President's Office of National Insurance proposal as well as Subcommittee Chairman Kanjorski's H.R. 2609.

In summary, while we do not believe an additional consumer protection regulator is necessary or even advisable for the annuity industry, we ask the Congress to continue to focus on how regulatory structures and necessary consumer protections can be operated and administered in the most effective manner. This is why we do support Treasury's proposals to modernize and improve our system of insurance regulation as well as its six principles for the regulation of insurance.

Thank you for the opportunity, and I welcome any questions you may have.

[The prepared statement of Ms. Weatherford can be found on page 206 of the appendix.]

Mr. MILLER OF NORTH CAROLINA. [presiding] Thank you, Ms. Weatherford.

Mr. Wilson, for 5 minutes.

STATEMENT OF CLIFF F. WILSON, SOUTHEAST ARIZONA INSURANCE SERVICES, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS (NAIFA)

Mr. WILSON. Good afternoon, members of the committee. Thank you. My name is Cliff Wilson, and I operate an insurance agency in Chandler, Arizona. I serve as president of the National Association of Insurance and Financial Advisers, NAIFA. Thank you for the opportunity to appear before you today to share our views regarding financial regulatory reform and the critically important area of consumer protection.

NAIFA comprises more than 700 State and local associations representing the interests of approximately 200,000 agents and their employees nationwide. Like me, NAIFA members focus their practices on one or more of the following: life insurance and annuities; health insurance and employee benefits; multiline; and financial advising and investments. NAIFA members share the views of the Administration and of this committee that robust consumer protection is necessary to ensure public trust in financial products and services and in the financial system as a whole. Stepped-up Federal oversight through a consumer financial protection agency may make sense for some products. Insurance, however, is different for three reasons:

First, insurance products are subject to comprehensive State regulatory oversight. Federal intervention is unnecessary and could lead to regulatory confusion. Insurers and insurance agents are required to comply with the laws and rules of every State in which we do business and are required to hold a license in every State. Agents who sell more than one line of coverage may be required to hold more than one license in each State. As an agency, I am required to have an agency license as well. As part of the license process, producers undertake pre-licensing and continuing education courses; they pass examinations; submit to an application process; and perhaps most importantly, they comply with State consumer protection laws.

Moreover, agents cannot sell a product in a State unless it has been approved by the State's insurance regulator. Until fairly recently, product approval was a State-by-State endeavor that could take years to complete. With the creation of the Interstate Insurance Product Regulation Commission by the NAIC, the product approval process for life insurance, annuities, long-term care, and disability income products has been streamlined dramatically in the 35 States that currently participate.

More than 40 States also have imposed suitability requirements in connection with the sale of annuity products. These State requirements are based on the NAIC's Suitability in Annuity Transactions Model Regulation, which imposes a suitability requirement on any recommendation to purchase or to exchange an annuity. The NAIC model rule also imposes duties on insurance companies regarding supervision and monitoring where none had previously existed.

Separate and apart from the requirements of the NAIC model, more than 80 percent of NAIFA members are securities licensed and are, therefore, subjected to FINRA rule 2821 in connection with the sale of variable products. For producers selling variable annuities in States that have not enacted the NAIC model, the requirements of the FINRA rules still apply.

To the extent that one of the missions of the CFPA would be to simplify consumer disclosures, we are unsure how that can be accomplished under a regime that would establish a regulatory floor under which State disclosure requirements would still be fully applicable. It appears that these twin objectives—disclosure simplification and the continued applicability of current State requirements—are at odds with one another, and all that the new Federal requirements would accomplish in the highly regulated insurance arena would be to add an additional set of requirements to an already very robust consumer protection scheme.

Second, the separation of insurance product regulation from insurance solvency regulation is dangerous. States regulate solvency to ensure that the ultimate consumer protection is available when needed—the promise to pay a claim when it comes due. A regulator focused on only one part of the puzzle may have oversight and may take actions not in the best interests of the product.

Third, Federal financial product oversight should be addressed only as part of a comprehensive review of insurance regulation. This should not be a piecemeal effort. The dangers and regulatory burdens on producers, companies and clients are too great. If the Federal Government is going to assume insurance regulatory authority, there must be a Federal insurance regulator with expertise and authority to fully understand the implications of regulatory actions for the industry, the marketplace, and the consumers. NAIFA members have debated long and hard regarding the proper Federal role in insurance regulation. We are long-time supporters of State regulation and continue to be so, but we understand there could be areas for Federal regulation.

We appreciate the opportunity to speak.

[The prepared statement of Mr. Wilson can be found on page 224 of the appendix.]

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Wilson. We will now have rounds of questions by members.

Mr. Kanjorski is recognized for 5 minutes.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Let me address this to the full panel:

Do you all think that this concept of a consumer agency of this nature is the best way to go about regulating the insurance industry? If you do, show your hands "yes" so I can separate the panel, or if the whole panel is for it, let me know. I am totally lost when it comes to it.

Who is for it? Who thinks this is the greatest thing since sliced bread? Just one of the panel. Two of the panel. Okay, four of the panel think it is the worst thing since sour milk. Is that it?

Ms. KEEST. Could I say that I think that, with respect to some kinds of insurance, it is a necessity to be part of this, and those are the ones that are related to the credit transactions.

Mr. KANJORSKI. All right. Could you help me out a little bit and explain to me what tremendous contribution consumers have made to the most recent recession and financial crisis?

Ms. KEEST. Are you asking me?

Mr. KANJORSKI. Anyone. I am trying to figure out why anybody thinks this is something we should not be moving on from in the Congress compared to all of the other disasters and compared to all of the other problems we have to meet.

What has happened in the last couple of years in protecting consumers that has caused such a disaster that we should divert all of our attention now to this one plank? It is not all of our attention, but it is a major part of our attention when we are doing reform regulation.

Mr. HUGHES. Without disagreeing with your premise, I think your question is an interesting one.

Again, if you go back to at least what we understood the Administration had in mind here, which was a focus on products, it was to say, if there are products that have harmed consumers as part of the crisis, if there are products that contributed to the crisis—worsened it, deepened it—then perhaps there is a way to get at that; but I think the people on this panel would be saying generally the products that we deal with do not fit that model. That is why, I think, as we look at the proposal on this agency that we do not think it is the right way to address insurance products.

Mr. KANJORSKI. I have been struggling with the regulation of insurance on a Federal level or on a State level and how it could or should be done and whether it warrants getting done for a number of years right now. I have never seen anything in the world more devious or backdoor to come in to Federal regulation than doing it this way, and with the least amount of real direct effect. I can see us spending years in court, trying to figure out the jurisdiction of this agency to do what it wants to do because it was or was not the intention of Congress to do that, and then as to how we are going to structure this.

Do you all see that is not a problem here?

Mr. PLUNKETT. Mr. Chairman, we responded to a request to consider if the notion to set up a consumer protection agency focused on a provision of credit and payment systems, to consider insurance in that light, and there are some positive aspects to that idea. In particular, what we threw out just before you arrived was the idea of a holistic jurisdiction from the consumer protection point of view over the entire credit transaction to include insurance products that are directly related to that credit transaction. Title, mortgage, credit, and forced placed insurance are some examples.

To answer your previous question, credit insurance has been a major part of single premium credit insurance, in particular, abusive mortgage lending practices. It has been tied very closely.

Mr. KANJORSKI. I can see that as an after the fact that some problem occurs with a particular element and that we are trying to find out whether there is some agency of the Federal Government that has jurisdiction to do something about it. The reality is: Shouldn't we get our hands around whether or not this is needed and whether it is essential? Are there other areas that we can strengthen or create that would do it more efficiently, more effectively, and more directly?

I hate to say this, but anything that gets the title "consumer" seems to have an express ticket on the train to getting there. Unfortunately, it may be very expensive; it may be very circuitous in the route we want to take, and it could probably impede what we are trying to do to create a Federal charter, if that is what we decide we need. After this, I do not think we need a Federal charter because it is going to take us 5 or 10 years to figure out what this agency is supposed to do.

Mr. PLUNKETT. Mr. Chairman, as you know, the consumer community is very concerned about a Federal charter, and we are talking about regulatory arbitrage today.

Mr. KANJORSKI. Right. Right.

Mr. PLUNKETT. It will allow regulated entities to play these State regulators off of Federal regulators.

Mr. KANJORSKI. You know, I heard testimony in this committee just 2 months ago from the consumer organizations, saying that they did not want a Federal optional charter or the Federal regulation of insurance companies because the States were doing such a magnificent activity, and they should keep it at the State level. Now, suddenly, the consumer groups are coming in and are telling us to create a whole consumer agency to handle something that the States are doing perfectly well. Give me one or the other, but do not try and get both. What do you mean?

Is there such a failure of consumer protection in the United States on the State level that they are not doing their jobs, and we have to create a Federal agency or regulator to do that or is that not true?

Mr. MILLER OF NORTH CAROLINA. If we proceed with 5 minutes, I think all of us can get in our questions, but I do appreciate the chairman of the Capital Markets Subcommittee, on which I serve, for his questions.

Mr. Bachus for 5 minutes.

Mr. BACHUS. Thank you, Mr. Miller.

I guess I will ask—is it Ms. Keest?

Of course, Mr. Miller and others worked on the subprime bill that has now passed.

Does that address most of the problems in subprime lending—that in combination with other things that have been done?

Ms. KEEST. No.

Mr. BACHUS. Okay.

Ms. KEEST. There is a lot left to be done. Part of the issue about it is that it was sort of the same thing that happened 15 years ago. It only deals with the mortgage market. It mostly deals with part of the mortgage market. It leaves the rest of the financial services, the basic package of consumer financial banking needs, unaddressed.

Mr. BACHUS. I am talking about the subprime mortgages, where it is just restricted to that. I sort of associate you all with subprime lending, but you are actually on all sorts of credit—with the Center for Responsible Lending.

Ms. KEEST. I am sorry.

Mr. BACHUS. I said I associate you all with subprime lending just because of the last few years, but you are actually concerned with all sorts of lending practices.

Ms. KEEST. Certainly. We work on credit cards. We work on payday loans, and we are affiliated with the financial institution that does mortgage lending, small business lending and that has retail credit union operations.

Mr. BACHUS. On the subprime, where do we stand on that after this legislation?

Ms. KEEST. Well, first off, number one, we have to make sure that it gets through the Senate and does something.

Mr. BACHUS. Okay. I keep forgetting that they have not passed it. It is the second time, I guess.

Ms. KEEST. There is a long distance to go.

The second thing is that, I think, it really does a lot of improvement to the existing problems, but it leaves a lot of questions unanswered, one of which is that it would require joint rulemaking by the Federal financial institutions, which sort of gets back to the flip side of the reason that we would like a single integrated unit because the examples of joint rulemaking by the financial regulators has been gridlock and a great race to the bottom, so the devil will be in the details. This law could be very good if those regulations turn out well, but one of the provisions in it is a joint rulemaking process that could basically mean it is a paper tiger.

Mr. BACHUS. Okay. Thank you.

Mr. MILLER OF NORTH CAROLINA. I like calling time on members who are much more senior than I am on this committee. We do need to try to get done before this series of votes. It is a real series of votes, not a temper tantrum of votes.

For Ms. Keest and Mr. Plunkett, one series of questions, or one point repeatedly made today, is that consumer protection is a vague concept for which Congress should enact very bright line rules, which is somewhat contrary to the wisdom of previous generations.

There was a famous 18th Century British case widely quoted in the United States that said that there should be no single, all-encompassing definition of "fraud" less the craft of men should find a way of committing fraud which might escape such a rule or definition. One of the principal functions of financial innovation in recent years appears to be to evade existing regulations.

In your experience, Ms. Keest and Mr. Plunkett, how easy has it been to get legislation through Congress to protect consumers from financial practices?

Mr. PLUNKETT. Well, Congressman, until this year, it has been virtually impossible.

Ms. KEEST. I would like to say that I was here 15 years ago when HOEPA was enacted. HOEPA did a good job of dealing with 1993's and 1994's markets. It is 15 years later, and we have had several more generations of things that nobody would have even thought of then, and there has still been no action coming out of the whole Congress.

Mr. MILLER OF NORTH CAROLINA. So the craft of men has found ways of escaping the rules of 15 years ago.

Mr. Tyler and Mr. Hughes, quickly, I think both of you or several witnesses have used the word "robust," which is a word you hear a lot more in Washington than you do in the rest of America to refer to insurance regulation. About an equal number of States have file and use policy form approvals and require prior approval for policies. It is striking how different that regulatory scheme is from credit products.

Can you offer any explanation for why a similar regulatory regime should not be in effect for approving or for at least requiring information about new credit products?

Mr. Tyler, you are on.

Mr. TYLER. Well, thank you, Congressman. You are right. States have made different choices about these things, but it would be a mistake, I would suggest, to look only at what the file and approval laws or procedures are in States. You would also need to take into account that all States have an Unfair Claims Practices Act and other consumer protections, which are the fabric of consumer protection. So whatever process a particular State has chosen for the initial approval of products, that is not the sum total of the regulatory regime.

Mr. MILLER OF NORTH CAROLINA. But my question is:

Why should other financial institutions credit institutions—banks, thrifts, credit unions, whoever? Why should they not be required to file what credit products they are selling to consumers? Here are the documents just as you have to get filings of policy forms. It seems not to require anything they do not already do.

Mr. TYLER. With all due respect, I am not really qualified to speak about what banks should do. My point, really, is that insurance should not be part of this.

Mr. MILLER OF NORTH CAROLINA. Mr. Hughes, can you think of any reason that banks and thrifts should not be subjected to the same kinds of approvals that you are for what they sell to consumers?

Mr. HUGHES. Again, like Commissioner Tyler, that is not our association's area of expertise, but off the top of my head, I would have to say no.

Mr. MILLER OF NORTH CAROLINA. All right. I will now yield back the balance of my time.

Mr. Manzullo?

Mr. MANZULLO. Thank you.

I do not believe we should start a whole new consumer agency to protect the consumer on financial products. However, the analysis done by Mr. Plunkett and Ed, I would commend that everybody on the panel read the reasons why they want to set up a new organization because of the complete failure of the existing organizations to stop the subprime massacre that took place in the country. So I can understand where they are coming from, but it is irrelevant to you guys on the insurance side.

I would like to ask this question of Mr. Plunkett. On page 3, the last paragraph, you state that the failure of Federal banking agencies to stem subprime mortgage lending abuses is fairly well-known. They did not use a regulatory authority granted to them to stop unfair and deceptive lending practices until it was too late.

You are advocating the setting up of another agency. I can understand the reason for that because what is there did not step into the breach. I mean the Fed had the authority, and Mr. Greenspan could have stopped it. Most of this occurred before Mr. Bernanke came on board, because there were no rules that said that you had to have proof of payment or proof of your income before you could buy a house or could do away with these predatory practices of 3/27 and 2/28 mortgages.

My concern is, even though the appointees to this new body would be "consumer-oriented," I would think that, ultimately, the bottom line is everything should be consumer-oriented because it is the consumer who has the greatest stake in the banks and in the other financial institutions being sound and safe. It protects them. So there is actually an identity of interest that is involved.

Mr. Plunkett, what would make this new agency political proof or able to do the job or to recognize what the other agencies did not?

Mr. PLUNKETT. Well, that is a very good question.

There was at its root a failure of will by Federal regulators, but that was, as I mentioned before, exacerbated and magnified by really serious structural problems in the ways that agencies are structured—two points here, the conflict that regulators sometimes see between safety and soundness regulation and consumer protection regulation and the ability of regulated parties to shop around for a regulator who would, you know, essentially, lower standards, you know, to a reduced level.

Mr. MANZULLO. But the President wants to combine OTS along with OCC. So that would do away with that problem.

Mr. PLUNKETT. To some extent, it would, but we still need an agency with purview over all credit products, looking at them all together, and that has a mission to be a proactive regulator, not a reactive regulator.

Mr. MANZULLO. Let me flip the question.

If you believe, as I do, that you do not need another agency, what would you do with the present structure to make sure this economic collapse did not occur again?

Mr. PLUNKETT. Well, that is another really thoughtful question, and I know a lot of folks who testified on the previous panel and on this panel have thought a lot about it.

I, frankly, think that the existing structure is broken and that we cannot really build on a regulatory structure in which the regulators have so many sometimes conflicting measures—

Mr. MANZULLO. You think it cannot be fixed in its present form. Is that your answer?

Mr. PLUNKETT. Yes. Yes. I think we need a consumer focus here, and the best way to do that is with a single agency.

Mr. MANZULLO. How could you add a consumer focus to the broken agencies?

Mr. PLUNKETT. Well, I have thought a lot about that.

Mr. MANZULLO. If your answer were that you cannot, I would accept that, but go ahead and take a stab at it.

Mr. PLUNKETT. I think a lot of people have thought about that. The truth is that, in the safety and soundness mission and in the case of the Fed with the monetary policy mission, you know, you will get good leaders who at times will focus a little more on consumer protection. Chairman Bernanke has done a little more of that, and that is a good thing.

Overall, I think the way that agencies like that will typically function is to put consumer protection in the backseat. I think that is the normal, sort of everyday way that they will function, and we cannot legislate based on exceptions, and Ellen Seidman is an exception.

Mr. MANZULLO. My time has expired. Thank you, Mr. Chairman.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Ms. Speier, a conscientious member of this committee, who missed the first round of questions. Ms. Speier for 5 minutes.

Ms. SPEIER. Thank you, Mr. Chairman.

Let me be very brief because I know we want to get to the vote, and I know there are others who want to ask questions.

First, let me just say that I disagree with my distinguished chairman, Mr. Kanjorski, who does not believe as I do that State regulation is really where insurance regulation should take place. I am a firm believer that it should. I think the actions of the last few years make it very clear, particularly with AIG. Mr. Liddy has said over and over again that we should have stuck to our knitting, meaning they should have stayed in the insurance business and not meandered out into credit default swaps and into other exotica, but let me ask this:

Mr. Hughes, Ms. Weatherford and Mr. Wilson, if insurance were exempted in this new agency, would you support the bill?

Mr. HUGHES. Well, I think, if insurance were exempted and we were not part of it and if there were other aspects of the bill, for example, and if the Office of National Insurance were part of it, then perhaps, yes, we would.

On the new agency specifically, if we are not part of it, we will not have any interest in it, but if there are other aspects of the Administration's proposal that we do favor and if we were not part of the agency, then, in fact, we would be inclined to be supportive, yes.

Ms. SPEIER. Ms. Weatherford?

Ms. WEATHERFORD. Our association represents financial security products, which are very different from the debt instruments that have been discussed by most of the panelists today, and we are already under the oversight of State insurance regulators—the SEC and FINRA—and fully believe that we should be exempted.

Ms. SPEIER. I understand that, but would you support the bill if you were exempted?

Ms. WEATHERFORD. If the Office of National Insurance were included, if Representative Kanjorski's language for his bill possibly had some of that in there where we could enjoy having some Federal knowledge of insurance and insurance regulation, I think it would be most helpful to us.

Ms. SPEIER. Wait. Are you saying that, if there were a national charter for insurers, then you would want to be exempted from this insurance being part of it?

Ms. WEATHERFORD. No. We could support it if there were the inclusion of the Office of National Insurance or of the Office of National Insurance Information where more knowledge was held at the Federal level about insurance regulation.

Ms. SPEIER. So, if it were just the Office of Insurance Regulation and not the preemption of States relative to international treaties and agreements, you would support this bill?

Ms. WEATHERFORD. I suppose, yes, we would, other than the fact that many of the aspects of the bill are about debt instruments and apply to other entities that have nothing to do with insurance.

Ms. SPEIER. All right. Finally.

Mr. WILSON. We would support the same position as Mr. Hughes. If there is not insurance as a part of it, we would have no position.

Ms. SPEIER. You all are supporters of an OFC; is that correct? I am speaking of just—not Mr. Commissioner.

Mr. TYLER. Surprisingly, I am not.

Mr. HUGHES. Yes, we are.

Ms. WEATHERFORD. My association has taken no position on the Federal chartering legislation. We are already enjoying dual regulation, Federal and State, today, but we have not taken a position on Federal chartering for the insurance industry.

Mr. WILSON. We have a position that we could support the concept with conditions, "conditions" being choice for the agent, consumer protection and to retain State-based as well, and so we have a dual position, a dual system of a position. So based on those conditions—

Ms. SPEIER. Meaning that you could forum shop then?

Mr. WILSON. Well, some of the parts of our industry have different needs and different circumstances, and with basic conditions of enhanced consumer protections and to retain State-based, we could support the concept.

Ms. SPEIER. All right. Thank you.

I yield back.

Mr. MILLER OF NORTH CAROLINA. Thank you, Ms. Speier.

Mr. Sherman for 5 minutes.

Mr. SHERMAN. I will try not to take all 5 minutes. I am going to ask you folks to respond for the record because I do have this dream of making the votes.

When I was dealing with the first panel, I focused on the fact that what we have seen in this country over the last 50-plus years is a transfer of power from the Legislative Branch to the Executive Branch, including Executive agencies. The question is:

Are we here to create a law enforcement agency, which is the appropriate role of the executive branch, or a law-making agency, which is a way for us to simply, again, transfer the powers vested in us by article I to the article II agencies? I am speaking of the U.S. Constitution.

Now, one way is—and this will be the question I would like you to respond to, and I will just use this as a specific. We passed a credit card bill through Congress. Normally, that is thought to be Congress' role. Of course, the Fed kind of had some regulations along the same lines.

If we create this new agency, will it have the power to add to the Credit Cardholders Bill of Rights a provision limiting total interest rate—an interest rate cap? In other words, we thought of an interest rate cap. We did not put it in the law, but could this agency do it?

Likewise, second, we specifically prevented double-cycle billing. Could this agency decide that it is in the interest of consumers to allow double-cycle billing? Let's not assume that every commissioner who is ever going to be appointed to this board is going to be certified by the Consumer Federation. I have seen the pendulum swing back and forth.

Finally, do you envision that we pass legislation that is simply so incredibly vague that the commission does not know whether it has the authority to either allow double-cycle billing or to cap interest rates? Should we here not only punt our authority to an administrative agency but punt on the issue of whether we are even doing that or not by making it so unclear that the agency's powers are in question?

The second question relates to the move here to separate consumer protection on the one hand with prudential or safety and soundness regulation on the other. With Fannie and Freddie, I see we used to have those two separated, and with OFHEO, we seem to have put them together. Now, with this bill, we are taking them—the prudential regulation and the compliance and consumer protection regulation—and separating it.

So the first question is: Is this a departure from recent precedent?

The second question is: If we separate compliance and oversight from prudential oversight, it can be expected that there might be conflicting mandates from the two separate regulators that a particular financial institution has to answer to. What does the regulated institution do in such a situation? How will these conflicts be addressed?

So one question is about the role of Congress. Another question is about whether it is best to sever compliance and prudential oversight. If we are going to separate them, how do we work out the conflicting demands of two regulatory agencies, both with power over the same financial institution?

Rather than miss the vote, I am going to ask you to respond in writing, not only to protect my voting record, but that of the chairman's.

I yield back.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Sherman.

That ends the questioning of this panel. On behalf of Mr. Frank and all of the members of the committee, I want to thank all of the witnesses for your testimony today.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to this panel and to place their responses in the record.

This hearing is adjourned.

[Whereupon, at 2:09 p.m., the hearing was adjourned.]

A P P E N D I X

June 24, 2009

Statement by Rep. Michele Bachmann
House Financial Services Committee
Hearing on "Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"

June 24, 2009

Thank you, Mr. Chairman, for holding this important hearing.

I have serious concerns that the Consumer Financial Protection Agency (CFPA) proposed by the President will do more harm than good. I am concerned that it will stifle innovation and consumer-choice in the financial marketplace. And, I am concerned that it will result in yet another massive bureaucratic agency that is ineffective and unable to actually achieve its mission.

Today's hearing is our opportunity to ask some very important questions about how this agency would operate, what powers it would hold, and whether it is fundamentally in the best interests of consumers to have a government regime dictating what financial products can be sold in our nation.

Will this agency be expected to approve each and every product, one by one, before it can be purchased by American consumers? We're talking about tens of thousands of financial products. Will this result in long delays before consumers can access different sources of financing? All the while, consumers would be forced to wait anxiously for the government to approve that mortgage or small business loan that could best suit their needs. How can we be sure that the agency will not become a slow, bureaucratic behemoth – something that regrettably has characterized many a government agency? Just think about the type of feedback we've gotten about the FDA's processes over the years.

There are also many questions about what sort of criteria the CFPA would use to determine whether a financial product gets the thumbs up or thumbs down. How will the government be able to accurately judge this? And, what threshold would be used to decide whether a product is appropriate to be sold? For instance, if a financial product is deemed unsuitable for 3% or 5% of the population, would the CFPA ban that product for all consumers?

Finally, I have serious misgivings that the President's proposal disconnects the mission of consumer protection from that of safety and soundness within the framework of this agency. If the agency's sole focus is on consumer protection without consideration for broader issues of safety and soundness, that could result in new consumer protection mandates that simultaneously weaken larger financial protections. The last thing we need is another government agency with tunnel-vision – that is already one of the problems within the existing financial regulatory framework.

I thank the witnesses for being here today and look forward to the discussion.

Thank you, Mr. Chairman, and I yield back the balance of my time.

ANDRÉ CARSON
7TH DISTRICT, INDIANA
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE ON
INTERNATIONAL MONETARY POLICY
AND TRADE

Congress of the United States
House of Representatives
Washington, DC 20515-1407

425 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-1407
(202) 225-4011

DISTRICT OFFICE
300 E FALL CREEK PKWY N DR. #300
INDIANAPOLIS, IN 46205
(317) 283-6516

Statement of Congressman Carson
Financial Services Committee Hearing
"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation."
June 24, 2009

Thank you, Mr. Chairman, for holding this important hearing today.

The creation of a Consumer Financial Protection Agency is one of the most critical pieces of regulatory reform for my constituents in Indiana's 7th Congressional District. Indianapolis residents who see their neighborhoods riddled with foreclosures or their credit card interest rates and fees skyrocketing know that there is an urgent need to reform the way financial products are supervised.

There are legitimate concerns relating to the scope of the agency and its implications for current, effective regulatory bodies. These concerns, however, must be vetted and overcome in light of the critical need for an independent agency that focuses solely on protecting consumer interests.

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

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

Further, as I mentioned before, my district has been devastated by foreclosures. In an attempt to help my constituents who have been targeted and defrauded by unscrupulous mortgage brokers and lenders, I have been working with my state Attorney General's office back home to make sure this activity is reported to enforcement authorities on a local level. I believe that kind of information sharing is invaluable and it should be strengthened.

We should work to institute a more coordinated effort through the Consumer Financial Protection Agency so that local and federal authorities can have an open line of communication regarding lending trends and abuses. In order for the agency to write effective rules to combat abusive behaviors, it must have timely and comprehensive information about what is happening on the ground in our communities.

Finally, as I work hard with the Chairman and my colleagues on the Committee and in the House to make sure that this vital agency becomes a reality, I want to make sure the voice of minority and women-owned businesses are central to its focus. If we want to revive our economy and bring about long-term growth and stability, this agency must help foster innovation in the market that empowers consumers to make educated decisions. Minority and women-owned businesses already offer this kind of innovation and must be included in that effort.

I want to commend the work of several witnesses today who were instrumental in making sure this agency was included in the Administration's broader regulatory reform proposal. I look forward to hearing their response to critiques of the proposed agency and to questions I have pertaining to specific enforcement activities.

Thank you, I yield back my time.

Financial Services full committee hearing: Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

Wednesday June 24, 2009
10:00

Opening statement

Chairman Frank, Ranking member Bachus, thank you for holding this important hearing today.

When the Consumer Product Safety Commission was proposed in 1972, toaster manufacturers, toy companies and car makers all screamed foul, much like the financial services industry is screaming about the Consumer Financial Protection Agency that we are discussing today.

But thank god for the CPSC. It has resulted in safer and more consumer friendly products and boosted American confidence that the products they bring into their homes will not kill them. And innovation and new product development is still alive and well.

The proposal for a consumer financial protection agency that we are talking about today is, I believe, the most important reform to come out of this economic meltdown.

A landscaper in my district who works for the City of San Francisco earns $60,000 a year, yet he got a $600,000 mortgage. He now has an $800,000 balance because his "pick a payment" loan allowed him to short his monthly payment and feed the balance back onto the principal. At this point, his mortgage is more than his take-home pay. How did he get a loan like that? A bank gave it to him.

It is far too generous to say that financial institutions were simply opportunistic for selling exotic mortgages to working people and pushing credit cards on students that they were unlikely to be able to repay.

Millions of Americans are losing their homes and jobs, and millions more have seen their retirement nest eggs evaporate. Sorry if I don't fall for the old canard that "the market will take care of itself".

Amazingly, many in the financial services industry argue that a consumer protection agency is unnecessary. Not only should consumers just trust their bankers, they also argue that the financial services industry is too complex for a consumer protection agency to understand.

Really??

Does anyone really want to make the argument that the status quo works? Let's be clear --existing regulators could have stopped the liar loans, sub-prime steering, pre-payment penalties, option ARMs and other mortgage products that nearly brought our economy down. The status quo could have jumped in at any time. But it didn't.

If a financial product is marketed with total disregard for a consumer's ability to repay, if it is purposely written so you need to hire an attorney to understand the terms, if it manipulates a customer into a more costly product than they are entitled to, you can't blame that on "the complexity of the system".

Regulators stood by while credit card companies used clever tricks to draw customers into ever deeper debt with teaser rates, balance transfers and so-called "convenience checks", all while burying the real credit terms in 30 pages of fine print. They watched while banks used ever larger over-limit and late fees to increase their bottom line at the expense of the most vulnerable consumers. Now more than 50 million American families can't pay off their credit cards each month.

It is essential that this new agency has real power and the resources necessary to carry out a difficult mandate:

- It must have real and flexible rulemaking authority to ensure that it can respond to innovations in the marketplace as institutions inevitably seek to find the loopholes that lead to higher profits.
- Financial institution profitability should have no impact in its deliberations. If a financial institution can't make money without using deceptive practices, it shouldn't be in business.
- It must establish a floor of regulation—not a ceiling. Currently, states often have to intercede to protect their consumers because federal regulators

won't. If this new agency does its job, the states won't have to enact tougher measures.

- It should leave insurance product regulation to the states who have the expertise and an existing strong consumer mandate.
- It must be adequately funded—separate from the institutions being regulated and not subject to starvation by Congress or the administration.
- It must have real enforcement authority, aided by states and a private right of action.

Financial institutions will say that they cannot possibly function under the kinds of restrictions proposed here. To which I ask them: Why are you afraid of letting consumers understand the terms of their mortgages and credit cards?

The industry has cried wolf too many times when reasonable regulatory changes have been proposed. Now we've spent hundreds of billions of dollars taking care of some of the biggest banks in this country. It is time to do something for the 117 million American families who don't have anyone to bail them out.

If we make it safer to take out a mortgage or use a credit card, then we will have accomplished something truly significant.

BILL DELAHUNT
TENTH DISTRICT, MASSACHUSETTS

2454 Rayburn House Office Building
Washington, DC 20515
(202) 225-3111
www.house.gov/delahunt

SOUTH SHORE
1-800-794-9911

1250 Hancock Street
Suite 802 N
Quincy, MA 02169

CAPE COD & ISLANDS
1-800-870-2626

146 Main Street
Hyannis, MA 02601

Congress of the United States
House of Representatives
Washington, DC 20515–2110

COMMITTEE ON FOREIGN AFFAIRS
SUBCOMMITTEES ON:
INTERNATIONAL ORGANIZATIONS, HUMAN RIGHTS AND OVERSIGHT
CHAIRMAN
EUROPE
VICE CHAIRMAN

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEES ON:
THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES
IMMIGRATION, CITIZENSHIP, REFUGEES, BORDER SECURITY, AND INTERNATIONAL LAW
COMMERCIAL AND ADMINISTRATIVE LAW
VICE CHAIRMAN

CO-CHAIR:
CONGRESSIONAL COAST GUARD CAUCUS
OLDER AMERICANS CAUCUS

STATEMENT OF CONGRESSMAN BILL DELAHUNT

Financial Services, Full Committee Hearing.

Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

June 24, 2009

First of all, I want to thank Chairman Frank for holding this important hearing on President Obama's plan for regulatory restructuring and for inviting me to testify today.

I am here to express my full support of President Obama's plan to rebuild the regulatory framework of our country's financial system and to speak specifically about a proposal Congressman Miller and I have worked on. I want to thank you for your interest in this proposal and allowing us to speak before you.

As we all have seen, it has been the systemic dismantling of our regulatory system that led to the meltdown of our financial system. While the crisis began on Wall Street, it quickly spread, taking a devastating toll on all Americans. American consumers and investors have lost trillions in investment income and home equity. Investors from around the world have lost confidence in our markets.

If we are to restore trust in our markets and to fulfill our obligations on behalf of the American people, then this Congress must work expeditiously to move the President's plan into law. Today's hearing is an important first step.

Let me speak to the proposed Financial Product Safety Commission. We envision it as a consumer "watchdog", charged with ensuring that the financial products sold to consumers are safe, responsible, accountable and transparent. The Commission idea was originally conceived by Harvard Law Professor Elizabeth Warren – who we all know and admire – is designed to give consumers much-needed protection from unscrupulous creditors and risky untested products.

There are currently ten federal regulators that have some degree of responsibility for protecting consumers from predatory or deceptive financial products, but none have oversight as their single, sole objective. As a result, debt instruments have become far riskier than in the past. We have witnessed an explosion in interest rates coupled with increasingly tricky credit charges including teaser rates, heightened imposition of fees, cross-default clauses, penalty interest rates and double-cycle billing. Families have been steered, often deceptively, into over-priced credit products including credit cards, car loans and subprime mortgages.

As a result, Americans are overwhelmed with debt. These levels of personal debt have not only played a significant role in the financial crisis that engulfed our nation, it is a major impediment to a full economic recovery. Today, one in four families says they are worried about how they will pay their credit card bills each month and nearly half of all credit card holders have missed payments in the past year. There are 2.1 million families who have missed at least one mortgage payment and about one in seven families is dealing with a debt collector. Not surprisingly, since 2000, American families have filed nearly 10 million petitions for bankruptcy. Aside from the astonishing numbers, it is important that we recognize the enormous human cost associated with this rise in debt.

Like other government agencies, the Financial Product Safety Commission would seek to shield the consumer from unreasonable risk. The Commission would review financial products for safety; modify dangerous products before they hit the markets; establish guidelines for consumer disclosure; and collect and report data about the uses of different consumer loans.

Specifically, the Commission will aim to:

- reduce consumer risk in using financial products;
- coordinate enforcement with other federal and state regulators; and
- report to the public regarding the state of consumer financial product safety.

The Commission will fulfill these goals by:

- preventing predatory and deceptive financial practices;
- educating consumers about the responsible use of financial products and services;
- establishing a regulatory floor for consumer financial and credit products; and
- recommending the steps that should be taken to improve financial products for consumers.

The Financial Product Safety Commission will not only give consumers renewed faith in our credit system, but will also ensure that the mistakes of our past will not be repeated.

The Congress has tried to enact reforms in the past – but to no avail. In each case, proposed restrictions were beaten back by private industries and special interests. Frankly, Congress has let the American people down by failing to create prudent regulations to protect the consumer from outlandish financial products. As a result, we are left in our current situation with fractured oversight of the nation's financial markets.

The Financial Product Safety Commission will change that. I believe this bill is the first step in making things right and beginning a new way of doing business and getting safe credit in America. The Financial Product Safety Commission will stimulate the markets and spur investment. With the knowledge that the credit products they are buying are safe, consumers will once again be able to enter the credit markets with confidence.

Credit helps make people's dreams come true. With it consumers can buy homes, cars and pay for a college education. When seeking a loan, however, consumers shouldn't have to understand the complicated nuances of sophisticated financial instruments – just as they don't need to understand how a toaster works or how drug interactions happen in their body. Like with other products that are crucial to a healthy life like food and medicine, consumers shouldn't have to worry whether they are being fooled or tricked into buying a subpar product. By alleviating Americans of this burden, we can help consumers again borrow with confidence, secure in the government's ability to protect them from fraudulent, unsafe products.

I am very pleased that the President has included the FPSC as a component of his plan for regulatory reform. I look forward to working with my colleagues – on both sides of the aisle – in efforts to shepherd this important proposal through the legislative process in the months ahead.

Testimony of
William F. Galvin
Secretary of the Commonwealth of Massachusetts
Massachusetts Securities Division

Before the Committee on Financial Services
of the U.S. House of Representatives

Hearing: Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

June 24, 2009

Chairman Frank, Ranking Member Bachus, and the members of this committee, thank you for this opportunity to testify on these important issues of consumer and investor protection.

As Secretary of the Commonwealth of Massachusetts, my office administers the Massachusetts Securities Act through the Massachusetts Securities Division. As such, I am the chief securities regulator for Massachusetts.

The Congress is now considering an array of initiatives to improve consumer and investor protection. These include the proposals contained in the White House white paper on Financial Regulatory Reform,[1] as well as bills proposing the creation of the Consumer Financial Protection Agency.

I commend and support the President's plan to strengthen and rationalize financial regulation, to provide greater protection against systemic risks in the financial markets, and to create a federal agency to protect consumers in credit transactions. The Massachusetts Securities Division looks forward to consulting and working with this new agency as an equal partner.

I support the proposal to strengthen the U.S. Securities and Exchange Commission. This will enhance the ability of the SEC, alongside the states, to oversee the securities markets and protect consumers.

I also applaud other elements of the White House plan that would directly improve investor protection. These include:

> Making securities brokers fiduciaries. True consumer protection requires that financial firms be fiduciaries for their customers, whether those firms happen to be licensed as investment advisers or brokers.
>
> Mandatory arbitration. The White House proposal asks the SEC to study the use of mandatory arbitration clauses in investor contracts. We need to act now on the documented problems of mandatory arbitration. Investor arbitration should be optional for investors, rather than mandatory.
>
> Hedge fund registration. We urge that both hedge fund managers and the funds themselves should register with the SEC. Hedge funds are often nearly-invisible participants in the financial markets. Moreover, hedge funds have been the source of abusive trading in the commodity and securities markets, including trades that have distorted the oil markets and market-timing of mutual funds. Hedge fund registration will bring a myriad of benefits, particularly market transparency.

---

[1] Financial Regulatory Reform, A New Foundation, http://www.financialstability.gov/docs/regs/FinalReport_web.pdf

Consumer Financial Protection Agency

We support the creation of a Consumer Financial Protection Agency (CFPA) to enhance the protection of consumers entering into credit, savings, and payment transactions.

Sadly, this hearing on the creation of a Consumer Financial Protection Agency is necessary because existing regulatory agencies dropped the ball. While some problems have slipped through the cracks of existing rules, too often regulators failed to maintain their independence from the industries they regulate, and they failed to use their powers to promulgate and enforce rules to protect the public. A key lesson is that regulators must maintain their independence, which often means standing up to powerful interests.

The problems of abusive credit transactions are well documented: predatory mortgage lending, unfair and abusive credit card and consumer loan terms, payday loans, purported loan restructuring companies, and abusive financial transactions that target the elderly and members of the armed forces.

I have seen the impact of bad lending practices. My duties include supervising most of the registries of deeds in Massachusetts. Through the real estate filings with those registries, we have seen the mortgage defaults and foreclosures that resulted from lax lending standards and predatory lending. The impact of foreclosures falls hardest on poor communities, which are ill equipped to deal with consequences like boarded-up properties, deteriorating neighborhoods, and homelessness.

Bad lending standards and unsound mortgages are also at the root of many failed mortgage-backed securities, which in turn led to the collapse of major financial institutions and markets. Recent history demonstrates that we cannot count on these markets to police themselves.

We need a Consumer Financial Protection Agency to ensure that the basic terms of consumer credit transactions will be transparent, understandable, and reasonable. My office looks forward to consulting and working with the CFPA as a co-equal agency.

Preserve and Enhance the Role of State Securities Regulators

As with the CFPA, the goal of the Massachusetts Securities Division is to protect investors against abuse and fraud. Massachusetts and the other states have a distinguished record of protecting retail investors and savers. As U.S. financial regulation is redesigned, I urge you to preserve and enhance the ability of the state securities regulators to protect investors. I urge you to give us the tools to do this work even more effectively.

There is an acute need for this protection. Retail investors and savers have been forced into the risk market to meet their basic financial goals. As a result, consumers are as vulnerable to abusive securities transactions as they are to abusive credit transactions.

Reverse Past Preemption of State Authority

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

The National Securities Markets Improvement Act of 1996 ("NSMIA")[2] preempted state authority in key areas where the states protected investors.

Mutual Funds. In the past, the states regulated pro-actively to protect mutual fund investors. Prior to NSMIA, the states required enhanced disclosure in mutual funds, including: periodic payment plans (which often resulted in consumers paying disproportionate fees for their funds); "plain English" disclosure for junk bond funds; and disclosures regarding layering of fees in "funds of funds." NSMIA removed the states' ability to require these protective measures.

Rule 506 Offerings. Prior to the adoption of NSMIA, the states could require substantive filings from issuers selling securities pursuant to the Rule 506 exemption under SEC Regulation D. NSMIA prohibited the states from requiring any substantive filing from these issuers.[3] This resulted in a regulatory blind spot for hedge funds and similar issuers.

Conduct Violations by Federally Registered Investment Advisers. NSMIA created a split system for the regulation of investment advisers, whereby large investment advisers register with the SEC and the smaller ones register with the states.[4] Under this system the states cannot take action against federally registered investment advisers for conduct violations, even when those violations rise to the level of unfair or deceptive practices in the securities industry.

The States Have a Demonstrated Record of Effectiveness as Securities Regulators

In my testimony before this Committee on March 20, 2009, I listed specific examples of cases where Massachusetts and other states have taken the lead in bringing enforcement actions and recovering funds for investors. These include: auction-rate securities, illegal market timing of mutual fund shares, misleading and false securities analyst reports, and Ponzi schemes, and misleading "senior designations."

The states remain the regulators that are closest to the investing public and they have demonstrated they can respond quickly and effectively to help investors. The states

[2] National Securities Markets Improvement Act of 1996 ("NSMIA"), Pub. L. No. 104-290, 110 Stat. 3416, 3416 (1996).
[3] *See*, Section 18(b)(4)(D) of the Securities Act of 1933, as amended (15 U.S.C. §77r(b)(4)(D)).
[4] *See*, Section 203(a) of the Investment Advisers Act of 1940 (15 U.S.C. §80b-3(a)).

have also cooperated effectively with the SEC and other regulators in structuring global settlements, including market timing, auction-rate securities, and stock analyst cases.[5]

The states have added value precisely because they are independent of other agencies and self-regulatory organizations. The states have been another set of eyes watching the markets. The states have also served as a regulatory backstop or circuit breaker, protecting investors in cases when other regulators have not taken action.

Do Not Curtail the Ability of the States to Protect Investors.

Based on the principle of federalism, we urge the Congress not to make the state securities agencies subject to the authority of any federal body, whether it be the Financial Services Oversight Council (the systemic risk regulator) or the Federal Reserve. Similarly, we urge that the states not be made subject to the Consumer Financial Protection Agency.

The independence of the states means that they are less likely to yield to pressure from regulated entities, and the states agencies therefore are much less likely to be "captured" by the firms and industries that they regulate.

We urge that any new legislation should <u>not</u> curtail the states' ability to:

- Require that firms, persons, or offerings register with the states;
- Police and inspect firms and persons; and
- Bring enforcement actions for violations of securities laws and industry rules.

In this regard, I must emphasize that the states have a strong record of cooperating with the SEC and FINRA, and that this record will continue. The states will cooperate and coordinate with the Consumer Financial Protection Agency. However, it is crucial that the states <u>not</u> be put under the CFPA's authority. The states' independence is vital, and it is the key to our record of success.

Give State Securities Regulators the Tools We Need to Be Effective

Give the states the tools we need to regulate effectively:

-Restore states' authority over non-public offerings, particularly hedge funds, which are typically sold pursuant to the exemption provided under Rule 506 of SEC Regulation D.

-Permit the states to police larger, federally-registered investment advisers for unethical and dishonest practices in the securities industry and for violation of industry conduct standards. The states are now limited to bringing fraud actions against these firms.

[5] See, e.g., S.E.C. Litigation Release 18438, October 31, 2003, "Federal Court Approves Global Research Analyst Settlement," http://www.sec.gov/litigation/litreleases/lr18438.htm.

-As financial regulatory reform is designed implemented, give the state securities agencies a place at the table to share information and views.

Further Reforms.

Restore Investors' Private Right of Action to Sue for Securities Fraud. The right for investors to sue for violations of the states and federal securities laws is a powerful tool to promote compliance with the law. I urge the Congress to review the detrimental impacts of the Private Securities Litigation Reforms Act (PSLRA)[6] and the Securities Law Uniform Standards Act (SLUSA)[7] order to permit defrauded investors to access to the courts and have their cases heard. When the securities laws have been violated, investor suits can be a valuable corrective measure and tool for recovery. The risk of being sued is a powerful incentive for companies and their executives not to engage in misconduct. We need to strengthen, not weaken, investors' remedies.

Make Arbitration a Voluntary Option for Investors. Customers who have disputes with their brokerage firms cannot go to court and must go to arbitration run by the Financial Industry Regulatory Authority (a self regulatory organization), even when serious fraud is alleged. Many investors regard FINRA arbitration as a pro-industry forum.[8] Reform of the arbitration system could include making arbitration a voluntary option that is available alongside litigation. Another reform to consider would be to give the SEC or CFPA oversight over the arbitration system, rather than a securities self-regulatory organization.

We Must Put the Interests of Retail Investors and Consumers First

I urge the Congress to put the interest of consumers and retail investors first. Creating a Consumer Financial Protection Agency will be a significant step toward this goal. I also urge the congress to maintain and strengthen the role of the states as securities regulators. We have been effective; give us the tools to better protect investors.

---

[6] Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737, (codified in various Sections of 15 U.S.C., particularly the pleading standards in 15 U.S.C. § 78u-4).

[7] Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. 105-353 (amending various sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 to cause state securities class actions to be removed to federal jurisdiction).

[8] See, Jill I. Gross and Barbara Black, *Perceptions of Fairness in Securities Arbitration: an Empirical Study* (Feb 26, 2008) http://ssrn.com/abstract=1090969 (Survey commissioned by the Securities Industry Conference on Arbitration found, among other findings, that participants disagreed with statements that securities arbitration is conducted without bias and in a way that is fair to all parties).

ACLI
Financial Security. For Life.

STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURERS

BEFORE THE

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON CAPITAL MARKETS, INSURANCE & GOVERNMENT SPONSORED ENTERPRISES**

ON

REGULATORY RESTRUCTURING: ENHANCING CONSUMER FINANCIAL PRODUCTS REGULATION

June 24, 2009

Statement Made by
Gary E. Hughes
Executive Vice President & General Counsel
American Council of Life Insurers

Mr. Chairman and members of the Committee, my name is Gary Hughes, and I am Executive Vice President and General Counsel of the American Council of Life Insurers. The ACLI is the principal trade association for U.S. life insurance companies, and its 340 member companies account for 93% of total life insurance company assets, 94% of the life insurance premiums, and 94% of annuity considerations in the United States.

The ACLI appreciates the opportunity to discuss with you the Administration's proposals for enhancing consumer protections in the financial products area. In particular, we will provide you with our views on the proposed Consumer Financial Protection Agency (CFPA) and its relevance to life insurance products (life insurance, annuities, disability income insurance and long-term care insurance).

We understand the impetus for the creation of the CFPA is to address consumer protections relative to financial products that may have played a role in the current financial crisis and which are viewed as being either largely unregulated or are partially regulated by different agencies with dissimilar or conflicting regulatory agendas. The ACLI and its member life insurance companies unequivocally support strong consumer protections with respect to our products and remain committed to working with our functional regulators to improve those protections as appropriate. We do not believe, however, that the interests of life insurance consumers would be well served by subjecting life insurance products to the additional jurisdiction of the CFPA.

Our position is grounded on four relevant facts. First, life insurance products are already one of the most heavily regulated financial products in the marketplace. Second, there have been no assertions nor has there been any evidence suggesting that life insurance products contributed in any way to the present crisis. Third, unlike most other financial products, the regulation of life insurance products has a direct and fundamental relationship to issuer solvency and therefore cannot prudently be separated from those other aspects of insurance regulation that in the aggregate constitute solvency oversight. And fourth, life insurance product regulation demands a comprehensive understanding of the fundamental mechanics of the life insurance business, and that understanding does not presently exist at the federal level and would not exist within the CFPA should it be established.

Life Insurance Product Regulation

Life insurance products are already heavily regulated by all states, and in most instances that process entails prior approval. A life insurance company must first file each product form, and all related disclosure and other materials, it wishes to market in a particular state with that state's insurance department for prior approval. A company doing business in all states and the District of Columbia must, for example, file the same product form and related materials 51 different times and await 51 different approvals. And this process must be repeated for each product the insurer wishes to sell.[1] Only after a state has given final approval to each individual product filing can that product be offered and sold to consumers in that jurisdiction. Variable life and variable annuities and life insurance products sold in the pension markets are subject to additional layers of federal product regulation.[2]

Indeed, the repetitive and overly costly nature of life insurance product regulation by the states is one of the principle reasons the insurance industry has sought an optional federal charter. Under a federal regime, new products would be required to satisfy a single set of uniform standards and be subject to one rather than 51 product review filings.

[1] In response to the redundancy, cost and delay associated with the life insurance product approval process, the states have, with the full support of the industry, been working for several years to implement a streamlined life insurance product approval process. Through an interstate compact, the states are moving toward having a centralized commission adopt uniform product standards and then permit an insurer to make a single product approval filing with the commission. Once approved, a product would be deemed approved in all jurisdictions that have enacted the interstate compact legislation. This remains a work in progress and is not yet available for all life insurance products and is not yet operational in a significant number of states.

[2] For variable life insurance and variable annuities, the SEC and FINRA add a layer of federal regulation on top of individual state regulation, as those products contain securities characteristics in addition to their insurance features. And recently, both the SEC and FINRA have asserted jurisdiction over indexed annuities. In addition, for any life insurance product offered in the pension market, the Department of Labor adds yet another layer of regulation as required under ERISA.

In addition to reviewing product filings, the states impose extensive consumer protection requirements on life insurance products and their issuing life insurers. Every state in the nation has enacted a form of the Unfair Trade Practices Model Act. This act addresses a number of consumer issues, including: misrepresentation and false advertising; unfair claims practices; maintenance of consumer inquiry and complaint procedures; misleading statements to consumers regarding policy provisions; false or misleading statements about a company's financial condition; and unfair discrimination. Additionally, the states are moving toward uniform annuity disclosure and suitability regulatory standards that mirror to the extent appropriate those of the SEC and FINRA applicable to variable life insurance and variable annuity products.

Because life insurance products are already heavily regulated by the states, there is no justification for the added scrutiny of an agency like the CFPA. Fifty-one product approvals are more than sufficient. Adding a 52^{nd} merely adds a regulatory burden, the costs of which will be born by consumers, without any corresponding consumer benefit.

In the same vein, we note that the Administration proposal would exempt SEC and CFTC regulated products form CFPA jurisdiction. The rationale for this exemption is presumably that these agencies already provide ample product oversight. We fail to see why the even more intense regulatory oversight of life insurance products by the states should not entitle these products to the same treatment.

Life Insurance Products and the Financial Crisis

There is no evidence that life insurance products were a cause of, or a contributing factor to, the current financial crisis. While there are unquestionably improvements that can be made to the way in which life insurance products can be regulated, the same can be said for every financial product extant, including those overseen by the SEC and the CFTC. The financial crisis has not highlighted or given rise to any additional and fundamental need for insurance products to be made subject to an agency such as the CFPA.

Life Insurance Product Regulation and Solvency

Life insurance product regulation and solvency regulation are inherently linked. The primary objective of insurance regulation is solvency, which is the most important consumer protection of all. Insurance regulators must assure that the companies they oversee have sufficient assets to pay all expected claims; claims that may arise today or 50 years from today. Strict solvency standards under current law define how life insurers can invest the premiums they receive. In addition, insurance regulators conduct regular financial and market conduct examinations to assure that insurance companies honor those standards.

In accordance with existing laws and regulations, life insurers use sophisticated mathematical techniques to assure that their investments are properly structured based on expected payouts. Thus, solvency regulation is inherently linked to the products a life insurer sells. Factors such as what is guaranteed, when the guarantee is triggered, and the length of time the guarantee is in force as well as other product features are crucial to the determination of how the premiums are invested to assure assets will be available to pay claims. This necessitates that product regulation be an integral part of solvency regulation.

Effective solvency oversight requires that a single regulator have authority over both solvency and product design. Separating these two functions undermines the essence of insurance regulation and harms the interest of consumers. A detached product regulator—one that focuses on product design and features without regard to solvency or life insurer financials—is not only unnecessary, but risky. Depending on its statutory mandate, this detached regulator may be solely concerned with imposing its own standards on the life insurance marketplace without regard to solvency.

For example, suppose that a life insurer designs an innovative new product. As part of that process, and based on sound actuarial data, the life insurer determines that individuals employed in certain high-risk professions should pay a higher rate due to a higher risk of loss. A detached product regulator, concerned solely with "consumer protection" and without any regard to financial issues, might object to this and similar risk classification criteria, even if they are necessary for adequate pricing and proper matching of assets to liabilities.

This example highlights the extraordinary importance of product regulation for life insurers, and its inherent link with solvency regulation. Efficient product regulation that is attuned to solvency concerns is critical to the financial health of life insurers. Bifurcating product and solvency regulation could force life insurers to choose between selling actuarially unsound products in order to maintain sales, or redesigning products that are actuarially sound, but which cannot gain timely market approval, or are not competitive with other financial products due to pricing requirements. This would lead to a breakdown of the entire risk classification system and potentially jeopardize the financial health of life insurers, and assuring the financial health of life insurers must be considered the most important consumer protection of all.

A number of months ago, and before the Administration conceived of the CFPA, the ACLI board of directors adopted a policy principle on regulatory reform providing:

> Legislation should not increase insurance systemic risk by separating the individual elements of effective life insurer solvency regulation (e.g., capital and surplus, underwriting, risk classification, nonforfeiture, product regulation) between either federal and state regulators or between two federal regulators.

Subjecting life insurance products to the jurisdiction of the CFPA and thus disaggregating important aspects of life insurance solvency regulation would run the very real risk of increasing, not decreasing, systemic risk for insurance and weakening, not strengthening, the protection of life insurance consumers. In the context of life insurance product regulation, the CFPA is simply not a vehicle that would serve the best interests of consumers.

No Federal Insurance Regulatory Expertise

The foregoing discussion makes clear that anyone presuming to regulate life insurance products must have a solid, in-depth knowledge and understanding of the technical underpinnings of those products as well as a full understanding of all other aspects of life insurance solvency. As this Committee well knows, there is not at present a federal functional regulator of the life insurance business. Consequently, the type of knowledge base that would be necessary to appropriately deal with life insurance product regulation simply does not exist at the federal level. Empowering the CFPA to delve into insurance product regulation while not functioning as the functional solvency regulator for life insurance would result in adverse consequences for life insurance consumers and for life insurance companies.

We note that the centerpiece of Administration's proposal with respect to insurance is the creation of the Office of National Insurance within the Department of the Treasury. The stated purpose of this office is to "... gather information, develop expertise ... and coordinate policy development in the insurance sector." Should it become a reality, the new ONI would be the more appropriate federal agency to coordinate with state functional insurance regulators regarding any issues related to consumer protection and life insurance products. And in any event, unless and until a federal regulatory body is invested with the authority to act as a functional solvency regulator, the role of any federal body should be advisory only.

Conclusion

Mr. Chairman, the best interests of life insurance consumers would not be well served by extending the jurisdiction of the CFPA to life insurance products. Our products are already more highly regulated than most, and they were not a cause of, or contributing factor to, the financial crisis. Divorcing the regulation of our products from the rest of life insurance solvency oversight would result in weakening consumer protections and jeopardizing the solvency of life insurers, particularly in light of the fact that the requisite expertise to deal effectively with life insurance products is absent at the federal level. Under the regulatory construct as envisioned by the Administration, consumer issues relative to life insurance products could best be addressed by the Office of National Insurance working cooperatively and in an advisory capacity with state functional insurance regulators.

Testimony of Kathleen E. Keest
Senior Policy Counsel, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services

"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"

June 24, 2009

Mr. Chairman, Ranking Member Bachus, members of the Committee: Thank you for inviting the Center for Responsible Lending to discuss consumer financial products reform – a fundamental component of the effort to modernize and repair our financial regulatory system.

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

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

For this reason, we strongly support a vibrant, innovative, state-of-the-art consumer protection agency for financial products, such as has been introduced by the Administration and in both Houses of Congress, provided that it is strong, well-resourced, independent of the companies it regulates, and fully transparent and accountable to the public. An independent consumer protection agency, dedicated and empowered to keep the markets free of abusive financial products, committed to transparency, and fully accountable to the public and Congress, would help to restore consumer trust and confidence, stabilize the markets, and put us back on the road to economic prosperity.

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

CRL views these matters from the vantage point of a small, independent financial institution serving a segment of the population devastated by the market and regulatory failures that produced the current crisis. Our affiliated financial institutions would be directly regulated by this independent agency.

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

1. Whether the agency should be independent or integrated with the prudential supervisors of depository institutions. We believe it should be an independent, stand-alone regulator with the primary mission of consumer protection. An independent agency is necessary to counteract the forces that drive regulators to put concerns about consumer protection on the back burner.

2. The scope of rule-making, examination and enforcement authority of the agency and the types of financial products that should be within its regulatory purview. The agency should have rule-making, supervision and enforcement authority over all providers of consumer credit, deposit, and payment systems (as well as over ancillary goods and services). At the same time, this authority should not displace the right of the states' to protect their citizens from abuses within their border, so federal law, including this agency's rules, should set the floor rather than the ceiling on state consumer protection. The agency should coordinate with the states to ensure robust state and federal enforcement.

3. The importance of, and the potential methods for, funding the agency. It is essential that the agency be funded in a way that ensures its capacity, strength and independence. We recommend that the agency be funded through a combination of appropriations, user fees, and assessments to minimize the risks that attend each option as a stand-alone mechanism.

I. <u>Background</u>

The Center for Responsible Lending is the research and policy affiliate of the Center for Community Self-Help (SH), a community development financial institution whose services include direct mortgage lending to low-wealth families, small business and neighborhood revitalization lending, a secondary market program that facilitates other lenders in their responsible lending to low-wealth families and neighborhoods, and retail credit unions in North Carolina and California. Since its founding in 1980, SH has made nearly $5.6 billion in financing available to over 62,000 families. Among our affiliates are entities subject to both state and federal regulation.[1] Consequently, we, too, must consider compliance costs and "regulatory burden" just as much as any other financial services provider of any size.

Yet we do not automatically equate either structural or substantive regulatory reform with extra and undue costs and burdens.[2] Technology has made compliance evaluations relatively easy and cost-effective. Just last week, SH evaluated the credit card program offered by its retail credit union to compare it against the requirements of the new CARD Act, passed with the leadership of Congresswoman Maloney and others on this Committee. For common-sense products, the Act's common-sense requirements do not impose significant extra burdens. Furthermore, viewed from a societal perspective, compliance costs are a bargain when compared to the cost of recklessness.

More telling is SH's experience in mortgage lending. It has kept its eye on the bottom line reason for encouraging home ownership in the first place: asset-building and promoting stability for families, neighborhoods and communities.[3] Indeed, CRL was founded when SH leadership recognized that much of the mortgage industry had lost sight of that fundamental principle.

For example, in the run-up to the current foreclosure crisis, subprime mortgage originators typically marketed to consumers a loan that had to be refinanced every two years, typically requiring the borrower to pay over 3% of the loan balance, plus refinance fees, with each transaction. In most instances, the homeowner could have received a 30-year fixed rate loan that would have cost less even just over those first two years, as well as far less when compared with the higher rates that prevailed after the second year. Instead of offering these lower-cost, more stable, more sustainable loans, subprime lenders pushed homeowners into more expensive, more volatile loans because of the higher fees they generated and because there would likely be another new loan in fairly short order.[4] Federal regulators could have and should have stepped in, but didn't – at least, not until long after the damage was done.

The regulators' collective failure to rein in the abuses stifled the development of safe, sustainable loan products that would have provided consumers with real choice. Lenders who might otherwise have been prepared to offer homeowners the lower-cost, fixed-rate loans for which they qualified eschewed these products in favor of the more expensive, refinance-generating subprime loans that allowed the loan originators to realize greater fees and to offer higher short term returns to the investors. Expensive loan terms such as prepayment penalties were touted as "choices" for consumers, but in fact, most consumers in the subprime market were given no real choice. In the long run, competition among loan originators to attract investors, coupled with the regulatory failure to ban the abuses had the unintended consequence of severely reducing consumer choice through the major credit crisis we are now experiencing.

For these reasons, we reject the assertion that an independent agency charged with protecting consumers – keeping the field swept of landmines, as it were – will stifle innovation. It is a false dichotomy to say that a market that is safe for consumers is bad for business. Again, to look at the experience of the last decade or so, we found that "Gresham's Law" is a strong force in the financial marketplace: bad money drives out good money, setting competition on a downward trajectory that hurts honest, ethical and efficient businesses.[5] Natural experiments with state laws show that pruning out bad practices makes room for good ones to develop and flourish.[6] Balanced and objective regulation thus stimulates productive innovation.

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

II. An independent agency is necessary to assure adequate, impartial, and fully informed oversight that is market wide

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

A. A single independent agency avoids regulator shopping and the race to the bottom for weak rules and weak enforcement.

The current system allows regulated depository institutions to shop for their own regulator. They can choose between state and federal regulators, and they can choose among federal regulators. With that choice, they can also choose what laws apply, or – given the federal regulators' aggressive preemption of state laws – whether any law applies at all. (See section II-D, below.) The result has been the unseemly behavior of federal regulators out shopping for "customers" (as they call their supervisees), and unashamedly using the preemption as a marketing tool.[7]

These regulators have an extremely poor record of treating consumer protection and fair lending as integral to prudential supervision. Indeed, by its own admission, the OCC did not exercise its consumer protection authority to address unfair and deceptive practices under the FTC Act for *twenty-five years*.[8] When it finally did so, it was a strategic move driven by its aggressive campaign of substantive and enforcement preemption.[9] Whether their effort to prevent states from enforcing even non-preempted state laws will succeed is something the Supreme Court will tell us shortly. But we know that the OCC's fair lending and consumer protection enforcement has been abysmal.[10]

Leaving consumer protection and fair lending oversight with the prudential supervisors would be simply to retread the failed path taken after the S&L crisis, when the Federal Home Loan Bank Board was eliminated and replaced with the OTS. As they did once the S&L crisis had passed, the prudential regulators will revert to norm, and forget the lessons learned.

The FHLBB/OTS had rule-making authority under the Alternative Mortgage Transaction Parity Act (AMPTA), an authority that applied to non-bank state chartered lenders, as well as its own supervisees. With that authority, some 14 years after AMTPA was passed, the OTS decided to further open the market to risk-layering, risk-enhancing features. It issued a rule in 1996 that preempted state laws limiting prepayment penalties for all "creative financing" loans – including adjustable rate loans. It can be argued that this was part of the reason that both adjustable rate loans and large prepayment penalties became so deeply embedded in the subprime market.[11]

It was not simply in its rule-making that the OTS failed consumers. Its failure to adhere to consumer protection principles integral to safety and soundness led to the failure of large institutions under its watch. Several were heavily exposed to poorly underwritten subprime and non-traditional mortgages. For example, even as Washington Mutual had OTS examiners permanently on-site from 2004 to 2006, risky products constituted half of its real estate loans. By mid-2008, over a quarter of its 2006-07 vintage subprime loans were delinquent.[12] In the short run, those loans looked good for growth. But then, at first, so did the S&L loans that led to that industry's collapse twenty years ago. There is no reason to believe that the same regulators performing the same mix of duties would work any better this time.

Our analysis would not change if the OTS were to be merged into the OCC for a single federal charter regulator, as the consumer protection performance of both agencies was severely substandard. While an OTS/OCC merger would eliminate that particular charter competition, the OCC would still have incentive to compete for charter share with states unless we make absolutely sure with this and other legislation that federal consumer protection and fair lending laws are a floor, not a ceiling.[13] What's more, there is still the incentive structure posed by the fees that fund its existence. The OCC's fees rose from $609 million in 2006 to $707 million in 2008, in part from getting new and larger institutions to sign on.[14]

The most recent example of the value the OCC places on consumer protection is found in the credit card market. The practices that Congress, the FRB, the OTS and the NCUA found unfair and deceptive became industry standards in large part because of OCC's preemption rules. Those rules essentially deregulated the credit card industry by permitting other depositories to, in effect, ignore the same laws the national banks were permitted to ignore.[15] Although several of the country's largest credit card issuers are national banks, the OCC did not rein in those practices. It even filed a comment letter opposing part of the other agencies' UDAP rules.[16]

This Committee is also aware of another recent example of the OCC taking action against a large bank only when forced to, and only to the degree forced to. Chairman Frank and two colleagues supported the efforts of consumers harmed by Wachovia's relationship to a telemarketing fraud to get meaningful restitution to the victims. The OCC had touted a $125 million settlement with Wachovia, but constructed the distribution plan so that the actual restitution to victims probably would have been less than $15 million, with the difference reverting to Wachovia.[17]

Moreover, while the OCC consistently denies that national banks originated any toxic subprime loans, this assertion is belied by the facts. Some OCC entities, such as Wells Fargo, did indeed make harmful subprime loans. In fact, evidence is now becoming public that Wells steered minority borrowers to those loans.[18] And, as noted above, the OCC has been careful not to deny that national banks made many risky Alt-A loans, which have aged no better than the subprime loans (and in some cases worse).

The litany of the federal financial supervisors' failures is long and much is being detailed in other testimony today, so we will not repeat it here.[19] Suffice it to say that the prudential supervisory agencies have not earned the confidence that they are up to the task that we hope Congress will set for this new agency.

B. A single regulator eliminates the regulatory gaps and the uneven playing field.

The model of "functional regulation" recognizes that similar products are offered by a wide array of providers, and the products and services should be consistently regulated. Today, national banks compete with payday lenders for triple-digit interest rate, short-term small loans. Depository institutions compete with non-banks to get origination business from mortgage brokers. Indeed, Countrywide wrote risky, poorly underwritten payment option ARMs ("POARMs") through its non-bank entities, its national bank, and finally through its federal thrift charter, implicating literally dozens of different state and federal regulators. Depository institutions have mortgage servicing affiliates that perform the same function as non-bank-affiliated servicers. Credit card issuers, supervised by federal prudential supervisors, team up with third party telemarketers who use the access their bank partners give them to "cram" expensive, useless products onto those accounts.

Leaving consumer protection in the hands of the safety and soundness regulator raises the question of what entity would regulate non-depository institutions that are not subject to safety and soundness supervision. The same standards and protections should apply to all consumer products, regardless of the nature of the originating lender. Creating a single consumer protection agency to cover all products would ensure a level playing field among lenders and consistency of regulation.[20]

C. A single, independent market-wide regulator can mitigate the risk of regulatory capture.

The phenomenon of close relationships between the regulator and the regulated is not a new one, nor is it limited to the financial services industry. The risk of regulatory capture is always present, and it can undermine rigorous rule-making and enforcement. Thus, in reforming the consumer protection function, it is important to include structures that will minimize the risk where possible. An agency tied to one segment of the market, over time, almost inevitably will try to assure that its supervisees have a competitive edge. An agency that covers the entire market will be able to work toward a fair, competitive, playing field for all players.

Consider what happened when federally chartered institutions wished to have some of the market share they saw in the subprime and non-traditional markets. Citi purchased Associates, even as the latter was under FTC investigation. HSBC purchased Household, even as it was under investigation by the states, and then got an OCC charter the following year. Professor Patricia McCoy's testimony to the Senate Banking Committee in March details the involvement of federal thrifts and national banks in risky loans during the credit bubble.[21] Yet the federal regulators were slow to clamp down, although insured deposits were at risk, and it was not until October 2006 that the federal financial regulators issued "guidance" on how to handle those products.[22] Countrywide, the top nontraditional originator in 2006, estimated that over 80% of its non-traditional loans would not qualify.[23] The performance of the 2007 vintage non-traditional loans has been among the worst, suggesting that the 2006 "guidance" received little respect. According to Prof. McCoy, IndyMac, Washington Mutual and Downey made loans in disregard of the guidance, and under the OCC's soft touch, some small banks rode that road to ruin, while Bank of America kept making stated income and no-doc loans until the market dried up in the late summer of 2007.[24]

In creating this new agency, it is also important to ensure that the funding mechanism does not encourage regulatory capture. Funding issues are discussed further in Section IV of this testimony and extensively in the testimony of witnesses Ed Mierzwinski and Travis Plunkett.

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

> ***A. Covered products and services should cover the full range of traditional banking services, their non-banking counterparts, and ancillary goods and services.***

We believe that the scope of products and practices that should be subject to the Agency's jurisdiction falls broadly into the categories of credit, deposit/savings, and payment systems, including stored value cards, plus closely related products and services. This universe of products, practices and providers parallels that suggested by Congressmen Delahunt and Miller in H.R.1705, (Section 3), as well as that envisioned in the proposal released by the Administration last week. They are the financial services that are central to the day-to-day economic life of American households. It is extraordinarily difficult for the average family to avoid using some or all of these products.

Ancillary products and services would include, for example, loan brokering, mortgage servicing, loan modification and foreclosure prevention services, debt collection, and payment processing. The agency should also have jurisdiction over additional products that are linked, intrinsically or by practice, to a credit transaction, such as credit insurance, gap insurance, and debt cancellation agreements. For example, credit insurance was a primary tool used to strip equity in the subprime loans in an earlier business model for predatory lending. That variety of equity stripping credit insurance was curbed by a pincer movement of state laws, public law enforcement and private litigation, as well as the FRB's amendment to HOEPA to add credit insurance premiums to the list of HOEPA trigger fees. There are bound to be variations on this theme, as there is no lack of imagination when it comes to devising these kinds of tricks. This agency must be able to look at the whole of these transactions and cover all related products and services for it to perform its function well.[25]

B. The agency should have the rule-making authority relating to these subject matter areas that are currently scattered among at least half a dozen agencies, sometimes overlapping and sometimes leaving gaps.

The fragmented system of identity-driven silos of regulation is compounded by fragmentation of rule-writing authority among at least half a dozen agencies. At CRL, we have catalogued nearly twenty consumer protection laws, including the Equal Credit Opportunity Act. *See Appendix B.* The Federal Reserve Board has exclusive rule writing authority for nine of them; the FTC has rule-writing jurisdiction for three; HUD has rule-writing jurisdiction for one, the Real Estate Settlement Procedures Act (RESPA), which overlaps with one under the FRB's jurisdiction, the Truth in Lending Act (TILA); and the Department of Defense has rule-writing authority over one. Rule-writing jurisdiction is shared under four of them, sometimes concurrent and sometimes joint. The latter, in particular, has led to gridlock, as the agencies cannot come to agreement. For example, in developing furnisher accuracy guidelines pursuant to Section 312 of the Fair and Accurate Credit Transaction Act of 2003, the FTC and Banking regulators could not agree on a definition of "integrity" or whether to place that definition in regulations or guidelines. [26] In three cases, no rule-writing authority is explicitly granted, and in one case, agency rule-writing authority is explicitly denied.

This rule-making authority is even more fragmented than the supervision structure, and compounds the "silo" problem that precludes anyone from training a clear eye on the market as a whole. Part of the impetus for a single-mission consumer protection agency comes from the recognition that no one has been looking at the full picture, keeping an eye on the overall market trends on products and practices, and evaluating their overall impact. A consolidated rule-writing authority in this Agency would make it more likely that rules could be harmonized, made more consistent, and evaluated for their usefulness. If the statutes themselves need revision, this agency could freely suggest consolidation, changes, or elimination of some requirements that serve no purpose, without fear of losing "turf." Thus by streamlining rules and grounding them in real-world behaviors, this consolidation into a single agency may ultimately *reduce* the level of "regulatory burden" on providers rather than increase it.

C. The agency should have authority to collect and evaluate data to ensure that regulation and enforcement are informed by empirical, real-world information.

1. The agency should test the performance of new products and practices under real-world conditions.

The ability and willingness of an agency like this to test the real-world function and performance of products in the marketplace is almost alone worth the effort of its creation. One of the most puzzling aspects of the run-up to the crisis is the absence of empirical scrutiny of the products and practices that dominated the market.

Red flags abounded, but faith among the regulators was unshaken. Assertions justifying both the safety and value of practices were relied upon, when those practices could have and should have been tested. Warnings came for years from community groups, lawyers representing homeowners, and counseling agencies that there were serious structural problems in the subprime market, and later, in the non-traditional market as that one grew. The disparate impact on borrowers of color has been a major theme of those warnings for nearly twenty years, since the early days of that market.[27] Yet although these warnings came from all parts of the country, over a number of years, about many different providers in the subprime and non-traditional market, they nonetheless were discounted as "anecdotes."

Shortly after trade press began reporting data on subprime originations separately in 1996, alert regulators could have noticed an inordinate number of business failures from the list. By 2005, a cursory look at the year-by-year list of top subprime originators would have shown an unsettling number of them had collapsed of their own weight or had been the targets of major law enforcement actions.

For example, two of the three top subprime originators in the five years between 1998 and 2002 were the subject of state and FTC actions by the end of 2002, each ending in record settlements. Household's settlement was for $484 million, and Associates for around $300 million. Then, after the crack-down on Household and Associates, Ameriquest jumped to the top spot for 2003-2005 using similar unfair, deceptive, and illegal practices. Together, these three entities perched at the top of the subprime market over an eight year period. Together, they were hit with over a billion dollars in liability as a result of enforcement actions. That should have been a clue that there were fundamental problems in the subprime market.

As early as 2000, when the fire was perhaps still small enough that it could have been contained, there were warnings of unusually high delinquency and foreclosure rates. But the warnings didn't come from regulators. Professor Cathy Lesser Mansfield and Alan White, then a legal aid attorney, collected default and foreclosure data from SEC filings in 2000, and they found the foreclosure and seriously delinquent rate for subprime was 4.62%, compared to 2.57% for FHA loans, which serve comparable borrowers. Even more troubling was what they found when they looked at the longitudinal performance of one static pool of loans made in 1998 by WMC, the 15th largest subprime originator in 1998) They found that nearly 25% of those 1998 vintage loans failed by the end of 1999. This data was presented to a joint HUD-Treasury hearing, and, in fact, to this Committee as well, in May 2000.[28]

Yet the industry, as well as most of the Washington regulators, continued to oppose regulation, asserting that it would have the "unintended consequence" of impeding access to credit. No one seemed to look behind that talking point, although the concomitant rise of America's debt-to-disposable income ratio from 60% in 1980 on its way up to 133% by 2006 could have been another clue that a debt bubble was growing.[29] A third clue was the fact that the ratio between the aggregate annual household income and aggregate household debt rose from 24% in 1975 to 110% in 1999 to 168% in 2006.[30]

Another argument advanced against regulator action was that subprime lending contributed to higher homeownership rates, particularly among minorities. That assertion was unlikely on its face, given that subprime was overwhelmingly a refinance market, not a purchase money market, but no one looked behind it. Mansfield and White estimated that 90% of those facing foreclosure in the subprime market in 2000 had owned their homes before getting the subprime loan. Even as the purchase money share of the subprime market grew with the housing bubble, it was still a majority refinance market even as the market peaked in 2006.[31] Even before the foreclosure meltdown, CRL predicted a net *loss* of nearly one million homes, not a gain – and that is a number that was likely far lower than the reality will turn out to be.[32]

The data exists to resolve the questions we just raised. A good regulatory system could have and should have followed through. A high failure rate would support the allegations of structural problems and widespread abusive practices. Indeed, when CRL looked at the longitudinal performance of about 6 million subprime loans, our study found that subprime loans had a very high failure rate from the earliest vintages we studied, just as Mansfield and White had found. Loans originated in years1998 to 2001 had already failed at a rate of 1 in 4-to-5 by spring of 2005, and 2003 originations were already on that same trajectory by spring of 2005.[33] That level of failure is too great to dismiss by blaming the borrowers. As Alan White remarked, "If 1 in 5 cars failed within the first 4 years, would you blame the consumer, or look for a design flaw?"

Table 1: Increased Risk of Foreclosure of Common Subprime Loan Features

	Increased likelihood of foreclosure[34]	**Average share of the feature in ten mortgage-backed securities offerings in the first half of 2007[35]**
ARM	72% (117% for 2003 vintage loans)	77% (90% of which were to reset in 2-3 years)
Prepayment penalty	52%	70%
Stated income or low-documentation	29% (64% for 2003 vintage loans)	37%

Not only did these risk-enhancing terms predominate, but they tended to be "risk-layered," so that the same loan had more than one such feature, creating yet more risk. If regulators had drilled down like this in 2004, they might have mitigated what happened next. Those results would have been at least a yellow light for the non-traditional Alt-A products that grew phenomenally from 2004: interest-only loans skyrocketed from $55 billion in 2004 to $418 billion in 2005 and POARMs grew from $145 billion in 2004 to

$255 in 2006.[36] These loans had even more risk-enhancing features. *Only about 17% of the POARMs originated between 2004 and 2007 were fully documented.*[37]

A single, market-wide regulator could have taken the long-view. There were different business models during the ten years, but there were common threads among all of them. The first was that they were "designed to terminate."[38] Forced refinances kept the origination volume up and growing to feed hungry investors. All the market incentives worked toward making loans less rather than more sustainable for the borrower. The second common thread was that underwriting became considered not only expendable, but actually an impediment to continued growth in a saturated market. Mortgage securitization enabled the originators to pass the risk right through to Wall Street, which then added yet more layers of "protection" through derivatives and credit default swaps.

2. The agency should have authority and responsibility to obtain data necessary to understand how products and practices work in the real world and what their impact is on customers.

Data collection, market monitoring and evaluation functions are key to effective regulation. Right now, the financial services industry controls the data. Access is rationed and controls are placed on its use, making it extraordinarily difficult to bring transparency to the way these transactions work in the real world. Indeed, fees for commercial databases are so expensive as to be an insurmountable hurdle for most non-profits and academics. But even more troubling than is the fact that, once obtained, its use may be controlled. Access may be conditioned by restraints on publication of the results, or access to the data may be denied altogether. For example, after publishing some of our early studies, we at CRL have been denied access to some commercial data.

Both of the current proposals recognize the importance of data collection and access. If there is concurrent supervisory authority, the agency must have the same access to the data as the prudential regulator. Furthermore, since providers typically collect a great deal of data for their own business purposes, data reporting requirements should not be opposed as an additional cost burden.. In my experience as a regulator and law enforcement official, the automatic response from the lawyers and government relations representatives was that they did not have it and it would be a burden to collect it. We'd ask them to check with their IT people, and their answer was just like the advertisement, "Yeah – We've got that. No problem." We recognize that there are legitimate concerns of privacy for consumers, and for the industry. But there is enough experience to tell us that these needs can be reconciled with meaningful transparency.

3. A procedure for reviewing new products and practices will provide an opportunity for review and realistic risk assessment, with streamlined systems for safe harbor products.

For some products or features, there is a point before sufficient data has been accumulated to give concrete results. What then? Most proponents of this consumer protection agency model recommend that there be some reasonable "safe harbor" for products that do not present obvious concerns. For truly new products and practices (and there are fewer of them than we like to think in this field[39]) some simple, common-sense questions may be all that's needed.

For example, when a marketing company began to approach banks about offering a fee-based "discretionary" bounce program, one regulator in Iowa initially balked, and asked, "Why would you encourage your customers to bounce checks?" This was a rather obvious question, particularly when there were perfectly sensible and widely available alternatives such as contracted-for overdraft agreements and linked savings programs. So what is the "value-added" to this product? One obvious one is that it exploited a legal loophole in the FRB's Regulation Z, so that, although it competed with other short term loan products, it didn't compete fairly and transparently. Simply asking the questions suggests some solutions.

These concepts are consistent with suggestions from Professor Dan Carpenter that a provider can propose a new product with an opportunity for the agency to review, as long as there is a commitment for empirical assessment of the program as it plays out in the real world. Similarly, the Administration's proposal suggests that proposed contracts and disclosures could be submitted for review and the equivalent of a "no-action" letter issued if they adequately present the benefits, costs, and risks. We caution, however, that this authority should not operate as the equivalent of a "filed-rate" doctrine in other areas, where notice filing and no agency action can insulate the product in all cases.

D. The agency should have supervision and enforcement authority over laws in its jurisdiction.

We believe that the Agency's rule-making authority must be bolstered by supervisory and enforcement authority over matters within its jurisdiction. However, the market is too vast for exclusive enforcement to rest with the agency, so States should have concurrent enforcement authority. We also support the position taken in HR 1705 that consumers should be able to enforce their own rights.

The agency should have supervisory jurisdiction. We have models of agencies with rule-making authority, and enforcement authority, but without routine supervisory authority. That gap shows. The Iowa Consumer Credit Code vested the authority to interpret and promulgate rules with the Attorney General, who also has authority to enforce it. I was the assistant attorney general who handled those interpretive duties and was charged with the enforcement. But our office did not have specific authority to do routine monitoring to catch problems early. That was vested in the banking division, even for non-depositories.

As a practical matter, that is the same situation faced by the Federal Trade Commission. There are three tools in a regulatory tool box, but an agency without supervisory jurisdiction is missing a key one. Supervision, when the will and capacity is there, can catch problems early, before they spread, and the agency is not doomed to trying to put out fires that started yesterday. Without supervisory authority, that is, in effect, what will happen.

It is simply not reasonable for the current financial supervisory agencies to retain exclusive supervisory authority. Earlier in this testimony we cited the example of on-site supervisors at large institutions even as those institutions loaded up with highly risky products, and supervisory guidance issued, and, by all appearances, ignored.

The size and nature of the market makes it unrealistic to envision supervision in the same way that bank examiners do. A wide array of methods might be used to accomplish that. Routine filings, similar to call reports, but better designed, might be required for some kinds of products. Mystery shoppers might be used to test sales practices. Workable plans will evolve, but the key thing now is to ensure that the Agency can implement them.

There should be concurrent enforcement, but structured so that the Agency retains the capacity to assure that there is consistency among federal agency enforcement. The record of the financial supervisory agencies on enforcement of consumer protection and fair lending laws is far too weak to make a credible case that exclusive enforcement authority should rest with them. Since 1987, the OCC brought only four enforcement actions under the ECOA, and since 1999, it made only one fair lending referral to DOJ based on race or national origin.[40]

Moreover, most of the enforcement violates one of the central tenants of effective reform: transparency. The OCC has essentially said that, in matters of consumer protection and fair lending enforcement, they do most of it in private: "Trust us."[41] Yet the performance of the agency – even on its core safety and soundness supervision – gives us little confidence that they have earned that trust. Inspector General reports for both the OCC and OTS have criticized the agencies for laxity in following through even when they had concerns.

Finally, enforcement by silos would still leave the regulators in the dark as to overall market impact. The ability of the agency to monitor market-wide trends and their impact on communities of color is another area where it could bring great value. The evidence is that across the spectrum, from small dollar loans to payment services to mortgage lending, the products and services offered to these communities more often focus on wealth extraction rather than asset building. Unlike the current regulatory model, which focuses on one provider at a time, a market-wide agency with strong supervision and enforcement authority is better positioned to identify the cause and facilitate market-based solutions.

E. The states should be partners: the agency's rules should be a floor, not a ceiling, and states should have concurrent enforcement authority.

Federal rules must be a floor, not a ceiling. One clear lesson of the meltdown is that overly aggressive and over-broad preemption helped spread the virus that affected the market. The deregulation of the credit card market occurred by preemption, not by explicit Congressional action, and the result was widespread abuse. States have tried since 1999 to recognize the abuses in the mortgage market and take timely action, but the response from the regulators has been to preempt those laws. While the agencies argue that state laws could still rein in the non-bank subprime lenders, they ignore the fact that many of their institutions were engaging in equally devastating practices in the non-traditional market. Indeed, Congress still has a law on the books that precludes states from taking action on adjustable rate loans.[42] It is also true that one reason more states have not acted is that they do not want to put their own institutions at a competitive disadvantage with banks that can ignore their law. Again, the result is a race to the bottom.

Those are examples where preemption has directly contributed to the current mess. But there are numerous additional examples where the OCC has devoted enormous energy and resources to exempting its regulated banks from state consumer protection law. This is in stark contrast to its extremely anemic and ineffective effort to protect consumers. For example, over the past several years, the OCC: (1) preempted a Maryland law limiting prepayment penalties that made it difficult for homeowners to refinance out of adjustable rate mortgages; [43] (2) preempted a Michigan law proscribing excessive "document preparation" fees by mortgage lenders; [44] and (3) preempted a New Hampshire law on "gift cards,"[45] to name just a few.

The time has come to recognize the vital role that states must play. They have their fingers closer to the pulse of the market and they can act more quickly to address problems – for both the consumers and providers.

States should have concurrent enforcement authority. This is a vast country with over a hundred million households, and about $13 trillion just in household credit outstanding. It is unrealistic to suggest that the federal enforcement alone is adequate. Consumer protection is a traditional state function, and states have considerably more experience in enforcement than the federal financial regulators. This should be an essential feature of this reformed system.

Private enforcement must also be available. H.R. 1705 would allow consumers to enforce the Agency's rules. Public enforcement, even with state concurrent enforcement, will never have adequate resources. That means that many consumers would never get relief at all, or not when needed. The existing foreclosure crisis is a prime example. Public enforcement officials cannot defend individuals in foreclosures. To deny private enforcement is to deny a homeowner the benefit of these consumer protection and fair lending rules at precisely the time when it is most important that they be vindicated.

IV. <u>The agency should be funded with a mix of sources.</u>

The last question we were asked to address is how the agency should be funded. Single source funding from each of the sources suggested comes with some inherent problems. Funding by supervisees can lead to conflicts of interest at one end of the spectrum, while appropriations alone may lead to funding inadequate to permit the Agency to do its job right. We agree with the recommendation of the Consumer Federal of American, the U.S. Public Interest Research Group, and others that a mix of sources will over the most stable source of funding.

Conclusion

Meaningful, substantive consumer protection is the foundation of a sustainable market for financial products, for the soundness of its institutions, and for the stability of the capital markets that provide its liquidity. Effective consumer protection requires a strong, properly-resourced, independent regulator whose mission is devoted to this purpose.

In terms of specifics, separating the consumer protection function from the "safety and soundness" function will help to guard against the tendency of prudential regulators to regard consumer protection as conflicting with lender profits, and ensure that conflicting interests do not relegate consumer protection to the background. Giving a single regulator authority over all consumer financial products, whether or not originated by depository institutions, will ensure a level playing field across the market. And ensuring that federal regulation and enforcement set the floor, not the ceiling, will allow states to continue their important role in innovating regulatory improvements, and protecting their citizens from the particular abuses that arise within their borders.

We strongly support the creation of an innovative, empowered, independent Consumer Financial Products Agency, and look forward to working with this Committee toward its realization.

Appendix A

FEDERAL TRADE COMMISSION

This hearing focused on consolidating federal consumer protection and fair lending responsibilities into a proposed new Consumer Financial Protection Agency, as opposed to continuing to vest those functions in federal bank supervisory agencies.

Considering the FTC as an alternative would fall within the purview of the House Commerce Committee, rather than the Financial Services Committee, and it is not discussed in the testimony. Yet it is a logical question, so we will briefly highlight in this appendix some of the structural impediments that make it a less than optimal choice for this agency.

- *It has multiple missions:* Although many think of the FTC as a consumer protection agency, Consumer Protection is only one of five bureaus within the FTC. The other main subject matter bureau is Competition, which deals with antitrust and fair competition matters.

- *Even its consumer protection bureau covers literally hundreds of thousands of businesses, small and large, engaged in all manner of commerce.* The FTC jurisdiction, even within the Consumer Protection Bureau, ranges from cereal advertising to health advertising to telemarketing fraud and beyond. As the default regulator for fair practices in commerce, it has tens of thousands of entities under its jurisdiction. It has been described as having a thousand jobs rather than one.

    - The Financial Practices division, which covers the areas that the new Agency would cover, is just one of seven divisions within the Consumer Protection Bureau.

    - Even after the recent hiring of five new attorneys into the financial practices division, that division still has only 6% of the attorneys in the FTC workforce.

- *It does not cover the entire market:* The FTC does not have jurisdiction over providers of financial services that are assigned to other federal agencies – most importantly, banks.

- *It does not have all the tools a regulator needs:* A regulator needs three tools to be effective: rule-making authority, oversight/ monitoring, and enforcement. (The will to use them and adequate resources are also necessary.) The FTC, in effect, has only one of those tools.

  - o Although it has nominal authority to issue rules for providers other than banks prohibiting unfair or deceptive acts or practices, the procedure required by Congress is so cumbersome, expensive, and burdensome that it is almost unusable. The last time it used that process, it literally took a decade. This spring, Congress gave it authority to use the standard process to address mortgage abuses as to entities under their jurisdiction.

  - o It has no authority to exercise real time oversight or monitoring.

- *Leadership may come from other areas of the Commissions' areas of jurisdiction.* Because the agency has more than one mission, and area of focus, the FTC's leadership does not always have a background in the area of financial practices.

To enable the FTC to accomplish the mission set for the new Agency, significant changes would have to be made to this existing structure. Even then, it would have to compete for funding with the rest of the agencies.

H.R. 1705's proposal for creating the new Agency would leave other agencies in place. The Administration's plan would transfer most of the areas of overlapping jurisdiction from the FTC to the new agency, although the FTC would retain backup authority and would be the lead agency for fraud.

Appendix B

FEDERAL CONSUMER PROTECTION: CURRENT RULE-WRITING JURIDISCTION

Statute	Cite	Rule-writing agency	Enforcement [1]
Consumer Credit Protection (federal title)	**Title 15, Chapter 41**	**(all § numbers in USC title 15 unless otherwise designated)**	
Truth in Lending Act (includes HOEPA, Fair Credit Billing Act, and Consumer Leasing Act) > Competitive Equality Banking Act (CEBA) rules & remedies cross-referenced to TILA	*Subchapter I* 15 USC §1601 – 1667f > 12 USC §3806	FRB > *TILA* §1604 >*HOEPA UDAP* §1639*l* > *CLA* § 1667f > *CEBA* 12 USC 3806(b)	>FTC default federal enforcing agency >Other federal agencies as to their regulated entities > consumer enforcement/aka PROA) > *HOEPA* – state AGs
Restrictions on Garnishment	*Subchapter II* 15 USC §1671-1677	No rule-writing authorization specified	> Dept of Labor > courts cannot issue garnishment orders in violation, so functionally enforceable as defense by debtor
Credit Repair Organizations (CRO)	*Subchapter II-A* 15 USC §1679-1679j	FTC (appears to incorporate general FTC TRR authority) § 1679h	> FTC > state AGs > consumer enforcement
Fair Credit Reporting Act (FCRA)	*Subchapter III* 15 USC §1681-1681x	> FTC as to consumer reporting agencies and non-bank furnishers under various FCRA provisions > federal banking agencies and FTC jointly with respect to various FACTA provisions > federal banking agencies generally for their respective entities.	> FTC > other federal agencies as to their regulated entities > State AGs >consumer enforcement
Equal Credit Opportunity Act (ECOA)	*Subchapter IV* 15 USC §1691-1691f	FRB §1691b	>FTC default federal enforcing agency, >Other federal agencies as to their regulated entities > consumer enforcement
Fair Debt Collection Practices Act (FDCPA)	*Subchapter V* 15 USC §1692-1692p	Explicitly denies any rule-making authority §1692*l*(d) [FTC issues non-binding commentary]	>FTC > consumer enforcement
Electronic Funds	*Subchapter IV*	FRB	>FTC default

[1] This chart refers only to federal law grants of enforcement rights. State laws may confer enforcement jurisdiction separately, *e.g.*, state financial regulators commonly have authority under their state law to enforce all laws applicable to their supervisees, both state and federal; state AGs may have authority under their state law to enforce federal laws directly; or federal law violations may also constitute violations of some state laws.

Transfer Act (EFTA)	15 USC §1693-1693*s*	1693b	>Other federal agencies as to their regulated entities > consumer enforcement

OTHER FEDERAL CONSUMER PROTECTION STATUTES

Statute	Cite	Rule-writing agency	Enforcement
Truth in Savings (TISA)	12 USC §4301-4313	FRB -- §4308 NCUA -- § 4311	>regulatory enforcement by relevant federal supervisory agencies
Federal UDAP (FTC Act)	15 USC §57a	FTC – default jurisdiction >independent UDAP and mandatory follow-on process (FRB for all banks, NCUA for credit unions, OTS for federal thrifts)	> FTC default jurisdiction > other agencies as to their regulated entities
RESPA (only applies to real estate lending)	12 USC §2601-2614	HUD	> HUD > some state AG enforcement & state insurance commission enforcement authorized > consumer enforcement for some specified portions of RESPA, but not all.
Federal Rebate statute	15 USC §1615 [Not part of TILA despite its location in that portion of USC.[2]]	No rule-making authority granted	None specified. (*See note 4 as to why remedy is not subsumed into general TIL remedies.*)
Military Lending Act (Talent/Nelson)	10 USC §987	Department of Defense 12 USC 987(h)	>misdemeanor for knowing violations > contract void from the inception
Check 21	12 USC §5001 - 5018	FRB §5014	>indemnification > consumer enforcement
Gramm-Leach-Bliley	Privacy: Subchapter I 15 USC 6801-6810 (Subchapter II addresses identity theft.)	Part A – each federal agency as to entities within its own jurisdiction, plus NAIC § 6804	> each agency and state insurance commissions as to entities within their own jurisdiction
Homeowners Protection Act of 1998 (PMI)	12 USC 4901	None specified	> each agency as to its own entities [*NB*: HUD has disclaimed any enforcement authority] > consumer enforcement (with different liability for

[2] This provision was *not* enacted as an amendment to Truth in Lending, but rather as part of the Housing and Community Development Act of 1992, Pub. L. 102-550, Title IX, §933. The placement in the USC was an administrative decision made by Code editors, and does not have legal effect.

			banks)
Home Mortgage Disclosure Act (HMDA)		FRB	

[1] Self-Help's North Carolina retail credit union is a state-chartered credit union, and SH recently opened a federally-chartered credit union in California.

[2] Over thirty-five years in this field has taught me that, unfortunately, part of what some call "compliance" costs entails expense in trying to figure out how to get around common sense rules, as well as how to turn competitive pressures against the interests of the customers.

[3] See Lei Ding, Roberto G. Quercia, Janneke Ratcliffe, Wei Li, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, comparing loans of this type to those which characteristics common in subprime., http://www.ccc.unc.edu/abstracts/091308_Risky.php

[4] Anthony Pennington-Cross calls these loans "designed to terminate" *See* Souphala Chomsisengphet, Timothy Murphy, Anthony Pennington-Cross, et al, *Product Innovation & Mortgage Selection in the Subprime Era,* Subprime Housing Crisis: Interdisciplinary Policy Perspectives (Univ. of Iowa, Oct. 10-11, 2008). http://ppc.uiowa.edu/dnn4/PenningtonCross_Anthony.pdf

[5] One of the central figures in 20[th] century neoclassical economics noted ruefully some 70 years ago that "there is truth in that allegation that unregulated competition places a premium on deceit and corruption." Frank Hyneman Knight, *The Ethics of Competition* (1935, reissued 1997 Transaction Pub., New Brunswick, NJ), at 42.

[6] Wei Li and Keith Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms,* Center for Responsible Lending (February 23, 2006), p. 15.

[7] *See,* Amanda Quester & Kathleen Keest, *Looking Ahead After* Watters v. Wachovia Bank: Challenges for Lower Courts, Congress, and the Comptroller of the Currency, 27 Rev. of Banking and Fin'l Law 187, 200-201 (2008).

[8] 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. La. 1243, 1244, 1246 & n. 25, 1253 (2003).

[9] Even then, i
It acted against a credit card issuer after state officials acted against the bank, and the agency was beginning its effort to expand its interpretation of exclusive visitation. As one lawyer who was a Treasury official at the time told a conference I attended, "they recognized they couldn't replace something with nothing." [speaking of consumer protection enforcement] (Practising Law Institute, Consumer Financial Services Litigation Conf,, San Francisco, CA, May, 2002.)

[10] That record is detailed in Brief of *Amici Curiae* of Center For Responsible Lending, et al, *Cuomo v. Clearinghouse Assoc'n, L.L.C. and Office of the Comptroller of the Currency,* No. 08-453 (filed March 4, 2009), pp. 20- 38. .

[11] The OTS had rule-making authority for the Alternative Mortgage Transaction Parity Act (AMTPA), and it used it to preempt state prepayment penalty limitations for AMTPA loans in 1996. It took seven years to get the OTS to repeal that rule. The repeal was effective July 1, 2003.,

[12] This and other examples are described in detail in Statement of Patricia A. McCoy, *Hearing on "Consumer Protections in Financial Services: Past Problems, Future Solutions" before the U.S. Senate*

Committee on Banking, Housing and Urban Affairs p. 19-20 (March 3, 2009), http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=11be680d-04db-42cc-89bf-7fe4ffe4d9cd&Witness_ID=b6ba604a-d441-43e3-9951-1fbab4b11e57

[13] *See, e.g.* Liz Moyer and Niv Elis, *The Real Problem in Banking*, http://www.forbes.com/2009/06/15/banking-regulation-obama-business-beltway-reg.html (June, 15, 2009) (noting that JP Morgan and HSBC went to the OCC "lured away from New York charters by the promise of federal preemption from stricter state consumer privacy and lending laws.")

[14] Id.

[15] *See generally* National Consumer Law Center, *The Cost of Credit* §§3.7.2-3.7.3 (3rd Ed. 2005).

[16] Cited in today's testimony of Consumer Federation of America, et al.

[17] Reps. Barney Frank, Edward Markey and Joseph Sestak filed an *amici* brief in support of a n intervenor's motion for Injunction Under the All Writs Act in USA v. Payment Processing Center, LLC, No 06-0725 (E..D. Pa. May 29, 2008). The case is described in the Brief of Amicus Curiae Center for Responsible Lending, et al, Cuomo v. Clearinghouse Assoc'n No. 08-453, p. 29-33 (filed Mar 4, 2009)..

[18] *See* Michael Powell, *Bank Accused of Pushing Mortgage Deals on Blacks*, New York Times, (June 6, 2009), http://www.nytimes.com/2009/06/07/us/07baltimore.html?_r=1&partner=rss&emc=rss

[19] *See, Testimony of Consumer Federation of America, et al. See also* Testimony of Patricia M. McCoy, *Hearing on "Consumer Protections in Financial Services: Past Problems, Future Solutions,"* Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, (March 3, 2009), at p. 16-24 (detailing regulatory failures of FRB, OCC and OTS) [McCoy].

[20] Perhaps because this Committee does not have jurisdiction over the Federal Trade Commission, we were not asked to discuss it as a third alternative to either a new agency or prudential banking regulators. Though it is outside this Committee's purview, we do discuss it briefly in Appendix A, because it is relevant to the issue of whether a new Agency or existing agencies are best suited to the task.

[21] McCoy, *supra* note 19.

[22] The federal agencies' guidance instructed lenders to evaluate the borrower's ability to pay based on the fully-indexed, fully-amortizing payment. *Interagency Guidance on Nontraditional Mortgage Product Risks*, 71 Fed. Reg. 58609, 58614 (October 4, 2006).

[23] Countrywide's estimate from Countywide Financial Corporation, "3Q 2007 Earnings Supplemental Presentation," October 26, 2007. Countrywide originated through both state chartered non-banks and a national bank. In March, 2007, it moved to an OTS charter. We do not know the allocation of originations between the state and national bank charters prior to the move to OTS. We have seen some of the egregious POARMs written by the national bank, but most appear to have been made through the federal charters.

[24] *See* McCoy, *supra* note 19 at 20-21; Office of the Inspector General Audit Report, *Safety and Soundness: Material Loss Review of First National Bank of Nevada and First Heritage Bank*, , 4-6, 13*NA* , OIG-09-033 (Feb. 27, 2009)

[25] Indeed, a colleague recently shared with me a mortgage variation of selling monthly credit insurance, adapting the same kind of tactics used to cram credit card accounts: after a free period, it's an additional $60 a month, unless one opts out.

[26] This disagreement could not be resolved prior to the issuance of the Notice of Proposed Rulemaking, and is openly reflected in the Federal Register notice, which included two competing versions of the proposal. See 72 Fed. Reg. 70944 (Dec. 13, 2007)This has troubling implications for the joint rule-writing provisions in H.R. 1728, the mortgage origination reform bill recently passed by the House and referred to the Senate.

[27] *See, e.g.* Nature Abhors a Vacuum: High-rate Lending in Redlined, Minority Neighborhoods in Boston, NCLC REPORTS *Consumer Credit and Usury Ed.* p. 21 (May/June, 1991). The Boston newspapers covered the issue heavily in May and June 1991. The first use of a fair lending law to attack predatory lending as "reverse redlining" was in 1991. *Alexander v. Kaye-Co, et al* (Civ. No. 91-RCCV-681)(Super. Ct. of Richmond Cty, [Ga], filed Aug. 20, 1991)(alleging defendants, including brokers and Fleet Finance targeted African American homeowners for high-rate loans unjustified by any legitimate business reason, in violation of Georgia's Fair Housing Act.) A class was certified, and the case was settled.

[28] Alan M. White and Cathy Lesser Mansfield, *Subprime Mortgage Foreclosures: Mounting Defaults Draining Homeownership*, (May 12, 2000), presented to the HUD-Treasury Joint Task Force on Predatory Mortgage Lending (May, 2000), available at http://facstaff.law.drake.edu/cathy.mansfield/subprime.html [hereafter White-Mansfield study]; Testimony of Prof. Cathy Lesser Mansfield Before the U.S. House of Rep. Committee on Banking and Financial Services, (May 24, 2000).

[29] Dean Baker, *Dangerous Trends: The Growth of Debt in the U.S. Economy*, at 4, Fig 1 (2004); Stephen Roach, *Comment: America's Inflated Asset Prices Must Fall*, Financial Times, January 8, 2008.

[30] See Comments of the Center for Responsible Lending on the Proposed Rule Regarding Unfair and Deceptive Acts and Practices with Respect to Credit Cards, at pp. 21-22, text accompanying notes 82-84 (August 4, 2008), http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/cc-udap-comments-final_2_-080408.pdf

[31] Of 2006 subprime originations, 56% were refinances. *Subprime Lending: A Net Drain on Home Ownership* , p. 3, Center For Responsible Lending Issue Paper No. 14 (March 27, 2007). The White-Mansfield foreclosure study, *supra* they estimated that only about 10% of the loans in their study of the 16 top subprime lenders were purchase money. White-Mansfield at p. 2.

[32] *See* White-Mansfield study, p. 2 (2000 data); *Subprime Lending: A Net Drain on Home Ownership* , p. 3, Center For Responsible Lending Issue Paper No. 14 (March 27, 2007). *See also,* Yuliya S. Demyanyk, *Quick Exits of Subprime Mortgages*, REVIEW Fed. Reserve Bank of St. Louis 91:79 (Mar/Apr. 2009)(effect of subprime lending on increase of homeownership most likely overstated); Krisopher S. Gerardi and Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods*, Fed. Res. Bk of Boston, Pub. Policy Disc. Paper No. 08-06 ,(Dec. 22, 2008) (Mass. evidence suggestions subprime lending did not lead to increase in homeownership by minorities).

[33] Ellen Schloemer, et al,Keith Ernst, Wei Li, and Kathleen Keest, *Losing Ground, supra* note 3, at Table 4, p. 13. A failed loan, as used here, is one which was either foreclosed on or "prepaid in distress," meaning that the loan balance went to $0 in any given month when it had been listed as in foreclosure, bankruptcy, or real-estate owned by the lender (REO) the previous month.

Origination Year	% foreclosed or distress prepaid by May 2005
1998	20.5%
1999	23.0%
2000	24.0%

In Philadelphia, as early as 2000-2003, subprime foreclosure filings in one neighborhood reached 19% of the housing stock. Ira Goldstein, *Lost Values: A Study of Predatory Lending in Philadelphia*, p. 58 (The Reinvestment Fund, April 2007), *available at* http://www.trfund.com/resource/downloads/policypubs/Lost_Values.pdf.

[34] Schloemer, et al, *Losing Ground, supra* note 3, above, at p. 21. Unless otherwise stated, the increased odds of foreclosure are those for 2000 vintage subprime loans. The study analyzed the performance of subprime loans originated 1998 – 2004 as of May, 2005. The foreclosure trend line for the more recent years, where the loans had not yet aged, was tracking the performance of 2000 originations. *Id* at p. 12.

[35] Details about the MBS offerings are found in Testimony of Michael Calhoun Before the U.S. Senate Committee on Banking, Housing and Urban Affairs – Subcommittee on Housing, Transportation and Community Development, *Ending Mortgage Abuse: Safeguarding Homebuyers* p. 3, 12-13 (June 26, 2007), *available at* http://banking.senate.gov/public/ files/calhoun1.pdf.

[36] Inside Mortgage Finance, I Mortgage Market Statistical Annual: 2009, p. 6

[37] *Option ARMs: It's Later Than It Seems,* Fitch Ratings (September 2, 2008), at 5.

[38] *See supra* note 4.

[39] Today's payday market, for example, is the old salary-lending business from the turn of the 20th century, only slightly tweaked.

[40] This information is found in annual reports that the FRB and US Attorney General provide to Congress.

[41] *See* Stephanie Mencimer, *No Account,* The New Republic, Aug. 27, 2007, at 14.[41]

[42] The Garn St GermaineAlternative Mortgage Transactions Parity Act of 1982, 12 U.S.C. XX.§3801, et seq.

[43] *See* Center for Responsible Lending, *Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners,* at 21 (Dec. 2006), available at http://www.responsiblelending.org/pdfs/FC-paper-12-19-new-cover-1.pdf. In National City Bank of Indiana v. Turnbaugh, 463 F.3d 325 (4th Cir. 2006), the OCC argued that Maryland law on prepayment penalties was preempted by OCC regulations and could not be applied to state-chartered mortgage companies that are operating subsidiaries of national banks. The court deferred to the OCC and held Maryland law preempted, leaving borrowers without an important protection against a practice that has strong implications for rising foreclosure rates in local housing markets.

[44] The Michigan Consumer Protection Act imposes certain limitations on the fees that state-chartered lenders can assess for the preparation of loan closing documents. State laws like this one protect consumers from efforts by lenders to get around the provisions of the Real Estate Settlement Procedures Act (RESPA) and to exploit a loophole in the Truth In Lending Act (TILA). The former was intended to protect consumers from unnecessarily high settlement charges, and the latter was intended to provide consumers with a standardized pricetag for the cost of credit. Lenders attempt to designate closing costs as "document preparation fees" in order to avoid the restrictions and disclosure requirements set forth in RESPA and the regulations thereunder. Consumers sued a state-chartered operating subsidiary of a national bank for violations of the Michigan law. The OCC submitted an amicus brief in support of the defendant mortgage company arguing that OCC regulations preempted the Michigan Act and rendered it inapplicable against the operating subsidiary. The court granted Huntington Mortgage's motion for summary disposition holding that the Michigan law did not apply. Brannam v. The Huntington Mortgage Co., 00-40439-CH (Muskegon (MI) County Circuit Court).

[45] New Hampshire attempted to enforce the provisions of its Consumer Protection Act that would have imposed certain requirements on a state-chartered company that distributes "gift cards" at shopping malls within the state. The company is not a national bank or even an affiliate of a national bank. Rather, it is owned by a company that owns and operates shopping malls. Nevertheless, because the cards were issued by a national bank and a federal savings association, a federal district court in New Hampshire held that OCC and OTS regulations preempted the state law gift card rules, and precluded their application to the

state-chartered shopping mall affiliate. See SPGGC v. Ayotte, 443 F.Supp.2d 197 (D.N.H. 2006). The reason that states seek to regulate gift cards is that they are frequently subject to expiration dates and hidden fees that reduce their value well below their face value. Preempting state law in this area allows gift-card venders to mislead consumers about the value of what they are buying.

Testimony of

Travis Plunkett, Consumer Federation of America
And Edmund Mierzwinski, U.S. PIRG

On Behalf of

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

Before the Committee on Financial Services
U.S. House of Representatives
The Honorable Barney Frank, Chairman

Hearing on
Regulatory Restructuring:
Enhancing Consumer Financial Products Regulation

24 June 2009

SUMMARY

Thank you, Chairman Frank, Rep. Bachus and members of the committee. We are pleased to be able to offer the views of leading consumer groups[1] in support of the establishment of a Consumer Financial Protection Agency, as proposed first by Reps. Delahunt and Brad Miller and later by President Obama. The testimony is being delivered by Travis Plunkett, Legislative Director of the Consumer Federation of America,[2] and Edmund Mierzwinski, Consumer Program Director of U.S. PIRG,[3] also on behalf of ACORN,[4] Americans for Fairness in Lending,[5] Consumer Action,[6] Center for Digital Democracy,[7] Consumers Union,[8] Demos,[9] National Association of Consumer Advocates,[10] National Consumer Law Center (on behalf of its low-income clients),[11] National Fair Housing Alliance,[12] National People's Action,[13] and Public Citizen.[14]

---

1 The testimony was drafted by Travis Plunkett and Jean Ann Fox of the Consumer Federation of America, Gail Hillebrand of Consumers Union, Lauren Saunders of the National Consumer Law Center and Ed Mierzwinski of U.S. PIRG.

2 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.

3 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.

4 **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.

5 **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.

6 **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.

7 **The Center for Digital Democracy** is dedicated to ensuring that the public interest is a fundamental part of the new digital communications landscape. CDD is especially concerning with the growing role of the Internet, online media and mobile platforms such as cell phones in the provision of consumer financial services.

8 **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 good, 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.

9 **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.

10 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.

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

In the testimony we present today, we outline the case for establishment of a robust, independent federal Consumer Financial Protection Agency to protect consumers from unfair credit, payment and debt management products, no matter what company or bank sells them and no matter what agency may serve as the prudential regulator for that company or bank. We describe the many failures of the current federal financial regulators. We discuss the need for a return to a system where federal financial protection law serves as a floor not as a ceiling, and consumers are again protected by the three-legged stool of federal protection, state enforcement and private enforcement. We rebut anticipated opposition to the proposal, which we expect will come from the companies and regulators that are part of the system that has failed to protect us. We offer detailed suggestions to shape the development of the agency in the legislative process. We believe that, properly implemented, a Consumer Financial Protection Agency will encourage innovation by financial actors, increase competition in the marketplace and lead to better choices for consumers.

We look forward to working with you and committee members to enact a strong Consumer Financial Protection Agency bill through the House and into law. We also look forward to working with you on other necessary aspects of financial regulatory reform to restore the faith and confidence of American families that the financial system will protect their homes and their economic security

SECTION 1. LEARNING FROM EXPERIENCE TO CREATE A FEDERAL CONSUMER FINANCIAL PROTECTION AGENCY

It has become clear that a major cause of the most calamitous worldwide recession since the Great Depression was the result of the simple failure of federal regulators to stop abusive lending, particularly unsustainable home mortgage lending. Such action would not only have

---

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.

12 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.

13 **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.

14 **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.

protected many families from serious financial harm but would likely have stopped or slowed the chain of events that has led to the current economic crisis.

The idea of a federal consumer protection agency focused on credit and payment products has gained broad and high-profile support because it targets the most significant underlying causes of the massive regulatory failures that occurred. First, federal agencies did not make protecting consumers their top priority and, in fact, seemed to compete against each other to keep standards low, ignoring many festering problems that grew worse over time. If agencies did act to protect consumers (and they often did not), the process was cumbersome and time-consuming. As a result, agencies did not act to stop some abusive lending practices until it was too late. Finally, regulators were not truly independent of the influence of the financial institutions they regulated.

Meanwhile, despite an unprecedented government intervention in the financial sector, the passage of mortgage reform legislation in the House of Representatives and the enactment of a landmark law to prevent abusive credit card lending, problems with the sustainability of home mortgage and consumer loans keep getting worse. With an estimated two million households having already lost their homes to foreclosure because of the inability to repay unsound loans, Credit Suisse now predicts that foreclosures will exceed eight million through 2012.[15] The amount of revolving debt, most of which is credit card debt, is approaching $1 trillion.[16] Based on the losses that credit card issuers are now reporting, delinquencies and defaults are expected to peak at their highest levels ever within the next year.[17] One in two consumers who get payday loans default within the first year, and consumers who receive these loans are twice as likely to enter bankruptcy within two years as those who seek and are denied them.[18] Overall, personal bankruptcies have increased sharply, up by one-third in the last year.[19]

The failure of federal banking agencies to stem sub-prime mortgage lending abuses is fairly well known. They did not use the regulatory authority granted to them to stop unfair and deceptive lending practices before the mortgage foreclosure crisis spun out of control. In fact, it wasn't until July of 2008 that these rules were finalized, close to a decade after analysts and experts started warning that predatory sub-prime mortgage lending would lead to a foreclosure epidemic.

[15] "Foreclosures could top 8 million: Credit Suisse," 9 December 2008, MarketWatch, available at http://www.marketwatch.com/story/more-than-8-million-homes-face-foreclosure-in-next-4-years (last visited 21 June 2009).

[16] See the Federal Reserve statistical release G-19, Consumer Credit, available at http://www.federalreserve.gov/releases/g19/

[17] "Fitch Inc. said it continues to see signs that the credit crunch will escalate into next year, and it said card chargeoffs may approach 10% by this time next year." "Fitch Sees Chargeoffs Nearing 10%," Dow Jones, May 5, 2009.

[18] Paige Marta Skiba and Jeremy Tobacman, "Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default," August 21, 2008. http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=1636 and Paige Marta Skiba and Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" October 10, 2008 http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221 (last visited 21 June 2009).

[19] "Bankruptcy Filings Continue to Rise" Administrative Office of the U.S. Courts, news release, 8 June 2009, available at http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsMar2009.cfm (last visited 21 June 2009).

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

Combining safety and soundness supervision – with its focus on bank profitability – in the same institution as consumer protection magnified an ideological predisposition or anti-regulatory bias by federal officials that led to unwillingness to rein in abusive lending before it triggered the housing and economic crises. Though we now know that consumer protection leads to effective safety and soundness, structural flaws in the federal regulatory system compromised the independence of banking regulators, encouraged them to overlook, ignore and minimize their mission to protect consumers. This created a dynamic in which regulatory agencies competed against each other to weaken standards and ultimately led to an oversight process that was cumbersome and ineffectual. These structural weaknesses threatened to undermine even the most diligent policies and intentions. They complicated enforcement and vitiated regulatory responsibility to the ultimate detriment of consumers.

These structural flaws include: a narrow focus on "safety and soundness" regulation to the exclusion of consumer protection; the huge conflict-of-interest that some agencies have because they rely heavily on financial assessments on regulated institutions that can choose to pay another agency to regulate them; the balkanization of regulatory authority between agencies that often results in either very weak or extraordinarily sluggish regulation (or both); and a regulatory process that lacks transparency and accountability. Taken together, these flaws severely compromised the regulatory process and made it far less likely that agency leaders would either act to protect consumers or succeed in doing so.

SECTION 2. CORRECTING REGULATORY SHORTCOMINGS BY CREATING A CONSUMER FINANCIAL PROTECTION AGENCY

Although a Consumer Financial Protection Agency (CFPA) would not be a panacea for all current regulatory ills, it would correct many of the most significant structural flaws that exist, realigning the regulatory architecture to reflect the unfortunate lessons that have been learned in the current financial crisis and sharply increasing the chances that regulators will succeed in protecting consumers in the future. A CFPA would be designed to achieve the regulatory goals of elevating the importance of consumer protection, prompting action to prevent harm, ending regulatory arbitrage, and guaranteeing regulatory independence.

A. Put Consumer Protection at the Center of Financial Regulation.

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.[20] Jurisdiction

[20] The Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTC) 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

over consumer protection statutes is scattered over several more agencies, with rules like RESPA and TILA, which both regulate mortgage disclosures, in different agencies.

Within agencies in which these functions are combined, regulators have often treated consumer protection as less important than their safety and soundness mission or even in conflict with that mission.[21] For example, after more than 6 years of effort by consumer organizations, federal regulators are just now contemplating incomplete rules to protect consumers from high-cost "overdraft" loans that financial institutions often extend without the knowledge of or permission from consumers. Given the longstanding inaction on this issue, it is reasonable to assume that regulators were either uninterested in consumer protection or viewed restrictions on overdraft loans as an unnecessary financial burden on banks that extend this form of credit, even if it is deceptively offered and financially harmful to consumers. In other words, 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 (like overdraft loans or mortgage pre-payment penalties) were harmful to consumers.

As mentioned above, recent history has demonstrated that this shortsighted view of consumer protection and bank solvency as competing objectives is fatally flawed. If regulatory agencies had acted to prevent loan terms or practices that harmed consumers, they would also have vastly improved the financial solidity of the institutions they regulated. Nonetheless, the disparity in agencies' focus on consumer protection versus "safety and soundness" has been obvious, both in the relative resources that agencies devoted to the two goals and in the priorities they articulated. These priorities frequently minimized consumer protection and included reducing regulatory restrictions on the institutions they oversaw.[22]

Though the link between consumer protection and safety and soundness is now obvious, the two functions are not the same, and do conflict at times. 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.[23]

(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.

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

[22] 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.

[23] 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.

Until recently, regulatory agencies have also focused almost exclusively on bank examination and supervision to protect consumers, which lacks transparency. This process 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.[24] Given that multiple regulators oversee similar institutions, the process has also resulted in different standards for products like credit cards offered by different types of financial institutions. In fact, widespread abusive lending in the credit markets has discredited claims by bank regulators like the Comptroller of the Currency that a regulatory process consisting primarily of supervision and examination results in a superior level of consumer protection compared to taking public enforcement action against institutions that violate laws or rules.[25] Financial regulatory enforcement actions are a matter of public record which has a positive impact on other providers who might be engaged in the same practices and provides information to consumers on financial practices sanctioned by regulators.

Additionally, the debate about the financial and foreclosure crisis often overlooks the fact that 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.[26] 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.[27]

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.[28] According to a study conducted

---

[24] "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 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.

[25] "...ours is not an 'enforcement-only' compliance regime – far better to describe our approach as 'supervision first, enforcement if necessary,' with supervision addressing so many early problems that enforcement is not necessary." Testimony of John C. Dugan, Comptroller of the Currency, Before the Committee on Financial Services of the U.S. House of Representatives, June 13, 2007.

26 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.

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

28 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.

by the Wall Street Journal, as much as 61% of those receiving subprime loans would "qualify for conventional loans with far better terms."[29] 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.[30] 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 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.

A CFPA, by contrast, would have as its sole mission the development and effective implementation of standards that ensure that all credit products offered to borrowers are safe and not discriminatory. The agency would then enforce these standards for the same types of products in a transparent, uniform manner. Ensuring the safety and fairness of credit products would mean that the CFPA would not allow loans with terms that are discriminatory, deceptive or fraudulent. The agency should also be designed to ensure that credit products are offered in a fair and sustainable manner. In fact, a core mission of the CFPA would be to ensure the suitability of classes of borrowers for various credit products, based on borrowers' ability to repay the loans they are offered – especially if the cost of loans suddenly or sharply increase, and that the terms of loans do not impose financial penalties on borrowers who try to pay them off. 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 types of loans would have a negative short-term financial impact on financial institutions.

B. Prevent Regulatory Arbitrage. Act Quickly to Prevent Unsafe Forms of Credit.

The present regulatory system is institution-centered, rather than consumer-centered. It is structured according to increasingly irrelevant distinctions between the type of financial services company that is lending money, rather than the type of product being offered to consumers. Right now, financial institutions are allowed (and have frequently exercised their right) to choose the regulatory body that oversees them and to switch freely between regulatory charters at the federal level and between state and federal charters. Many financial institutions have switched charters in recent years seeking regulation that is less stringent. Two of the most notorious examples are Washington Mutual and Countrywide,[31] which became infamous for promoting dangerous sub-prime mortgage loans on a massive scale.[32] Both switched their charters to

[29] See "Subprime Debacle Traps Even Very Creditworthy," *Wall Street Journal,* December 3, 2007.
30 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).
[31] Of course, following their stunning collapses, Countrywide was acquired by Bank of America and Washington Mutual by Chase, both in regulator-ordered winding-downs.
[32] In fact, several other large national banks have chosen in recent years to convert their state charter to a national charter. Charter switches by JP Morgan Chase, HSBC and Bank of Montreal (Harris Trust) alone in 2004-05 moved over $1 trillion of banking assets from the state to the national banking system, increasing the share of assets held by national banks to 67 percent from 56 percent, and decreasing the state share to 33 percent from 44 percent. Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Threaten to Undermine the Dual Banking System, Consumer

become thrifts regulated by the Office of Thrift Supervision (OTS). At the federal level, where major agencies are funded by the institutions they oversee, this ability to "charter shop," has undeniably led regulators like the OTS to compete to attract financial institutions by keeping regulatory standards weak. It 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.[33]

When agencies do collaborate to apply consumer protections consistently to the institutions they regulate, the process has been staggeringly slow. 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. 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.

The "charter shopping" problem would be directly addressed through the creation of a single CFPA 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 CFPA would be required to focus on the safety of credit products, features and practices, no matter what kind of lender offered them. As for regulatory competition with states, it would only exist to improve the quality of consumer protection. Therefore, the CFPA should be allowed to set minimum national credit standards, which states could then enforce (as well as victimized consumers). States would be allowed to exceed these standards if local conditions require them to do so. If the CFPA sets "minimum" standards that are sufficiently strong, a high degree of regulatory uniformity is likely to result. With strong national minimum standards in place, states are most likely to act only when new problems develop first in one region or submarket. States would then serve as an early warning system, identifying problems as they develop and testing policy solutions, which could then be adopted nationwide by the CFPA if merited. Moreover, the agency would have a clear incentive to stay abreast of market developments and to act in a timely fashion to rein in abusive lending because it will be held responsible for developments in the credit market that harm consumers.

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.
[33] For a detailed analysis, see brief amicus curiae of Center for Responsible Lending et al in the case currently before the Supreme Court, 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.

C. Create an Independent Regulatory Process.

The ability of regulated institutions to "charter shop" combined with aggressive efforts by federal regulators to preempt state oversight of these institutions has clearly undermined the independence of the OTS and OCC. This situation is made worse by the fact that large financial institutions like Countrywide 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. The OTS and OCC are almost entirely funded through assessments on the institutions they regulate (see Appendix 4). The ability to charter shop combined with industry funding has created a significant conflict-of-interest that has contributed to the agencies' disinclination to consider upfront regulation of the mortgage and consumer credit markets.

Given that it supervises the largest financial institutions in the country, the OCC's funding situation is the most troublesome.

> *More than 95% of the OCC's budget is financed by assessments paid by national banks, and the twenty biggest national banks account for nearly three-fifths of those assessments. Large, multi-state banks were among the most outspoken supporters of the OCC's preemption regulations and were widely viewed as the primary beneficiaries of those rules. In addition to its preemption regulations, the OCC has frequently filed amicus briefs in federal court cases to support the efforts of national banks to obtain court decisions preempting state laws. The OCC's effort to attract large, multi-state banks to the national system have already paid handsome dividends to the agency....Thus, the OCC has a powerful financial interest in pleasing its largest regulated constituents, and the OCC therefore faces a clear conflict of interest whenever it considers the possibility of taking an enforcement action against a major national bank.*[34]

The leadership of a CFPA 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. Crucial to the success of the agency would be to ensure that its funding is adequate, consistent and does not compromise this mission. Congress could also ensure that the method of agency funding that is used does not compromise the CFPA's mission by building accountability mechanisms into the authorizing statute and exercising effective oversight of the agency's operations. (See section 4 below.)

Recent history has demonstrated that even an agency with an undiluted mission to protect consumers can be undermined by hostile or negligent leadership or by Congressional meddling on behalf of special interests. However, unless the structure of financial services regulation is realigned to change not just the focus of regulation but its underlying philosophy, it is very unlikely that consumers will be adequately protected from unwise or unfair credit products in the future. The creation of a CFPA is necessary because it ensures that the paramount priority of

[34] 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.

federal regulation is to protect consumers, that the agency decision-making is truly independent, and that agencies do not have financial or regulatory incentives to keep standards weaker than necessary.

SECTION 3: ERRORS OF OMISSION AND COMMISSION BY THE FEDERAL BANK REGULATORS

Current regulators may already have some of the powers that the new agency would be given, but they haven't used them. Conflicts of interest and a lack of will work against consumer enforcement. In this section, we detail numerous actions and inactions by the federal banking regulators that have led to or encouraged unfair practices, higher prices for consumers, and less competition.

A. The Federal Reserve Board ignored the growing mortgage crisis for years after receiving Congressional authority to enact anti-predatory mortgage lending rules in 1994.

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.[35]

B. At the same time, the Office of the Comptroller of the Currency engaged in an escalating pattern of preemption of state laws designed to protect consumers from a variety of unfair bank practices and to quell the growing predatory mortgage crisis, culminating in its 2004 rules preempting both state laws and state enforcement of laws over national banks and their subsidiaries.

In interpretation letters, amicus briefs and other filings, the OCC preempted state laws and local ordinances requiring lifeline banking (NJ 1992, NY, 1994), prohibiting fees to cash "on-us" checks (par value requirements) (TX, 1995), banning ATM surcharges (San Francisco, Santa Monica and Ohio and Connecticut, 1998-2000), requiring credit card disclosures (CA, 2003) and opposing predatory lending and ordinances (numerous states and cities).[36] Throughout, OCC ignored Congressional requirements accompanying the 1994 Riegle-Neal Act not to preempt without going through a detailed preemption notice and comment procedure, as the Congress had found many OCC actions "inappropriately aggressive."[37]

In 2000-2004, the OCC worked with increasing aggressiveness to prevent the states from enforcing state laws and stronger state consumer protection standards against national banks and their operating subsidiaries, from investigating or monitoring national banks and their operating subsidiaries, and from seeking relief for consumers from national banks and subsidiaries.

---

[35] 73 FR 147, Page 44522, Final HOEPA Rule, 30 July 2008

[36] "Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law," USGAO, prepared for Financial Services Committee Chairman James Leach, 7 February 2000, available at http://www.gao.gov/corresp/ggd-00-51r.pdf (last visited 21 June 2009).

[37] [Statement of managers filed with the conference report on H.R. 3841, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Congressional Record Page S10532, 3 August 1994

These 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, plus briefs in court cases supporting national banks' efforts to block state consumer protections.

We discuss these matters in greater detail below, in Section 5, rebutting industry arguments against the CFPA.

C. The agencies took little action except to propose greater disclosures, as unfair credit card practices increased over the years, until Congress stepped in.

Further, between 1995 and 2007, the Office of the Comptroller of Currency issued only one public enforcement action against a Top Ten credit card bank (and then only after the San Francisco District Attorney had brought an enforcement action). In that period, "the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws."[38] The OCC's failure to act on rising credit card complaints at the largest national banks triggered Congress to investigate, resulting in passage of the 2009 Credit Card Accountability, Responsibility and Disclosure Act (CARD Act).[39] While this committee was considering that law, other federal regulators finally used their authority under the Federal Trade Commission Act to propose and finalize a similar rule.[40] By contrast, the OCC requested the addition of two significant loopholes to a key protection of the proposed rule.

Meanwhile, this committee and its Subcommittee on Financial Institutions and Consumer Credit had conducted numerous hearings on the impact of current credit card issuer practices on consumers. The Committee heard testimony from academics and consumer representatives regarding abusive lending practices that are widespread in the credit card industry, including:

- The unfair application of penalty and "default" interest rates that can rise above 30 percent;
- Applying these interest rate hikes retroactively on existing credit card debt, which can lead to sharp increases in monthly payments and force consumers on tight budgets into credit counseling and bankruptcy;
- High and increasing "penalty" fees for paying late or exceeding the credit limit. Sometimes issuers use tricks or traps to illegitimately bring in fee income, such as requiring that payments be received in the late morning of the due date or approving purchases above the credit limit;
- Aggressive credit card marketing directed at college students and other young people;

[38] Testimony of Professor Arthur Wilmarth, 26 April 2007, before the Subcommittee on Financial Institutions and Consumer Credit, hearing on Credit Card Practices: Current Consumer And Regulatory Issues http://www.house.gov/financialservices/hearing110/htwilmarth042607.pdf

[39] HR 627 was signed into law by President Obama as Public Law No: 111-24 on 22 May 2009.

[40] The final rule was published in the Federal Register a month later. 74 FR 18, page 5498 Thursday, January 29, 2009

- Requiring consumers to waive their right to pursue legal violations in the court system and forcing them to participate in arbitration proceedings if there is a dispute, often before an arbitrator with a conflict of interest; and
- Sharply raising consumers' interest rates because of a supposed problem a consumer is having paying another creditor. Even though few credit card issuers now admit to the discredited practice of "universal default," eight of the ten largest credit card issuers continue to permit this practice under sections in cardholder agreements that allow issuers to change contract terms at "any time for any reason."[41]

In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates, including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US Bancorp – for a wide variety of abusive practices over the past decade...[42]

The OCC and FRB were largely silent while credit card issuers expanded efforts to market and extend credit at a much faster speed than the rate at which Americans have taken on credit card debt. This credit expansion had a disproportionately negative effect on the least sophisticated, highest risk and lowest income households. It has also resulted in both relatively high losses for the industry and record profits. That is because, as mentioned above, the industry has been very aggressive in implementing a number of new – and extremely costly – fees and interest rates.[43] Although the agencies did issue significant guidance in 2003 to require issuers to increase the size of minimum monthly payments that issuers require consumers to pay,[44] neither agency has proposed any actions (or asked for the legal authority to do so) to rein in aggressive lending or unjustifiable fees and interest rates.

In addition, in 1995 the OCC amended a rule, with its action later upheld by the Supreme Court,[45] that allowed credit card banks to export fees nationwide, as if they were interest, resulting in massive increases in the size of penalty late and overdraft fees.

D. The Federal Reserve has Allowed Debit Card Cash Advances ("Overdraft Loans") without Consent, Contract, Cost Disclosure or Fair Repayment Terms

The FRB has refused to require banks to comply with the Truth in Lending Act (TILA) when they loan money to customers who are permitted to overdraw their accounts. While the FRB issued a staff commentary clarifying that TILA applied to payday loans, the Board refused to

---

[41] Testimony of Linda Sherry of Consumer Action, House Subcommittee on Financial Institutions and Consumer Credit, April 26, 2007.
[42] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, April 26, 2007.
[43] Testimony of Travis B. Plunkett of the Consumer Federation of America, Senate Banking Committee, January 25, 2007.
[44] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.
[45] The rule is at 12 C.F.R. § 7.4001(a)). The case is Smiley v. Citibank, 517 U.S. 735.

apply the same rules to banks that make nearly identical loans. As a result, American consumers spend at least $17.5 billion per year on cash advances from their banks without signing up for the credit and without getting cost-of-credit disclosures or a contract that the bank would in fact pay overdrafts. Consumers are induced to withdraw more cash than they have in their account at ATMs and spend more than they have with debit card purchases at point of sale. In both cases, the bank could simply deny the transaction, saving consumers average fees of $35 each time.

The FRB has permitted banks to avoid TILA requirements because bankers claim that systematically charging unsuspecting consumers very high fees for overdraft loans they did not request is the equivalent to occasionally covering the cost of a paper check that would otherwise bounce. Instead of treating short term bank loans in the same manner as all other loans covered under TILA, as consumer organizations recommended, the FRB issued and updated regulations under the Truth in Savings Act, pretending that finance charges for these loans were bank "service fees." In several dockets, national consumer organizations provided well-researched comments, urging the Federal Reserve to place consumer protection ahead of bank profits, to no avail.

As a result, consumers unknowingly borrow billions of dollars at astronomical interest rates. A $100 overdraft loan with a $35 fee that is repaid in two weeks costs 910 percent APR. The use of debit cards for small purchases often results in consumers paying more in overdraft fees than the amount of credit extended. The FDIC found last year that the average debit card point of purchase overdraft is just $20, while the sample of state banks surveyed by the FDIC charged a $27 fee. If that $20 overdraft loan were repaid in two weeks, the FDIC noted that the APR came to 3,520 percent.[46]

As the Federal Reserve has failed to protect bank account customers from unauthorized overdraft loans, banks are raising fees and adding new ones. In the most recent survey of the sixteen largest banks included in comments to the Federal Reserve and testimony before this Committee, CFA found that nine of the sixteen largest banks charge $35 for repeat overdrafts and half of the largest banks use a tiered fee structure to escalate fees over the year. For example, US Bank charges $19 for the first overdraft in a year, $35 for the second to fourth overdraft, and $37.50 thereafter. Ten of the largest banks charge a sustained overdraft fee, imposing additional fees if the overdraft and fees are not repaid within days. Bank of America began in June to impose a second $35 fee if an overdraft is not repaid within five days. As a result, a consumer who is permitted by her bank to overdraw by $20 with a debit card purchase can easily be charged $70 for a five day extension of credit.[47]

Cash advances on debit cards are not protected by the Truth in Lending Act prohibition on banks using set off rights to collect payment out of deposits into their customers' accounts. If the purchase involved a credit card, on the other hand, it would violate federal law for a bank to pay

[46] FDIC Study of Bank Overdraft Programs, Federal Deposit Insurance Corporation, November 2008 at v.

[47] Testimony of Travis B. Plunkett and Edmund Mierzwinski, Subcommittee on Financial Institutions and Consumer Credit, Legislative Hearing Regarding H. R. 627 and H. R. 1456, Appendix C. See also, Bank of America, "Important Information Regarding Changes to Your Account, page 2. Accessed online June 15, 2009. "Extended Overdrawn Balance Charge, June 5, 2009: For each time we determine your account is overdrawn by any amount and continues to be overdrawn for five or more consecutive business days, we will chage one fee of $35. This fee is in addition to applicable Overdraft Item Fees and NSF Returned Item Fees."

the balance owed from a checking account at the same bank. Banks routinely pay back debit card cash advances to themselves by taking payment directly out of consumers' checking accounts, even if those accounts contain entirely exempt funds such as Social Security.

The Federal Reserve is considering comments filed in yet another overdraft loan docket, this time considering whether to require banks to permit consumers to opt-out of fee-based overdraft programs, or, alternatively, to require banks to get consumers to opt in for overdrafts. This proposal would change Reg E which implements the Electronic Fund Transfer Act and would only apply to overdrafts created by point of sale debit card transactions and to ATM withdrawals, leaving all other types of transactions that are permitted to overdraw for a fee unaddressed. Consumer organizations urged the Federal Reserve to require banks to get their customers' affirmative consent, the same policy included in the recently-enacted credit card bill which requires affirmative selection for creditors to permit over-the-limit transactions for a fee.[48]

E. The Fed is Allowing A Shadow Banking System (Prepaid Cards), Outside of Consumer Protection Laws To Develop and Target the Unbanked and Immigrants; The OTS is Allowing Bank Payday Loans (Which Preempt State Laws) on Prepaid Cards.

The Electronic Funds Transfer Act requires key disclosures of fees and other practices, protects consumer bank accounts from unauthorized transfers, requires resolution of billing errors, gives consumers the right to stop electronic payments, and requires statements showing transaction information, among other protections. The EFTA is also the statute that will hold the new protections against overdraft fee practices that the Fed is writing.

Yet the Fed has failed to include most prepaid cards in the EFTA's protections, even while the prepaid industry is growing and is developing into a shadow banking system. In 2006, the Fed issued rules including payroll cards – prepaid cards that are used to pay wages instead of a paper check for those who do not have direct deposit to a bank account -- within the definition of the "accounts" subject to the EFTA. But the Fed permitted payroll card accounts to avoid the statement requirements for bank accounts, relying instead on the availability of account information on the internet. Forcing consumers to monitor their accounts online to check for unauthorized transfers and fees and charges is particularly inappropriate for the population targeted for these cards: consumers without bank accounts, who likely do not have or use regular internet access.

Even worse, the Fed refused to adopt the recommendations of consumer groups that self-selected payroll cards – prepaid cards that consumers shop for and choose on their own as the destination for direct deposit of their wages – should receive the same EFTA protections that employer designated payroll cards receive. The Fed continues to take the position that general prepaid cards are not protected by the EFTA.

This development has become all the more glaring as federal and state government agencies have moved to prepaid cards to pay many government benefits, from Social Security and Indian Trust Funds to unemployment insurance and state-collected child support. Some agencies, such as the Treasury Department when it created the Social Security Direct Express Card, have included in

[48] Federal Reserve Board, Docket No. R-1343, comments were due March 30, 2009.

their contract requirements that the issuer must comply with the EFTA. But not all have, and compliance is uneven, despite the fact that the EFTA itself clearly references and anticipates coverage of electronic systems for paying unemployment insurance and other non-needs tested government benefits.

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

Indeed, the Fed is not the only one that has recently dropped the ball on consumer protection on prepaid cards. One positive effort by the banking agencies in the past decade was the successful effort to end rent-a-bank partnerships that allowed payday lenders to partner with depositories to use their preemptive powers to preempt state payday loan laws.[49] But more recently, one prepaid card issuer, Meta Bank, has developed a predatory, payday loan feature – iAdvance -- on its prepaid cards that receive direct deposit of wages and government benefits. At a recent conference, an iAdvance official boasted that Meta Bank's regulator – the OTS – has been very "flexible" with them and "understands" this product.

F. Despite Advances in Technology, the Federal Reserve has Refused to Speed up Availability of Deposits to Consumers.

Despite rapid technological changes in the movement of money electronically, the adoption of Check 21 to speed check processing, and electronic check conversion at the cash register, the Federal Reserve has failed to shorten the amount of time that banks are allowed to hold deposits before they are cleared. Money flies out of bank accounts at warp speed. Deposits crawl in. Even cash that is deposited over the counter to a bank teller can be held for 24 hours before becoming available to cover a transaction. The second business day rule for local checks means that a low-income worker who deposits a pay check on Friday afternoon will not get access to funds until the following Tuesday. If the paycheck is not local, it can be held for five business days. This long time period applies even when the check is written on the same bank where it is deposited. Consumers who deposit more than $5,000 in one day face an added wait of about five to six more business days. Banks refuse to cash checks for consumers who do not have equivalent funds already on deposit. The combination of unjustifiably long deposit holds and banks' refusal to cash account holders' checks pushes low income consumers towards check cashing outlets, where they must pay 2 to 4 percent of the value of the check to get immediate access to cash.

Consumer groups have called on the Federal Reserve to speed up deposit availability and to prohibit banks from imposing overdraft or NSF fees on transactions that would not have overdrawn if deposits had been available. The Federal Reserve vigorously supported Check 21 which has speeded up withdrawals but has refused to reduce the time period for local and nonlocal check hold periods for consumers.

[49] Payday lending is so egregious that even the Office of the Comptroller of the Curreney refused to let storefront lenders hide behind their partner banks' charters to export usury.

G. The Federal Reserve Has Supported the Position of Payday Lenders and Telemarketing Fraud Artists by Permitting Remotely Created Checks (Demand Drafts) to Subvert Consumer Rights Under the Electronic Funds Transfer Act.

In 2005, the National Association of Attorneys General, the National Consumer Law Center, Consumer Federation of America, Consumers Union, the National Association of Consumer Advocates, and U. S. Public Interest Research Group filed comments with the Federal Reserve in Docket No. R-1226, regarding proposed changes to Regulation CC with respect to demand drafts. Demand drafts are unsigned checks created by a third party to withdraw money from consumer bank accounts. State officials told the FRB that demand drafts are frequently used to perpetrate fraud on consumers and that the drafts should be eliminated in favor of electronic funds transfers that serve the same purpose and are covered by protections in the Electronic Funds Transfer Act. Since automated clearinghouse transactions are easily traced, fraud artists prefer to use demand drafts. Fraudulent telemarketers increasingly rely on bank debits to get money from their victims. The Federal Trade Commission earlier this year settled a series of cases against telemarketers who used demand drafts to fraudulently deplete consumers' bank accounts. Fourteen defendants agreed to pay a total of more than $16 million to settle FTC charges while Wachovia Bank paid $33 million in a settlement with the Comptroller of the Currency.[50]

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

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

The use of remotely created checks is common in online payday loan contracts. ZipCash LLC "Promise to Pay" section of a contract included the disclosure that the borrower may revoke authorization to electronically access the bank account as provided by the Electronic Fund Transfer Act. However, revoking that authorization will not stop the lender from unilaterally

[50] 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.

withdrawing funds from the borrower's bank account. The contract authorizes creation of a demand draft which cannot be terminated. "While you may revoke the authorization to effect ACH debit entries at any time up to 3 business days prior to the due date, *you may not revoke the authorization to prepare and submit checks on your behalf until such time as the loan is paid in full.*" (Emphasis added.)[51]

H. The Federal Reserve Has Taken No Action to Safeguard Bank Accounts from Internet Payday Lenders.

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

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

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

As a result of inaction by the Federal Reserve, payday loans secured by repeat debit transactions undermine the protections of the Electronic Fund Transfer Act, which prohibits basing the extension of credit with periodic payments on a requirement to repay the loan electronically.[52] Payday loans secured by debit access to the borrower's bank account which cannot be cancelled also functions as the modern banking equivalent of a wage assignment – a practice which is prohibited when done directly. The payday lender has first claim on the direct deposit of the borrower's next paycheck or exempt federal funds, such as Social Security, SSI, or Veterans Benefit payments. Consumers need control of their accounts to decide which bills get paid first and to manage scarce family resources. Instead of using its authority to safeguard electronic access to consumers' bank accounts, the Federal Reserve has stood idly by as the online payday loan industry has expanded.

[51] Loan Supplement (ZipCash LLC) Form #2B, on file with CFA.
[52] Reg E, 12 C.F.R. § 205.10(e). 15 U.S.C. § 1693k states that "no person" may condition extension of credit to a consumer on the consumer's repayment by means of a preauthorized electronic fund transfer.

I. The Banking Agencies Have Failed to Stop Banks from Imposing Unlawful Freezes on Accounts Containing Social Security and Other Funds Exempt from Garnishment.

Federal benefits including Social Security and Veteran's benefits (as well as state equivalents) are taxpayer dollars targeted to relieve poverty and ensure minimum subsistence income to the nation's workers. Despite the purposes of these benefits, banks routinely freeze bank accounts containing these benefits pursuant to garnishment or attachment orders, and assess expensive fees – especially insufficient fund (NSF) fees – against these accounts.

The number of people who are being harmed by these practices has escalated in recent years, largely due to the increase in the number of recipients whose benefits are electronically deposited into bank accounts. This is the result of the strong federal policy to encourage this in the Electronic Funds Transfer Act. And yet, the banking agencies have failed to issue appropriate guidance to ensure that the millions of federal benefit recipients receive the protections they are entitled to under federal law.

J. The Comptroller of the Currency Permits Banks to Manipulate Payment Order to Extract Maximum Bounced Check and Overdraft Fees, Even When Overdrafts are Permitted.

The Comptroller of the Currency permits national banks to rig the order in which debits are processed. This practice increases the number of transactions that trigger an overdrawn account, resulting in higher fee income for banks. When banks began to face challenges in court to the practice of clearing debits according to the size of the debit -- from the largest to the smallest -- rather than when the debit occurred or from smallest to largest check, the OCC issued guidelines that allow banks to use this dubious practice.

The OCC issued an Interpretive Letter allowing high-to-low check clearing when banks follow the OCC's considerations in adopting this policy. Those considerations include: the cost incurred by the bank in providing the service; the deterrence of misuse by customers of banking services; the enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and the maintenance of the safety and soundness of the institution.[53] None of the OCC's considerations relate to consumer protection.

The Office of Thrift Supervision (OTS) addressed manipulation of transaction-clearing rules in the Final Guidance on Thrift Overdraft Programs issued in 2005. The OTS, by contrast, advised thrifts that transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees.[54] The Guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies. The Interagency "Best Practices" state: "Clearly explain to consumers that transactions may not be processed in the order in which they occurred, and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumers."[55]

---

[53] 12 C.F.R. 7.4002(b).

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

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

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. One of the OCC's "considerations" is that the overdraft policy should "deter misuse of bank services." Since banks deliberately program their computers to process withdrawals high-to-low and to permit customers to overdraw at the ATM and Point of Sale, there is no "misuse" to be deterred.

No federal bank regulator took steps to direct banks to change withdrawal order to benefit low-balance consumers or to stop the unfair practice of deliberately causing more transactions to bounce in order to charge high fees. 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.[56] Since ordering withdrawals largest first is likely to deplete scarce resources and trigger more overdraft and insufficient funds fees for many Americans, banks have no incentive to change this practice absent strong oversight by bank regulators.

K. The regulators have failed to enforce the Truth In Savings Act requirement that banks provide account disclosures to prospective customers.

According to a 2008 GAO report[57] to Rep. Carolyn Maloney, then-chair of the Financial Institutions and Consumer Credit subcommittee, based on a secret shopper investigation, banks don't give consumers access to the detailed schedule of account fee disclosures as required by the 1991 Truth In Savings Act. From GAO:

> *Regulation DD, which implements the Truth in Savings Act (TISA), requires depository institutions to disclose (among other things) the amount of any fee that may be imposed in connection with an account and the conditions under which such fees are imposed. [...] GAO employees posed as consumers shopping for checking and savings accounts [...] Our visits to 185 branches of depository institutions nationwide suggest that consumers shopping for accounts may find it difficult to obtain account terms and conditions and disclosures of fees upon request prior to opening an account. Similarly, our review of the Web sites of the banks, thrifts, and credit unions we visited suggests that this information may also not be readily available on the Internet. We were unable to obtain, upon request, a comprehensive list of all checking and savings account fees at 40 of the branches (22 percent) that we visited. [...]The results are consistent with those reported by a consumer group [U.S. PIRG] that conducted a similar exercise in 2001.*

This, of course, keeps consumers from being able to shop around and compare prices. As cited by GAO, U.S. PIRG then complained of these concerns in a 2001 letter to then Federal Reserve

---

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

[57] "Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts," GAO-08-281, January 2008, available at http://www.gao.gov/new.items/d08281.pdf (last visited 21 June 2009).

Board Chairman Alan Greenspan.[58] No action was taken. The problem is exacerbated by a 2001 Congressional decision to eliminate consumers' private rights of action for Truth In Savings violations.

L. The Federal Reserve actively campaigned to eliminate a Congressional requirement that it publish an annual survey of bank account fees.

One of the consumer protections included in the 1989 savings and loan bailout law known as the Financial Institutions Reform, Recovery and Enforcement Act was Section 1002, which required the Federal Reserve to publish an annual report to Congress on fees and services of depository institutions. The Fed actively campaigned in opposition to the requirement and succeeded in convincing Congress to sunset the survey in 2003.[59] Most likely, the Fed was unhappy with the report's continued findings that each year bank fees increased, and that each year, bigger banks imposed the biggest fees.

SECTION 4. STRUCTURE AND JURISDICTION OF A CONSUMER FINANCIAL PROTECTION AGENCY

If the CFPA is to be effective in its mission, it must be structured so that it is strong and independent with full authority to protect consumers. Our organizations have strongly endorsed two complementary proposals regarding what should be the agency's jurisdiction, responsibilities, rule-writing authority, enforcement powers and methods of funding. Earlier this year, Representatives Delahunt and Brad Miller proposed H.R. 1705, which would create a new Financial Product Safety Commission with jurisdiction over credit, savings and payment products. (Senator Richard Durbin has offered the same proposal, S. 566.) Just last week, President Obama offered a very strong and detailed proposal to create a CFPA with a broad jurisdiction to include not only the above-mentioned products, but also existing fair lending and community reinvestment laws.[60]

In its work to protect consumers and the marketplace from abuses, the CFPA as envisioned by the Administration would have a full set of enforcement and analytical tools. The first tool would be that the CFPA could gather information about the marketplace so that the agency itself could 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 or to offer advice to consumers directly about the risk of a variety of products on the market. For some of these 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. A second tool would be to address and rein in

[58] The 1 November 2001 letter from Edmund Mierzwinski, U.S. PIRG, to Greenspan is available at http://static.uspirg.org/reports/bigbanks2001/greenspanltr.pdf (last visited 21 June 2009). In that letter, we also urged the regulators to extend Truth In Savings disclosure requirements to the Internet. No action was taken.
[59] The final 2003 report to Congress is available here http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf (last visited 21 June 2009). The 1997-2003 reports can all be accessed from this page, http://www.federalreserve.gov/pubs/reports_other.htm (last visited 21 June 2009).
[60] "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," Department of the Treasury, June 17, 2009, pages 55-70.

deceptive marketing practices or require improved disclosure of terms. The third tool would be the identification and regulatory facilitation of "plain vanilla," low risk products that should be widely offered. The fourth tool would be to restrict or ban specific product features or terms that are harmful or not suitable in some circumstances, or that don't meet ordinary consumer expectations. Finally, the CFPA would also have the ability to prohibit dangerous financial products. We can only wonder how much less pain would have been caused for our economy if a regulatory agency had been actively exercising the latter two powers during the run up to the mortgage crisis.

A. Agency Jurisdiction. Under the Administration proposal, the agency will govern the sale and marketing of credit, deposit and payment products and services and related products and services, and will ensure that they are being offered in a fair, sustainable and transparent manner. This should include debit, pre-paid debit, and stored value cards; loan servicing, collection, credit reporting and debt-related services (such as credit counseling, mortgage rescue plans and debt settlement) offered to consumers and small businesses. Our organizations support this jurisdiction because credit products can have different names and be offered by different types of entities, yet still compete for the same customers in the same marketplace. Putting the oversight of competing products under one set of minimum federal rules regardless of who is offering that product will protect consumers, as well as promote innovation provides consumers with valuable options and spurs vigorous competition

As with the Administration and H.R. 1705, we recommend against granting this agency jurisdiction over investment products that are marketed to retail investors, such as mutual funds. While there is a surface logic to this idea, we believe it is impractical and could inadvertently undermine investor protections. Giving the agency responsibility for investment products that is comparable to the proposed authority it would have over credit products would require the agency to add extensive additional staff with expertise that differs greatly from that required for oversight of credit products. Apparently simple matters, such as determining whether a mutual fund risk disclosure is appropriate or a fee is fair, are actually potentially quite complex and would require the new agency to duplicate expertise that already exists within the SEC. Moreover, it would not be possible simply to transfer the staff with that expertise to the new agency, since the SEC would continue to need that expertise on its own staff in order to fulfill its responsibilities for oversight of investment advisers and mutual fund operations. In addition, unless the new agency was given responsibility for all investment products and services a broker might recommend, brokers would be able to work around the new protections with potentially adverse consequences for investors. A broker who wanted to avoid the enhanced disclosures and restrictions required when selling a mutual fund, for example, could get around them by recommending a separately managed account. The investor would likely pay higher fees and receive fewer protections as a result. For these reasons, we believe the costs and risks of this proposal outweigh the potential benefits.

The Administration plan is silent on whether the agency should have any authority over insurance products. We would recommend that strong consideration be given to providing the agency with jurisdiction over insurance products that are central or ancillary to credit transactions, such as credit, title, mortgage and forced place insurance. This would provide the agency with holistic jurisdiction over the entire credit transaction, including ancillary services often sold with or in connection with the credit. Additionally, there is ample evidence of significant consumer abuses in many of these lines of insurance, including low loss ratios, high mark ups, and "reverse competition" where the insurer competes for the business of the lender, rather than of the insurance consumer.[61] This federal jurisdiction could apply without interfering with the licensing and rate oversight role of the states.

The United States has never sufficiently addressed the problems and challenges of lending discrimination and redlining practices, the vestiges of which include the present day unequal, two-tiered financial system that forces minority and low-income borrowers to pay more for financial services, get less value for their money, and exposes them to greater risk. It is therefore, imperative that the Consumer Financial Protection Agency also focus in a concentrated way on fair lending issues. To that end, the Agency must have a comprehensive Office of Civil Rights which would ensure that no federal agency perpetuated unfair practices and that no member of the financial industry practices business in a way that perpetuates discrimination. Compliance with civil rights statutes and regulations must be a priority at each federal agency that has financial oversight or that enforces a civil rights statute. There must be effective civil rights enforcement of all segments of the financial industry. Moreover, each regulatory and enforcement agency must undertake sufficient reporting and monitoring activities to ensure transparency and hold the agencies accountable. A more detailed description of the civil rights functions that must be undertaken at the CFPA and at other regulatory and enforcement agencies can be found in the Civil Rights Policy Paper available at www.ourfinancialsecurity.org.[62]

B. Rule-Writing . Under the Administration proposal and H.R. 1705, the agency will have broad rule-making authority to effectuate its purposes, including the flexibility to set standards that are adequate to address rapid evolution and changes in the marketplace. Such authority is not a threat to innovation, but rather levels the playing field and protects honest competition, as well as consumers and the economy.

The Administration's plan also provides rule-making authority for the existing consumer protection laws related to the provision of credit would be transferred to this agency, 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 Fund Transfer Act (EFTA), and Fair Debt Collection Practices Act (FDCPA). (H.R. 1705 is not explicit on this matter.) Current rule-writing authority for nearly 20 existing laws is spread out among at least seven agencies. Some authority is exclusive, some joint, and some is concurrent. However, this hodge-podge of statutory authority has led to fractured and often ineffectual enforcement of these laws. It has also led to a situation where federal rule-writing agencies may be looking at just part of a credit transaction when writing a rule, without considering how the various rules for different parts of the transaction effect the marketplace and the whole transaction. The CFPA with expertise, jurisdiction and oversight that cuts across all segments of the financial products marketplace, will be better able to see

[61] Testimony of J. Robert Hunter, Director of Insurance, Consumer Federation of America, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the U.S. House Financial Services Committee, October 30, 2007, pages 8-9.
[62] http://ourfinancialsecurity.org/issues/leveling-the-playing-field/

inconsistencies, unnecessary redundancies, and ineffective regulations. As a market-wide regulator, it would also ensure that critical rules and regulations are not evaded or weakened as agencies compete for advantage for the entities they regulate.

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

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

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

First, the CFPA itself will have the tools, the mission and the focus necessary to enforce its mandate. The CFPA will have a range of enforcement tools under the Administration proposal and H.R. 1705. The Administration, for example, would give the agency examination and primary compliance authority over consumer protection matters. This will allow the CFPA to look out for problems and address them in its supervisory capacity. But unlike the banking agencies, whose mission of looking out for safety and soundness led to an exclusive reliance on supervision, the CFPA will have no conflict of interest that prevents it from using its enforcement authority when appropriate. Under both the Administration proposal and H.R. 1705, the agency will have the full range of enforcement powers, including subpoena authority; independent authority to enforce violations of the statues it administers; and civil penalty authority.

Second, both proposals allow states to enforce federal consumer protection laws and the CFPA's rules. As stated in detail in Section 5, states are often closer to emerging threats to consumers and the marketplace. They routinely receive consumer complaints and monitor local practices which will permit state financial regulators to see violations first, spot local trends, and augment the CFPA's resources. The CFPA will have the authority to intervene in actions brought by states, but it can conserve its resources when appropriate. As we have seen in this crisis, states were often the first to act.

Finally, consumers themselves are an essential, in some ways the most essential, element of an enforcement regime. Recourse for individual consumers must, of course, be a key goal of a new consumer protection system. The Administration's plan appropriately states that the private enforcement provisions of existing statutes will not be disturbed, and H.R. 1705 also leaves these protections intact.

The Administration's plan does not address the enforceability of new CFPA rules, but it is equally critical that the consumers who are harmed by violations of these rules be able to take action to protect themselves. H.R. 1705 provides a right of action for consumers to enforce these rules.

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

- No matter how vigorous and how fully funded a new CFPA is, it will not be able to directly redress the vast majority of violations against individuals. The CFPA will likely have thousands of institutions within its jurisdiction. It cannot possibly examine, supervise or enforce compliance by all of them.

- Individuals have much more complete information about the affect of products and practices, and are in the best position to identify violations of laws, take action, and redress the harm they suffer. An agency on the outside looking in often will not have sufficient details to detect abusive behavior or to bring an enforcement action.

- Individuals are an early warning system that can alert states and the CFPA of problems when they first arise, before they become a national problem requiring the attention of a federal agency. The CFPA can monitor individual actions and determine when it is necessary to step in.

- Bolstering public enforcement with private enforcement conserves public resources. A federal agency cannot and should not go after every individual violation.

- Consumer enforcement is a safety net that ensures compliance and accountability after this crisis has passed, when good times return, and when it becomes more tempting for regulators to think that all is well and to take a lighter approach.

- The Administration's plan rightly identifies mandatory arbitration clauses as a barrier to fair adjudication and effective redress. We strongly agree -- but it is also critically important to access to justice that consumers have the right to enforce a rule.

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

Conversely, the statutes that lack private enforcement mechanisms are notable for the lack of compliance. The most obvious example is the prohibition against unfair and deceptive practices in Section 5 of the FTC Act. Though the banking agencies eventually identified unfair and deceptive mortgage and credit card practices that should be prohibited (after vigorous congressional prodding), individuals were subject to those practices for years with no redress because they could not enforce the FTC Act. Not only consumers, but the entire economy and even financial institutions would have been much better off if consumers had been able to take action earlier on, when the abusive practices were just beginning.

Two other statutes that lack private enforcement mechanisms are also notable for the lack of compliance. The right of action under the Truth in Saving Act was eliminated in 2001. As discussed above, a 2008 GAO survey found that 22% of depositories were not complying with TISA's simple disclosure requirements. That is a shockingly high number and shows the effect of the lack of enforcement.

Similarly, RESPA's requirement that homebuyers be given a good faith estimate of closing costs ahead of time also lacks private enforcement, with predictable results: it is honored in the breach. Estimates are often given to homebuyers only moments before a closing, too late to do any good, and when they are given in advance they often bear little resemblance to the actual closing costs. In HUD's latest proposed rulemaking, it cites as one reason the need to make the GFE binding is the prevalence of "surprise 'junk fees'" at closing.[63]

In the debt collection area, the FTC received 78,000 complaints against debt collectors last year, an industry that consistently tops the FTC's list of complaints. Though the weak penalties in the Act are insufficient to deter wrongdoing, consumers at least have the ability to seek redress directly without waiting for the FTC to Act.

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

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

D. Product evaluation, approval and monitoring. Under the Administration's proposal and HR. 1705, the agency would have significant enforcement and data collection authority to evaluate and to remove, restrict or prevent unfair, deceptive, abusive, discriminatory or unsustainable products, features or practices. The agency could also evaluate and promote practices, products and features that facilitate responsible and affordable credit, payment devices, asset-building and savings. Finally, the agency could assess the risks of both specific products and practices and overall market developments for the purpose of identifying, reducing and preventing excessive risk, (e.g. monitoring longitudinal performance of mortgages with certain

[63] 73 F.R. 14020, 14034

features for excessive failure rates; and monitoring the market share of products and practices that present greater risks, such as weakening underwriting.)

Specifically, we would recommend that the agency take the following approach to product evaluation, approval and monitoring under the proposal offered by the Administration and H.R. 1705:

- Providers of covered products and services could be required to file adequate data and information to allow the agency to make a determination regarding the fairness, sustainability and transparency of products, features and practices. This could include data on product testing, risk modeling, credit performance over time, customer knowledge and behavior, target demographic populations, etc. Providers of products and services that are determined in advance to represent low risk would have to provide de minimus or no information to the agency.
- "Plain vanilla" products, features or practices that are determined to be fair, transparent and sustainable would be determined to be presumptively in compliance and face less regulatory scrutiny and fewer restrictions.
- Products, features or practices that are determined to be potentially unfair, unsustainable, discriminatory, deceptive or too complex for its target population might be required to meet increased regulatory requirements and face increased enforcement and remedies.
- In limited cases, products, features or practices that are deemed to be particularly risky could face increased filing and data disclosure requirements, limited roll-out mandates, post-market evaluation requirements and, possibly, a stipulation of pre-approval before they are allowed to enter or be used in the marketplace. Harvard Professor Daniel Carpenter has offered some thoughtful ideas on how such an ex ante approval process might work fairly and effectively.[64]
- The long-term performance of various types of products and features would be evaluated, and results made transparent and available broadly to the public, as well as to providers, Congress, and the media to facilitate informed choice.
- The Agency should hold periodic public hearings to examine products, practices and market developments to facilitate the above duties, including the adequacy of existing regulation and legislation, and the identification of both promising and risky market developments. These hearings would be especially important in examination of new market developments, such as, for example, where credit applications will soon be submitted via a mobile phone, for example, and consumer dependence on the Internet for conducting financial transactions is expected to grow dramatically. In such hearings, in rule-makings, and in other appropriate circumstances, the Agency should ensure that there is both opportunity and means for meaningful public input, including consideration of existing models such as funded public interveners.

E. Funding. The Administration proposal is fairly vague on how it should be funded. H.R. 1705 would fund the agency through Congressional appropriations. The major goals for the agency would be to have a stable (not volatile) funding base that is sufficient to support robust

[64] "Particulars of a Financial Product Safety Commission," Professor Daniel Carpenter, Director of the Center for Political Studies, Harvard University, The Tobin Project.

enforcement and is not subject to political manipulation by regulated entities. Funding from a variety of sources, as well as a mix of these sources, should be considered, including Congressional appropriations, user fees or industry assessments, filing fees, priced services (such as for compliance examinations) and transaction-based fees. See Appendix 4 for a comparison of current agency funding and fee structures.

None of these funding sources is without serious weaknesses. Industry assessments or user fees can provide the regulated entity with considerable leverage over the budget of the agency and facilitate regulatory capture of the agency, especially if the regulated party is granted any discretion over the amount of the assessment (or is allowed to decide who regulates them and shift its assessment to another agency.) Transaction-based fees can be volatile and unpredictable, especially during economic downturns. Filing fees can also decline significantly if economic activity falls. Congressional appropriations, as we have seen with other federal consumer protection agencies over the last half-century, can be fairly easily targeted for reduction or restriction by well funded special interests if these interests perceive that the agency has been too effective or aggressive in pursing its mission.

If an industry-based funding method is used, it should ensure that all providers of covered products and services are contributing equally based on their size and the nature of the products they offer. A primary consideration in designing any industry-based funding structure is that certain elements of these sectors should not be able to evade the full funding requirement, through charter shopping or other means. If such requirements can be met, we would recommend a blended funding structure from multiple sources that requires regulated entities to fund the baseline budget of the agency and Congressional appropriations to supplement this budget if the agency demonstrates an unexpected or unusual demand for its services.

F. Consumer Complaints. As the Administration proposal details, the agency should receive, analyze and work to resolve all federally-directed complaints regarding credit or payment products, features or practices under the agency's jurisdiction. Ideally, the agency should be the sole repository of consumer complaints on products, features or practices within its jurisdiction, and should ensure that this is a role that is readily visible to consumers, simple to access and responsive. The agency should also be required to conduct real-time analysis of consumer complaints regarding patterns and practices in the credit and payment systems industries and to apply these analyses when writing rules and enforcing rules and laws. From the Foundation document:

> *The CFPA should have responsibility for collecting and tracking complaints about consumer financial services and facilitating complaint resolution with respect to federally-supervised institutions. Other federal supervisory agencies should refer any complaints they receive on consumer issues to the CFPA; complaint data should be shared across agencies....*[65]

G. Federal preemption of state laws. As the Administration proposal states, the agency should establish minimum standards within its jurisdictions. CFPA rules would preempt weaker state laws, but states that choose to exceed the standards established by the CFPA could do so. The

[65] "A New Foundation", Pages 59-60, The Obama Administration, June 2009

agency's rules would preempt statutory state law only when it is impossible to comply with both state and federal law.

We also strongly agree with the Administration recommendation that federally chartered institutions be subject to nondiscriminatory state consumer protection and civil rights laws to the same extent as other financial institutions. A clear lesson of the financial crisis, which pervades the Administration's plan, is that protections should apply consistently across the board, based on the product or service that is being offered, not who is offering it.

Restoring the viability of our background state consumer protection laws is also essential to the flexibility and accountability of the system in the long run. The specific rules issued by the CFPA and the specific statutes enacted by Congress will never be able to anticipate every innovative abuse designed to avoid those rules and statutes. The fundamental state consumer protection laws, both statutory and common law, against unfair and deceptive practices, fraud, good faith and fair dealing, and other basic, longstanding legal rules are the ones that spring up to protect consumers when a new abuse surfaces that falls within the cracks of more specific laws. We discuss preemption in greater detail in the next section.

H. Consumer Empowerment: As discussed briefly above, the CFPA should have the authority to grant intervener funding to consumer organizations to fund expert participation in its stakeholder activities. The model has been used successfully to fund consumer group participation in state utility ratemaking. Second, a government-chartered consumer organization should be created by Congress to represent consumers' financial services interests before regulatory, legislative, and judicial bodies, including before the CFPA. This organization could be financed through voluntary user fees such as a consumer check-off included in the monthly statements financial firms send to their customers. It would be charged with giving consumers, depositors, small investors and taxpayers their own financial reform organization to counter the power of the financial sector, and to participate fully in rulemakings, adjudications, and lobbying and other activities now dominated by the financial lobby.[66]

SECTION 5. REBUTTAL TO ARGUMENTS AGAINST THE CFPA

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

Opponents of reform of the financial system have made several arguments against the establishment of a strong independent Consumer Financial Protection Agency. Indeed, the new CFPA appears to be among their main targets for criticism, compared with other elements of the

[66] As his last legislative activity, in October 2002. , Senator Paul Wellstone proposed establishment of such an organization, the Consumer and Shareholder Protection Association, S 3143.

reform plan. They have basically made six arguments. They have argued that regulators already have the powers it would be given, that it would be a redundant layer of bureaucracy, that consumer protection cannot be separated from supervision, that it will stifle innovation, that it would be unfair to small institutions and that its anti-preemption provision would lead to balkanization. Each of these arguments is wrong.

A. Opponents argue that regulators already have the powers that the CFPA would be given.

This argument is effectively a defense of the status quo, which has led to disastrous results. Current regulators already have between them some of the powers that the new agency would be given, but they haven't used them. Conflicts of interest and missions and a lack of will have worked against consumer enforcement. While our section above goes into greater detail on the failures of the regulators, two examples will illustrate:

- **NO HOEPA RULES UNTIL 2008:** 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.[67]

- **NO ACTION ON ABUSIVE CREDIT CARD PRACTICES UNTIL LATE 2008:** Further, between 1995 and 2007, the Office of the Comptroller of Currency issued only one public enforcement action against a Top Ten credit card bank (and then only after the San Francisco District Attorney had brought an enforcement action) and only one other public enforcement order against a mortgage subsidiary of a large national bank (only after HUD initiated action). In that period, "the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws.[68]" The OCC's failure to act on rising credit card complaints at the largest national banks triggered Congress to investigate, resulting in passage of the 2009 Credit Card Accountability, Responsibility and Disclosure Act (CARD Act).[69] While that law was under consideration, other federal regulators used their authority under the Federal Trade Commission Act to propose and finalize a similar rule.[70] By contrast, the OCC requested the addition of two significant loopholes to a key protection of the proposed rule.

Federal bank regulators currently face at least two conflicts. First, their primary mission is prudential supervision, with enforcement of consumer laws taking a back seat. Second, charter shopping in combination with agency funding by regulated entities encourages a regulatory race to the bottom as banks choose the regulator of least resistance. In particular, the Office of the Comptroller of the Currency and the Office of Thrift Supervision have failed utterly to protect

[67] 73 FR 147, Page 44522, Final HOEPA Rule, 30 July 2008
[68] Testimony of Professor Arthur Wilmarth, 26 April 2007, before the Subcommittee on Financial Institutions and Consumer Credit, hearing on Credit Card Practices: Current Consumer And Regulatory Issues http://www.house.gov/financialservices/hearing110/htwilmarth042607.pdf
[69] HR 627 was signed into law by President Obama as Public Law No: 111-24 on 22 May 2009.
[70] The final rule was published in the Federal Register a month later. 74 FR 18, page 5498 Thursday, January 29, 2009

consumers, let alone the safety and soundness of regulated entities. Instead, they competed with each other to minimize consumer protection standards as a way of attracting institutions to their charters, which meant that they tied their own hands and failed to fulfill their missions. (Note: they weren't trying to fail, but that was a critical side effect of the charter competition).

Establishing a new consumer agency that has consumer protection as its only mission and that regulated firms cannot hide from by charter-shopping is the best way to guarantee that consumer laws will receive sustained, thoughtful, proactive attention from a federal regulator.

B. Opponents argue that the CFPA would be a redundant layer of bureaucracy.

We do not propose a new regulatory agency because we seek more regulation, but because we seek better regulation. The very existence of an agency devoted to consumer protection in financial services will be a strong incentive for institutions to develop strong cultures of consumer protection.

– **The Obama Administration, *Financial Regulatory Reform: A New Foundation,*** page 57

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.*[71]

And today, a single transaction such as a mortgage loan is subject to regulations promulgated by several agencies and may be made or arranged by an entity supervised by any of several other agencies. Under the CFPA, one federal agency will write the rules and see that they are followed.

C. Opponents argue that consumer protection cannot be separated from supervision.

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

---

[71] The Obama Administration, Financial Regulatory Reform: A New Foundation, page 57

while the length of time banks hold checks under Regulation CC may be a consumer issue, "fraud and payments systems operational issues" are not.[72]

Again, as the administration points out in its carefully thought-out blueprint for the new agency:

> *The CFPA would be required to consult with other federal regulators to promote consistency with prudential, market, and systemic objectives. Our proposal to allocate one of the CFPA's five board seats to a prudential regulator would facilitate appropriate coordination.*[73]

We concur that the new agency should have full rulemaking authority over all consumer statutes. The checks and balances proposed by the administration, including the consultative requirement and the placement of a prudential regulator on its board and its requirement to share confidential examination reports with the prudential regulators will address these concerns. In addition, the Administration's plan provides the CFPA with full compliance authority to examine and evaluate the impact of any proposed consumer protection measure on the bottom line of affected financial institutions. While collaboration between regulators will be very important, it should not be used as an excuse by either the CFPA or other regulators to unnecessarily delay needed action. The GAO, for example, has identified time delays in interagency processes as a contributor to the mortgage crisis.[74] This is why it is important that the CFPA retain final rulemaking authority, as proposed under the Administration's plan. Such authority, along with the above mentioned mandates, will ensure that both the CFPA and the federal prudential regulator collaborate on a timely basis.

For most of the last twenty years, bank regulators have shown little understanding of consumer protection and have not used powers they have long held. OCC's traditional focus and experience has been on safety and soundness, rather than consumer protection.[75] Its record on consumer protection enforcement is one of little experience and little evidence of expertise. In contrast, as already noted, the states have long experience in enforcement of non-preempted state consumer protection laws. OCC admits that it was not until 2000 that it invoked long-dormant consumer protection authority provided by the 1975 amendments to the Federal Trade Commission Act.[76]

---

[72] Letter of 28 May 2009 from the American Bankers Association to Treasury Secretary Tim Geithner, available at http://www.aba.com/NR/rdonlyres/4640E4F1-4BC9-4187-B9A6-E3705DD9B307/60161/GeithnerMay282009.pdf (last viewed 21 June 2009).

[73] The Obama Administration, Financial Regulatory Reform: A New Foundation, page 59

[74] "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.

[75] *See* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 Temp. L. Rev. 1, 73 (2005).

[76] *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

D. Opponents argue that a single agency focused on consumer protection will "stifle innovation" in the financial services marketplace.

To the contrary, protecting consumers from traps and tricks when they purchase credit, savings or payment products should encourage confidence in the financial services marketplace and spur innovation. 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.*[77]

E. Opponents argue that the CFPA would place an unfair regulatory burden on small banks and thrifts.

Small banks and thrifts that offer responsible credit and payment products should face a lower regulatory burden under regulation by a CFPA. Members of Congress, the media and consumer organizations have properly focused on the role of large, national banks and thrifts in using unsustainable, unfair and deceptive mortgage and credit card lending practices. In contrast, many smaller banks and thrifts have justifiably been praised for their more responsible lending practices in theses areas. In such situations, the CFPA would promote fewer restrictions and less oversight for "plain vanilla" products that are simple, straight-forward and fair.

However, it is also important to note that some smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA. More than 75 percent of state chartered banks surveyed by the FDIC, for example, automatically enrolled customers in high-cost overdraft loan programs without consumers' consent. Some of these banks deny consumers the ability to even opt out of being charged high fees for overdraft transactions that the banks chose to permit. Smaller banks have also been leaders in facilitating high-cost refund anticipation loans, in helping payday lenders to evade state loan restrictions and in offering deceptive and extraordinarily expensive "fee harvester" credit cards. (See appendix 1 for more information.)

---

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").

[77] "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.

F. Opponents argue that the agency's authority to establish only a federal floor of consumer protection would lead to regulatory inefficiency and balkanization.

The loudest opposition to the new agency will likely be aimed at the administration's sensible proposal that CFPA's rules be a federal floor and that the states be allowed to enact stronger consumer laws that are not inconsistent, as well as to enforce both federal and state laws. This proposed return to common sense protections is strongly endorsed by consumer advocates and state attorneys general.

We expect the banks and other opponents to claim that the result will be 51 balkanized laws that place undue costs on financial institutions that are then passed onto consumers in the form of higher priced or less available loans. In fact, this approach is likely to lead to a high degree of regulatory uniformity (if the CFPA sets high minimum standards,) greater protections for consumers without a significant impact on cost or availability, increased public confidence in the credit markets and financial institutions, and less economic volatility. For example, comprehensive research by the Center for Responsible Lending found that subprime mortgage loans in states that acted vigorously to rein in predatory mortgage lending before they were preempted by the OCC had fewer abusive terms. In states with stronger protections, interest rates on subprime mortgages did not increase, and instead, sometimes decreased, without reducing the availability of these loans.[78] Additionally, as Nobel Laureate Joseph Stiglitz has pointed out, the cost of regulatory duplication is miniscule to the cost of the regulatory failure that has occurred.[79]

It is also clear that the long campaign of preemption by the OTS and OCC, culminating in the 2004 OCC rules, contributed greatly to the current predatory lending crisis. After a discussion of the OCC's action eliminating state authority, we will discuss more generally why federal consumer law should always be a floor.

F.1 The OCC's Preemption of State Laws Exacerbated The Crisis

In 2000-2004, the OCC worked with increasing aggressiveness to prevent the states from enforcing state laws and stronger state consumer protection standards against national banks and their operating subsidiaries, from investigating or monitoring national banks and their operating subsidiaries, and from seeking relief for consumers from national banks and subsidiaries.

These 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, plus briefs in court cases supporting national banks' efforts to block state consumer protections.

---

[78] Wei Li and Keith S. Ernst, Center for Responsible Lending, The Best Value in the Subprime Market: State Predatory Lending Reforms, February, 23, 2006, page 6.

[79] "Some worry about the cost of duplication. But when we compare the cost of duplication to the cost of damage from inadequate regulation—not just the cost to the taxpayer of the bail-outs but also the costs to the economy from the fact that we will be performing well below our potential—it is clear that there is not comparison," Testimony of Dr. Joseph E. Stiglitz, Professor, Columbia University, before the House Financial Services Committee, October 21, 2008, page 16.

In a letter to banks on November 25, 2002, the OCC openly instructed banks that they "should contact the OCC in situations where a State official seeks to assert supervisory authority or enforcement jurisdiction over the bank."[80] The banks apparently accepted this invitation, notifying the OCC of state efforts to investigate or enforce state laws. The OCC responded with letters to banks and to state banking agencies asserting that the states had no authority to enforce state laws against national banks and subsidiaries, and that the banks need not comply with the state laws.[81]

For example, the OCC responded to National City Bank of Indiana, and its operating subsidiaries, National City Mortgage Company, First Franklin Financial Corporation, and Altegra Credit Company, regarding Ohio's authority to monitor their mortgage banking and servicing businesses. That opinion concluded that "the OCC's exclusive visitorial powers preclude States from asserting supervisory authority or enforcement jurisdiction over the Subsidiaries."[82]

The OCC responded to Bank of America, N.A., and its operating subsidiary, BA Mortgage LLC, regarding California's authority to examine the operating subsidiary's mortgage banking and servicing businesses and whether the operating subsidiary was required to maintain a license under the California Residential Mortgage Lending Act. That opinion concluded that "the Operating Subsidiary also is not subject to State or local licensing requirements and is not required to obtain a license from the State of California in order to conduct business in that State."[83]

The OCC wrote the Pennsylvania Department of Banking, stating that Pennsylvania does not have the authority to supervise an unnamed national bank's unnamed operating subsidiary which engages in subprime mortgage lending.[84] (The national bank and operating subsidiary were not named because this interpretive letter was unpublished.)

---

80. Office of the Comptroller of the Currency, Interpretive Letter No. 957 n.2 (Jan. 27, 2003) (citing OCC Advisory Letter 2002-9 (Nov. 25, 2002)) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int957.doc , and available at 2003 OCC Ltr. LEXIS 11).

81. *E.g.*, Office of the Comptroller of the Currency, Interpretive Letter No. 971 (Jan. 16, 2003) (letter to Pennsylvania Department of Banking, that it does not have the authority to supervise an unnamed national bank's unnamed operating subsidiary which engages in subprime mortgage lending (unnamed because the interpretive letter is unpublished) (viewed Jun. 19, 2009, at http://comptrollerofthecurrency.gov/interp/sep03/int971.doc, and available at 2003 OCC QJ LEXIS 107).

82. Office of the Comptroller of the Currency, Interpretive Letter No. 958 (Jan. 27, 2003) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int958.pdf, and available at 2003 OCC Ltr. LEXIS 10).

83. The OCC's exclusive visitorial powers preclude States from asserting supervisory authority or enforcement jurisdiction over the Subsidiaries (Jan. 27, 2003) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int957.doc), and available at 2003 OCC Ltr. LEXIS 11).

84. Office of the Comptroller of the Currency, Interpretive Letter No. 971 (unpublished) (Jan. 16, 2003) (viewed Jun. 19, 2009, at http://comptrollerofthecurrency.gov/interp/sep03/int971.doc, and available at 2003 OCC QJ LEXIS 107).

The OCC even issued a formal preemption determination and order, stating that "the provisions of the GFLA [Georgia Fair Lending Act] affecting national banks' real estate lending are preempted by Federal law" and "issuing an order providing that the GFLA does not apply to National City or to any other national bank or national bank operating subsidiary that engages in real estate lending activities in Georgia."[85]

As Business Week pointed out in 2003, not only did states attempt to pass laws to stop predatory lending, they also attempted to warn federal regulators that the problem was getting worse.[86]

> *A number of factors contributed to the mortgage disaster and credit crunch. Interest rate cuts and unprecedented foreign capital infusions fueled thoughtless lending on Main Street and arrogant gambling on Wall Street. The trading of esoteric derivatives amplified risks it was supposed to mute. One cause, though, has been largely overlooked: the stifling of prescient state enforcers and legislators who tried to contain the greed and foolishness. They were thwarted in many cases by Washington officials hostile to regulation and a financial industry adept at exploiting this ideology.*

Under the proposal, critical authority will be returned to those attorneys general, who have demonstrated both the capacity and the will to enforce consumer laws. In addition to losing the states' experience in enforcing such matters, depriving the states of the right to enforce their non-preempted consumer protection laws raises serious concerns of capacity. According to a recent congressional report, state banking agencies and state attorneys general offices employ nearly 700 full time staff to monitor compliance with consumer laws, more than seventeen times the number of OCC personnel then allocated to investigate consumer complaints.[87]

Earlier this year, Illinois Attorney General Lisa Madigan testified before this committee and outlined the numerous major, multi-state cases against predatory lending that have been brought by her office and other state offices of attorneys general. However, she included this caveat:

> *State enforcement actions have been hamstrung by the dual forces of preemption of state authority and lack of federal oversight. The authority of state attorneys general to enforce consumer protection laws of general applicability was challenged at precisely the time it was most needed – when the amount of subprime lending exploded and riskier and riskier mortgage products came into the marketplace.*[88]

---

[85] Office of the Comptroller of the Currency, Preemption Determination and Order, 68 Fed. Reg. 46,264, 46,264 (Aug. 5, 2003).

[86] Robert Berner and Brian Grow, "They Warned Us About the Mortgage Crisis," Business Week, 9 October 2008, available at http://www.businessweek.com/magazine/content/08_42/b4104036827981.htm, (last visited 21 June 2009).

[87] See H. Comm. on Financial Services, 108th Cong., Views and Estimates on Matters To Be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005, at 16 (Comm. Print 2004). "In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."

[88] Testimony of Illinois Attorney General Lisa Madigan Before the Committee on Financial Services, Hearing on Federal and State Enforcement of Financial Consumer and Investor Protection Laws, 20 March 2009, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/il_-_madigan.pdf (last visited 22 June 2009).

This month, General Madigan and seven colleagues sent President Obama a letter supporting a Consumer Financial Protection Agency preserving state enforcement authority:

> *[W]e believe that any reform must (1) preserve State enforcement authority, (2) place federal consumer protection powers with an agency that is focused primarily on consumer protection, and (3) place primary oversight with government agencies and not depend on industry self regulation.*[89]

F.2 Why Federal Law Should Always Be a Floor

Consumers need state laws to prevent and solve consumer problems. State legislators generally have smaller districts than members of Congress do. State legislators are closer to the needs of their constituents than members of Congress. States often act sooner than Congress on new consumer problems. Unlike Congress, a state legislature may act before a harmful practice becomes entrenched nationwide. In a September 22, 2003 speech to the American Bankers Association in Hawaii, Comptroller John D. Hawke admitted that consumer protection activities "are virtually always responsive to real abuses." He continued by pointing out that Congress moves slowly. Comptroller Hawke said, "It is generally quite unusual for Congress to move quickly on regulatory legislation – the Gramm-Leach-Bliley privacy provisions being a major exception. Most often they respond only when there is evidence of some persistent abuse in the marketplace over a long period of time." U.S. consumers should not have to wait for a persistent, nationwide abuse by banks before a remedy or a preventative law can be passed and enforced by a state to protect them.

States can and do act more quickly than Congress, and states can and do respond to emerging practices that can harm consumers while those practices are still regional, before they spread nationwide. These examples extend far beyond the financial services marketplace.

States and even local jurisdictions have long been the laboratories for innovative public policy, particularly in the realm of environmental and consumer protection. The federal Clean Air Act grew out of a growing state and municipal movement to enact air pollution control measures. The national organic labeling law, enacted in October 2002, was passed only after several states, including Oregon, Washington, Texas, Idaho, California, and Colorado, passed their own laws. In 1982, Arizona enacted the first "Motor Voter" law to allow citizens to register to vote when applying for or renewing drivers' licenses; Colorado placed the issue on the ballot, passing its Motor Voter law in 1984. National legislation followed suit in 1993. Cities and counties have long led the smoke-free indoor air movement, prompting states to begin acting, while Congress, until this month, proved itself virtually incapable of adequately regulating the tobacco industry. A recent and highly successful FTC program—the National Do Not Call Registry to which fifty-eight million consumers have added their names in one year—had already been enacted in forty states.

But in the area of financial services, where state preemption has arguably been the harshest and most sweeping, examples of innovative state activity are still numerous. In the past five years,

---

[89] Letter of 15 June 2009 from the chief legal enforcement officers of eight states (California, Connecticut, Illinois, Iowa, Maryland, Massachusetts, North Carolina and Ohio) to President Obama, on file with the authors.

since the OCC's preemption regulations have blocked most state consumer protections from application to national banks, one area illustrating the power of state innovation has been in identity theft, where the states have developed important new consumer protections that are not directed primarily at banking. In the area of identity theft, states are taking actions based on a non-preemptive section of the Fair Credit Reporting Act, where they still have the authority to act against other actors than national banks or their subsidiaries.

There are seven to ten million victims of identity theft in the U.S. every year, yet Congress did not enact modest protections such as a security alert and a consumer block on credit report information generated by a thief until passage of the Fair and Accurate Credit Transactions Act (FACT Act or FACTA) in 2003. That law adopted just some of the identity theft protections that had already been enacted in states such as California, Connecticut, Louisiana, Texas, and Virginia.[90]

Additionally FACTA's centerpiece protection against both inaccuracies and identity theft, access to a free credit report annually on request, had already been adopted by seven states: Colorado, Georgia, Maine, Maryland, Massachusetts, New Jersey and Vermont. Further, California in 2000, following a joint campaign by consumer groups and realtors, became the first state to prohibit contractual restrictions on realtors showing consumers their credit scores, ending a decade of stalling by Congress and the FTC.[91] The FACT act extended this provision nationwide.

Yet, despite these provisions, advocates knew that the 2003 federal FACTA law would not solve all identity theft problems. Following strenuous opposition by consumer advocates to the blanket preemption routinely sought by industry as a condition of all remedial federal financial legislation, the final 2003 FACT Act continued to allow states to take additional actions to prevent identity theft. The results have been significant.

Since its passage, fully 47 states and the District of Columbia have granted consumers the right to prevent access to their credit reports by identity thieves through a security freeze. Indeed, even the credit bureaus, longtime opponents of the freeze, then adopted the freeze nationwide.[92]

A key principle of federalism is the role of the states as laboratories for the development of law.[93] State and federal consumer protection laws can develop in tandem. After one or a few states legislate in an area, the record and the solutions developed in those states provide important information for Congress to use in deciding whether to adopt a national law, how to craft such a law, and whether or not any new national law should displace state law.

---

[90] See California Civil Code §§ 1785.11.1, 1785.11.2, 1785,16.1; Conn. SB 688 §9(d), (e), Conn. Gen. Stats. § 36a-699; IL Re. Stat. Ch. 505 § 2MM; LA Rev. Stat. §§ 9:3568B.1, 9:3568C, 9:3568D, 9:3571.1 (H)-(L); Tex. Bus. & Comm. Code §§ 20.01(7), 20.031, 20.034-039, 20.04; VA Code §§ 18.2-186.31:E.

[91] See 2000 Cal. Legis. Serv. 978 (West). This session law was authored by State Senator Liz Figueroa. "An act to amend Sections 1785.10, 1785.15, and 1785.16 of, and to add Sections 1785.15.1, 1785.15.2, and 1785.20.2 to the Civil Code, relating to consumer credit."

[92] Consumers Union, U.S. PIRG and AARP cooperated on a model state security freeze proposal that helped ensure that the state laws were not balkanized, but converged toward a common standard. More information on the state security freeze laws is available at http://www.consumersunion.org/campaigns/learn_more/003484indiv.html (last visited 21 June 2009).

[93] *New State Ice Co. v. Leibman*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

A few more examples from California illustrate the important role of the states as a laboratory and a catalyst for federal consumer protections for bank customers. In 1986, California required that specific information be included in credit card solicitations with enactment of the then-titled Areias-Robbins Credit Card Full Disclosure Act of 1986. That statute required every credit card solicitation to contain a chart showing the interest rate, grace period, and annual fee.[94] Two years later, Congress chose to adopt the same concept in the Federal Fair Credit and Charge Card Disclosure Act (FCCCDA), setting standards for credit card solicitations, applications and renewals.[95] The 1989 federal disclosure box[96] (know as the "Schumer Box") is strikingly similar to the disclosure form required under the 1986 California law.

States also led the way in protecting financial services consumers from long holds on deposited checks. California enacted restrictions on the length of time a bank could hold funds deposited by a consumer in 1983; Congress followed in 1986. California's 1983 funds availability statute required the California Superintendent of Banks, Savings and Loan Commissioner, and Commissioner of Corporations to issue regulations to define a reasonable time after which a consumer must be able to withdraw funds from an item deposited in the consumer's account.[97] Similar laws were passed in Massachusetts, New York, New Jersey and other states. Congress followed a few years later with the federal Expedited Funds Availability Act of 1986.[98] California led the way on security breach notice legislation. Its law and those of other states have functioned as a de facto national security breach law, while Congress has failed to act.[99]

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

Nonetheless, as these examples show, state law is an important source of ideas for future federal consumer protections. As Justice Brandeis said in his dissent in New State Ice Co., "Denial of the right [of states] to experiment may be fraught with serious consequences to the Nation" (285 U.S. at 311). A state law will not serve this purpose if states cannot apply their laws to national banks, who are big players in the marketplace for credit and banking services. State lawmakers

[94] 1986 Cal. Stats., Ch. 1397, codified at California Civil Code § 1748.11.
[95] P. L. 100-583, 102 Stat. 2960 (Nov. 1, 1988), codified in part at 15 U.S.C. §§ 1637(c) and 1610(e).
[96] 54 Fed. Reg. 13855 (April 6, 1989 Appendix G, form G-10(B)).
[97] 1983 Cal. Stat. Ch. 1011, § 2, codified at Cal. Fin. Code § 866.5.
[98] P. L. 100-86, Aug. 10, 1987, 101 Stat. 552, 635, codified at 12 U.S.C. § 4001.
[99] More information on state security breach notice laws is available at http://www.consumersunion.org/campaigns//financialprivacynow/002215indiv.html (last visited 21 June 2009).
[100] Military Lending Act, 10 U.S.C. § 987. Credit Repair Organizations Act, 15 U.S.C. § 1679h (giving state Attorneys General and FTC concurrent enforcement authority).

simply won't pass new consumer protection laws that do not apply to the largest players in the banking marketplace.

Efficient federal public policy is one that is balanced at the point where even though the states have the authority to act, they feel no need to do so. Since we cannot guarantee that we are ever at that optimum, setting federal law as a floor of protection as the default—without also preempting the states—allows us to retain the safety net of state-federal competition to guarantee the best public policy.[101]

CONCLUSION

As detailed above, a strong federal commitment to robust consumer protection is central to restoring and maintaining a sound economy. The nation's financial crisis grew out of the proliferation of inappropriate and unsustainable lending practices that could have and should have been prevented. That failure harmed millions of American families, undermined the safety and soundness of the lending institutions themselves, and imperiled the economy as a whole. In Congress, a climate of deregulation and undue deference to industry blocked essential reforms. In the agencies, the regulators' failure to act, despite abundant evidence of the need, highlights the inadequacies of the current regulatory regime, in which none of the many financial regulators regard consumer protection as a priority.

As outlined in the testimony above, establishment of a single Consumer Financial Protection Agency is a critical part of financial reform. As detailed above, its funding must be robust, independent and stable. Its board and governance must be structured to ensure strong and effective consumer input, and a Consumer Advocate should be appointed to report semi-annually to Congress on agency effectiveness.

Our organizations, along with many other consumer, community, civil rights, labor and progressive financial institutions, 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.

[101] For further discussion, see Edmund Mierzwinski, "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," Government, Law and Policy Journal of the New York State Bar Association Spring 2004 (Vol. 6, No. 1, pgs. 6-12).

Attachments:

Appendix 1: Abusive Lending Practices by Smaller Banks and Thrifts

Appendix 2: Private Student Loan Regulatory Failures and Reform Recommendations

Appendix 3: Rent-A-Bank Payday Lending

Appendix 4: Information on Income (primarily user and transaction fees depending on agency) of Major Financial Regulatory Agencies

Appendix 1: Abusive Lending Practices by Smaller Banks and Thrifts

Members of Congress, the media and consumer organizations have properly focused on the role of large, national banks and thrifts in using unsustainable, unfair and deceptive mortgage and credit card lending practices. In contrast, smaller banks and thrifts have justifiably been praised for their more responsible lending practices in theses areas. However, when considering the need for and responsibilities of a federal Consumer Financial Protection Agency, it is also important to note that some smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA.

High Cost Refund Anticipation Loans

The high cost refund anticipation loans (RALs) sold by tax preparers to the working poor are made by some of the largest banks, JPMorgan Chase and HSBC, but also by much smaller Santa Barbara Bank & Trust and Republic Bank & Trust. In fact, refund anticipation loans offered by the two smaller banks are much more expensive than those now sold by Chase and HSBC. For the 2009 tax season, a typical $3,000 refund anticipation loan cost $62.14 at H&R Block through HSBC and $62 through independent preparers who used JPMorgan Chase to make RALs. In contrast, Republic Bank & Trust charged $110.45 and Santa Barbara Bank & Trust charged $104.95 for the same $3,000 RAL. Furthermore, Santa Barbara permits the independent tax preparers with whom it partners to charge an additional $40 (we do not have information on the amount of additional fees for Republic Bank & Trust). With all fees included the annual percentage rate for RALs at the small banks ranged from 134 percent up to 187 percent for a $3,000 loan repaid by direct deposit of the taxpayers tax refund and/or Earned Income Tax Credits.[102]

Rent-A-Bank Payday Lending

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

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

[102] Chi Chi Wu and Jean Ann Fox, "Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Workers at Risk," National Consumer Law Center and Consumer Federation of America, February 2009, page 10.

all the enforcement tools at their disposal.[103] By the time bank regulators deprived payday lenders of willing bank partners, state consumer protections had been undermined.

Bank Overdraft Loans

Small banks also extend extremely expensive unauthorized credit through overdraft loans, charging consumers steep fees for covering transactions on accounts with insufficient funds. Instead of denying point-of-purchase debit card purchases or cash withdrawals from ATMs, banks large and small cover those overdrafts and charge high fees. The FDIC issued a ground-breaking report in late 2008 based on a survey of 462 FDIC-supervised state banks drawn from a sample of 1,172 banks which included banks scheduled for examination from May through December 2007, as well as FDIC-supervised banks with at least $5 billion in assets. The FDIC found that 75.1 percent of the mostly small banks surveyed automatically enrolled customers in automated overdraft programs with some of them denying consumers the ability to even opt out of having overdrafts paid for a fee. The fees charged by FDIC banks ranged from $10 to $38 with the median fee $27. About a fourth of these state banks added sustained overdraft fees when consumers did not repay the overdraft in just days. A quarter of all banks surveyed and over half of the largest surveyed banks batch processed overdraft transactions largest to smallest, which the FDIC noted can increase the number of overdrafts. Small banks turn their overdraft programs over to third-party vendors to manage and pay them a percentage of the fees generated, typically 10 to 20 percent of additional fees.

Overdraft and insufficient funds fees are a major source of revenue for banks, including the smaller state banks supervised by the FDIC. These fees in 2006 represented three-quarters of the $2.66 billion in service charges on deposit accounts reported by the surveyed banks in their Call Reports. Banks that permit overdrafts at cash registers with debit cards and at ATMs collected more in fees than banks that deny those transactions at no cost to consumers. Banks that process withdrawals largest first also rake in more revenue than banks that do not.[104]

Third-Party Direct Deposit Arrangements with Check Cashers and Loan Companies

Last year, CFA surveyed third-party direct deposit account arrangements by which federal exempt funds are delivered to unbanked recipients through check cashers, loan companies, and other outlets that partner with a handful of banks. The *Wall Street Journal* published a front page story, titled "Social Insecurity: High Interest Lenders Tap Elderly, Disabled[105]," which described the high cost and unfair terms of financial arrangements that target low-income recipients of taxpayer-supported federal benefits. Readers were shocked to learn that the Social Security Administration would direct deposit Social Security and SSI benefits into a bank

---

[103] Jean Ann Fox, Consumer Federation of America and Edmund Mierzwinski, USPIRG, "Rent A Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," November 2001. See, also, Jean Ann Fox, Consumer Federation of America, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," March 2004, and Testimony, Jean Ann Fox, House Oversight and Domestic Reform Subcommittee on Domestic Policy Regarding Foreclosures, Predatory Lending and Payday Lending in America's Cities, March 21, 2007.

[104] FDIC, "FDIC Study of Bank Overdraft Programs," November 2008, pages ii-v.

[105] Ellen Schultz and Theo Francis, "Social Insecurity: High Interest Lenders Tap Elderly, Disabled," *Wall Street Journal*, February 12, 2008, A1.

account controlled by a loan company, not by the recipient. The Social Security Administration and Treasury Department permit delivery of exempt benefits through Master/Sub account arrangements that can include a bank, an intermediary, and the outlet where consumers go to pick up their "checks." Unbanked recipients are targeted by these "third-party direct deposit providers" as a means of getting faster access to their checks that is safer than receiving paper checks in the mailbox. Loan companies also use the direct deposit arrangements to secure repayment of loans before recipients gain access to their funds.

Banks set up a master account to receive exempt funds in the name of the recipient. The beneficiary goes to the check cashing outlet and pays to receive and then cash the "check" printed to deliver their funds or to have funds loaded onto a prepaid debit card. Fees are charged to set up the account, to deliver each payment, and to cash each check. The direct deposit accounts offered by check-cashers simply convert the electronic payment of benefits back into a paper check. When the benefits are delivered by debit card, recipients are provided a stored value card, which appears to be not covered by Federal Reserve Regulation E protections that provide limits on liability for unauthorized transfers, procedures to resolve disputes, disclosures, and other substantive protections.

Recipients who are enrolled in these third-party direct deposit accounts have no direct control over their funds. The bank deducts its fees and those paid to the check casher or other entity that delivers the "check" or provides the debit card. Contracts include fine print that permits the bank to channel exempt funds to make loan payments on behalf of the recipient before handing over the rest of that month's check. Recipients get what is left over.

CFA presented testimony to both the Social Security Administration and to the House Ways and Means Subcommittee on Social Security last June that detailed the bank/third-party arrangements in effect at that time. Banks included in the survey were Republic Bank & Trust, based in Louisville, Kentucky; River City Bank, based in Kentucky; Bank of Agriculture and Commerce in California; and First Citizens Bank/FirstNet/Cornerstone Community Bank based in Radcliff, Kentucky and Chattanooga, TN.[106] Following the hearing, the FDIC investigated and took regulatory action against the banks they supervise.[107]

Third-Party Subprime "Fee-Harvester" Credit Card and Loan Arrangements

Smaller banks also issue high fee, low limit credit cards to consumers with impaired credit. These "fee-harvester" cards are marketed to the most vulnerable consumers, and come with loaded high fees that use up most of the card's capacity, leaving consumers with minimal credit at an exorbitant price. While some large banks engaged in the fee-harvester sector, a report by the National Consumer Law Center identified several small banks that partnered with card issuers, including Columbus Bank and Trust and several other small banks that partnered with

[106] Testimony of Jean Ann Fox, Consumer Federation of America, Before the Subcommittee on Social Security, Committee on Ways and Means, "Hearing on Protecting Social Security Beneficiaries from Predatory Lending and Other Harmful Financial Institution Practices," June 24, 2008.
[107] "Bank Ordered to Cease and Desist 'unsound' Banking Practices," Central Valley Business Times, March 28, 2009. See also, Social Security Administration Policy Instruction: EM-09039, "FDIC Investigation of the Bank of Agriculture & Commerce One-Time-Only Instructions, effective date May 15, 2009.

CompuCredit Corporation in Atlanta, Georgia; South Dakota based First Premier bank; First National of Pierre (SD); First Bank of Delaware, and Applied Bank, formerly known as Cross Country Bank. A MasterCard issued by CorTrust exemplifies the abuses of fee-harvester cards, as it featured a $250 credit limit that was quickly consumed by a $119 Acceptance Fee, a $50 annual fee, and a $6 per month Participation Fee, leaving users just $75 in total usable credit. A First Bank of Delaware card issued by Continental Finance in 2007 started with a $300 credit limit but provided only $53 in usable credit after charging a $99 account set-up fee, an $89 Participation Fee, a $49 Annual Fee, and $10 per month in Account Maintenance fees.[108]

Last year the Federal Trade Commission and the FDIC brought charges against CompuCredit and its small bank partners, accused of using unfair practices in marketing fee-harvester cards. The small banks subject to the FDIC's enforcement actions included $118 million-asset First Bank of Delaware in Wilmington, Delaware and $794 million-asset First Bank & Trust in Brookings, South Dakota.[109] In addition, $6 billion-asset Columbus Bank and Trust, Columbus, Georgia, settled the FDIC's charges related to CompuCredit by agreeing to a Cease and Desist Order and paying $2.4 million in a civil money penalty.[110] First Bank of Delaware agreed to a cease and desist order which required the bank to terminate its relationship, not only to CompuCredit, but with seventeen third-party lending programs and providers in total. These third party entities included payday lender Check 'n Go Online, CashCall, Inc., ThinkCash (TC Loan Service LLC), Fortris Financial, LLC, and several prepaid card providers.[111] First Bank & Trust was ordered by the Office of Comptroller of the Currency in 2003 to stop partnering with payday lenders and to set aside $6 million to reimburse credit card customers impacted by deceptive lending practices.[112]

Bank Payday Loans

As described at length in a separate appendix on Rent-A-Bank payday lending, starting in the 1990s and early 2000s, many smaller banks partnered with payday lenders to pass on their preemptive powers to avoid state payday loan laws. Though those rent-a-bank partnerships have ended, preemptive bank payday lending has not.

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

[108] Rick Jurgens and Chi Chi Wu, National Consumer Law Center, "Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers," November 2007, Pages 1, 6.
[109] Cheyenne Hopkins, "Will Third-Party Crackdown Set Stage for Showdown?" American Banker, June 11, 2008.
[110] Press Release, "FDIC Seeks in Excess of $200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing," June 10, 2008, http://www.fdic.gov/news/news/press/2008/pr08047.html.
[111] FDIC Stipulation and Consent to the Issuance of An Order to Cease and Desist, Order for Restitution, and Order to Pay, First Bank of Delaware, FDIC-07-256b. FDIC-07-257k, Exhibit A, October 3, 2008.
[112] Steve Young, "S.D. Bank Denies Credit Card Deception," Argus Leader, June 12, 2008.

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

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

Third, the cost can be much higher because the loan is not even necessarily outstanding the full two weeks that a typical payday loan is. It might only be a few days.

Some larger banks also have payday-loan products. Wells Fargo, Fifth Third Bank, and U.S. Bank have direct deposit account advances, which operate just like Meta Bank's iAdvance loans except that they offset a bank account not a prepaid card account.

Appendix 2: Private Student Loan Regulatory Failures and Reform Recommendations

During the height of the most recent wave of abusive mortgage loans, federal regulators took almost no public action. There was a similar lack of regulatory activity in the student loan area. There were problems in the federal student loan industry as well. However, at least for these products, there is a comprehensive set of borrower protections in the Higher Education Act (HEA) and a clear regulatory authority, the U.S. Department of Education. We recommend that jurisdiction over federal student assistance remain in the HEA and Department of Education.

In contrast, many different types of lenders originate, service, and collect private student loans and as a result, there is a wide range of regulatory agencies. These products are similar to other private unsecured credit products, such as credit cards.

In recent years, a subprime private student loan industry began to prey on vulnerable borrowers seeking to better their lives through education. Key problems included:

1. Pressuring Borrowers into High Cost Private Loans.
Many schools and lenders pressured borrowers into high cost private loans even in cases where borrowers had not yet exhausted the more affordable federal loans (and even grants in some cases). New York Attorney General Andrew Cuomo and others recently exposed many of the improper financial arrangements and collusions between schools and lenders.

2. Private Loans and Scam Schools.
As the private student loan industry developed, a particularly unholy alliance developed between unlicensed and unaccredited schools 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. Regulatory agencies for the most part ignored their responsibility to stop unfair lending practices.

A key regulatory check, the FTC Holder Rule, could be more efficiently enforced by a single agency with clear jurisdiction over all financial players. If banks are routinely being referred loans by schools and the schools are not arranging for the banks to put the notice in the notes as they are required to do, then the banks are using notes that violate federal law and should be liable for unfair practices.

Banking regulators must coordinate to enforce the FTC holder rule. The trade commission, state attorney generals, state licensing and accreditation agencies must review loan documents provided to students by schools and sue schools that violate federal law by not including the holder notice. Meanwhile, government agencies supervising lenders must monitor school notes and sue lenders that violate federal law by contradicting or otherwise trying to evade the holder requirement.

The FTC rule must also be amended so that lenders in addition to schools are obligated to include the notice. Other federal agencies must also adopt the FTC rule so that there is absolutely no doubt that loan providers outside of the FTC's jurisdiction, including all national banks, can be held liable. A single agency should be able to more efficiently enact these reforms.

3. Unchecked Rates and Fees.
As in the subprime mortgage and credit card industries, very high cost loans were made to borrowers without evaluation of reasonable ability to repay. In a March 2008 report, NCLC surveyed a number of private student loan products and found that all of the loans in our survey had variable rates. The lowest initial rate in our sample was around 5% and the highest close to 19%. The average initial disclosed annual percentage rate (APR) for the loans in our survey was 11.5%.[113]

Some of the margins were shockingly high. Multiple loans in our survey had margins of close to 10%. None of the loans we examined contained a rate ceiling. A few set floors. These floors are particularly unfair for borrowers in an environment of declining interest rates.

There are no limits on origination and other fees for private student loans. According to the loan disclosure statements we reviewed, there were origination charges in all but about 15% of the loans. For those with origination fees, the range was from a low of 2.8% up to a high of 9.9%. The average in our survey was 4.5%. Most of the lenders in the private student notes we surveyed reserved the right to charge additional fees for other services.

4. Denying Access to Justice, including Mandatory Arbitration Clauses.
Sixty-one percent of the loan notes in the March 2008 NCLC report contained mandatory arbitration clauses. These clauses are just one example of lenders' systematic strategy to limit a borrower's ability to challenge problems with the loans or with the schools they attend.

5. Arbitrary and Unfair Default Triggers.
Borrowers are in default on federal loans if they fail to make payments for a relatively long period of time, usually nine months. They might also be in default if they fail to meet other terms of the promissory note. There are no similar standardized criteria for private loan defaults.

A few of the default "triggers" in the loans we reviewed in the March 2008 report were particularly troubling. For example, the typical loan we reviewed stated that borrowers could be declared in default if "in the lender's judgment, they experience a significant lessening of ability to repay the loan" or "are in default on any other loan they already have with this lender, or any loan they might have in the future."

Another troubling trigger is the lender's discretion to declare a default if the lender believes that the borrower is experiencing a significant lessening of her ability to repay the loan. If interpreted broadly, a borrower could be placed in default if she requests a temporary postponement of loan payments due to job loss or some other factor.

---

[113] National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at:
http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

6. Disclosures.
The Higher Education Opportunity Act (HEOA) amended TILA to significantly improve disclosures for private student loans. A coalition of consumer advocacy organization filed comments on these proposed regulations in May 2009.[114] There is significant overlap between the new private student loan disclosure requirements and disclosure requirements for other types of credit. Enforcement should be enhanced if jurisdiction is clearly within one oversight agency.

7. Lack of Loss Mitigation Relief.
A key barrier to improved assistance programs is that lenders have not been *required* to provide redress for their irresponsible actions. Voluntary efforts have been few and far between. Similar trends occurred in the mortgage industry where most creditors failed to act on their own to stem the foreclosure tide.

Meaningful assistance should include loan restructuring and flexible repayment. Servicers should have the authority to modify loan terms, change interest rates, forbear or forgive principal, extend maturity dates, offer forbearances, repayment plans for arrearages, flexible repayment and deferments. Congress and the Administration should also act to ensure that borrowers receiving relief through these programs do not face tax consequences.

8. False and Misleading Advertising.
Private student loans are increasingly sold directly to consumers. We recommend schools be required to certify these loans before funds are disbursed.

9. Data Collection.
It is very difficult to understand private loan trends, including such important data as default rates. There is no comprehensive data base for private loans as there is for federal loans. The new regulatory agency should develop a data base of easily accessible data. The lack of this type of information in the private student loan context is a major impediment to understanding the scope of the problem and helping borrowers.

10. Private Enforcement.
Victims of abusive lending practices have very little recourse because the industry often uses its market power to limit borrowers' access to justice. To be effective, consumer protection laws must: (1) give borrowers a private right of action, the right to pursue class actions, and the right to raise school-related claims and defenses against lenders in cases where the school and lender have a referral relationship or other close affiliation; (2) contain strong remedies and penalties for abusive acts; (3) provide effective assignee liability so that borrowers can pursue legitimate claims even when the originator has sold their loan; and (4) prohibit mandatory arbitration clauses that weaken victims' legal rights and deny them access to seeking justice in a court of law. Without these fundamental procedural protections, other consumer protection rules are unenforceable.

[114] See http://www.studentloanborrowerassistance.org/uploads/File/policy_briefs/PrivateLoanCommentsJune09.pdf.

Appendix 3: Rent-A-Bank Payday Lending

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

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

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

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

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

---

115 Press Release, Commonwealth of Massachusetts Consumer Affairs and Business Regulation, "High Rate Payday Loan Operation Shut Down by Consumer Affairs Agency," April 20, 2000.

in Virginia.[116] Rent-a-bank lenders also made loans that exceeded the limits set by states that had authorized this product. ACE Cash Express partnered with Goleta National Bank and Dollar Financial Group partnered with Eagle National Bank to make loans up to $500 in California, a state that limited payday loans to $255 (if a lender charged the maximum fee). Colorado's payday loan law prohibited loan renewals but rent-a-bank lenders "rolled over" loans three or four times, charging borrowers the fee each payday without paying off the loan. While it is difficult to quantify the cost of rent-a-bank payday lending to consumers, the Center for Responsible Lending wrote to the FDIC Board of Directors in 2004 that 3,000 payday loan stores were at that time partnering with FDIC-supervised state banks. CRL estimated that over one million borrowers annually were trapped in a cycle of borrowing at a cost of about $750 million in fees per year that would otherwise be illegal under state law.[117]

Timeline of regulatory actions

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

1999: National and state consumer groups wrote to Comptroller of the Currency John D. Hawke, in mid-1999, to urge regulatory action on Eagle National Bank, a small bank based in Pennsylvania, which partnered with payday loan outlets to make loans in states that prohibited such high interest rates.[118] The Comptroller replied on November 30, 1999 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."

September 2000: Office of Thrift Supervision lowered Crusader Bank's CRA rating because of its payday loan operations. The bank was later acquired and the program was discontinued.

November 2000. The Office of Comptroller of the Currency and the Office of Thrift Supervision issued advisory letters warning banks of the risks of partnering with payday lenders. "Title loans and payday loans are examples of types of products being developed by non-bank vendors who have targeted national banks and federal thrifts as delivery vehicles...We urge national banks and federal thrifts to think carefully about the risks involved in such relationships, which can pose not only safety and soundness threats, but also compliance and reputation risks." The OCC and OTS letter bluntly noted "Payday lenders entering into such arrangements with national

[116] Jean Ann Fox and Edmund Mierzwinski, Consumer Federation of America and U. S. PIRG, "Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," November 2001, page 14.
[117] Mark Pearce and Eric Stein, Center for Responsible Lending, Letter to FDIC Board of Directors, Re: The Need for FDIC Action Regarding Payday Lending Rent-A-Bank Arrangements," August 26, 2004, page 15.
[118] 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.

banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them."[119]

April 2001: National Credit Union Administration issued a directive, reminding federal credit unions of their 18 percent annual interest rate cap and urging credit union members to serve the legitimate short term credit needs of their members.[120]

September 2001. The Comptroller of the Currency filed an amicus brief in the Colorado Attorney General's case against ACE Cash Express for failing to get a license to make payday loans after partnering with Goleta National Bank. In a dramatic break with OCC preemption policy, the Comptroller stated that "ACE is the only defendant in this case and ACE is not a national bank."[121]

January 2002: Comptroller of the Currency ordered Eagle National Bank to cease its payday loan program, noting that "the bank essentially rented out its national bank charter to a payday lender to facilitate that nonbank entity's evasion of the requirements of state law that would otherwise be applicable to it."[122]

September 2002: The Illinois banking regulator and the Federal Deposit Insurance Corporation set high enough capitalization requirements for Brickyard Bank that the bank withdrew from its payday lending arrangement with Check 'n Go in Texas and North Carolina.

October 2002: Comptroller of the Currency ordered Goleta National Bank to cease making payday loans. The bank had partnered with ACE Cash Express. This action also brought resolution to state litigation against Goleta in Ohio, Colorado, North Carolina and in class action lawsuits filed in Florida, Texas, Maryland, and Indiana.

January 2003: Comptroller of the Currency ordered Peoples National Bank to terminate its payday loan arrangements with Advance America due to safety and soundness concerns.[123]

January 2003: Comptroller of the Currency issued a cease and desist order to First National Bank in Brookings, SD to terminate its payday loan program.[124]

January 2003: The Office of Thrift Supervision directed First Place Bank in Warren, Ohio to terminate its payday loan arrangements in Texas with Check 'n Go.[125]

---

[119] OCC Advisory Letter AL 2000-10, "Payday Lending," November 27, 2000, p. 1
[120] NCUA Letter to Credit Unions, Letter No. 01-FCU-03, April 2001.
[121] Amicus Curiae brief filed by Julie Williams, Chief Counsel, Comptroller of the Currency, State of Colorado v. ACE Cash Express, Inc., Civil Action No. 01-1576, United States District Court for the District of Colorado, September 26, 2001.
[122] Press Release, "OCC Orders Eagle to Cease Payday Lending Program," January 3, 2002, NR 2002-01.
[123] Office of Comptroller of the Currency, Notice of Charges for Issuance of an Order to Cease and Desist, In the Matter of Peoples National Bank, Paris, TX, AA-ED-02-03, May 17, 2002.
[124] Press Release, OCC, January 27, 2003.
[125] "Texas Payday Lending to End: First Place Lists Earnings," Tribune Chronicle, Warren, Ohio, Jan. 30, 2003.

July 2003: FDIC issued guidelines for bank payday loan programs that did not definitively prohibit rent-a-bank payday lending by banks.[126] State banks continued to partner with payday lenders.

October 2003: The FDIC permitted First Bank of Delaware to switch to its supervision after the Federal Reserve imposed stiff regulatory requirements on the bank's payday loan business.[127]

March 2005: The FDIC issued revised payday loan guidelines for banks which further tightened lending to repeat borrowers by limiting loans to no more than three months out of a twelve month period.[128]

February 2006: 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.

[126] FDIC, Guidelines for Payday Lending, issued July 2003.
[127] CFA Letter to FDIC Chairman Powell, October 8, 2003, www.consumerfed.org/fdicletter10-2003.pdf.
[128] Press Release, "FDIC Revises Payday Lending Guidance," March 2, 2005.

APPENDIX 4: Information on Income (primarily user and transaction fees depending on agency) of Major Financial Regulatory Agencies

OTS

User fee income 2008: $245.699 million (2009 estimated: $246.706)[3]
FY 2009 Budget: $246.706 million[3]
Consumer Affairs Budget: $4.4 million[4]
Consumer Affairs Budget percent of total budget: 1.78%
OTS receives no appropriations from Congress, budget funded by user fees.

OCC

User fee revenue: $ 707.5 million
Total Budget 2008: $749.1 million[2]
Consumer Affairs Budget: $12.1 million ($9.1 million in 2008)[2]
Consumer Affairs Budget percent of total budget: 1.21%
Total FY 2008 revenue: $736.1 million[2]
Revenue from investment income: $ 26.1 million
Other revenue: $2.5 million (Other sources of revenue include bank licensing fees, revenue received from the sale of publications, and other miscellaneous sources.)[2]
The OCC receives no appropriations from Congress.

FDIC

User fee revenue was $2.965 billion for fourth quarter 2008.[8]
FY 2009 Budget: $2,243,765,244 ($1,205,161,868 in 2008)[7]
FTE for Consumer Affairs: 28 (33 in 2008)[4]
Consumer Affairs Budget: $7.2 million ($4 million in 2008)[4]
Consumer Affairs Budget as % of total Budget in 2009: .32%

FTC

Funding:
FY 2008 HSR Filing Fees: $144.600 million [10]
Do-Not Call Fees: $19 million [10]
General Fund: $76.639 million [10]
FY 2008 Total Budget: $240.239 million[10]
FY 2008 Total FTE: 1,084 [10]
FY 2008 Consumer Protection Budget: $139.122 million [10]
FY 2008 Consumer Protection FTE: 581 [10]
% of total Budget spent on Consumer Affairs: 57.9%

FED

Total Revenue from services provided to depositary institutions: $773.4 million [1]
Income from Priced Services: $53.4 million [1]
Budgeted Cost of Consumer and Community Affairs: $38.2 million budgeted 2008-2009[11]
Total Board Operations: $706.3 million[11]
Percent of total Budget spent on Consumer Affairs: 5.04 %

SEC

FY 2009 Budget: $913 million[13]
SEC Source of Fees:
Registration of securities: Securities Act of 1933: $234 million (FY 2008 estimate)[13]
Securities transactions under the Securities Exchange Act of 1934: $892 million (FY 2008 estimate) [13]
Merger and Tender Fees under the Securities Exchange Act of 1934: $21 million (FY 2008 estimate) [13]
Collections amount total: $1,147 million (FY 2008 estimate) [13]
Investor Protection and Education Program: $124.449 million[13]
Investor Protection Budget is 14% of total Budget.[6]
Investor Protection, 524 FTE are 15% of all FTE.[6]
Congressional Appropriation FY 2008: $63 million[12]
Exchange Revenues:
Securities Transactions Fees $794.672 million[12]
Securities Registration, Tender Offer, and Merger Fees $161.377 million[12]
Total Exchange Revenues: $956.317 million. [12]

PCAOB

2008 accounting support fee of $134.5 million.[5]
Total Budget: $144.6 million for 2008.[5]
The PCAOB income is from registration fees, user fees and transaction fees as approved by the Commission.[5]

Sources:
[1] http://www.federalreserve.gov/boarddocs/rptcongress/annual08/pdf/fro.pdf
[2] http://www.occ.treas.gov/annrpt/1-2008AnnualReport.pdf
[3] http://files.ots.treas.gov/481151.pdf
[4] http://www.house.gov/apps/list/speech/financialsvcs_dem/viewsandestimates2009.pdf
[5] http://www.pcaobus.org/About_the_PCAOB/Budget_Presentations/2008.pdf
[6] http://www.sec.gov/about/secfy08congbudgjust.pdf
[7] http://www.fdic.gov/about/strategic/report/2007annualreport/bud_exp_prog.html
[8] http://www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/sum_trends_results.html

[9] http://ftc.gov/os/testimony/P064814subprime.pdf
[10] http://www.ftc.gov/ftc/oed/fmo/budgetsummary08.pdf
[11] http://www.federalreserve.gov/boarddocs/rptcongress/budgetrev/br08alt.htm
[12] http://www.sec.gov/about/secpar/secpar2008.pdf#sec3
[13] http://www.sec.gov/about/secfy09congbudgjust.pdf

American Enterprise Institute
for Public Policy Research

Statement before the Committee on Financial Services
U.S. House of Representatives
On Restructuring Consumer Financial Products Regulation

One Good Idea and a Number of Bad Ones

Alex J. Pollock

Resident Fellow

American Enterprise Institute

June 24, 2009

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Mr. Chairman, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to be here today. I am Alex Pollock, a resident fellow at the American Enterprise Institute, and these are my personal views. Before joining AEI, I spent 35 years in banking, including twelve years as President and CEO of the Federal Home Loan Bank of Chicago. I have experienced and studied many cycles of financial bubbles and busts, including the political reactions, and overreactions, which inevitably follow. It appears to me that the proposals we are considering represent the normal political reaction phase.

The Proposed "Consumer Financial Protection Agency"

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

According to the Administration's White Paper on regulatory restructuring, the proposed CFPA would not only "define standards for 'plain vanilla' products"—that is, define products—but would "be authorized to require all providers and intermediaries to offer these products." All "providers and intermediaries"—a vast jurisdiction apparently unrelated to any chartering definitions—would have part of their business dictated by this agency. That is a truly amazing assertion.

Moreover, CFPA should "be authorized to place tailored restrictions"—that is, restrictions—"on product terms and provider practices." "Terms" presumably includes pricing. Does it include credit standards, such as required down payments?

A more sensible proposal would have been to define certain financial products as "plain vanilla," and require disclosure that "This is—or is not—a plain vanilla financial product suitable for an unsophisticated customer." But this idea, which strikes me as reasonable, would not require a new agency. I will discuss disclosures more in a moment.

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

Community Banks

The first major regulatory overreaction of the 21st century, the Sarbanes-Oxley Act, proved highly successful at generating cost and bureaucracy, while apparently having no influence at impeding the buildup of risk. For large companies, it was proportionately less of a problem, since they simply created internal corporate bureaucracies to deal with its demands. But it created, and still creates, disproportionate burdens on small and venture businesses.

I believe we would see a similar pattern for a CFPA—large financial companies would respond in the same way as they did for Sarbanes-Oxley, and small ones would be disproportionately burdened.

Community banks had and have little to do with the issues of the complex mortgages and mortgage securities which led to the panic and bust. Should Congress ever proceed with a CFPA, it would be reasonable to exempt all community financial institutions.

One Good Idea: Clear, Simple Disclosures

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

In Congressional testimony in the spring of 2007, I proposed a one-page mortgage form so borrowers could easily focus on what they really need to know. The one-page form idea was included in bills in both the House and Senate, but not enacted, unfortunately. It remains my opinion that something like it would be a huge improvement in the way the American mortgage system works.

Subsequently, at the request of a member of Congress, I designed a one-page overdraft form. It seems to me that this approach would be valuable in consumer financial services generally, but it is most important for mortgages, because that is by far the largest debt and financial commitment for most households.

By far the most important use of mortgage disclosures is for borrowers to be able to underwrite themselves—that is, to decide whether they can afford the debt service commitments they are making. In the ideal case, the borrowers would be able to correctly complete the one-page form themselves.

In my view, the indubitably best consumer protection is the ability to exercise personal responsibility in making informed decisions about underwriting yourself for the credit and about how much risk you wish to take. This is the best reason to have clear and straightforward disclosures: not just to get understandable information, but to act on it. This is why I believe, by the way, that it is essential to have the one-page form, or any variation of it, include the signature of the borrowers.

A Missing Idea: Personal Responsibility

With this as context, it seems remarkable to me that the idea of enabling and building personal responsibility on the part of consumers does not seem to appear anywhere in the

Administration's proposal. One of my friends did a computer search of the White Paper for the term "personal responsibility" and got zero hits.

Another Missing Idea: Fannie and Freddie

While looking to restructure regulation of the entire financial system, the Administration's White Paper gets to Fannie Mae and Freddie Mac and loses its courage, merely concluding that they need to be studied further.

But it is impossible to address the issues of the mortgage finance system, or indeed the problems of the bubble and bust, or the problems of defaulted nonprime mortgage borrowers, without addressing Fannie and Freddie. As everybody knows, they represent a vast half of all outstanding residential mortgage credit; they made a huge contribution to inflating the mortgage bubble; they plunged into low quality mortgage credit and pushed the top higher; they accumulated hundreds of billions of dollars of subprime and nonprime mortgages, the defaults on which have driven them into insolvency. Fannie and Freddie's operations dominate and shape the mortgage market—now more than ever, ironically.

What is the relationship of Fannie and Freddie to the CFPA proposed to be? Without addressing this issue, the proposal leaves a central issue of the mortgage market unanswered.

A Bad Idea: CRA in the CFPA

The CFPA is proposed to have "sole authority to evaluate institutions under the CRA" and to "promote community development investment," taking these responsibilities away from the existing regulators. I believe this is a truly bad idea.

The proposal believes that there is a "conflict" between CRA and safety and soundness responsibilities. On the contrary, I believe that whenever credit risk and investment risk are involved, it is absolutely necessary to have to balance between "community investment" and safety and soundness. Thus, it is imperative for such responsibilities to be combined in one regulatory agency. The alternative, to have credit and investment being "promoted" by people with no responsibility for safety and soundness, appears to me worse than dubious.

Conflict Among Regulators

Moreover, the preceding issue points out an obvious question: What happens when the safety and soundness regulator disagrees with the CFPA? It seems to me such disagreements are inevitable. The question is simply unaddressed in the proposal.

Sitting, as we are, in the wake of a credit collapse, it should be readily concluded that the superior authority should be placed with responsibility for safety and soundness.

A more straightforward solution to this issue, if one wants to keep the idea of centralizing consumer protection and disclosure responsibilities, is to make use of a logical existing organization, and just drop the notion of the CFPA. My suggestion would be to use the Federal Reserve. It seems to me the Fed is highly qualified for this responsibility.

Attracting Capital

As a final thought, I would like to repeat that any proposals which substantially increase regulatory burden and regulatory risk must be considered in the light of the government's intense need to attract very large amounts of additional private equity capital into the banking system.

Thank you again for the chance to share these views. It would be a pleasure to address any questions on these or other aspects of the Administration's proposal, such as the "systemic risk regulator."

NEW AMERICA FOUNDATION

Testimony of Ellen Seidman, Senior Fellow, New America Foundation, Before the Financial Services Committee United States House of Representatives

JUNE 24, 2009

Chairman Frank, Ranking Member Bachus and members of the Committee: I appreciate your inviting me here this morning to discuss consumer protection and oversight in the financial services industry in the context of the current economic crisis, and to provide my thoughts on how the regulatory system should be restructured to enhance consumer protection in the future. My name is Ellen Seidman, and I am a Senior Fellow at the New America Foundation. I also serve as Executive Vice President, National Program and Partnership Development, at ShoreBank Corporation, the nation's first and leading community development bank holding company, based in Chicago. The views expressed here are my own, and not those of New America or ShoreBank.

Last week, the Administration proposed creation of a very broad-based and powerful Consumer Financial Protection Agency (CFPA) that would have regulatory, supervisory and enforcement authority over consumer protection in the financial services sector and also over the Community Reinvestment Act (CRA).[1] The Administration's recognition of the seminal importance of consumer protection in financial services is a critical reversal of the trends of the last several decades. I agree with the Administration that the time has come to create a well-funded single federal entity with the responsibility and authority to receive and act on consumer complaints about financial services and to adopt consumer protection regulations that would be applicable to all providers of financial services, and applaud the Administration's bold stroke.

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

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

[1] Department of the Treasury, "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," June 2009, available at http://financialstability.gov/docs/regs/FinalReport_web.pdf, hereafter "Proposal." The section of the proposal dealing with consumer protection is at pages 55-70.

My testimony starts by explaining how my experience informs my opinion on these issues, provides some background on the source of the crisis, sets out regulatory principles, and then comments on the Administration's proposal and ends with a discussion of CRA in the context of the proposal.

HOW MY EXPERIENCE INFORMS MY POSITION

My views on these topics are informed by my current experience, including service on the Boards of two Community Development Financial Institution loan funds and as Chair of the Board of the Center for Financial Services Innovation,[2] as well as by my years at the Treasury Department, at Fannie Mae, at the National Economic Council under President Clinton, and as Director of the Office of Thrift Supervision from 1997 to 2001.

During my tenure at OTS, we placed significant emphasis on both consumer and compliance issues and on the responsibility of the institutions we regulated to serve the communities in which they were chartered, both because of their obligations under the CRA and because it was good business. We paid particular attention to compliance, building up our staff and examination capability, establishing a special award (done away with by my successor) to honor the best performer in compliance and community affairs, reaching out to consumers and communities, and enhancing our complaint function. In three particular cases during my OTS tenure, concern about consumer issues led directly to safety and soundness improvements. Two involved guidance that got thrifts out of sub-prime monoline credit card lending (just months before that industry got into serious trouble) and payday lending. In another case involving a specific institution, through our compliance examiners' concern about bad credit card practices, we uncovered serious fair lending and safety and soundness issues. We were by no means always successful, but we worked to put compliance on an equal footing with safety and soundness.

Since I left OTS, I have spent much of my time working on issues relating to asset building and banking the underbanked, in which context the importance of consumer protection, for both credit and other products, is plainly apparent. Finally, my years at Fannie Mae and at ShoreBank and the community development work I have been doing have made me both conscious of and extremely sad about what has happened in the mortgage market and the effects it is having on both households and communities.

I believe the bank regulators, given the proper guidance from Congress and the will to act, are quite capable of effectively enforcing consumer protection laws. Moreover, because of the system of prudential supervision, with its on-site examinations, they are also in a good position to do so efficiently and in a manner that benefits both consumers and the safety and soundness of the regulated institutions. Consumer protection can be the canary that gives early warning of safety and soundness issues—but only if someone is paying attention to dying birds.

SOURCES OF THE CURRENT CRISIS

The current crisis has many causes, including an over-reliance on finance to "solve" many of the needs of our citizens. When real incomes stagnate while the cost of housing, health care and education skyrocket, there are really only two possible results: people do without or they become more and more overleveraged. Financial engineering and cheap investor funding, largely from abroad, enabled the overleveraging, but a lack of adequate attention to the manner in which the financial services system interacted with consumers certainly kept the process going and caused consumers and the economy to fall harder when it ended. By 2007, consumer debt was 138% of disposable income, and almost 15% of families devoted more than 40% of their disposable income to paying off debts. After artificially falling in response to revisions to the Bankruptcy Code in 2006, consumer bankruptcy filings have been rising at the rate of 30% a year and reached over 1 million in 2008. Consumers were harmed by both the proliferation of bad products and practices and the sale of hard-to-understand credit and investment products to

[2] I serve on the boards of the Low Income Investment Fund (www.liifund.org) and Coastal Enterprises, Inc. (www.ceimaine.org). The Center for Financial Services Innovation (www.cfsinnovation.com) is a non-profit affiliate of ShoreBank that works to transform the financial services marketplace to help underbanked consumers achieve financial prosperity.

customers for whom they were not suitable, and by the lack of high quality products that meet consumer needs, well priced and effectively marketed, especially in lower income communities.

I believe that there where three basic regulatory problems. First, there was a lack of attention, and often unwillingness, to effectively regulate products and practices even where regulatory authority existed. The clearest example of this is the Federal Reserve's unwillingness until recently to regulate predatory mortgage lending under HOEPA. However, as the recent actions by the Federal Reserve, OTS and NCUA have demonstrated, there was also authority under the FTC Act that went unused. Moreover, neither the Federal Reserve nor the OTS—at least until fairly recently—has seriously probed the consumer practices of non-depository subsidiaries of the holding companies they regulate. This is not just an issue at the federal level. While there are certain states—North Carolina, Maryland and Massachusetts prominent among them—that have been aggressive with respect to consumer protection, others, including California, the home of many of the most aggressive mortgage lenders, were not. Capital regulations also played their part; the ability to move badly underwritten products completely off the balance sheet, earning fees for originating them, but holding no capital against them, only encouraged the proliferation of such products.

Second, we need to acknowledge that there were, and are, holes in the regulatory system, both in terms of unregulated entities and products, and in terms of insufficient statutory authority. The clearest case relates to mortgage brokers, where there was no federal regulation at all, no regulation beyond simple registration in many states, and ineffective regulation even in most of the states that actually asserted some regulatory authority. But there are other examples—payday lending is prohibited in some states, regulated more or less effectively in others, and pretty much allowed without restriction in still others. And then of course there is the question of what kind of responsibility sellers of financial products have to customers. We know we have not imposed a fiduciary duty on them, but does that mean there is no responsibility to match customer with product?

Finally, there is and was confusion, for both the regulated entities and consumers and those who work with them. Consumer protection comes in many forms, from substantive prohibitions like usury ceilings and payday lending prohibitions, through required terms and practices, to disclosures and marketing rules. Multiple regulators exacerbate the confusion. At the federal level, there are multiple bank regulators, not to mention the NCUA, the FTC and HUD, and their jurisdiction is frequently overlapping. States and even localities also regulate consumer protection, again often through multiple agencies. And of course, sometimes the federal and state laws overlap.

The system clearly could be improved. But as we do so, we should not be lulled into thinking the solutions are obvious or easy. In general they're not, and I would assert that they are harder and more subtle than is the case with manufactured consumer products. The products, even the good ones, can be extremely complex. Just try describing the lifetime interest rate on a Savings Bond or how a capped ARM works. Or for that matter whether a payday loan or a bounced check is more expensive. Many products, especially loans and investments, involve both uncertainty and difficult math over a long period of time, which is hard for even the most educated consumer. And the differences between a good product and a bad one can be subtle, especially if the consumer doesn't know where to look. An experienced homeowner knows the importance of escrowing insurance and taxes, but the dire consequences of the lack of an escrow are easy for a first-time homebuyer to miss. And a relatively safe ARM can turn into a risky one when caps are removed or a prepayment penalty added.

Finally, different consumers legitimately have different needs. To take the example economists love, when there is a normal, upward sloping yield curve, most homebuyers are better off with a 5-year ARM than with a 30 year fixed rate mortgage. With the long-term loan they are paying a higher interest rate for an option they are unlikely to use, since they will likely move, prepay or refinance long before 30 years are up. But for a consumer whose income is unlikely to increase, who has few other resources, who has difficulty budgeting—or who is just plain risk-averse—the certainty of the fixed rate mortgage may well be worth the additional cost.

LOOKING FORWARD

Before turning to regulatory issues, I suggest there is a broader social context of change that we need to consider. To what extent can we turn some of the complex, long-term financial obligations that we have foisted on individual consumers—most clearly retirement and health care—back to more collective management? We also should recognize that there is some rate of interest and some level of financial engineering at which the drive for "availability of credit" masks both lack of sufficient income and collateral supports (such as health care) and an insufficient level of financial understanding. We need to educate our children from day one about what money means, how interest rates work, and who to get help from, and we need to create systems of helpers, which can include the internet and things like overdraft alarms, but which also requires low-cost access to people who are competent to give advice and have a fiduciary duty to the consumer.[3]

In this period when consumers are being forced to deleverage and cut back, and are actually beginning to save more on their own accord, we should once again make saving easy and an expected part of life.[4] Having an account at a bank or credit union helps encourage saving, although the account needs to be designed so consumers have the liquidity they need without paying for it through excessive overdraft fees. Tying savings to credit, such as by requiring part of a mortgage payment to go into a savings account for emergencies like repairs or temporary inability to make a payment, can also help. And so would moving toward more savings opt-outs, like payroll deductions for non-restricted savings accounts that can be used in an emergency (as well as for retirement accounts), a concept we are testing at the New America Foundation as AutoSave.

PRINCIPLES FOR REGULATION

The regulatory framework, of course, involves both how to regulate and who does it. With respect to how, I suggest three guiding principles. First, to the maximum extent possible, products that perform similar functions should be regulated similarly, no matter what they are called or what kind of entity sells them. For example, we know that many people regarded money market mutual funds and federally-insured deposit accounts as interchangeable. Either they are, and both the products and—to the extent the regulation has to do with making sure the money is there when the customer wants it—the regulation should be similar, or they are not and they should not be treated as such, including by regulators who are assessing capital requirements. To take another example, payday loans and bounced check protection have a good deal in common, and probably should be regulated in a similar manner. This also means that a mortgage sold directly through a bank should be subject to the same regulatory scheme and requirements as one sold through a broker. This principle is at the heart of the Administration's proposal.

Second, we should stop relying on consumer disclosure as the primary method of protecting consumers. While such disclosures can be helpful, they are least helpful where they are needed the most, when products and features are complex. The Federal Reserve's recognition of this with respect to double cycle credit card billing was a critical breakthrough: by working with consumers, they came to understand that no amount of disclosure was going to enable consumers to understand the practice. The same is true of very complex mortgage products. The "one page disclosure" is great for simple mortgage products, but where there are multiple difficult-to-understand concepts in a single mortgage—indexes and margins, caps on rate increases and on payments, per adjustment and over the loan's lifetime, escrows or not, prepayment penalties that change over time, option payments and negative amortization, and many different fees—the likelihood is low that any disclosure will enable those for whom these issues really make a difference to understand them. The Administration's proposal recognizes the principle that disclosure may be helpful, but is unlikely to be sufficient when products are complex, and moreover would require the CFPA to test and evaluate disclosures to make them reasonable and understandable.[5]

---

[3] See Proposal, page 68.
[4] See Proposal, pages 74-75.
[5] Proposal, pages 63-64.

In the last few years, several academics have suggested potential substitutes for disclosure that go beyond the traditional type of prohibitory consumer protection rules. For example, Professor Ronald Mann has suggested that credit card contracts be standardized, with competition allowed on only a few easily-understood terms, such as annual fees and interest rates.[6] In some ways, this is what the situation was with most mortgages well into the 1990s. Professors Michael Barr (now Assistant Secretary of the Treasury for Financial Institutions), Eldar Shafir and Sendil Mullainathan have suggested the development of high quality, easily understood "default" products such as mortgages, credit cards and bank accounts, allowing other products to be sold, but with more negative consequences for sellers if the products go bad, such as requiring the seller to prove that the disclosures were reasonable as a condition to enforcing the contract, including in a mortgage foreclosure action.[7] This is the genesis of the concept in the Administration's proposal that the CFPA propose and give special protection to "plain vanilla" products with terms that are simple and easy to compare.[8]

Third, enforcement is important. Rules that are not enforced, or not enforced equally across providers, generate both false comfort and confusion, and tend to drive, through market forces, all providers to the practices of the least well regulated. This is in many ways what we have seen with respect to mortgages; it is not just that some entities were not subject to the same rules as others, but also that the rules were not enforced consistently across entities. The Administration proposes to accomplish this by transferring primary federal supervision and enforcement for consumer protection with respect to all depositories into the CFPA. As noted above and discussed below, while this could improve consistency, on balance I think it may not be the most effective result. The Administration's proposal appears to contemplate that the CFPA would also engage in prudential supervision, i.e., on-site examinations, of state-regulated non-depository institutions, although "the states should be the first line of defense."[9] Especially if it means that entities not now subject to prudential supervision would be, it could be very large undertaking, given the number and type of institutions involved, but it could also lead to substantial improvements for consumers of the services of non-depositories.

ESTABLISHING A CONSUMER FINANCIAL PROTECTION AGENCY

The time has come to elevate the consistent consideration of consumer protection with respect to financial instruments to the same level of concern as the financial stability of the financial system. Indeed, as the current crisis demonstrates, failure to do so leads to financial instability. As the Administration notes in its proposal, elevating consumer protection requires understanding what consumers need; how products are marketed and sold; how consumers get information about, understand and use products; and the benefits and risks of various products to different consumers. Solving for protection given varied needs and experiences is difficult enough. But solving for protection without also paying attention to meeting needs—for example the liquidity needs of someone living paycheck to paycheck—will just push both providers and consumers into the "informal" sector, a sector that will exist no matter what laws and regulations we enact.[10]

I support the creation of a new, independent Consumer Financial Protection Agency, with rulemaking, enforcement and complaint-collection responsibilities. This would be an independent agency, on the model of the Federal Trade Commission or Consumer Product Safety Commission, with responsibility for (i) receiving and investigating consumer complaints; (ii) writing regulations to enhance the protection of consumers with respect to financial products, practices and features and to enhance access to products that are transparent, simple and fair; and (iii) enforcement of those regulations. The agency should also conduct cutting-edge in-depth research on

---

[6] Ronald Mann, "'Contracting' for Credit," 104 Mich LR 899 (2006) at 927-28.

[7] Michael Barr, Sendhil Mullainathan, and Eldar Shafir, "A One-Size-Fits-All Solution," *New York Times*, December 26, 2007, available at http://www.nytimes.com/2007/12/26/opinion/26barr.html?scp=1&sq=michael percent20barr percent20mortgage&st=cse. See also Michael Barr, Sendhil Mullainathan, and Eldar Shafir, "Behaviorally Informed Financial Services Regulation" (Washington, DC: New America Foundation, October 2008), available at http://www.newamerica.net/files/naf_behavioral_v5.pdf.

[8] Proposal, pages 66-67.

[9] Proposal, page 59.

[10] Proposal, page 59.

needs, products and practices, the utility of various approaches to protection, and the efficacy of consumer protection regulations. As the Administration has proposed, the initial scope of authority of the CFPA should be consumer credit and related transaction, deposit, payment and savings products,[11] although one might consider extending the scope over time, and as the new agency proves its value. The products named are the most widely used, most likely to cause long-term serious financial difficulties (especially for families with little cushion for loss) and subject to the most checkered and inconsistent regulatory coverage at both the state and federal levels.

Complaints

There has only been limited focus on the treatment of complaints, but centralizing the consumer complaint function at a single agency is important. While the Administration proposes centralizing complaints related to federally-regulated entities,[12] we would do well to think more broadly. A nationwide complaint function, covering state-regulated, as well as federally-regulated entities would have sufficient scale and focus to make it possible to create a world-class system, easy to use, and effective in serving individuals, helping providers resolve problems, and finding systemic problems. It would provide consumers a single point of contact, rather than requiring them to navigate the complex world of financial services providers and regulators when they have a problem or concern about a financial service or product, and also provide some consistency in response. It addition, the agency would have the tools to recognize, research and respond to developing problems before they threaten the economy—or large numbers of consumers.

Regulations

With respect to regulations, the mortgage situation has shown that a base level of regulations that all providers must adhere to is a precondition to keeping the market at the level of those engaged in best practices—or at least the practices condoned by the regulators—not the worst. The Administration proposes that the CFPA's mission "be to help ensure that:

- consumers have the information they need to make responsible financial decisions;
- consumers are protected from abuse, unfairness, deception, or discrimination;
- consumer financial services markets operate fairly and efficiently with ample room for sustainable growth and innovation; and
- traditionally underserved consumers and communities have access to lending, investment and financial services."[13]

The Administration proposes to unite responsibility for all federal consumer protection laws relating to consumer financial products other than investment products[14] in the new entity. This will ensure regulatory consistency and thus enhance innovation. Moreover, bringing all financial consumer responsibilities together will help provide the scale and scope of regulatory authority to develop expertise and give the CFPA the gravitas and power to attract high quality talent and be taken seriously.[15] Establishing the CFPA while not shifting regulatory responsibility for existing statutes to it might well reduce the interest of current regulators in the field, thus potentially reducing, rather than enhancing, overall consumer protection.

[11] Proposal, page 57.
[12] Proposal, page 62.
[13] Proposal, pages 57-58. The proposal also recognizes the importance of compensating the staff on a par with staff of other independent financial regulatory agencies.
[14] Jurisdiction over investment products would remain with the SEC, but a Financial Consumer Coordinating Council would be established to enhance consistent regulation of products that could fall under the jurisdiction of multiple agencies. Proposal, pages 70-74.
[15] Given changes in financial services and technology in the years since some of these statutes were last considered in depth, the CFPA should also be required within a reasonable period to recommend any changes needed in these laws.

The CFPA would be not just be about protection in the "thou should not" sense of the word; indeed, there is emphasis in the Administration's proposal on the affirmative, on consumers having access to the financial products they need to live their lives fully and that those products are transparent, simple and fair.[16] Access is a concept that extends beyond fair lending and the CRA. It covers issues like understanding how consumers actually use financial products and what kinds of protections and notice consumers value and use. For example, how valuable are monthly paper statements to consumers who run the risk of overdraft at the end of every bi-weekly pay period? Would text alerts be more effective in helping them manage their accounts?[17] By focusing on these issues the CFPA may be able to spur innovation and keep costs down while enhancing consumer protection. The Administration envisions the CFPA having strong research capacity, using data both it and the industry collects to enable it to become expert in consumer understanding and behavior.[18] This can help it regulate effectively without necessarily having a heavy hand.

As I understand the Administration's proposal, the CFPA would not be required to pre-approve products, although "no action" letters would be available to producers and developers of new products who wanted to be sure their product disclosures met the CFPA's "reasonableness" standard. I agree that requiring product pre-approval would be a mistake. Financial products are almost infinitely variable, and small variations can make a big difference in safety and effectiveness. Moreover, financial activities consist of practices and processes, as well as products—and sometimes the delivery channel matters more than the product. In addition, technology is generating new opportunities, which can work to consumers' benefit as well as their detriment, at a very fast pace. In this atmosphere, requiring pre-approval would be a drain on resources and a bar to useful innovation. In addition to the "no action" concept, an alternative to pre-approval that might be useful, especially as to products, would be to require providers to file product descriptions with the new agency, at least with respect to a specified group of products and terms. This could enhance the agency's ability to stay up-to-date on innovations in the market and potentially to respond to troublesome products or terms before they become widespread.

Supervision and Enforcement

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

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

---

[16] Proposal, pages 63-70.
[17] Proposal, pages 59, 65-66.
[18] Proposal, pages 62, 70.

Funding

A critically important concern in creating any new agency, especially a regulatory agency whose primary constituency is a diffuse public of consumers of financial services, is how to fund it. The two major options, which can be used in tandem (as with the Food and Drug Administration), are appropriations and some sort of special tax or user fee. Appropriations have the advantage of being subject to the normal budget process, in which national priorities are reflected in funding levels. However, as the rather depressing history of funding for both the FTC and the CFTC (as well as for OFHEO, the former regulator of Fannie Mae and Freddie Mac) has demonstrated, consumer safety agencies do not always come out of this process with sufficient funds to meet their responsibilities. User fees also have their problems. Although all agencies that deal repeatedly and primarily with a relatively small group of private firms are subject to regulatory "capture," in which the interests of the regulated diminish the zeal for regulation, the situation is particularly difficult when the agency is funded by those it regulates.

For the CFPA, a possible solution would be to use appropriated funds to get the agency—including the consumer complaint function—up and running and to fund the research and analytical and other functions that are not purely regulatory. However, long-term reliance on funding the regulatory function through the general budget (even if ultimately funds are appropriated) would fly in the face of the experience with other regulatory agencies. And although regulatory capture is a potential problem with user fees, since all providers of consumer financial services will be subject to the agency's jurisdiction, the issue of charter choice is not present. This is not to say that a user fee is easy to craft. There is no all-encompassing licensing system to add a fee to,[19] the CFPA's proposed jurisdiction is so broad that it would be inefficient to tax all transactions covered by it, and requiring federal bank regulators to fund the new agency would put the entire funding burden on only one part of the affected industry. One possibility would be require entities in major groups 60 (depository institutions) and 61 (non-depository credit institutions) of the Standard Industrial Classification to pay a fee, preferably based on transaction volume, not assets, to support the agency. While this would not cover entities that were not "primarily engaged" in providing these services (e.g., a retailer that extends credit), it is likely to reach all major providers, and others could be added as gaps become apparent.

Relationship between Federal and State Laws and Regulations

A final question that needs to be faced is the relationship between the regulations promulgated by the CFPA and those of other regulators. This is primarily an issue relating to state laws and regulations, and raises the issue whether we are content with a low ceiling (i.e., federal preemption with relatively low standards) or whether we have learned from the recent crisis that a high floor (high federal standards, but with states allowed to supplement) is more effective for both consumers and the economy. Financial institutions are understandably concerned about having to follow multiple sets of rules, especially if they are in conflict. But the Administration's proposal may actually enhance the likelihood of consistency. If the federal government—either by statute or regulation—sets a relatively high bar with respect to consumer product regulation, states have little interest in adding regulation. On the other hand, there may be local conditions or circumstances in which problems are more apparent or apparent earlier and more appropriate for response at the state level than at the federal, and I believe that door should remain

[19] The proposal suggests establishment of a licensing regime for non-depository financial service providers and intermediaries, built on the model for licensing of mortgage originators in the SAFE Act, whose federal responsibilities the Administration proposes to transfer to the CFPA. (Housing and Economic Recovery Act of 2008, Pub. L. 110-289, Division A, Title V, §§ 1501 – 1517, 122 Stat. 2654, 2810 – 2824 (July 30, 2008), codified at 12 U.S.C. 5101- 5116, Proposal at 61.) The federal government would establish minimum standards for licensing providers of consumer financial products who are not already subject to state or federal prudential supervision, and require states to adopt a licensing system with standards at least as stringent as the federal floor. As the proposal suggests, the standards could include net worth and bonding requirements, as well as a central database of providers. Although licensing would not directly enhance consumer protection standards, it could be a way of keeping track of providers, enhancing solvency (including the ability to compensate injured consumers), and potentially establishing a mechanism for collection of fees to support the CFPA.

open. States should not, however, be able to adopt laws or regulations in conflict with federal rules. This is essentially the position that the Administration has taken in its proposal.

The situation can be illustrated with an example. Let us assume the CFPA decides to take up the issue of payroll cards. These are generally a very positive tool by which workers who do not have bank accounts can be paid quickly and safely, even if they are in remote locations. But the cards also can come with a variety of fees that can limit the benefit, especially if workers are not well-informed about how to best use them. Moreover, until recently there was some question whether the funds on the cards benefitted from deposit insurance. So the CFPA might be interested in regulating fees, enhancing disclosure and education, and making certain that the preconditions for deposit insurance are met. Let us say the CFPA adopts regulations that limit the fees that can be charged. A payroll card company notices that dormancy fees—fees that reduce balances when the card is not used—are not explicitly prohibited and decides to implement them. What could a state regulator who believed such fees were improper do?

I think the answer is "it depends," and that's an appropriate answer. Did the regulation explicitly state that the fees it covered are the only kinds of fees that could be charged? In that case, the state regulator has an enforcement action—perhaps in concert with the CFPA. Did the regulation explicitly say dormancy fees are allowed? In that case, the state regulator's concern would be in direct conflict with the federal regulation, and the federal regulation should govern. Is the regulation silent, but it is clear the federal regulators considered limiting dormancy fees and rejected such a limitation? I believe that case also limits the prerogatives of the state regulator. But what if the record is silent, or if the federal regulator explicitly left the issue for another day? In those cases, as well as the situation in which someone invents something that essentially performs the function of a payroll card but is designed to get around the regulatory definition, the state regulator should be free to act. One can hope that he or she (or the state legislature) will act after consulting and potentially in coordination with the CFPA, but limiting the states' ability to respond to problems that arise outside the scope of federal regulations would, in my opinion, be a mistake.

The Proposal to Move Community Reinvestment Act Evaluations to the CFPA

I would like to say a special word about the inclusion of the Community Reinvestment Act in the President's proposal. The proposal states (at pages 69-70) that "The [CFPA] should enforce fair lending laws and the Community Reinvestment Act . . . [and] . . . have sole authority to evaluate institutions under the CRA." What is encouraging about this is the Administration's strong support for CRA and view of CRA as a critical element in making quality financial services available to all people in all communities.[20] As stated in an article I recently co-authored with Jeremy Nowak of The Reinvestment Fund,[21]

> [I]t is time for explicit recognition that government regulation and oversight are what enable private financial services companies to operate profitably at high levels of leverage. In return, those companies must be held to an affirmative mandate to fairly and equitably serve all communities, sectors and constituencies. . . .The case for doing so revolves around four observations:
>
> - Mainstream financial institutions have a long history of neglecting lower income and minority communities
> - Such neglect degrades the impact of significant government expenditures at the federal, state and local levels
> - The dislocation of financial institutions from local communities limits the capacity of these communities to marshal civic resources
> - Regulated industries and their regulators are inherently conservative (notwithstanding recent excesses) and overestimate the risks involved in serving these communities"

[20] The proposal does not, however, suggest extending CRA's obligations beyond banks and thrifts to the other types of financial institutions that would be subject to the jurisdiction of the CFPA.

[21] Nowak, Jeremy and Seidman, Ellen, "Rediscovering a Public Purpose in Financial Services," Opportunity Finance Network, February 2009, available at http://www.opportunityfinance.net/store/Downloads/Call_to_Action_021309.pdf.

Nevertheless, I am not convinced that the CFPA is the best place to locate CRA, especially if the CRA obligation is not extended beyond banks and thrifts. This is for three primary reasons. First, CRA explicitly and appropriately states that the affirmative obligation to serve is to be exercised "consistent with safe and sound operation."[22] This will be harder to accomplish if CRA evaluation is separated from the entity responsible for evaluating safe and sound operation. Second, possibly the most consistently effective part of CRA over the past thirty years has been its support for community economic development—affordable multifamily housing; community facilities such as clinics, schools and community centers; shopping centers and other economic anchors; pre-bankable small business lending; support of Community Development Financial Institutions. These are not consumer protection functions, although there certainly is a correlation between communities in need of economic development and consumers most in need of consumer protection. But they are different concepts, using different tools, for different purposes. Finally, the current enforcement mechanism for CRA—consideration of CRA evaluation at the time of a merger, acquisition or certain other actions—must, as the Administration's proposal recognizes, remain with the prudential supervisor. This mechanism is outdated in a world in which 4% of banking institutions (those with assets of more than $10 billion) already hold 77% of the system's assets.[23] Moreover, it is counterproductive in that the permission to merge that a high CRA rating facilitates also has a tendency to dilute service to the very communities previously well served. Nevertheless, unless and until that mechanism is changed, separating the rating from the enforcement seems unwise.

If the decision is made to move CRA to the CFPA, I suggest three safeguards to mitigate some of the problems cited above. First, there should be a statutory requirement for a separate division of the CFPA devoted explicitly to all parts of CRA, including in particular community economic development and the affirmative obligation to serve all communities. Several of the bank regulatory agencies, including several Federal Reserve Banks, have been doing good work in this area over the last several years, and those staffs could form the basis of such a division. Second, the prudential supervisors should be given an opportunity to participate in CRA examinations and also to review and comment on CRA evaluations before they are issued. Finally, the CFPA should be required to report to the Administration and Congress within a year with recommendations for updating, expanding and improving CRA. Much work has already been done to lay the groundwork for such recommendations;[24] if the CFPA is to effectively implement an affirmative mandate to serve communities, it should bring that work to fruition.

CONCLUSION

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

[22] 12 USC 1209.

[23] Calculation based on Federal Deposit Insurance Corporation, "Quarterly Banking Profile," June 2009 (covering first quarter 2009), Table III-A, available at http://www2.fdic.gov/qbp/2009mar/all3a2.html.

[24] See in particular "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act," Federal Reserve Banks of Boston and San Francisco, February 2009, available at http://www.frbsf.org/publications/community/cra/index.html.

Testimony of the
National Association of Insurance Commissioners

Before the
Committee on Financial Services
United States House of Representatives

Regarding:
"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"

Wednesday, June 24, 2009

Ralph S. Tyler
Commission of Insurance
State of Maryland
On Behalf of the National Association of Insurance Commissioners

Testimony of Ralph S. Tyler
Commissioner of Insurance
State of Maryland
On Behalf of the National Association of Insurance Commissioners

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today on enhancing consumer financial product regulation. My name is Ralph Tyler. I am the Commissioner of the Maryland Insurance Administration and I am here today on behalf of the National Association of Insurance Commissioners (NAIC).

In light of turmoil in the financial markets, legislators and regulators are appropriately questioning the structure and protections of our financial regulatory system. Much of that attention has been on the efficiency and effectiveness of financial or prudential supervision. But equal attention must be given to consumer protection encompassing not just financial supervision but market regulation and oversight of company conduct.

It is clear that some areas of the financial regulatory system have separated these two critical missions: financial supervision and consumer protection. While that may be an appropriate structure for other financial sectors, the states believe insurance has unique challenges best handled by a single regulatory department. Product design directly affects solvency, so we do not think supervision of these areas should be separated. Unlike other financial products, insurance is a promise to pay an unknown cost if an unknown event occurs. While a fundamental consumer protection is the underlying ability of the insurer to honor those promises, it also includes how the insurer treats its customers, beginning with the contents of the policy through claims payment. What also makes these products unique is that consumers tend to interact with insurers only when a negative event has transpired, creating additional strain on the relationship between the insurer and the policyholder.

The states have developed a wide range of consumer protection tools, detailed below, designed around these complex products and unique interactions between insurers and policyholders. For these reasons, we believe a new agency to regulate consumer protections in insurance is not necessary, and would cause the kind of overlaps that lead to preemption of state laws and rules designed specifically to address the complexities of insurance.

Establishment of Market Regulation

Congress is appropriately asking how to ensure that consumer protection is as fundamental to financial product regulation as safety and soundness protection. Insurance regulators view these two areas, financial regulation and market regulation, as essential and linked. We have a national system for solvency assessment that has weathered the current economic crisis reasonably well, and while we believe such financial supervision is a critical consumer protection, I will focus my remarks today on market regulation.

The basic purpose of market regulation is to protect consumers by identifying and correcting insurer operating practices that are in conflict with contract provisions, state laws, rules, regulations, or orders of the Commissioner. A cornerstone of this effort is the NAIC Unfair Trade Practices Model Act. Every jurisdiction has adopted this model act or substantially similar legislation to protect consumers from inappropriate activity. The model prohibits sixteen defined unfair trade practices which, for example, include: 1) misrepresentation and false advertising, including omission; 2) providing false information, such as publishing an advertisement or announcement containing any assertion with respect to the business of insurance that is untrue, deceptive or misleading; and 3) distributing any literature that is false or maliciously critical of or derogatory to the financial condition of any insurer, calculated to injure such insurer.

Coupled with the Unfair Trade Practices Act is the Unfair Claims Settlement Practices Act, which provides consumers the necessary protections during the insurance claims process. This model act, adopted in forty-seven jurisdictions (the remaining states have similar protections), prohibits insurers from engaging in the following practices: (1) misrepresenting material facts or policy provisions relating to coverage; (2) failing to make a good faith effort to pay claims with clear liability; (3) trying to make unreasonably low claim settlements; and (4) failing to approve or deny coverage within a reasonable time after receiving a proof-of-loss statement.

These laws provide a framework of consumer protection that gives state insurance departments broad authority to intervene on behalf of insurance policyholders.

Company Licensing

The ability to license or not license an insurance company to conduct business in Maryland is a powerful tool I have to protect consumers from bad actors. During the company licensing process, a state insurance department reviews the financial resources of the applicant to ensure there is a minimum level of capital and reserves to operate as an ongoing insurance company. In addition, attention is given to the officers and directors of the applicant to ensure that the listed individuals have the minimum level of competency and trustworthiness. Finally, the company will be licensed for a specific line or lines of authority. As part of this process, the state insurance department obtains an understanding of the products to be sold and the market to be served. Some common questions a state insurance department attempts to answer include: (1) does the insurer have the financial capacity to write the business?; (2) does the insurance company have the appropriate expertise?; (3) can the insurer properly price the product?; and (4) will the insurer be competitive?

States carry out this licensing function through the Uniform Certificate of Authority Application, or UCAA, which all states have adopted. The UCAA is an electronic application form that sends the relevant licensing information to each state, preserving each state's ability to perform an independent review. As part of this effort, the NAIC has also published a Company Licensing Best Practices Handbook to assist regulators in reviewing licensing applications.

Producer Licensing

In addition to scrutinizing a company that wants to sell insurance, regulators must also scrutinize the primary point of sale for insurance. Similar to company licensing, an insurance department will also license the business entities (agencies) and individual producers (agents and brokers) selling insurance products. This is an extremely important process, as most consumers look to their insurance agent as the expert on insurance. The producer licensing process includes examinations, background checks, and continuing education requirements to ensure that individuals selling, soliciting or negotiating insurance have the appropriate knowledge and are of good moral character. Throughout this process, state insurance regulators retain broad authority to deny, suspend or revoke an insurance producer's license. In 2007, state insurance regulators reported nearly 16,000 license suspensions, 1500 license revocations, 333 cease and desist orders, over $25 million in producer fines and nearly $30 million in restitution to consumers.

All of these activities are coordinated through the State Producer Licensing Database (SPLD), a central repository of producer licensing information updated regularly by participating state insurance departments. Currently, the SPLD includes information from all fifty states, as well as the District of Columbia and Puerto Rico.

In 2007-2008, the NAIC membership initiated and completed a comprehensive Producer Licensing Assessment Project, an on-site review of each state's producer licensing laws and processes. Through the NAIC, states have also made tremendous progress in national uniformity and reciprocal treatment of producers using electronic licensing initiatives. As of January 31, 2009, the following states utilize the electronic licensing services of the National Insurance Producer Registry, a non-profit affiliate of the NAIC:

- Non-Resident Licensing for Individuals – 49 states.
- Non-Resident Licensing for Business Entities – 34 states.
- Non-Resident Renewals for Individuals – 39 states.
- Electronic Funds Transfer for State Fees – 47 states.
- Address Change Requests – all states.
- Electronic document storage for applicants – all states.

Consumer Services

Once the companies, producers and products are in the marketplace, 1,600 state consumer service personnel help monitor the marketplace by handling consumer inquiries and consumer complaints. The consumer service representatives in state insurance departments are truly the front line regulators, as they interact with consumers on a daily basis. They respond to over 2.3 million consumer inquiries and 370,000 formal consumer complaints each year. Information for the state of Maryland is below:

	2006	2007	2008
Complaints received	14,435	13,399	12,482
Complaints closed	15,092	13,557	12,903
Recovery	$5.4 million	$5.4 million	$5.7 million
Orders	17	26	29

Administrative penalty	$5,500	$16,750	$7,250

In order to make this type of information more accessible to consumers, the NAIC has established the Consumer Information Source (CIS) (https://capps.naic.org/cis/) to give insurance consumers across the country a centralized location to access marketplace information on insurers. Through the CIS, consumers can access key information, including closed insurance complaints, licensing information and key financial data. In addition, consumers can file an insurance complaint directly through the CIS.

Antifraud/Criminal Investigation

To deal with issues involving criminal activity, many insurance departments have antifraud and criminal investigators who work closely with federal, state and local law enforcement officials to prosecute insurance fraud. To help fight fraud, the NAIC created a uniform fraud reporting system through which consumers and insurance companies can electronically report suspected fraud to the appropriate insurance department. In addition, the NAIC maintains the Special Activities Database (SAD) to capture market activities and legal actions involving entities engaged in the business of insurance. Fraud adds unnecessary cost to insurance consumers, so my staff actively works to bring bad actors to justice. As an example, we recently investigated a producer suspected of embezzling $39,113 from an insurance company. The producer admitted to writing six separate checks to himself and his wife from the insurer's checking account. We ordered the producer to pay the full $39,113 in restitution, revoked his license and referred the matter to the Fraud Division for criminal prosecution. Maryland is not unique in this effort. There are over 1,200 state employees involved in anti-fraud and related enforcement activities.

Rate and Form Review

Again, because the ultimate value of insurance is only known after the product is purchased and a claim is filed, states have taken steps to review the adequacy and appropriateness of many insurance products before they are made widely available. State insurance regulators recognize that insurance policies are very complicated contracts that many, if not most, insurance consumers do not read or understand. With that in mind, insurance departments review policy forms to ensure that consumers are getting the coverage they've paid for, and that the policy provisions are in compliance with statutes and regulations for readability and the offer of mandated benefits. This approach also assures the public that the policy is sold for a legal purpose, has an appropriate insuring agreement, and does not contain exclusions, exceptions or conditions that are contrary to law.

Because insurance rates are based on actuarial analysis and assumptions that are challenging for the average consumer to determine, states have stepped in to review insurer rates and rate methodologies. With rate review, the general standard of review is to determine if the rates are adequate but not excessive or unfairly discriminatory. To streamline the filing of rates and forms, the NAIC has developed the System for Electronic Rate and Form Filing (SERFF), now used in fifty-one jurisdictions. SERFF is an electronic processing system that in 2008 allowed 2,851 insurance companies to make 554,261 rate and form filings to the states.

Market Analysis

States have taken significant steps recently towards the creation of a more systematic, structured and uniform market analysis program. The purpose of market analysis is to identify, assess and prioritize market conduct problems that have a substantial adverse impact on consumers, policyholders and claimants. Through this effort, state analysts are able to identify companies that warrant further regulatory scrutiny. As part of this process, state analysts can use the NAIC's Market Analysis Review System to get a basic understanding of a company under review, to eliminate companies that do not warrant further analysis and to begin investigating the cause of an anomaly when a company does warrant additional analysis.

The NAIC has also created the confidential Market Analysis Prioritization Tool, which allows market analysts to compare similar companies on a national and state basis, and the Market Conduct Annual Statement, which provides for the capture of much needed market data from insurance companies. The Market Conduct Annual Statement allows companies to be compared on an equal basis using uniform data and helps regulators allocate market regulation resources where they can be most effective.

Market Conduct Examinations

A key component of consumer protection for insurance is on-site examinations of insurers through market conduct examinations. Market conduct examinations involve direct contact with a company to discuss and correct an identified problem or to obtain a better understanding of how the company is operating in the marketplace. While usually completed on a targeted basis using upon market analysis, states have broad authority to examine company management and operations, marketing and sales, underwriting, customer service, claims handling and licensing. Market analysis and market conduct examinations are a critical component of consumer protection, with over 600 state employees and another 100 contractors involved in these functions. In the state of Maryland, there have been tangible benefits for consumers:

	2006	2007	2008
Property and casualty	39 investigations/exams $278,000 penalties $19.1 million restitution	144 investigations/exams $1.1 million penalties $6.8 million restitution	245 investigations/exams $533,000 penalties $2 million restitution
Life and health	8 investigations/exams $400,000 penalties $0 restitution	11 investigations/exams $490,000 penalties $950,000 restitution	15 investigations/exams $740,000 penalties $0 restitution
Producer enforcement	443 cases closed $50,000 penalties $1.6 million restitution	441 cases closed $27,000 penalties $3.4 million restitution	683 cases closed $110,000 penalties $5.9 million restitution

Interstate Collaboration

Clearly there is a robust system for consumer protection at the state level, but the states have also made great strides to coordinate their efforts wherever possible and appropriate. Through the NAIC, the states have a forum to coordinate market analysis and examination efforts. By implementing market analysis techniques and sharing pertinent information, states can identify those regulated entities where there is a shared concern regarding the regulated entities' market practices. Also through the NAIC, the states maintain centralized data collection so that key information on consumer complaint tracking, examination tracking and enforcement actions is available to all states without duplication of cost or effort. These efforts provide for a national system of consumer protection, with local control and responsiveness to meet the needs of consumers in varying state markets.

<u>The Interstate Compact: Uniform Standards and Single Approval for Life Products</u>

In the life insurance sector, states have gone beyond the forum of NAIC to create a system of uniform standards and approval, while retaining the checks and balances of state-based consumer protections. Life insurance risks do not vary from state to state the way property risks do, and the products lend themselves to uniform treatment. To preserve state market regulation while streamlining the standards and approval process for this sector, the states have formed an interstate compact, called the Interstate Insurance Product Regulation Commission (IIPRC), to develop a single set of uniform standards and a single point of product review and approval for life insurance, annuities, disability income and long-term care insurance.

IIPRC has been adopted by thirty-five states and Puerto Rico (Compacting Member States), and represents over half of the premium volume nationwide. The concept was developed in 2002 and became operational in 2006 when twenty-six states passed enabling legislation. The IIPRC is a public entity treated as an instrumentality of the Compacting Member States. The IIPRC provides the States with a vehicle to: (1) develop uniform national product standards that will afford a high level of protection to consumers of life insurance, annuities, disability income and long-term care insurance products; (2) establish a central point of filing for these insurance products; and (3) thoroughly review product filings and make regulatory decisions according to the uniform product standards.

The Compact requires that product standards prohibit the use of any inconsistent, misleading or ambiguous provisions. It also requires that the form of the product made available to the public shall not be unfair, inequitable or against public policy as determined by the IIPRC. Companies maintain the choice of filing products through the IIPRC or filing products directly with a state. IIPRC represents a unique tool that combines national treatment, uniform standards, and state consumer protections.

Federal Consumer Financial Protection Agency

States have a long history of consumer protection, with the ability to respond quickly when problems arise. This responsiveness can lead to inconsistencies among various state laws, but any cost associated with complying with these different state laws is offset by the value of a strong and nimble regulatory system. The current financial crisis illustrates this reality, as regulatory systems built to emphasize uniformity and efficiency over responsibility and effectiveness were primary sources of systemic risk and systemic failure.

The fundamental question for today's hearing is: How should the financial regulatory system be improved to ensure consumers are protected? As a state insurance regulator, it is not for me to decide whether a separate agency is necessary for other financial sectors, or whether empowering existing regulators with a consumer protection mandate is the best course of action for those different products. However, it is clear that there was a lack of attention to market regulation in certain segments of the financial system, and it is in those areas that Congress should focus its efforts and taxpayer resources.

What the Congress should not do, in our view, is to empower that agency to wade into insurance, an area where strong consumer protections have long been a fundamental tenet of supervision and embedded in our regulatory and legal systems. It is the strong standards in the states that, in part, cause our critics to call for broader federal preemption. We do not need a competing federal regulator to feel the pressure from our industry and the Congress for sustained reform, but a competing regulator, no matter how innocuously envisioned, will ultimately erode a state system that is inherently centrist and undeniably effective.

Our system is not without its flaws and challenges. Congress has never shied away from pointing out where we can do better, and we welcome that scrutiny. If there are areas of insurance consumer protection that need improving, I would venture a guess that the states are aware of and working on those issues already. But stripping that fundamental authority from the states, or bifurcating it with a federal entity that inevitably will cause conflicts, confusion, and down the road, preemption, will do nothing to solve the problems exposed by our financial crisis.

As you approach this legislation, please by guided by the Hippocratic Oath imposed on the medical profession – above all, do no harm.

Thank you for the opportunity to testify, and I look forward to your questions.

HARVARD LAW SCHOOL
CAMBRIDGE, MASSACHUSETTS

ELIZABETH WARREN
LEO GOTTLIEB PROFESSOR OF LAW

PHONE: 617 495 3101
FAX: 617 496 6118
EWARREN@LAW.HARVARD.EDU

Testimony
House Financial Services Committee
"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"
Wednesday, June 24, 2009

My name is Elizabeth Warren. I'm the Leo Gottlieb Professor of Law at Harvard University and the Chair of the Congressional Oversight Panel.

Washington is a complicated place, and this Committee deals with its fair share of complicated issues. But we are here today because of a problem that can be explained in five blunt words: the credit market is broken.

That problem not only caused the current financial crisis, but it threatens to perpetuate the crisis and also trigger similar economic tragedy in the future.

I'm not here today to talk about everyone who has gotten into trouble on a credit card or who has a mortgage that is too big. The need for personal responsibility is as strong as ever. If someone goes to the mall and charges thousands of dollars to buy things they can't afford, they should have to deal with the consequences. And if someone signs on to buy a five-bedroom home with a spa bath and a media room that they can't afford, they should lose it.

We are here today to talk about broken markets—and about the consequences of those broken markets for hard-working, play-by-the-rules families, for financial institutions competing on a skewed playing field, and for our entire economy.

We all know the value of a well-functioning market. It increases efficiencies and produces prosperity. But when a market is broken, the cost is enormous—not just for consumers, but for everyone.

I'm happy to be here today to talk about how I think we can help fix the broken credit market. And I can sum it up in four words: Consumer Financial Protection Agency.

Tricks and Traps Pricing

I've been around long enough to remember the old model of banking. It's a model that most of us grew up with, as I did in Oklahoma. The model was simple and effective: consumers shopped around for products and terms, and lenders evaluated the creditworthiness of potential borrowers before making loans.

Today, the business model has shifted. Giant lenders "compete" for business by talking about nominal interest rates, free gifts, and warm feelings, but the fine print hides the things that really rake in the cash. Today's business model is about making money through tricks and traps.

There are three problems with this new model.

The first problem hits consumers directly. Plain and simple, consumers cannot compare financial products because the financial products have become too complicated. In the early 1980s, the average credit card contract was about a page long. Today, it is more than 30 pages.[1] It would take hours to parse these contracts, and even then, I'm not sure what the customer would know. I am a contract law professor, and I cannot understand some of the fine print. Even people who try to understand their contracts and who do their best to live up to their side of the bargain fall into traps and get stuck with well-hidden risks.

Part of the problem is some bad regulations that encourage fine print. But much of the problem is part of the business plan. Study after study shows that credit products are designed in ways that obscure the meaning and trick consumers.[2] A 2006 study by the Government Accountability Office (GAO) found that "many [credit card holders] failed to understand key aspects of their cards, including when they would be charged for late payments or what actions could cause issuers to raise rates."[3] Moreover, the GAO found that "the disclosures in the customer solicitation materials and card member agreements provided by four of the largest credit card issuers were too complicated for many consumers to understand."[4]

These findings are reinforced by a 2007 study commissioned by the Federal Reserve Board. That study, based on focus group sessions and one-on-one interviews, found that many consumers have difficulty understanding current credit card disclosures.[5] The Federal Reserve identified terms that many consumers did not understand, including:

- many of the numerous interest rates listed;
- when issuers disclose a range of annual percentage rates (APRs), that their specific APR will be determined by their creditworthiness;
- that the APR on a "fixed rate" credit card product can change;
- what event might trigger a default APR;
- what balances the default APR will apply to;
- how long the default APR will apply;
- what fees are associated with the credit card product;
- how the balance is calculated (*i.e.*, two-cycle billing);
- how payments are allocated among different rate balances;
- the meaning and terms of "grace period" and "effective APR";
- the time, on the due date, that payment is due;
- when the introductory rate expires;

- how large the post-introductory rate is; and
- the cost of convenience checks.

The Federal Reserve Board has revised its regulations under the Truth and Lending Act, but there is no indication that credit card contracts will get shorter and more manageable.[6] Even the more effective disclosure designs that were tested in the study and adopted by the Federal Reserve in the proposed revisions to Regulation Z did not eliminate consumer mistakes.[7]

Mortgage products raise the same concerns. A recent Federal Trade Commission (FTC) survey found that many consumers do not understand, or even can identify, key mortgage terms.[8] A survey conducted by the Federal Reserve found that homeowners with adjustable rate mortgages (ARMs) were poorly informed about the terms of their mortgages.[9] Focusing on closing costs, the Department of Housing and Urban Development (HUD) has concluded that, "[t]oday, buying a home is too complicated, confusing and costly. Each year, Americans spend approximately $55 billion on closing costs they don't fully understand."[10] Mortgage lenders furnish reams of unreadable documents shortly before closing, often leaving people with no practical option but to take whatever terms the lender has filled in.

Survey evidence on other consumer credit products similarly suggests that consumers are only imperfectly informed about the relevant characteristics and costs of these products. For example, payday loan customers, while generally aware of finance charges, were often unaware of annual percentage rates.[11] With respect to another consumer credit product, the tax refund anticipation loan, approximately 50% of survey respondents were not aware of the fees charged by the lender. Survey evidence also suggests that "[m]ost consumers do not understand what credit scores measure, what good and bad scores are, and how scores can be improved."[12]

Consumers who face financial documents that do not communicate the basic terms of a credit agreement cannot make accurate predictions about how much risk they are taking on and cannot make effective comparisons among products.

A straightforward comparison among credit products is now impossible. Bank of America offers more than 400 different credit card products alone on its website—and who knows how many more on college campuses, at malls and through the mail? And how many of these cards include terms that permit the lenders to change any of the terms at any time? It makes little sense to invest in a comparison of terms when those terms can change at the next billing cycle. There are plenty of different cards today, but if consumers have no real ability to compare all the terms—particularly those complex terms that result in fees and higher interest—then there is no well-functioning credit market.

Economists of all stripes agree that thriving markets depend on information. The invisible hand of the market works well only when buyers and sellers both have full information about the value of the items they exchange.

Without information, market innovations do not work. For a clear example of this, consider what happened to Citibank. In 2007, under pressure from this very committee, Citibank took an admirable step and made a public pledge to ban universal default and any-time rate changes—practices that had allowed them to raise interest rates on customers who paid on time. Some members of this committee applauded that step. But a year later, Citi realized that, despite all the fanfare, the cards were still so complex that customers could not tell the difference between credit cards with these terms and credit cards without them. Citibank quietly picked the practice right back up again.[13] In a broken market, a better product does not attract buyers.

Good Products Get Lost

The broken credit market also creates problems for the lenders. The lack of meaningful competition has tilted the playing field between small and large institutions. Large institutions have the capacity to spend billions of dollars on advertisements to lure customers from local and regional banks and credit unions—even when those community banks or credit unions are offering better products with fewer—or no—tricks and traps.

Similarly, our existing body of complicated regulations helps large institutions and hurts the smaller ones. While a big institution can hire an army of lawyers and regulatory compliance specialists—and spread the costs over tens of millions of customers—regulatory costs can put enormous financial pressure on a small institution. In addition, as we have learned painfully, large financial institutions can take huge risks—including shaky consumer mortgages and credit cards—knowing that taxpayers will pick up the tab if they fail. Ironically, the taxpayers are often the same customers who have already paid an enormous price for these financial products. By comparison, smaller institutions know that if they take those risks and fail, they will be closed. The FDIC has closed more than 50 small banks just in the past year.[14] Because the comparison among products is not clear, the playing field between big banks and local banks is not level.

Risky Consumer Credit Increases Systemic Risk

Finally, a third problem with the broken credit markets—systemic risk—is a problem that affects everyone—even those who own their homes, don't have a credit card, and wait to buy a car until they have saved the cash. These risky credit products—particularly home mortgages and credit cards—were bundled up, put into trusts, sliced and diced, and sold to bigger financial institutions and eventually to pension funds and municipal governments.

The broken credit market helped create the crisis we are in now—the crisis that has cost Americans their secure pensions, the crisis that has pushed unemployment to 9.4%, the crisis that has frozen small businesses out of the credit market. The broken credit market has put American taxpayers on the hook for billions in subsidies and trillions in guarantees to shore up our largest financial institutions. We have all been hurt. If we do not fix this, we will be hurt again and again.

The last time we had an economic crisis this big was the Great Depression. In response, Congress and the President acted to prevent future disasters. Those new laws gave us fifty years without such a serious financial crisis. We spent those years building a strong middle class. Just like the 73rd Congress that passed FDIC insurance, making it safe for families to put money in banks and pretty much ending bank runs forever, this Congress has the chance to create a safer system for all of us—and for our children and grandchildren. In times of great crisis, narrow interests give way to an American public looking for Congress to get things right. This is an historic moment, and today you have a rare opportunity to bypass those narrow interests and serve the public interest.

What a Consumer Financial Protection Agency Can Do

I am here today because I believe that the establishment of a Consumer Financial Protection Agency is the best way to get things right. Specifically, I believe it will do four things:

Reduce Systemic Risk

First, it will reduce systemic risk. If we don't feed high-risk, high-profit loans into the system, those risks will not get sliced and diced into questionable asset-backed securities and sold throughout the financial system. If we had had a Consumer Financial Protection Agency five years ago, Liar's Loans and no-doc loans would never have made it into the financial marketplace—and never would have brought down our banking system. The economic system took on so much risk—one household at a time—that it destabilized our entire economy. If we stop feeding these high risk loans into the system on the front end, then we're all safe, and we will not need as much new regulation elsewhere in the system.

Reduce Regulatory Burdens

Second, a single regulatory agency watching out for families and individuals can reduce the overall regulatory burden. Right now, we have layers of contradictory, expensive, and sometimes flat-out useless regulations. We need to cut through all that, to authorize one agency to encourage and help develop some plain-vanilla, safe-harbor mortgages, credit cards, car loans and the like that will automatically pass regulatory muster. Picture it—a credit card contract that is two pages long, clear and easy to read, and that has a few well-lit blanks—the interest rate, the penalty rate, when a penalty will be imposed, and how to get the free gift. Each lender can decide how to fill in the blanks for the cards it wants to sell, and each customer can make quick comparisons to see who is offering the best deals. That is a market that works—cheap for the card issuer and good for the customer. Yes, banks could offer something else, but they have to show it meets basic safety rules—things like whether a customer can read it in four minutes or less. It is time to spend less time and less money on regulations that don't work and pass those savings on to the customers.

Foster Innovation

Third, the Consumer Financial Protection Agency will foster innovation. It is important to distinguish good innovation and bad innovation. Figuring out one more trick that boosts company revenues while picking a customer's pocket is not good innovation. Again, the analogy to physical products is useful. The Consumer Product Safety Commission does not permit manufacturers to "innovate" by cutting down on insulation or removing shut off switches. Safety is the baseline, so toaster manufacturers compete by coming up with better products at lower prices. That's innovation that works. Likewise, the proliferation of bad products can in fact hinder the innovation of good products. When the FDA began keeping sugar pills off the market, the pharmaceutical industry had more incentive to innovate and develop those safe products. Again, that is a market that works.

Some are arguing that the Agency will limit consumer choice. They say that consumers should choose the products they want for themselves without Big Brother stepping in. But how can consumers pick the products they want when they are unable to make real comparisons between them? What kind of choice is presented by stacks of paper with incomprehensible legalese—and a billion-dollar ad campaign to sell consumers on the highest-profit items? The Agency will fix the market by putting consumers in a position to make the best decisions for themselves. The financial institutions who have profited from hiding tricks and traps in the fine print may not like reform, but that is what happens when markets work like they should.

Level the Playing Field by Putting Someone on the Consumer's Side

Fourth, the Agency will provide a regulatory home for specialists who care about this issue and whose priority is to level the playing field and give American families a fair shake. We need an agency that allows regulators to make consumers their first priority—not where consumer protection plays second fiddle to bank profitability. We need specialists who won't just be on the bottom rung of an agency dedicated to other priorities.

If you have any doubts about whether a Consumer Financial Protection Agency can work, just look to history.

The FDIC was opposed by the big banks.[15] Would we be better off today if it hadn't been set up to insure deposits?

The FDA gets its fair share of criticism, but would we better off if we could still buy pharmaceuticals from anyone with a bathtub and some chemicals or if no one checked for carcinogens in our cosmetics?

The Consumer Product Safety Commission isn't perfect, but would we better off with fewer protections over infant car seats, bb guns, or lead in children's toys?

People are alive today because agencies made sure that products were safe. Markets work better today because agencies put basic safety regulations in place, so that competition is about things consumers can see. People who charge too much or who buy houses they cannot afford shouldn't be bailed out, but everyone should have a fighting chance to make good financial decisions.

You have a rare opportunity—in this committee and in this Congress—to get things right. Now is the time for a Consumer Financial Protection Agency to repair a broken market, to give families the properly functioning credit market that they deserve, to level the playing field among financial institutions, and to prevent the next economic crisis.

---

[1] Brian Grow and Robert Berner, *About that New, "Friendly" Consumer Product*, BusinessWeek (Apr. 30, 2009); Mitchell Pacelle, *Putting Pinch on Credit Card Users*, Wall Street Journal (July 12, 2004). For example, Citibank's credit card agreement was about 600 words—one page of normal type.

[2] For a more detailed discussion of the difficulties customers face in trying to decipher their credit agreements, *see* Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer*, University of Pennsylvania Law Review (2008) (online at www.pennumbra.com/issues/article.php?aid=198). The research from that paper is summarized here.

[3] United States Government Accountability Office (GAO), *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, at 6 (2006) (GAO-06-929) (online at www.gao.gov/new.items/d06929.pdf).

[4] *Id.* Edward Yingling, the President and CEO of the American Bankers Association, admitted that the complexity of their products and contracts confuses consumers. House Subcommittee on Financial Institutions and Consumer Credit, Testimony of Edward Yingling, *Hearing on Credit Card Practices: Current Consumer Regulatory Issues*, 110th Cong. (Apr. 26, 2007) (online at www.house.gov/financialservices/hearing110/htyingting042607.pdf) (acknowledging that the increased complexity of credit cards confuses consumers and can result in a difficult financial situation). Comptroller of the Currency

John Dugan similarly acknowledged that current credit card disclosure rules should be changed to improve consumers' ability to make well-informed decisions. *See* House Subcommittee on Financial Institutions and Consumer Credit, Testimony of John Dugan, *Hearing on Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives*, 110th Cong. (June 7, 2007) (online at www.house.gov/financialservices/hearing110/htdugan060707.pdf). After problems have increased for 30 years, the Federal Reserve Board and Office of Comptroller of the Currency recently made some revisions under TILA. *See* Federal Reserve Board, *Press Release* (May 2, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/20080502a.htm).

[5] *See* Macro International, *Design and Testing of Effective Truth in Lending Disclosures*, at ii-x (May 16, 2007) (online at www.federalreserve.gov/dcca/regulationz/20070523/Execsummary.pdf) (hereinafter "Disclosure Efficacy Study").

[6] *See* Federal Reserve Board, *Press Release* (May 23, 2007) (online at www.federalreserve.gov/newsevents/press/bcreg/20070523a.htm).

[7] *See* Disclosure Efficacy Study, *supra* note 5 (throughout the report, a comparative qualitative assessment is provided for different disclosure designs; the proposed designs were shown to be more effective, but not fully effective).

[8] *See* James M. Lacko and Janis K. Pappalardo, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms*, Federal Trade Commission Bureau of Economics Staff Report (June 2007) (online at www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf). For example, 95% of respondents could not correctly identify the prepayment penalty amount, 87% could not correctly identify the total up-front charges amount, and 20% could not identify the correct APR amount.

[9] *See* Brian Bucks and Karen Pence, *Do Homeowners Know Their House Values and Mortgage Terms?*, Federal Reserve Board, at 26-27 (Jan. 2006) (online at www.federalreserve.gov/pubs/feds/2006/200603/200603pap.pdf).

[10] U.S. Department of Housing and Urban Development, *News Release* (June 27, 2005) (online at www.hud.gov/news/release.cfm?content=pr05-091.cfm).

[11] *See* Gregory Elliehausen, *Consumers' Use of High-Price Credit Products: Do They Know What They Are Doing?*, Networks Financial Institute, at 29 (May 2006) (online at www.networksfinancialinstitute.org/Lists/Publication%20Library/Attachments/73/2006-WP-02_Elliehausen.pdf); Gregory Elliehausen and Edward C. Lawrence, *Payday Advance Credit in America: An Analysis of Customer Demand*, Georgetown University Credit Research Center, at 2 (Apr. 2001) (online at www.cfsa.net/downloads/analysis_customer_demand.pdf).

[12] *See* Consumer Federation of America & Providian, *Most Consumers Don't Understand Credit Scores According to a New Comprehensive Survey* (2004).

[13] Eric Dash, *Citibank Considers Repealing a Pledge and a Slogan with It*, New York Times (June 25, 2008) (citing Citibank officer explaining why the company was reinstituting the practices it had dropped).

[14] Federal Deposit Insurance Corporation, *Bank Failures & Assistance* (www.fdic.gov/BANK/HISTORICAL/BANK/index.html) (accessed June 14, 2009).

[15] Mark D. Flood, *The Great Deposit Insurance Debate*, Federal Reserve Bank of St. Louis (July/August 1992) (online at www.research.stlouisfed.org/publieations/review/92/07/Deposit_Jul_Aug1992.pdf).

NAVA®

The Association for Insured Retirement Solutions

Summary of Testimony

Chairman Frank, Ranking Member Bachus and Members of the Committee, my name is Cathy Weatherford and I am President and CEO of NAVA—The Association for Insured Retirement Solutions. I am pleased to appear before you today to provide our perspective on the extensive regulatory structure under which our member companies currently operate and in light of the existing regulatory regime, to share our view regarding whether an independent consumer financial products regulator should have authority to regulate insurance products. I commend Chairman Frank and Ranking Member Bachus for holding this important hearing to examine gaps or perceived gaps in and overlapping regulation of financial products. I welcome the opportunity to address the Committee.

As many of you know, I have over 30 years of regulatory experience, including over half of that time as an elected Insurance Commissioner and Insurance Department Staff in the state of Oklahoma, and most recently, as CEO of the National Association of Insurance Commissioners for over 12 years. I did that work because I care deeply about serving the public and providing citizens necessary consumer protections, particularly measures aimed at safeguarding our senior citizens, and I joined NAVA less than a year ago because my life's work is perfectly aligned with the Board's mission.

We are the only national trade association focused on all types of annuities and other insured retirement products, and, just as important, our member companies represent every component of the industry: (1) manufacturers of all types of annuities and variable life products (the insurance companies); (2) distributors of those products, including broker-dealers and banks; (3) assets managers for the underlying mutual funds offered through variable insurance products, and other insurance company assets; and (4) law firms and other services providers for these companies. Our current board members represent the following companies: LPL Financial (largest independent broker dealer in the country); AXA Equitable; Hartford Life, Inc.; Nationwide Financial; MetLife, Inc. ; Wells Fargo-Wachovia Corporation; General Re-New England Asset Management, Inc.; Genworth Financial; Jackson National Life; Fidelity Investments Institutional Services; ING US Annuity; John Hancock Financial Services, Inc.; Legg Mason, Inc.; Prudential Annuities; T. Rowe Price Group, Inc.; PIMCO; UBS Global Asset Management (Americas) Inc.; Morgan Stanley Global Wealth Management Group.

In connection with our Board's new mission and expansion of our reach and focus, in just three weeks, we will be unveiling a new name for the association – a name that more fully reflects the work we do serving American consumers with good information and the industry that provides financial products consumers need as a part of their overall retirement planning. As a reminder, annuities are the only financial instruments available today, other than Social Security and pensions, that guarantee a lifetime stream of income during retirement.

Our members are represented by hundreds of thousands of registered financial advisors across the country, and therefore, we bring a perspective from Main Street America to the Congress today. After my many conversations with these financial advisors, I have developed a deep level of appreciation for the long—standing relationships they have with their clients and friends—ten, twenty or even forty years. Our financial advisors consider that relationship to be a sacred trust and as such, they are intensely committed to helping their clients reach their retirement income objectives, which involves a series of the most significant financial decisions a person ever makes over a very long lifetime. The Congress has long recognized and incentivized retirement savings for our members' clients and all American citizens, and that decision has been shown to be wise foresight during these turbulent economic times when citizens recognize more than ever the need to plan for retirement.

As an association, our consumer focused mission includes our commitment to:

- Addressing the need and importance of retirement income preparation and management for retirement-focused Americans;
- Focusing on the growth, acceptance, and understanding of annuity and variable life products to fulfill important objectives of retirement income planning;
- Providing educational, standards and informational resources to our members and the public; and
- Promoting adherence to the highest ethical standards by insurers, distributors, and all other participants in our diverse industry.

Following this mission, the Board's very first guiding principles, "The best interests of the consumer come first."

Consistent with our consumer–focused mission and guiding principles, my testimony today will address five (5) key points.

1. **<u>Retirement Savings Needs Have Never Been Greater.</u>** Retirement savings is more critical to our nation's citizens because a very significant shortfall in asset accumulation is occurring at the very time of medical breakthroughs, which means Americans are living longer in retirement. In the future, the face of America will be radically different. One in three 65-year-old women today can expect to live into her 90s, and 77 million Baby Boomers will be entering retirement over the next few years. The aging of this huge number of Baby Boomers is placing increasing pressure on Social Security as well as on employer-funded retirement benefits. We commend Congressman Pomeroy's sponsorship of HR 2748, the Retirement Security Needs Lifetime Pay Act, which will encourage the purchase of annuities to supplement other retirement savings vehicles to provide a guaranteed stream of income for individuals during retirement.

2. **<u>Key Role of Insured Retirement Products in Retirement—Only Product Providing Guaranteed Lifetime Income.</u>** Life insurers hold $2.6 trillion in annuity reserves, and in 2007, life insurers paid $72 billion in annuity benefits to consumers. From 1999 to 2008, total annuity purchases almost doubled from $164.7 Billion to $264 billion. Variable annuity and fixed net assets under management grew from $1.3 trillion in 1999 to over $2 trillion in 2007, declining during the 2008 economic crisis to $1.6 trillion, with over 23 million variable contacts in force. First quarter 2009 net purchases, which shows how many new consumers are buying annuities, showed a 20% increase over fourth quarter net purchases of $4.2 billion. According to one source, annuity purchases were up nearly 33% in 2008. When comparing first quarter to the end of the fourth quarter of 2008, the combined net assets of U.S. variable annuities decreased 5.4% versus the steeper 11% drop in the S&P 500—showing the value of a diversified variable annuity in turbulent economic. Importantly, annuities appeal to individuals of all income levels and people who don't have another retirement savings vehicle. Two out of three owners have household incomes under

$75,000. Almost one half (42%) of non-qualified annuities are business owners and professionals. Almost one half (42%) of non-qualified annuities are business owners and professionals. Nineteen percent are (or were) blue collar or service workers and 12% worked in supervisory positions.

3. **Support for Strong Consumer Protection Laws.** We are committed to mobilizing our member companies and their hundreds of thousands of registered financial advisors in support of uniform adoption either at the state level or federal level of three important consumer protection laws aimed at transparency, appropriate disclosure, and suitable sales. All consumers across country should benefit from these vital consumer protection measures, and our member companies should be subject to a uniform requirement, rather than a patchwork of requirements and regulatory interpretations that will make products more costly for the end consumer. For these reasons, we urge uniform passage of the current NAIC Model Suitability Law, NAIC Model Disclosure Law and NAIC Senior Designations Model. We also support the adoption of a summary prospectus by the SEC for annuity purchasers similar to the summary prospectus adopted for mutual funds to promote transparency and consumer understanding. In addition, while we do not believe an additional consumer protection regulator is necessary or advisable for the insurance industry as discussed below, we ask the Congress to continue to the focus on how regulatory structures can be operated in the most effective and efficient manner in the interests of consumers. Right now, the current system does not work well in terms of costs to consumer and regulatory burdens, and we support Treasury's proposals to modernize and improve our system of insurance regulation, as well as the six principles for insurance regulation.

4. **Consumers are Adequately Protected by Current Regulatory Structure Consisting of Extensive Regulation and Multiple Regulators.** As you will see from the extensive description of the current regulatory structure in my testimony, insurance consumers and annuity owners are protected by an existing, comprehensive regulatory structure consisting of the SEC, FINRA and insurance and securities regulators in over 50 different state and territorial jurisdictions, with total regulatory staff exceeding 11,000, as well as a large number of other federal and state agencies, probably more than any other industry. Our broker dealer members and their registered financial advisors are required to maintain comprehensive compliance systems, which are examined by FINRA at least every four (4) years and more often for larger firms. State insurance and other regulators routinely conduct comprehensive market conduct examinations for violations of state consumer protection laws, including Unfair Trade Practices and advertising laws. It is common for most large companies to be undergoing five (5) to ten (10), if not more, examinations by different state insurance departments simultaneously in any given year. Importantly, each and every product issued by an insurance company must contain legally required contractual provisions and be approved by every state insurance regulator where the product will be issued before the product can be sold to a consumer –, a process that can take well over a year to obtain approvals in all states. Variable product registration statements must also be filed with and approved by the SEC. Given the current regulatory protections, the focus should be not on adding another layer of regulation. Instead, the focus should be on how the current regulatory structure can be operated in the most effective and efficient manner using limited resources to perform critical consumer protection activities—enforcing the right regulations, not just adding more regulation with no discernable additional value.

5. **New Layer of Regulation is Unnecessary and Potentially Harmful to Consumers.** While we have not conducted a comprehensive study of all issues related to the jurisdiction of the Financial Products Consumer Protection Agency, we urge the Congress to study the use of existing regulatory bodies with years of experience and expertise to

regulate industries previously subject to no or insufficient regulation. Considering the need to use limited resources for these industries and the extensive regulation under which our members currently operate, a new layer of regulation and another regulator for the insurance industry is unnecessary. Further, separating financial regulation and consumer protection regulation is not prudent and would present significant risks to consumers. Our members use sophisticated actuarial science methodologies to assure investments are properly structured to meet the contractual obligations set forth in the designed products. Therefore, product regulation is vitally linked to financial solvency regulation. Bifurcating product regulation and solvency could also result in consumers not having access to the most up-to-date products that meet their needs. As stated, given the current regulatory regime, the focus should be not on adding another layer of regulation, but rather on how the current regulatory structure can be operated in the most effective and efficient manner value to achieve our collective consumer protections objectives. To this end, we support the President's Office of National Insurance proposal, as well as Subcommittee Chairman Kanjorski and the Committee's continued efforts to advance insurance regulatory reform through HR 2609 creating an Office of Insurance Information within the Department of the Treasury.

Testimony of Catherine Weatherford

Retirement Savings Needs Have Never Been Greater

Changing landscape for retirement income needs. Alarmingly, 49.7% of Americans recently surveyed by a leading annuity writer and NAVA member said the number one financial concern for retirement was "keeping up with daily expenses for food, shelter and other *basic needs* such as health care." Just a year ago, when asked the same question, 43.2% of Americans responded "enjoying life." "Having enough money to enjoy life" was cited as a key concern of the US citizens (43.2%), while running out of money was listed as one of the least appealing aspects about retirement (27%). The survey results concluded by noting 72.3% of Americans think they will be largely responsible for providing their own income in retirement.

As the population in the US ages and more baby boomers retire or approach retirement, concerns about financial preparedness remain high, according to industry reports. The combination of longer life spans and a declining birth rate mean the ratio of workers to retirees will continue to decline, increasing pressure on public and private pensions systems, and health care systems. The aging of 77 million Baby Boomers is placing increasing pressure on the Social Security as well as on employer funded retirement benefits. People are living longer, and savings have to last through retirements that can span 20-30 years or more.

According to another industry paper, individuals are assuming more of the risk and responsibility for retirement savings and income generation. Traditional defined benefit (DB) pension plans in the private sector are increasingly being frozen or terminated; virtually all replacement and new plans are definite contribution (DC) plans, such as 401k. Historically low personal savings rates, coupled with general insufficiency of DC plan savings, mean many retirees will have to consider alternative sources of retirement income, such as working in retirement and tapping into home equity. Healthcare expenses are rising more quickly than the general rate of inflation. Funding post retirement healthcare is looming larger as a threat to individual's retirement security. The shift in DB to DC plans has shifted much of the burden for retirement security from employers to individuals. In contrast to DB plans, where the employer generally bears all the risk and responsibility to the employee to decide to participate, save adequately, invest appropriately, and, at retirement, determine how to make the nest egg last for life – while managing the risks that go along with that. The retiree in a DB plan usually receives a pension check every month for life. Traditionally, the employer pays a lump sum to an insurer; in return; the insurer promises to pay the retiree a monthly amount as long the customer lives – sometimes for as long as a beneficiary lives as well, and sometimes with a number of years guaranteed. A retiree in a DC plan, however, has a sum of money that the consumer must decide how to use in retirement.

The Face of Retirees. A recent Ernst and Young report noted that one in three 65-year-old women today can expect to live into her 90s, and millions of Baby Boomers who will be entering retirement over the next few years. This is of particular concern for women, who have fewer full-time working years than men and have median earnings that are about $10,000 less than those of working men. Women typically live longer than men and are likely to spend some of their retirement years alone due to widowhood or divorce. These disparities lead to lower savings and retirement income and smaller payouts from Social Security, ultimately resulting in a greater risk of poverty in retirement. It is especially important for women to investigate guaranteed retirement income sources such as annuities and protect their income while working and in retirement through vehicles such as life, disability and long-term care insurance.

Here are two examples highlighting the importance of retirement savings from industry sources

- A recently retired married couple earning $75,000 a year with a defined benefit plan has a 57 percent chance that they will have enough financial resources in retirement. The same couple, without any guaranteed source of retirement income, is left with only a 6 percent chance of financial success.

- A near retiree single female, earning $50,000 a year with a defined benefit plan, has a 66 percent chance that she will not outlive her financial resources. The same female, without any guaranteed source of income in retirement, is left with only an 18 percent chance of financial success.

We look forward to working with Congress as we help the American public adequately prepare for retirement. NAVA commends Congressman Pomeroy's recent sponsorship of HR 2748, the Retirement Security Needs Lifetime Pay Act. This legislation will encourage the purchase of annuities to provide a guaranteed stream of income for individuals during retirement. By using insurance tools that supply the much needed cash flow in retirement, annuities could be particularly attractive for those that do not have employer-sponsored retirement plans including the self-employed like farmers and ranchers, and small business owners. All Americans need secure reliable retirement to ensure savings will last through their lifetime and annuity products are an excellent financial tool to help secure their future.

Key Role of Insured Retirement Products in Retirement—Only Product Providing Guaranteed Lifetime Income

The Growing Use of Annuities: Annuities are the only financial instruments available today, other than social security and pensions, that guarantee a lifetime stream of income during retirement. With the proper use of annuity products and other retirement savings vehicles, retirees can be assured they will not outlive their assets and benefit significantly by having the ability to increase their current income.

An annuity is a contract between an individual and an insurance company, a secure product structured to offer a steady cash flow when there is no longer a paycheck in retirement. Annuities are designed to grow a person's assets to contribute to a secure retirement, and consumers, more and more, are turning to annuities as a part of their retirement planning.

Life insurers hold $2.6 trillion in annuity reserves, and in 2007, life insurers paid $72 billion in annuity benefits to consumers. From 1999 to 2008, total annuity purchases almost doubled from $164.7 Billion to $264 billion. In that same time period, variable annuity and fixed net assets under management grew from $1.3 trillion to over $2 trillion in 2007, but because of the economic turmoil, dropped to $1.6 trillion in 2008. People put larger amounts into variable annuities, with the average contract size growing from $33,000 to $67,000 from 2000 to 2007. In 2008, over 23 million variable contacts were in force. First quarter 2009 net purchases, which shows how many new consumers are buying annuities, were $5.1 billion compared to fourth quarter net purchases of $4.2 billion -- an increase of nearly $1 billion. Overall purchases of individual annuities continue at a record setting pace in 2008, reaching $197.1 billion through the first three quarters, and according to one source, annuity purchases were up nearly 33% in 2008.

These numbers support a recent industry survey where 90% of the financial advisors said they expect their 2009 annuity purchases will be as high as or higher than in 2008. Good reasons exist for this increased level annuity purchases and the flight to the security and safety provide by annuities. The combined net assets of U.S. variable annuities decreased 5.4% to slightly over $1 trillion, as compared to the end of the fourth quarter of 2008. However, in comparison, during the same time period, the S&P 500 dropped over 11%--showing the value of a diversified variable annuity in turbulent economic.

Why Consumers Use Annuities? Recent reports show eighty-nine percent (89%) of annuity purchasers use annuities as a source for retirement income, and 83% of annuity savings are used for a financial cushion in case they or their spouse live well beyond their life expectancy. The third most important reason individuals cite for purchasing an annuity (81%) is to avoid being a financial burden on children. Other reasons include use as an emergency fund in case of catastrophic illness or nursing home care (70%) as well as financial protection if other investments do not do well or inflation is high

As most would expect, reports reflect the largest source for retirement income currently is Social Security. However, according to information provided by the Social Security Administration, a reduction in benefits will be required in the future, so retirees and pre-retirees will need to take greater responsibility for their security in retirement. Thus, the roles of different retirement saving vehicles are ever-changing, and the importance of annuities is continually increasing.

Especially in the volatile economic times, annuities are viewed as providing financial stability and are an important income source to many retirees. According one report earlier this year, one in five retirees receives income from individually purchased annuities.

Finally, in terms of demographics, according to another study, a typical annuity owner earns a middle class income or lower. The majority of annuity owners have household incomes between $20,000 and $74,999, Two out of three owners have household incomes under $75,000. Almost one half (42%) non-qualified annuities are business owners and professionals. Almost one half (42%) of non-qualified annuities are business owners and professionals. Nineteen percent are (or were) blue collar or service workers and 12% worked in supervisory positions.

Annuities appeal to individuals of all income levels and people who don't have another retirement savings vehicle. That is what makes annuities so versatile in an individual's retirement portfolio.

Annuity Product Innovation to Meet Consumer Demond: Companies and financial advisors have worked together extensively over the past 10 years to innovate annuity products to meet consumer demand. While some argue that annuities can be complicated and cost too much in terms of fees, the product features are driven by consumer demand and in the end, the additional benefits not provided by other financial products have a cost associated with that enhanced benefit.

For example, it is helpful to look at the product evolution resulting in the Variable Annuity Guarantee Living Withdrawal Benefits (GLWB). GLWB were developed to provide guaranteed lifetime income. GLWBs represent the latest generation of variable annuity guarantees that have developed logically over time to address certain concerns expressed by consumers and their financial representatives.

After variable annuities evolved to include death benefits, thereby addressing investors' concerns that their families be protected in the event of death, insurance companies turned to address the other major concern of investors — that they might not reach their income goals. To address this concern, insurance companies developed a series of "living benefits," beginning with the guaranteed minimum income benefit ("GMIB") riders.

GMIBs guaranteed a future level of annuity payments, but contract owners were required to annuitize to receive the guaranteed payments. Over time, insurance companies experienced a continued hesitation on the part of contract owners to give up control over the level and timing of their payments. Rather, it appeared that contract owners would prefer to take periodic discretionary withdrawals.

As a result, beginning in 2002, companies began offering guaranteed minimum withdrawal benefit ("GMWB") riders. GMWBs guarantee a specified return of principal to contract holders. To do so, a GMWB sets a contractual withdrawal rate, and after a specified date (e.g., 65), investors may withdraw funds at their discretion within this rate. If an investor's account falls to zero, the GMWB rider is triggered and provides regular withdrawals until the guaranteed amount (often equal to the initial premium) is paid out. Companies typically charge for GMWB riders by deducting an ongoing fraction of assets, rather than an up-front fee. They also usually add certain restrictions, such as requiring that a contract owner's funds be invested in a conservative asset allocation model.

The latest generation of GMWBs, called guaranteed lifetime withdrawal benefits, went one step further by guaranteeing that if a contract owner's account value is depleted before he or she dies, and assuming other contract conditions are satisfied, the insurance company will begin paying what amounts to a lifetime annuity for the remainder of the owner's life. The annual amount of the payments equals some percentage (e.g., 5%) of the "benefit base" accumulated by the contract owner over the years. Therefore, if the benefit base under a contract was $500,000, beginning at a specified age the contract owner would be able to withdraw $25,000 annually, and if his account value declined to zero (or below some specified minimum amount), the insurance company would continue paying the $25,000 annual payments for the remainder of the owner's life.

GLWB riders have proven to be very popular. According to one estimate, close to 75% of variable annuity buyers in 2004 selected a GLWB rider (a more recent estimate puts the proportion of variable annuities carrying living benefit riders at two-thirds). Furthermore, the inclusion of GLWB riders caused some of those who had previously criticized variable annuities as overpriced to turn to recommending variable annuities.

This product evolution example shows how companies, broker dealers and financial advisors are constantly working to meet consumer demand for products that meet their needs.

Support for Strong Consumer Protection Laws and Enforcement of Those Laws

We are committed to mobilizing our member companies and their hundreds of thousands of registered financial advisors in support of uniform adoption either at the state level or federal level of three important consumer protection laws aimed at transparency, appropriate disclosure, and suitable sales. All consumers across country should benefit from these vital consumer protection measures, and our member companies should be subject to a uniform requirement, rather than a patchwork of requirements and regulatory interpretations that will make products more costly for the end consumer. For these reasons, we urge uniform passage of the current NAIC Model Suitability Law, NAIC Model Disclosure Law and NAIC Senior Designations Model. We also support the adoption of a summary prospectus by the SEC for annuity purchasers similar to the summary prospectus adopted for mutual funds to promote transparency and consumer understanding. In addition, while we do not believe an additional consumer protection regulator is necessary or advisable for the insurance industry as discussed below, we ask the Congress to continue to the focus on how regulatory structures can be operated in the most effective and efficient manner in the interests of consumers. Right now, the current system does not work well in terms of costs to consumer and regulatory burdens, and we support Treasury's proposals to modernize and improve our system of insurance regulation, as well as the six principles for insurance regulation.

NAVA strongly urges states adopt the current NAIC Suitability Model, which has been adopted by more than 35 states but for less than 50% of the US population. We believe this would address concerns expressed by the Senate Special Committee on Aging that minimum standards have not proliferated to a sufficient number of states.

The Disclosure Model Regulation requires that certain information be disclosed, including an explanation of rates and how or if they change, a summary of the options and restrictions for accessing money, and an outline of fees. In an effort to ensure the model is adopted nationwide, NAVA will continue to work with the states to secure adoption of these important consumer protections. Building on the NAIC Disclosure Model, NAVA developed disclosure templates in cooperation with other associations for the purpose of presenting required disclosure information for fixed, index, and variable annuities in a consumer-friendly manner. These templates, which enhance the disclosure requirements found in the NAIC model and federal securities laws, have been positively viewed by all regulators who have conducted a review of the template. In fact, the Iowa Division of Insurance launched a pilot program in 2008 to introduce the templates to the marketplace. NAVA, along with several industry trades are working with the state and federal regulators to gain widespread adoption of the templates throughout the country.

The use of misleading senior citizen specific professional designations and credentials has been a top concern of regulators, the Congress and NAVA. NAVA will continue to work with regulators and other stakeholders to stop the use of deceptive certifications and designations. Therefore, NAVA strongly supports the uniform adoption in the states of the NAIC Senior Designation Model Regulation.

Consumers are Adequately Protected by Current Regulatory Structure Consisting of Extensive Regulation and Multiple Regulators

As you will see, insurance consumers and annuity owners are protected by an existing, comprehensive regulatory structure consisting of the SEC, FINRA and insurance and securities regulators in over 50 different state and territorial jurisdictions, with total regulatory staff exceeding 11,000, as well as a large number of other federal and state agencies, probably more than any other industry. Our broker dealer members and their registered financial advisors are required to maintain comprehensive compliance systems, which are examined by FINRA at least every four (4) years and more often for larger firms. State insurance and other regulators routinely conduct comprehensive market conduct examinations for violations of state consumer protection laws, including Unfair Trade Practices and advertising laws. It is common for most large companies to be undergoing five (5) to ten (10), if not more, examinations by different state insurance departments simultaneously in any given year. Importantly, each and every product issued by an insurance company must contain legally required contractual provisions and be approved by every state insurance regulator where the product will be issued before the product can be sold to a consumer, a process that can take well over a year to obtain approvals in all states. Variable product registration statements must also be filed with and approved by the SEC. Given the current regulatory protections, the focus should be not on adding another layer of regulation. Instead, the focus should be on how the current regulatory structure can be operated in the most effective and efficient manner using limited resources to perform critical consumer protection activities—enforcing the right regulations, not just adding more regulation with no discernable additional value.

The following provides detailed information about how our member companies, their registered financial advisors and annuity products are currently subject to extensive regulatory oversight and enforcement. Annuities are insurance contracts and as such are regulated under state insurance laws. Variable annuities are securities as well. As a result, the

Securities and Exchange Commission (SEC) regulates them under the federal securities laws. The SEC and the Financial Industry Regulatory Authority (FINRA) (formerly known as the National Association of Securities Dealers, Inc., or NASD) both regulate firms that sell variable annuities.

REGULATION BY THE STATES

Overview

All fixed and variable annuities are governed by a comprehensive state regulatory framework. State laws govern the organization, licensing and activities of insurance companies, and state insurance departments oversee insurance company operations on an ongoing basis by receiving consumer complaints and requiring company responses, investigations, and routine market conduct and financial examinations. Annuity contracts and amendments must be filed with, and approved by, each state in which contracts are sold, which can take a year to eighteen months to obtain approval by all states nationwide. Insurance agents need to be licensed in each state in which they operate and regulators maintain enforcement units to investigation agent activity in violation of the law. Only licensed insurance agents may sell annuity contracts. As you can see, insurance companies and agents are subject to very complicated and interconnected regulatory oversight of many different parts of its operations and therefore, we urge the Congress that it would be unwise to separate financial solvency regulation from product or market conduct regulation. These two components are just too interrelated for that to occur.

Insurance Company Licensing

In order to offer annuity products in a state, an insurance company must be licensed in that state. A company needs to be licensed regardless of whether it is a "domestic" insurance company (i.e., organized in the state) or a "foreign" insurance company (i.e., organized in another state). To be licensed, an insurance company must be organized according to specific state laws. Before it is granted a license, an insurance company must demonstrate compliance with strict capital, surplus, and financial requirements. In addition, the state scrutinizes the experience and character of the company's management. The state issues a license only if it determines that the company is organized and managed in such a way that it will protect the interests of its contract owners.

Agent Licensing

Insurance agents must be licensed by state insurance departments in each state where the agent has clients, which can be a large number of states in these days of increased mobility given the tendency for many clients to want to remain with their original agent. Applicants must submit a form to the state providing information about their experience, character, and financial responsibility. They also have to pass a written examination. (Agents selling variable annuities are also subject to FINRA requirements.). Agents are also subject to ongoing oversight of their activities and insurance departments have active enforcement programs aimed at rouge agents who violate unfair trade practices and other laws.

Contract Requirements and Prior Regulatory Approval

Annuity contracts and related forms generally must be filed and approved in every state where they will be sold, which can take well over a year to obtain approval by all states. While there is no standard required form for annuity contracts, states mandate that certain provisions be included in all contracts, such as a free-look provision that allows a contract owner to examine the contract for a period of time and return it for a refund if dissatisfied for any reason. Generally, contracts need to be readable and cover all of the contract's basic features before the state will approve the contract for sale. Amendments to contracts also must be filed and approved. If the amendment could adversely affect existing contract owners' rights, the state may require prior approval from the contract owners.

Complaint Handling

Every state insurance department has a Consumer Division that handles complaints and inquiries, as well as providing consumer buyers guides and other types of guides. From 2006 to 2008, the NAIC reports that of the complaints received by Departments in each of those years, less than 10% were related to life and annuity business. As a result of this service, consumers have a free, local, highly experienced regulatory forum in which to raise complaints and as a result have obtained money recoveries or other remedies when merited.

State Guarantee Funds

All states, the District of Columbia, and Puerto Rico have guarantee funds to protect contract owners against insurance company insolvency. Insurers doing business in a state must contribute to that state's guarantee fund. The actual coverage provided for annuity contracts varies from state to state, but cash values and annuity benefits generally are protected for at least $100,000. Coverage is not provided for variable annuity contracts (other than assets invested in the fixed account option under a variable annuity contract). However, as discussed below, variable annuity contracts are issued through life insurance company separate accounts, which are insulated from the general creditors of the insurance company in the event of insolvency.

Variable Annuity Asset Protection

When a contract owner allocates purchase payments to a variable investment option under a variable annuity contract, those assets are held in the insurer's separate account. The assets in the separate account are insulated against the creditors of the insurance company in the event of the company's insolvency. In some states, annuity assets are shielded from a contract owner's creditors as well.

Advertising and Unfair Trade Practices Rules

Most states have adopted advertising rules governing the marketing of annuity contracts. State insurance departments review advertising materials periodically. Advertising rules are designed to prevent misleading, deceptive, or confusing advertisements, as measured against the impression a person who is not knowledgeable in insurance matters may receive from the materials.

All states have adopted unfair trade practices acts with provisions that apply to an insurer's activities. These laws define and prohibit unfair methods of competition and unfair or deceptive business practices, including those involved with the issuance, sale, and administration of annuity contracts.

Over forty (40) states have adopted a requirement that all sales be suitable given the customer's financial condition and objectives, and most of those 40 states explicitly require companies to have a reasonably designed compliance system providing reasonable assurance of compliance with the suitability law.

National Association of Insurance Commissioners

The National Association of Insurance Commissioners (NAIC) is an association that according to its mission promotes fairness and uniformity in state insurance laws. It has developed numerous "model laws" and "model regulations" many of which, while non-binding, have been adopted in one form or another by many states.

REGULATION UNDER THE FEDERAL SECURITIES LAWS

Introduction

Besides being governed by the state regulatory framework, variable annuities as securities are regulated under federal securities laws. The primary federal securities laws that regulate variable annuities and the separate accounts through which they are issued are the Securities Act of 1933 (1933 Act), the Securities Exchange Act of 1934 (1934 Act), and the Investment Company Act of 1940 (1940 Act). The SEC administers these acts. Fixed annuities, where the insurance company guarantees a specific rate of return to the contract owner, generally are not subject to these laws.

In summary, the federal securities laws require certain disclosure documents, including a prospectus, to be given to investors. Certain disclosure documents must also be filed with the SEC. In addition, written marketing materials such as advertisements are subject to regulation under SEC and FINRA rules. Certain periodic reports must be filed with the SEC and delivered to investors. These requirements are discussed in more detail on the following pages.

Securities Act of 1933

Contract Registration

Because variable annuities are securities, they must be registered with the SEC under the 1933 Act before they can be offered to the public (with two exceptions noted below). The SEC staff reviews and comments on registration statements, which usually must be amended in response to staff comments before they will be declared effective. (The SEC does not, however, approve or disapprove of any securities, including variable annuities, and does not pass on the accuracy or adequacy of any prospectus.) A "post-effective" amendment updating the variable annuities registration statement generally must be filed at least annually.

The first registration exception is for annuity contracts that are issued in connection with certain qualified plans such as 401(k) plans. The second exception is for privately placement annuities, which are contracts that, among other things, are offered only to sophisticated investors who meet certain requirements under federal security laws (and not to members of the general public). Even with these exceptions, however, issuers and others involved in marketing non-registered variable annuities, remain subject to the anti-fraud provisions of the 1933 Act.

Prospectus Delivery
When someone purchases a registered non-qualified variable annuity, he or she receives a prospectus. Prospectuses are updated regularly. Separate prospectuses describe underlying investment options—the funds to which the purchaser may allocate his or her investments. This can result in a purchaser receiving numerous prospectuses. However, the SEC recently adopted a rule permitting fund "profiles," that are shorter, user-friendly summary prospectuses, to be given to prospective investors. The SEC also permits limited use of variable annuity profiles.

Disclosure of Fees and Expenses
Variable annuity prospectuses contain fee tables that disclose the maximum guaranteed charge for all contract transaction expenses and recurring charges. These amounts are expressed in dollars or percentages of the contract value so purchasers will know what they will pay if they buy the contract. The fee tables also list the range of total operating expenses for all of the underlying funds offered by the contract. In addition, variable annuity prospectuses contain numerical examples showing in dollars per $10,000 what a contract owner would pay for the contract and the maximum fees and expenses charged by any of the funds over one-, three-, five-, and ten-year periods. These examples assume a 5% return and that the contract is surrendered at the end of the relevant period. Additional examples are required that assume the investor does not surrender the contract if a sales load or other fee is charged upon surrender. This format shows the effect of any surrender charge.

Securities Exchange Act of 1934

The 1934 Act generally requires variable annuities to be distributed through registered broker-dealer firms and their registered representatives. Broker-dealers and their representatives are subject to extensive operational and financial rules that cover minimum net capital requirements, reporting, recordkeeping, supervision, advertising, and sales activities.

In addition to the broker-dealer regulatory framework established by the 1934 Act, registered broker-dealer firms that sell variable annuities also must be members of FINRA. FINRA is a self-regulatory organization overseen by the SEC. It has an extensive body of rules with which broker-dealers must comply. For example, examinations are required; fingerprints must be provided; and numerous supervisory, suitability, advertising, recordkeeping, and reporting rules apply.

A 1934 Act rule requires broker-dealers to send confirmation statements to contract owners after each purchase and sale transaction made involving a variable annuity contract. In addition, insurance companies send contract owners periodic account statements showing a beginning balance, transactions during the period, and an ending balance so that the owner will have a record of all activity in his or her contract.

Investment Company Act of 1940

The 1940 Act imposes an extensive federal regulatory structure on investment companies, including separate accounts and underlying funds. Some separate accounts and funds however, such as those used in connection with tax-qualified retirement plans, are not subject to the 1940 Act. For example, the act governs how variable annuities and shares of underlying funds are issued and redeemed. There are also corporate governance requirements and prohibitions against self dealing.

Each separate account regulated under the 1940 Act must file a report on its operations annually with the SEC. In addition, an annual and semi-annual report containing information about the underlying mutual funds that serve as investment options for the variable annuities must be sent to contract owners. In some cases, these reports also contain information on the variable annuities themselves.

The SEC inspects variable annuity separate account operations regularly. The SEC also inspects various locations, such as broker-dealer offices, from which variable annuities are sold. Recommendations are made and any deficiencies are noted. If the situation is serious enough, it is referred to the SEC's enforcement division.

Regulation of Fees and Charges

Currently, the SEC does not regulate individual variable annuity fees and charges. However, the 1940 Act makes it unlawful for any registered separate account funding variable annuity contracts, or for the sponsoring insurance company, to sell any such contract unless the fees and charges deducted under the contract are, in the aggregate, reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company. The insurer must represent in the annuity contract's registration statement that the fees and charges are reasonable.

SEC and FINRA Advertising Rules

SEC Rules

SEC rules govern variable annuity advertising. If past performance of a fund or variable annuity is presented, performance must be calculated according to standardized formulas. "Non-standardized" performance may also be shown, but must be presented along with standardized performance. In addition, if an advertisement contains performance information, total returns current to the most recent month end must be made available within seven business days of the end of the month at a toll-free or collect telephone number or on a website.

FINRA Rules

In addition to the SEC rules, FINRA rules also govern variable annuity advertisements. Broker-dealer firms that disseminate variable annuity advertising must file these communications with FINRA and take into account comments provided by FINRA staff.

FINRA Complaint Handling Requirements and Dispute Resolution Process

Under FINRA Rule 8210, broker-dealers are required to maintain a separate file of all written complaints in each office of supervisory jurisdiction. The file must contain a description of action taken by the broker-dealer in regard to the complaint, and it must contain or refer to another file containing any correspondence regarding the complaint. FINRA reviews these complaint processes and complaint handling during its routine examinations.

FINRA also provides cost effective dispute resolution methods such as mediation and arbitration which are faster and less expensive than a state or federal lawsuit. In arbitration cases brought by investors, whether through settlements, decisions by arbitrators or stipulated awards, investors receive some compensation more than 70 percent of the time. In mediations, the overall settlement rate exceeds 80 percent. FINRA arbitrators and mediators are carefully selected from a broad cross-section of people with extensive business or professional experience.

Recent Regulatory Action

There are several regulatory initiatives that have been adopted or are pending that affect or potentially could impact the sale of variable annuities.

Redemption Fees

In May 2006, the SEC adopted new Rule 22c-2 under the 1940 Act that allows mutual funds to impose a redemption fee of up to 2% on short-term redemptions of fund shares. The rule also applies to short-term transfers among funds offered as subaccounts in variable annuities. In addition, regardless of whether a fund board approves a redemption fee, all funds must enter into written agreements with each of their financial intermediaries under which the intermediary agrees to provide information about share transactions upon request, and to execute instructions from the fund to restrict or prohibit further purchases or exchanges of shares by shareholders who have engaged in transactions that violate the fund's policies.

Point of Sale and Confirmation Disclosure

On February 28, 2005, the SEC reopened the comment period on proposed rules, first published in January 2004 that would require broker-dealers to provide their customers with information regarding certain distribution-related costs and conflicts of interest that arise from the distribution of mutual fund shares, 529 college savings plan interest, and variable insurance products. The revised proposal would require disclosure of a substantial amount of information for variable annuities at the point of sale—up-front sales fees, surrender charges, ongoing fund fees and insurance charges, annual contract charges, narrative information, and the existence of conflicts of interest. No final action has been taken on the proposal. It is believed a further revised proposal likely will be released.

Deferred Variable Annuity Transactions

In April 2009, the SEC approved Amended FINRA Rule 2821. The rule imposes a wide range of new requirements tailored specifically to deferred variable annuity transactions, including suitability, principal review, supervision, and training. The rule provides that, in recommending a deferred variable annuity, a registered representative must have a reasonable basis to believe that (a) the customer has been informed of the material features of a deferred variable annuity; (b) the customer would benefit from certain features of a deferred variable annuity, such as deferred growth, annuitization, or a death or living benefit; and (c) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated, and riders and product enhancements, if any, are suitable for the particular customer based on required customer information.

Indexed Annuities

In August 2005, FINRA (at the time "NASD") issued Notice to Members 05-50 that addresses the responsibility of member firms to supervise the sale by their personnel of indexed annuities (IAs) that are not registered under the federal securities laws. The notice recommends that firms consider whether they should supervise unregistered IA sales as private securities transactions according to Rule 3040. The notice also recommends that firms consider maintaining a list of acceptable unregistered IAs and prohibit associated persons from selling any other unregistered IA without the firm's written confirmation that the sale is acceptable. The NASD at the time also updated its investor alert addressing IAs.

In December 2008, the SEC adopted Rule 151A to clarify the status under the federal securities laws of indexed annuities. The new rule defines certain contracts as not being "annuity contracts" under the exemption contained in Section 3(a)(8) of the Securities Act of 1933. The SEC noted that this action will provide purchasers of indexed annuities all of the consumer protections of the federal securities laws, including disclosure, antifraud, and sales practice protections. Under the Rule as adopted, both amounts payable and amounts guaranteed are to be determined by taking into account all charges. In addition to requiring registration of indexed annuity contracts, the Rule will also significantly impact the manner in which indexed annuities are sold, requiring a distributor to now either have to be registered as a broker-dealer, or enter into a networking arrangement with a registered broker dealer. The Rule is now subject to a court challenge in the United States District Court for the District of Columbia.

After reviewing this extensive statutory and regulatory regime, it should be clear that an additional regulator is not needed.

New Layer of Regulation is Unnecessary and Potentially Harmful to Consumers

While we have not conducted a comprehensive study of all issues related to the jurisdiction of the Financial Products Consumer Protection Agency, we urge the Congress to study the use of existing regulatory bodies with years of experience and expertise to regulate industries previously subject to no or insufficient regulation. Considering the need to use limited resources for these industries and the extensive regulation under which our members currently operate, a new layer of regulation and another regulator for the insurance industry is unnecessary and potentially harmful to consumers. Further, separating financial regulation and consumer protection regulation is not prudent and would present significant risks to consumers. Our members use sophisticated actuarial science methodologies to assure investments are properly structured to meet the contractual obligations set forth in the designed products. Therefore, product regulation is vitally linked to financial solvency regulation. Bifurcating product regulation and solvency could also result in consumers not having access to the most up-to-date products that meet their needs. Finally, given the current regulatory regime, the focus should be not on adding another layer of regulation, but rather on how the current regulatory structure can be operated in the most effective and efficient manner to achieve our collective consumer protection objectives.

As stated above, we support strong and necessary consumer protection regulation. However, as explained, consumers are already protected by extensive regulation and multiple regulators, with over 11,000 regulator staff at the state level and a very well resourced and funded operation at FINRA and the SEC. No compelling need has been identified in the insurance and annuity market for an additional regulator focused on consumer protection. FINRA and state regulators have publicly identified senior sales protections as one of their top priorities, and therefore, they have identified and are addressing a key regulatory issue in this sector.

An additional layer of regulation would only risk confusion, which would exacerbate the already concerning issues with the current regulatory structure. Consumers would ultimately bear the burden in terms of increased costs and lack of access to needed products on a timely basis, given the natural and inevitable scenario of two different regulators of the same product having differing views about product standards. That disagreement occurs at the state level now within the Interstate Insurance Product Compact, causing delays in adoption of products standards and lack of consumer access to products on a timely basis. So, it is reasonable to conclude this same regulatory friction would occur if a new regulator were introduced into the regulatory regime.

With regard to the dangers of splitting financial solvency and product and sales practices regulation, Patrick Baird, CEO, AEGON USA, a NAVA member company, stated the following during a Subcommittee Hearing on Systemic Risk last week:

> "There are many regulatory elements that collectively constitute solvency regulation for a life insurance company, including capital and surplus, reserves, underwriting, risk classification, nonforfeiture, investments, accounting and, pertinent to this point, product regulation. For a life insurer, solvency regulation is inherently linked to the products it sells. Factors such as what is guaranteed, when the guarantee is triggered, the length of time the guarantee is in force and others product features are crucial to a determination of how the premiums are invested to assure assets will be available to pay claims. Effective solvency oversight necessitates that a single regulator have authority over all aspects of solvency, including product regulation. If different regulators assumed responsibility for any of these aspects of insurance solvency oversight, the net result would be an increase in systemic risk, not a reduction of it. For this reason, concepts such as a financial product safety commission, if made applicable to life insurance, would raise significant concerns."

We agree.

As an alternative to subjecting insurance and annuity product to the jurisdiction of any new consumer protection agency, we support Subcommittee Kanjorski's and the Committee's continued efforts to advance insurance regulatory reform through HR 2609, which would create an Office of Insurance Information within the Department of the Treasury. While we are still reviewing the details of his plan, we applaud the President's statement in his White Paper:

> "Our legislation will propose the establishment of the Office of National Insurance within Treasury to gather information, develop expertise, negotiate international agreements, and coordinate policy in the insurance sector. Treasury will support proposals to modernize and improve our system of insurance regulation in accordance with six principles outlined in the body of the report."

The President's White Paper proposes that "[t]he ONI should be responsible for monitoring all aspects of the insurance industry. It should gather information and be responsible for identifying the emergence of any problems or gaps in regulation that could contribute to a future crisis. The ONI should also recommend to the Federal Reserve any insurance companies that the Office believes should be supervised as Tier 1 FHCs." Therefore, the President's plan already includes a Treasury Department National Insurance Office. Any additional consumer protection agency would be duplicative and unnecessary.

Finally, given the current regulatory regime, the focus should be not on adding another layer of regulation, but rather on how the current regulatory structure can be operated in the most effective and efficient manner to achieve our collective consumer protection objectives. In addition, while we do not believe an additional consumer protection regulator is necessary or advisable for the insurance industry as discussed below, we ask the Congress to continue to the focus on how regulatory structures can be operated in the most effective and efficient manner in the interests of consumers. Right now, the current system does not work well in terms of costs to consumer and regulatory burdens, and we support Treasury's proposals to modernize and improve our system of insurance regulation, as well as its six principles for insurance regulation. As a part of this examination, we urge the Congress to continue to focus on the need for regulatory reform to allow consumers access to innovative retirement products in a timely manner nationwide, uniform adoption of suitability, disclosure and other consumer protection laws so all American citizens have the same safe guards, and efficient and costs effective licensing of our hundreds of thousands of financial advisors across the country provided by HR 2554 (NARAB II), as well as other important reforms we will be discussing with you in the coming weeks.

Mr. Chairman, I again want to thank you for holding today's hearing. Financial Services regulatory reform is arguably the most important matter before Congress, and determining how best to deal with insurance as part of the structural changes you will be making will be critical in assuring that the resulting regulatory framework works effectively and achieves our collective consumer protection objectives. We are committed to working with you and the Members of this Committee toward these ends.

Statement of

Cliff F. Wilson, CLU, ChFC, LUTCF, CLF

on behalf of

NAIFA

NATIONAL ASSOCIATION OF
INSURANCE AND FINANCIAL ADVISORS

Before

The House of Representatives Committee on Financial Services

Regarding

Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

June 24, 2009

Good morning Chairman Frank, Ranking Member Bachus and Committee members. My name is Cliff Wilson and I am the president of the National Association of Insurance and Financial Advisors (NAIFA). Thank you for the opportunity to appear before you today to share our views regarding financial regulatory reform and the critically important area of consumer protection.

NAIFA comprises more than 700 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. NAIFA members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. The Association's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members. NAIFA's website can be accessed at www.naifa.org.

I read with interest President Obama's regulatory reform proposal, "A New Foundation: Rebuilding Financial Supervision and Regulation," and listened intently to Treasury Secretary Geithner's testimony before the Senate Banking Committee last week. NAIFA members share the views of the Administration and this Committee that protecting consumers is the ultimate purpose of regulation and that robust consumer protection is necessary to ensure public trust in financial products and services and in the financial system as a whole. We see the impact of strong consumer protection laws and rules every day and, despite the burden in cost and time to us as producers, believe in the benefits they bring to our customers.

Moreover, we understand the desire for improved regulatory oversight of products and services that have, to date, been un-regulated or under-regulated. The fact is that many financial products are not subject to the same level of oversight as insurance products and, because of current regulatory structures, may fall into regulatory "gaps," thus escaping meaningful supervision and / or enforcement of current protections. Stepped-up federal oversight through a Consumer Financial Protection Agency (CFPA) may make sense for these products.

Insurance, however, is different for the following reasons, which I will address more fully below:

(1) Insurance products currently are subject to comprehensive state insurance regulatory oversight, which places a strong emphasis on consumer protection;

(2) It is dangerous to separate insurance product regulation from solvency regulation because the pricing and cost of products is so interrelated to the financial health of the insurer offering the product; and

(3) There is no insurance expertise or regulatory infrastructure within the federal government to support a CFPA. To the extent the federal government assumes insurance product regulatory authority, it should be part of a comprehensive insurance regulatory reform effort that brings the required insurance expertise to Washington, addresses regulatory overlap with the states, and has the authority to address the full panoply of regulatory issues that arise in connection with the oversight of this critical sector of the economy.

For these reasons, unless and until comprehensive insurance regulatory reform results in federal regulation of insurance, insurance products should not be placed under the authority of a federal financial products agency. Such oversight is not workable, nor is it necessary, in the insurance context.

Let me address each of these differences more fully.

(1) Insurance products are subject to comprehensive state regulatory oversight; federal intervention is unnecessary and could lead to regulatory confusion.

The states have been the primary regulators of insurance for 150 years. State insurance regulatory authority was affirmed by Congress in 1945, with enactment of the McCarran-Ferguson Act, and, more recently, with the Gramm-Leach-Bliley Act and its functional regulation structure. Today, each state, plus the District of Columbia and the five United States territories, has in place a comprehensive cradle-to-grave insurance regulatory regime that covers the universe of issues from corporate structure, to solvency, to consumer protections (market conduct), to product regulation.

Insurers, insurance agencies, and insurance agents are required to comply with the laws and rules of every state in which we do business and are required to hold a license in every such state. Agents that sell more than one line of coverage may be required to hold more than one license in each state. As part of the licensure process, most states require agents to undergo pre-licensing and continuing education courses, pass examinations, submit to an application process, and, perhaps most important, comply with state consumer protection laws.

Moreover, agents cannot sell a product in a state unless it has been approved by the state's insurance regulator. Product approval is an extensive process by which regulators review products for sale in their states. Until fairly recently, it was a state-by-state endeavor that could take years to complete. With the adoption in 2003 of the NAIC's Interstate Insurance Product Regulation Compact, the product approval process for life insurance, annuities, long-term care, and disability income products has been streamlined dramatically, even as the regulatory review and analysis of products has been maintained. The Compact became operational in 2006, when it was adopted by 26 states (states with over 40 percent of the premium volume for the covered products). Since that time, the Interstate Insurance Product Regulation Commission (IIPRC) has approved approximately 175 products for sale in the now 35 compacting states and territories (which represents over 50% of the premium volume in for the covered products).

In addition to product approval, many states require approval of the rates charged for many insurance products, particularly property and casualty products and health insurance. Most, if not all, states require that rates not be excessive, inadequate, or unfairly discriminatory. Some states require that a rate be approved prior to use, some allow a rate to be used unless the regulator subsequently disapproves it for failing to meet regulatory requirements. Still other states impose "flex-rating" laws that do not require prior approval for rate changes unless they exceed certain parameters.

More than 40 states have also imposed suitability requirements in connection with the sale of annuity products. The NAIC's "Suitability in Annuity Transactions Model Regulation" (Model) imposes a suitability requirement on any recommendation to purchase or exchange an annuity – be it fixed or variable. With respect to the purchase and exchange of variable annuities, the rule imposes a duty on insurance companies where none previously existed. In addition to this requirement, more than 80% of NAIFA members are securities licensed and subject to FINRA rule 2821 with regard to the sale of variable products. The NAIC Model expressly states that compliance with FINRA suitability rules satisfies suitability requirements in the Model with respect to the sale of variable annuities. It is important to keep in mind that for agents/registered representatives selling variable annuities in states that have not enacted the Model, the FINRA requirements still apply.

I could go on at length describing the states' consumer protection and product oversight rules and requirements, but suffice it to say that the states have a thorough process that provides robust consumer protections. The specifics of the President's financial regulatory reform proposal have yet to be fleshed out, so it is impossible to know with certainty what the role of the CFPA will be with respect to insurance products. We have a pretty good sense, however, that it was designed to be able to cover at least some insurance products – those deemed to be "payment products and other consumer financial products and services" – and the providers of such products and services. Annuities could be slotted into these categories. We also know that the CFPA would have authority to implement and enforce regulations, including a wide array of new disclosure obligations.

What is unclear – and what may, in practice, remain unclear if the legislation is enacted to encompass insurance products – is where federal authority would stop and current state regulatory authority would remain. The danger is that we could end up with a dual regulatory structure in which the authority of the states is undercut, or at least put into question. This uncertainty with respect to the finality of regulatory decisions will hinder the industry's ability to effectively serve consumers and could lead to a chilling effect in connection with the development of new life insurance, annuity or other traditional insurance products like long-term care and disability income products in new markets – just at a time when we should be encouraging people to plan for their futures.

Moreover, to the extent that one of the missions of the CFPA would be to simplify consumer disclosures, we are unsure how that can be accomplished under a regime that would establish a regulatory floor under which state disclosure requirements would still be fully applicable. It appears that these twin objectives – disclosure simplification and the continued applicability of current state requirements – are at odds with one another and that all the new federal requirements would accomplish in the highly regulated insurance arena would be to add an additional set of duplicative requirements.

(2) Separation of insurance product regulation from insurance solvency regulation is dangerous.

In an apparent effort to avoid undercutting solvency regulation and thereby causing market disruptions, the CFPA would be required to consult with other federal regulators to promote consistency with solvency, market and systemic objectives, and to share regulatory information with those regulators. Having said that, there is no similar requirement to work with state insurance regulators, and this is cause for serious concern.

We believe it is extremely dangerous to separate product regulation from solvency regulation. The states regulate solvency to ensure that the ultimate consumer protection is available when needed – the promise to pay when a claim comes due. A regulator focused only on one part of the puzzle – product oversight – may take actions with the best of intentions to regulate a product, but without sufficient knowledge or understanding of the industry or marketplace, those actions could have the effect of undercutting the solvency of the insurer providing that product. So in the long term, the consumer is not protected at all.

We have some first-hand experience with this that few of you are likely to recall. In 1979-1980, the Federal Trade Commission (FTC) attempted to impose regulations with respect to life insurance products. The FTC made assumptions about the returns on these insurance products vis-á-vis mutual funds and other investment products that were misleading for the consumers of those products. Because of the FTC's lack of understanding of the products and of the insurance industry more generally, the assumptions it made were incorrect, or at least misleading, and it took an act of Congress to fix the situation.

This is why we are very sensitive to this issue – product regulation, if done blindly, can damage the industry and harm, rather than help, the consumer. Consumer protection must be undertaken, therefore, as part of a comprehensive regulatory structure that looks at all aspects of the industry and its marketplace.

(3) Federal financial product oversight should be addressed only as part of a comprehensive review of insurance regulation.

To the extent you decide to include insurance products in a federal oversight scheme, it should be undertaken only as part of a broader effort to streamline and improve the current insurance regulatory regime. This should not be a piecemeal effort – as I have discussed above, the dangers and regulatory burdens are too great. If the federal government is going to assume insurance regulatory authority, there must be a federal insurance regulator with the expertise and authority to fully understand the implications of regulatory actions for the industry, the marketplace and consumers, and take action based on that knowledge.

We appreciate the Administration's call for the creation of an Office of National Insurance within the Treasury Department to serve as a federal source of expertise on insurance matters, and NAIFA was an early supporter of Rep. Kanjorski's Office of Insurance Information legislation. That is a welcome start for federal understanding of insurance. But an information-gathering office is not enough if the plan includes assumption of regulatory authority over insurance products. In that case, the federal government must fully understand the industry and be able to take appropriate and necessary regulatory actions so that product regulation meshes with, and does not conflict with, solvency and other substantive regulatory issues.

NAIFA members have debated long and hard regarding the proper federal role in insurance regulation. NAIFA members are long-time supporters of state regulation and remain steadfastly committed to this tradition. Having said that, NAIFA recognizes the shortcomings of the current regulatory structure. Unnecessary distinctions among the states and inconsistencies within the states on issues such as licensing, product approval, and consumer protection, thwart competition, reduce predictability and add unnecessary expenses to the cost of doing business, all of which ultimately harm consumers. We have – and continue to – work with the states to make improvements. We recognize that reform is critical to protect consumers and to ensure a strong and healthy insurance marketplace, and we believe that fixing the problems with the insurance regulatory system ultimately will enable the insurance industry to provide better and greater choices for consumers, without sacrificing consumer protection.

Despite the solid efforts made by the states to improve the current regulatory system, it has become increasingly clear that the state system needs help. NAIFA believes it is imperative that the problems and inefficiencies in the state regulatory system be corrected quickly, and supports the active involvement of the Congress in the reform process. To that end, NAIFA has had a policy in place since 2002 that supports in concept congressional action to improve and augment the regulation of insurance, provided such action meets NAIFA's specific guidelines aimed at maintaining fairness to agents and protection for the consumers they serve. To that end, NAIFA supports legislation introduced by Reps. David Scott and Randy Neugebauer, H.R.2554, which would create the National Association of Registered Agents and Brokers or "NARAB II" as it is frequently called. NARAB II would streamline the nonresident licensing requirements for agents choosing to do business in multiple states. NAIFA is also very supportive of an important consumer protection provision of NARAB II that would require all NARAB members to submit to a federal criminal background check – a requirement currently only imposed by only 17 states. We are incredibly thankful that this Committee approved NARAB II last Congress and it ultimately passed the full House in September of last year. H.R. 2554 has already received overwhelming support by the members of this Committee and we ask that you once again approve NARAB II and send it to the full House for their consideration.

With respect to comprehensive reforms, we specifically support the concept of an optional federal insurance regulator. To be clear, NAIFA's support for an optional federal insurance charter is not absolute. We continue to believe in the state system and recognize the benefits it offers for many insurance professionals and consumers. Moreover, no federal charter plan will gain NAIFA's support unless it meets the principles set forth by our members including, perhaps most important, the inclusion of strong consumer protections. (NAIFA's "Themes and Conditions for Support of the Concept of An Optional Federal Charter for Insurance" are attached hereto as Appendix A.)

NAIFA believes that federal charter legislation must provide a federal insurance regulator with authority to adequately address the following consumer protection issues:

a. Encompass the NAIC's model Unfair Trade and Unfair Claims Settlement Practices Acts;
b. Adhere to generally accepted replacement regulations;
c. Include file and use of rates with appropriate regulator review and approval of products;
d. Maintain the ability of insurers to share loss, underwriting and trending data;
e. Not exceed the 2004 NAIC standard for insurance commission disclosure;
f. Ensure adequate solvency standards for insurers; and
g. Include regulator responsiveness to and accessibility for consumers.

These principles are the guideposts for NAIFA's analysis and support of federal regulation of insurance. Strong consumer protections are essential to any workable federal oversight scheme. But, we believe they cannot be separated from other aspects of insurance oversight.

Conclusion:

The current financial crisis has rightly raised concerns about deficiencies in the regulatory oversight of certain types of financial products. The Obama Administration has proposed creating a new federal regulator, the Consumer Financial Protection Agency, to oversee those products and impose and enforce new rules with respect to the products and the people that provide them.

NAIFA has always supported strong consumer protections – it is good for our customers and good for us – and we fully understand the logic behind the Administration's proposal. Having said that, we strongly believe that insurance products should not be subject to federal product regulation unless it is undertaken as part of a comprehensive approach to insurance regulatory reform that addresses all issues related to insurance oversight including in particular solvency issues and the interaction with state laws and regulations.

We realize that this is the start of a long process toward improving our financial regulatory structure, and appreciate the opportunity to share our views with you today on this issue that is so critical to consumers and to our country. We welcome the opportunity to assist you in any way that we can as the legislative process moves forward.

Appendix A

NAIFA's Themes and Conditions for Support of the Concept of an Optional Federal Charter for Insurance

1. True Agent Choice

Federal insurance legislation shall:

a. Permit producers to choose federal or state regulation
b. Prohibit companies from discriminating against a producer based on his or her choice of federal or state regulation
c. Address producer regulation for all major lines of insurance

2. Enhanced Consumer Protections

Federal insurance legislation shall:

a. Encompass the NAIC's model Unfair Trade and Unfair Claims Settlement Practices Acts
b. Adhere to generally accepted replacement regulations
c. Include file and use of rates with appropriate regulator review and approval of products
d. Maintain ability of insurers to share loss, underwriting and trending data
e. Not exceed the 2004 NAIC standard for insurance commission disclosure
f. Ensure adequate solvency standards for insurers
g. Include regulator responsiveness and accessibility to consumers

3. Single Federal Voice & Preserve State Regulation

Federal insurance legislation shall:

a. Provide a single, comprehensive regulatory structure for all producers who opt for federal regulation
b. Include a federal entity with expertise in insurance to weigh in on national and international policy with regard to insurance
c. Provide producers with a position at the table when new regulations are being considered by the national insurance regulator
d. Allow for creation of a new self regulatory organization (SRO) to address insurance and/or securities issues
e. Allow for increased efficiencies and cost savings for our members
f. Create a federal insurance regulator who is the sole regulator of insurance for federally licensed entities -- not any other federal body
g. Be cost neutral to the states
h. Promote cooperation between state and federal regulators
i. Not impede the operation or expansion of the Interstate Insurance Product Regulation Commission (Interstate Compact) or other efforts to improve state insurance regulation
j. Fully preserve McCarran-Ferguson antitrust exemption for state regulation of insurance.

June 24, 2009

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

AMERICAN BANKERS ASSOCIATION ®

Testimony of Edward L. Yingling
On Behalf of the American Bankers Association
Before the
Committee on Financial Services
United States House of Representatives
June 24, 2009

Chairman Frank, Ranking Member Bachus, and members of the committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

ABA appreciates how this committee has responded to the financial crisis in a thoughtful, deliberative, and thorough manner. Changes are certainly needed, but the pros and cons and unintended consequences must be carefully evaluated before dramatic changes – affecting the entire structure of financial regulation – are enacted. That is why hearings like this one today are so important.

I am pleased to present the ABA's views today on the proposal to create a new consumer regulatory body for financial services that would be separate and apart from any future prudential regulatory structure. We believe that a separate consumer regulator should not be enacted, and, in fact, is in direct contradiction with an integrated, comprehensive approach that recognizes the reality that consumer protection and safety and soundness are inextricably bound. Consumer protection is not just about the financial product, it is also about the financial integrity of the company offering the product. Simply put, it is a mistake to separate the regulation of an institution from the regulation of its products.

Banks can only operate safely and soundly if they are treating customers well. Banks are in the relationship business, and have an expectation to serve the same customers for years to come. *In fact, 73 percent of banks (6,013) have been in existence for more than a quarter-century, 62 percent (5,090) more than half-century, and 31 percent (2,557) for more than a century.* These banks could not have been successful for so many years if they did not pay close attention to how they serve customers. Satisfied customers are the cornerstone of the successful bank franchise. The proposal for a new consumer regulator, rather than rewarding the good banks that had nothing to do with the current problems, will add an extensive layer of new regulation that will take resources that could be devoted to serving consumers and make it more difficult for small community banks to compete.

The banking industry fully supports effective consumer protection. We believe that Americans are best served by a financially sound banking industry that safeguards customer deposits, lends those deposits responsibly and processes payments efficiently. ***Traditional*** FDIC-insured banks – more than any other financial institution class – are dedicated to delivering consumer financial services right the first time and have the compliance programs and top-down culture to prove it. Certainly, there were deficiencies under the existing regulatory structure; and banks, bank regulators, non-bank overseers, and policymakers all share some responsibility for the financial and economic problems that developed. Creating a new consumer regulatory agency, however, is not the solution to these problems. It would simply complicate our existing financial regulatory structure by ***adding another extensive layer of regulation***. There is no shortage of laws designed to protect consumers. Making improvements to enhance consumer protection under the existing legal and regulatory structures – particularly aimed at filling the gaps of regulation and supervision of nonbank financial providers – is likely to be more successful, more quickly, than a separate consumer regulator.

Certainly the members of this committee should look at this consumer agency proposal from the point of view of the consumers, who are paramount, but we would also ask you to look at this issue from another point of view. While all banks would be negatively impacted, think of community banks, and credit unions also for that matter. These banks never made one subprime loan and they have the trust and support of their local consumers. As this committee has frequently noted, these community bankers are already overwhelmed with regulatory costs that are slowly but surely strangling them.

Yet last week, these community banks found the Administration proposing a potentially massive new regulatory burden that will fall disproportionately on them. The largest banks, which will certainly bear a significant burden as well, do have economies of scale. While the non-banks – the shadow banking industry which includes those who are most responsible for the crisis – are covered, at least in part, by the new agency (and that is positive), their regulatory and enforcement burden is, based on history, likely to be much less. The new agency, according to the Administration proposal, will rely first on state regulation and enforcement, and yet we all know that the budgets for such state regulation and enforcement are completely inadequate to do the job. Community banks, on the other hand, are likely to have greatly increased fees to fund a system that falls disproportionately and unfairly on them.

No one has seen the legislative language to create this agency, and so we don't know exactly how it will work. However, reading the Administration's narrative, it appears that the new agency would have vast and unprecedented authority to regulate in detail all bank consumer products and services. The agency is even instructed to create its own products and services – whatever it decides is "plain vanilla" – and <u>mandate</u> that banks offer them. Even further, the agency is basically urged to give the products and services it designs regulatory preference over the bank's own products and services. The agency is even encouraged to require a statement by the consumer acknowledging that the consumer affirmatively was offered and turned down the government's product first.

The proposal goes beyond simplifying disclosures – which is needed – to require that all bank communication with consumers be "reasonable." This is a term so vague that no banker would know what to do with it. But not to worry -- the proposal offers to allow thousands of banks, and thousands of non-banks, to pre-clear all communications with the agency.

CRA enforcement is apparently to be increased on these community banks, although they already strongly serve their communities.

And that is not to mention the inherent conflicts, discussed below, that will occur between the prudential regulator and the consumer regulator, with the bank caught in the middle.

All this cost, regulation, conflicting requirements and uncertainty would be placed on community banks that in no way contributed to the financial crisis.

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

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

These lessons lead to two fundamental building blocks of any reform of consumer protection oversight. First, uniform regulation and uniform supervision of consumer protection performance must be applied to non-banks as rigorously as it has been applied to the banking industry. Second, regulatory policymakers for consumer protection should not be divorced from responsibility for financial institution safety and soundness. Separating the safety of the institution from the safety of its products means each agency only has half the story. Without building upon these keystones, the hope for better transparency, simplicity, accountability, fairness and access will not be realized, and we will have missed the opportunity to build a consumer protection culture across the financial services industry.

Unfortunately, the Consumer Financial Products Agency (CFPA) proposal, in our opinion, contains a number of very serious flaws. The proposal, as outlined:

- Severs the connection between consumer protection and safety and soundness – forcing each to attempt to work independently and freeing each to contradict the valid goals of the other – to the detriment of consumer choice and safety and soundness.
- Subjects banks to added enforcement, but leaves the "first line of defense" for the supervision and examination of non-banks to the states, which suffer from a lack of resources for meaningful enforcement. ***This is where the failure of non-bank regulation was most severe under the current system.*** Once again there would be perverse incentives for financial products to flow out of the closely examined banking sector to those who will skirt the meaning, and even the language, of regulations.
- Excludes competitor financial products from its reach – including securities and money market funds, and possibly insurance – thus further belying the promise of uniform or systemic oversight and creating incentives for development of products outside the scope of the CFPA that may be risky for consumers.
- Imposes government designed one-size-fits-all products – so-called plain vanilla products – over services that are designed for an increasingly diverse customer base. These products would be given regulatory preference over the products designed by the individual banks, and consumers could even be required to sign a notice that they have first turned down the government's product.
- Requires communications with consumers to be "reasonable", an incredibly vague and unworkable standard.
- Basically ends uniform national standards, eventually creating a patchwork of expensive and contradictory rules that will create uncertainty, increase consumer costs, and lead to constant litigation.
- Saddles consumers and providers with a new regime of fees to fund yet another agency.

To be successful in the regulation of, examination of, and enforcement on non-banks, the agency will have to be very large and have a significant budget. We believe a better course exists. ABA offers to work with the Administration and the Congress to achieve meaningful regulatory reform to improve consumer protection and preserve financial system integrity. As the crisis has proven, a strong banking industry is indispensible to a strong economy; and a sound banking system is the greatest single protection of consumer access to financial services fairly delivered. Traditional banking is back in style, but that does not mean improvements cannot be made. We pledge to work with this committee to find the hest solutions to assure that consumers bave the protection they deserve for any financial product.

I would like to further discuss several points today:

- Consumer regulation ***should not be separated*** from safety and soundness regulation.
- The key focus of change should be on ***closing existing gaps in supervisory oversight*** across the financial institution marketplace, not on adding yet another vast layer.
- The proposal would give the agency unprecedented authority to control the products and services offered by banks.
- The undermining of uniform national standards will increase costs and cause tremendous litigation and uncertainty.
- The question of how to pay for this new agency was left very vague and raises significant issues.
- The regulatory authority to address consumer concerns is already there for highly regulated banks, particularly with the new focus on unfair and deceptive practices. However, improvements can be made, and ABA will work with the committee to make such improvements.

I will address each of these points in turn.

I. Consumer regulation should not be separated from safety and soundness regulation.

Consumer regulation and safety and soundness regulation are two sides of the same coin. Neither one can be separated from the other without negative consequences; nor should they be separated. An integrated and comprehensive regulatory approach is the best method to protect consumers and protect the safety and soundness of the financial institution. While certainly improvements can be made, the current regulatory structure applied to banks provides an appropriate framework for effective regulation for both consumer protection and bank safety and soundness. As I note throughout this testimony, that same framework was virtually non-existent for non-bank providers of financial products.

FDIC Chairman Sheila Bair, testifying recently before Congress, summarized the synergies between both these elements: "The current bank regulation and supervision structure allows the banking agencies to take a comprehensive view of financial institutions from both a consumer protection and safety and soundness perspective. Banking agencies' assessments of risks to consumers are closely linked with and informed by a broader understanding of other risks in financial institutions. Conversely, assessments of other risks, including safety and soundness, benefit from knowledge of basic principles, trends, and emerging issues related to consumer protection. Separating consumer protection regulation and supervision into different organizations would reduce information that is necessary for both entities to effectively perform their functions. Separating consumer protection from safety and soundness would result in similar problems."[1]

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

Almost every bank product or service has both consumer issues and safety and soundness issues that need to be balanced and resolved. As I mentioned at the outset, the very nature and application of good underwriting standards is by definition an inseparable consumer protection and a safety and soundness issue. A second simple example is check hold periods. Customers would like the shortest possible holds, but this desire needs to be balanced with complex operational issues in check clearing, and with the threat of fraud, which costs banks – and ultimately consumers in the form of increased costs that are passed on – billions of dollars.

Similarly, the Electronic Funds Transfer Act contains numerous important consumer protections, developed and modified over the years based on experience, new technologies, and new types of fraud. Separating the consumer consideration from the safety and soundness, anti-fraud, and systems considerations would certainly seem unworkable.

Banks also have extensive duties under "know your customer" regulations designed to fight money laundering and terrorism. These critical regulations must be coordinated with consumer and safety and soundness regualtion. A simple example is in the account opening process, which is subject to extensive consumer and "know your customer" regulations. It would seem unworkable to separate these as well.

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

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

[1] Bair, Sheila, C. *Modernizing Bank Supervision and Regulation,* testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, March 19, 2009.

same agency is in charge of CRA and safety and soundness. To separate the two is a receipe for conflicting regularory demands, with the bank caught in the middle.

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

II. The key focus of change should be on closing existing gaps in regulation, not on adding yet another bureaucratic layer.

The biggest failures of the current regulatory system, including consumer protection failures, have not been in the regulated banking system, but in the unregulated or weakly regulated sectors.[2] As you have noted many times, Mr. Chairman, to the extent that the system did work, it is because of prudential regulation and oversight of banking firms. While improvements within the banking regulatory process can certainly be made, the most pressing need is to close the regulatory gaps ***outside*** the banking industry through better supervision and regulation – both on the consumer protection and safety and soundness sides of the coin.

Take the case of independent mortgage brokers and other non-bank originators. Again, as the Administration's own proposal states, 94% of the high cost mortgages occurred outside the regulated banking sector. And it is likely that an even higher percent of the most abusive loans were made outside our sector. In contrast to banks, these firms operate in a much less regulated environment, generally without regulatory examination of their conduct, without strong capital provisions, and with different reputational concerns. They have not been subjected to the breadth of consumer protection laws and regulations with which banks must comply. Equally important, a supervisory system does not exist to examine them for compliance even with the comparatively few laws that do apply to them. In addition, independent brokers typically do not have long-term business relationships with their customers. Instead, they originate a loan, sell the loan to a third party, and collect a fee. This results in a very different set of incentives and can and does work at cross-purposes with safe and sound lending practices. Proposals are also being offered with respect to credit derivatives, hedge funds, and others, and the ABA supports closing these regulatory gaps.

---

[2] Before the recent crisis, a coalition of 46 state Attorneys General recognized that based on consumer complaints received, as well as investigations and enforcement actions undertaken by them, predatory lending abuses were largely confined to the subprime mortgage lending market and to non-depository institutions. Almost all of the leading subprime lenders were mortgage companies and finance companies, not banks or direct bank subsidiaries. We stress the past tense, because their lack of financial robustness assured that they would not be around to answer for their consumer protection misdeeds.

In stark contrast to the weakness of oversight or examination of consumer compliance issues for most other financial service providers, bank regulators have an extraordinarily broad array of tools at their disposal to assure both consumer protection and safety and soundness. Banks are regularly examined for compliance with consumer regulations, and regulators devote significant resources to supervision and training in consumer compliance issues.[3] While certainly improvements can be made to make this process more effective, the structure, rules, supervision and examination are already in place at banks. The need is for the same bank-like structure, supervision and examination to be applied to non-bank financial service providers.

These enforcement and supervisory options are coordinated through the Federal Financial Institutions Examination Council (FFIEC)[4], which sets standards for ***both*** consumer and safety and soundness examination. In addition, the FFIEC agencies have set forth common standards for determining a bank's ***rating*** for consumer compliance performance. This rating stands as an identifiable grade, separate and apart from the CAMEL rating, so that boards of directors and regulators can hold management directly accountable for the quality of their institution's consumer compliance management programs and performance. Moreover, the FFIEC's agency members have endorsed top-down consumer compliance programs expected of banks that contain system controls, monitoring of performance, self-evaluation, accountability to senior management and the board, self-correcting processes, and staff training.

The ***breadth*** of this supervisory authority is extensive. Consumer compliance management plays a role in every operational aspect where a bank comes into contact with customers – from the marketing of products, through account opening and credit administration, to handling personal information and monitoring for financial crime. Further, banks hold their employees accountable for meeting their obligations. Every bank invests heavily in consumer compliance with dedicated compliance professionals who take great pride and apply tremendous effort to assure that consumers are being treated fairly.

Healthy, well-regulated banks have already been hurt deeply by unscrupulous players and regulatory failures. They watched mortgage brokers and others make loans to consumers that a good banker just would not make. They watched local economies suffer when the housing bubble burst. Now they face the prospect of another burdensome layer of regulation aimed primarily at their less-regulated or unregulated competitors. It is simply unfair to inflict another burden on these banks that had nothing to do with the problems that were

---

[3] Bank regulators are just as concerned about consumer protection as are law enforcement authorities, but the bank regulators are better able to achieve their objectives through an enormous array of enforcement and supervisory options that allow them to meet their broader mandate for law enforcement as well as financial stability. These range from the behind-the-scenes citation in an exam report as a matter requiring attention to the public actions of issuing a cease-and-desist or civil money penalty order or even closing a bank and imposing lifetime bans from participating in banking activities. Bank examiners can direct a bank to stop taking an action or to take some different action. These tools are most appropriately and effectively exercised by one regulator that is focused on achieving the balance described above.

[4] The FFIEC, represented by the Federal Reserve, OCC, FDIC, OTS and NCUA, is charged with prescribing "uniform principles and standards for the federal examination of financial institutions" designed to "promote consistency in such examination and to insure progressive and vigilant supervision."

created. The separate consumer regulator will only add costs to these banks – which already suffer under the enormous regulatory burden placed on them.

This committee has worked hard in recent years to temper the impact of regulation on banks. You have passed bills to remove unnecessary regulation, and you have made existing regulation more efficient and less costly. As you contemplate major changes in regulation – and change is needed – I urge you to ask this simple question: how will this change impact those thousands of banks that did not create the problem and are making the loans needed to get our economy moving again?

There obviously have been consumer concerns with respect to banks – we certainly know of this committee's concerns with credit card practices – but if the great majority of abuses occurred outside the banking industry (with toxic subprime mortgages, for example), why would Congress create a new regulatory agency that will end up focusing its resources predominately on banks and not non-banks? We see that the intention is to have regulations that cover most providers. However, regulation without enforcement can be worse than no regulation in that it gives rogue institutions a veneer of legitimacy. All evidence tells us that the states will not have the resources to enforce all these regulations. We have, frankly, little confidence that the CFPA will force equal examination and enforcement on non-bank lenders and others, or that it will have the resources to do so.

III. The proposal gives the CFPA unprecedented authority to control the products and services offered by banks.

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

It also would very much undermine incentives for innovation and better customer choice. Certainly banks and non-banks would be less likely to create new products or consumer enhancements. Any deviations from the government-designed product would be subject to additional regulation and clearances.

In many cases, the government product might not fit with the institution's business plan. Niche banks, which serve important constituencies such as small businesses, might be required to offer products that simply do not fit. There will even be safety and soundness issues. For example, some banks that maintain all their loans in portfolios do not, and should not, hold 30-year fixed "plain vanilla" mortgages.

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

The Commerce Clause of the Constitution was designed to allow products and services to flow freely across state lines. It is hard to think of an area of our economy where this should be encouraged more than in financial services, where the market for products from loans to deposits is national in scope. With changes in technology – such as the Internet – and the incredible mobility of our society, the free flow of financial services is even more pronounced.

Furthermore, the National Bank Act, enacted during the Civil War, was created to provide for a national bank system that would not be subject, in its basic bank functions, to state laws. This national banking system, as part of the dual banking system, has served us well. However, it is hard to imagine that a national system can function effectively if all national bank consumer products are subject to fifty different state laws. As we have noted, the safety and soundness regulator will not be able to function well if it has no authority over consumer laws, much less if that authority is held by not only the federal consumer regulator, but every state regulator, legislature, and attorney general as well.

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

Costs to consumers would increase as banks try to address all the different rules. Innovation would be discouraged as any changes would have to be tested against all the different state rules. The European Union is working to develop common rules in order to have greater efficiencies and innovation, and yet the Administration's proposal would go in exactly the opposite direction – toward balkanization.

V. The question of how to pay for this new agency was left very vague and raises significant issues.

To be remotely effective, this new agency will have to be very large. It will need to regulate, and in many cases examine, not just banks, but credit unions, finance companies, pay-day lenders, mortgage brokers, mortgage bankers, and many others – maybe even pawn shops. To provide full and equal consumer protections, it should regulate equivalent insurance, securities, and mutual fund products that compete directly with bank loan, deposit, and savings products.

Where is this agency's budget to come from? The Consumer Products Safety Commission, said to be the model for the CFPA, is not funded by toy or appliance manufacturers, but rather by an appropriation. However, if the CFPA is to accomplish its goals and to effectively regulate non-banks, it would need to be considerably bigger than the CPSC. Banks are already heavily burdened with funding their regulators, directly and indirectly (e.g., deposit insurance premiums fund the FDIC's regulatory costs). These costs cannot simply be split apart to pay for the banks' part of the consumer regulator, as there are tremendous efficiencies in combining regulation that will be lost.

How is the agency to collect fees from other providers? On what basis? How is it going to know about new entrants, unless they are required to register with the agency? As new types of providers spring up, how are they to be incorporated?

The proposal also talks about possible fees on products or transactions, but will the Congress want to impose what could be considered a tax on consumer financial products and transactions?

Obviously, these are very difficult questions that were not addressed in the Administration's proposal.

VI. Improvements can be made.

ABA agrees that improvements can and should be made to protect consumers. The great majority of the problems, as has been noted by both Democrats and Republications on the committee, occurred outside the highly regulated traditional banks, but there are legitimate issues relating to banks as well. The ABA is committed to working with Congress to address these concerns and implement improvements. In that regard, let me outline some concepts that should be considered.

- As you know, the Federal Reserve Board and the OTS have long had a very powerful tool called unfair and deceptive practices or UDAP. This had not been used in a material fashion prior to the extensive credit card rule. However, use of this authority would address many of the issues raised. The authority is already there. The ABA supports legislation the House passed last year to extend this authority in a coordinated fashion to the OCC and FDIC. The FTC has this authority for non-banks, but there have been constraints in using it, and Congress should work to give the FTC the capability to apply it to non-banks much more aggressively.
- Disclosures can and should be improved, although it will not be easy. Current disclosures are by-and-large driven by lawyers and the need to cover the many legal complexities that are involved, and to protect against the real threat of litigation. Congress, the regulators, the industry, and consumer advocates need to overcome this bias. Progress has been made through the insights gained from consumer testing. Simple disclosures, perhaps in combination with the larger ones required for legal purposes, should be

made in ways that most benefit consumers. Concepts gleaned from behavioral science relating to how consumers really react should be included in disclosure design.

- In some cases financial products have become overly complex and difficult, if not impossible, for consumers to understand. This is not unusual in our economy as many product offerings – from consumer electronics, to telephone plans, to insurance – have become very complex. Often this complexity results from efforts to add options that consumers may want. Sometimes, as we all know, the complexity induces consumers to buy products or enhancements that are not right for them or for which they pay too much. However, as discussed previously, ABA believes the answer is not to have the government design products, mandate that they be offered, and give them an advantage over private sector products. Nevertheless, there is a need to have product options that are basic and easily compared, and to have, at the same time, a flexible, private-sector driven system that does not stifle competition and innovation. For example, the private sector, perhaps through the ABA as the industry's trade association, could consult with the regulators, Congress, and consumer advocates to develop basic product forms that could be easily compared.
- It is difficult, perhaps impossible, for many consumers to understand whom they should call in the government to register concerns or complaints. ABA supports a centralized call center for consumers that could forward complaints to the right agency and serve as a coordinated information source.
- The structure of consumer regulation within agencies can be reviewed and strengthened. Regular reports to Congress could be required.
- The systemic regulator could be required to look specifically at consumer issues that can lead to systemic problems. One clear lesson from the mortgage crisis is that consumer issues can raise systemic issues. If a systemic regulator had been in place, we would hope that it would have identified the rapid growth of subprime lending as a problem that had to be addressed well before it grew to such a hurricane force. The systemic regulator could be given the power to require regulatory agencies to address in a timely manner systemic consumer issues.

Conclusion

The ABA has very serious concerns about the proposed CFPA and the authorities it is to be given under the President's proposal. We believe it will result in a huge regulatory burden, particularly for community banks, while non-banks, which are primarily responsible for the crisis, will have ineffective enforcement. As outlined above, we believe thar separating safety and soundness regulation from consumer regulation would be a mistake. Nevertheless, there are important improvements that can and should be made in the consumer arena, and we will work with members of this committee to make such improvement in this arena, as well as on the many other important issues in regulatory reform.

ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

June 24, 2009

The Honorable Barney Frank
Chairman,
House Financial Services Committee
2129 Rayburn HOB
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member,
House Financial Services Committee
B-371A Rayburn HOB
Washington, DC 20515

RE: Hearing on "Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the 5,000 members of the Independent Community Bankers of America, I write to express our significant concern with the Administration's plan to create a Consumer Financial Protection Agency (CFPA). There is little doubt that this far-reaching expansion of government will do more harm than good by unduly burdening our nation's community bankers who did not engage in the types of deceptive practices targeted by the proposal.

The success of community banking depends on superior customer service consumers cannot find with the competition. This higher level of customer service, combined with more favorable terms and conditions on financial products is, at the end of the day, what makes any community bank a viable enterprise. The existing regulatory framework, while often costly to a fault, allows community bankers to ensure their customers are fully informed and educated of their choices, while also allowing the bank to operate in a safe and sound manner. As such, community bankers agree that consumer protection is a cornerstone of our financial system.

The Administration's deeply flawed proposal rests on incorrect assumptions about consumers and the motives of financial institutions – assumptions that do not reflect the way community banks conduct business. One rationale for the CFPA is that banks will attempt to exploit consumers with complicated products and incomprehensible contracts. The proposal suggests this tendency is exacerbated by a regulatory environment more attuned to the soundness of institutions and markets, than to consumer protection.

The proposal suggests that consumers need to be protected from themselves. Therefore, a core function of the CFPA is to promote the "simplicity" of financial products because any product that is not simple is likely to be bad for consumers. To be sure, community banks prefer to offer consumers simpler products when it is appropriate; but "simpleness" as a doctrine should not be promoted at the expense of all other products. Not every consumer's situation is best served by the simplest product. This proposal simply does not reflect the nature of community banking, particularly the emphasis community bankers place on maximizing long-term relationships with their customers. It is a one-size-fits-all prescription will add significant costs to small banks.

Because community banks are so closely tied to their local economies, the success or failure of a community bank depends on its ability to know and encourage what is in the best interest of its customers. As a consequence, community bankers have no incentive to peddle inappropriate or unwise financial products. While community banks are fairly risk-averse and conservative lenders, we are concerned this agency will place too great a value on "simplicity" and generic lending products, which are not always in the best interest of the consumer or the local economy.

1615 L Street NW, Suite 900, Washington, DC 20036 • (800)422-8439 • FAX: (202)659-3604 • Email: info@icba.org • www.icba.org

As an example, many community banks have been offering balloon loans for decades. These loans were the only product that many rural, underserved, or otherwise risky consumers could possibly qualify for, so they extended the credit. However, community banks would not turn around and sell or securitize these loans, instead keeping them on their books, maintaining all of the risk and all of the incentive to ensure those consumers met their obligations. The proposed CFPA would make it costly, burdensome, and a bureaucratic nightmare for a community bank to do that in the future. Requiring banks to offer less diverse financial products limits the ability of many consumers to gain access to credit, and will unintentionally create an economic environment catering to higher-income consumers who possess greater economic flexibility.

The regulatory and enforcement powers shifted to the CFPA would unwisely separate consumer protection from safety and soundness enforcement, when both types of enforcement must co-exist under one agency for efficient financial services regulation. Separating this enforcement among two different agencies would only give each agency half of the information it would need. If the CFPA is not equally interested in the safety and soundness of the lender, it is likely to promulgate burdensome regulations that make many currently safe financial products, which are beneficial to consumers but might be considered complicated, unavailable or too costly to offer. Furthermore, this lack of perspective could lead to the CFPA issuing directives that compete or run contrary to those issued by the prudential regulator. A community bank could find itself in a position with two conflicting mandates, each of which must be followed, with no clear means of resolution.

Giving the CFPA jurisdiction over the Community Reinvestment Act (CRA) highlights this issue for community banks. Unlike statutes such as the Truth in Lending Act, the CRA does not regulate consumer products or consumer rights. The CRA regulates bank services, lending and investments, all of which are integral to overall bank operations, which is the central concern of safety and soundness regulators. Separating enforcement of CRA from safety and soundness regulation, as the Administration has proposed, could easily result in conflicts between the CRA requirements of the CFPA and the safety and soundness requirements of banking agencies, leaving banks in the middle. It would be far better to leave with the banking agencies jurisdiction over statutes, such as the CRA, that directly govern bank operations.

We urge Congress to focus the CFPA on the lack of oversight of non-bank entities – which were at the heart of the current crisis – not on increasing regulation of community banks. ICBA believes this is the best way to avoid future abuse in the marketplace. Creating yet another agency and layer of bureaucracy for community banks that are already heavily examined and regulated, is not. ICBA believes that the examinations regularly conducted by bank regulatory agencies are the best means to ensure compliance with consumer protection requirements established by statute and regulation.

On behalf of our nation's community banks, thank you for considering our views. The ICBA looks forward to working with you and the members of your committee on this issue and the other aspects of financial regulatory reform that will be addressed in the future.

Sincerely,

Camden R. Fine

Camden R. Fine
President and CEO

CC: Members of the Financial Services Committee

Department of
Consumer Affairs

40 years of ensuring a fair and vibrant marketplace

Testimony of Jonathan Mintz
Commissioner
New York City Department of Consumer Affairs

Before the House Committee on Financial Services

Hearing on: Enhancing Consumer Financial Products Regulation

Wednesday, June 24, 2009

I. Introduction

Thank you for giving the New York City Department of Consumer Affairs (DCA) the opportunity to submit testimony for the Committee's hearing on June 24, 2009. We appreciate this opportunity to comment on the regulatory reform effort on behalf of Mayor Michael R. Bloomberg and the City of New York.

Strong, comprehensive and systemic reforms are imperative for restoring the confidence of American businesses and consumers, and critical to protecting our economy from another financial meltdown. In short, this is important work, and we wish to add New York City's voice to the chorus commending this Committee and the Obama Administration for the thoughtful and ambitious proposals under consideration here today.

DCA is the largest and most aggressive municipal consumer protection agency in the country. Our comments focus on the proposed new protections afforded to consumers in the financial services market place. In proposing to create a Consumer Financial Protection Agency, the President has marked the end of second-class status for consumer protection issues. Even more importantly, by advancing such an effort in the midst of economic turmoil, he has reinforced that such protections are in fact the foundation of a sound and profitable financial services industry.

This testimony sets forth several lessons we've learned in New York City in Mayor Bloomberg's innovative experiment to implement at a local level what now has been proposed federally: that is, inserting robust consumer protection directly into the financial services sector. With the addition of the Department of Consumer Affairs specialized Office of Financial Empowerment (OFE), DCA has paired its core protection functions

—including rulemaking, licensing, inspecting, educating, resolving consumer complaints, and bringing targeted litigation—with a successful and large-scale financial empowerment mission that brings financial institutions to the table to offer, and actually sell, jointly developed and specially branded safe consumer financial products. In other words, DCA has on-the-ground experience in the same work that the Consumer Financial Protection Agency would undertake.

In this testimony, we flesh out more examples of this innovative – and doable – integration of consumer protection within the financial services sector. Then we offer several recommendations based on our experience that should inform the debate about the mandate of a federal Consumer Financial Protection Agency. In particular, we highlight a novel approach—an innovative ratings system—that we believe could be a game changer in this debate—for consumers, for financial sector players, and for the network of regulators seeking to rationalize the many interests at stake.

II. The Need for Consumer Protections: Including Safety and Soundness

An important lesson learned from the financial crisis is this: our regulatory framework permitted short-term profit objectives to proliferate at the expense of both consumers and the long-term safety and soundness of firms and, as it turns out, the economy. Our current regulatory framework was ill equipped – and generally unwilling – to stem this tide of dangerous financial products. Non-bank lenders were unfettered and reckless, and even regulated institutions had monitors who allowed gains in firm profits to come at the expense of consumers. You will be told by those who have profited from the existing system that we must choose between safety and soundness on the one hand

and consumer protection on the other. DCA applauds our President for rejecting that dichotomy as a "false choice" and proposing an agency that would accomplish both objectives.

More than anything else, consumer protection demands *informed choice*. Imagine where we might be today if banks and other lenders had been held to this expectation. Consumers would have had had the opportunity to choose to *accept* products and services rather than having to opt out of often costly features, *and* in plain language, clear and understandable terms. Customer confidence in financial institutions, and their successful, long-term engagement with those products and services, would have created a strong base for our system, offering financial institutions *sustained* profitability.

Consumer protection does not represent a threat to safety and soundness. To the contrary, a Consumer Financial Protection Agency could ensure the sound and stable market that can only come with informed choice.

III. Lessons Learned by the New York City Department of Consumer Affairs

As the largest local consumer protection agency in the country, New York City's Department of Consumer Affairs has learned quite a bit about effective approaches to protecting consumers. With DCA's Office of Financial Empowerment, we've also spent more than two years pushing the envelope on scalable efforts to interweave that protection framework into the financial services sector in New York.

To ensure a fair and vibrant marketplace for the businesses of New York City, its 8.3 million inhabitants, and its 47 million annual visitors, DCA licenses more than 70,000 businesses in 55 different industries; enforces municipal laws including the strongest local unfair and deceptive practices act in the nation through both inspections and targeted litigation; mediates thousands of individual consumer complaints annually; educates consumers and businesses through public hearings and public marketing and outreach campaigns. DCA also works with other city, state and federal law enforcement agencies to protect consumers from deceptive practices and ensure a fair marketplace.

We've learned that often the best way to protect – and educate – consumers is through targeted enforcement initiatives. The Department's aggressive enforcement of New York City laws regulating income tax preparers complements well our asset building work, as one example. Those of us engaged in financial empowerment know it is critical to get consumers every dollar of their tax refunds, particularly those from the Earned Income Tax Credit. Yet refund anticipation loans, with their high fees and exorbitant interest rates, are classic examples of truly dangerous products. In early 2009, DCA enforcement officers inspected more than 700 income tax preparation businesses and found 39% in violation of at least one consumer protection regulation. DCA issued more than 1,200 violations, assessing some $600,000 in fines, primarily against businesses deceptively promoting these loans as though they were simply very fast refunds from the IRS.

In addition to protecting against unfair and predatory practices, DCA's OFE spearheads an array of other financial empowerment efforts, each designed with a focus on scale.[1] Leading the way in the municipal financial empowerment movement, Mayor Bloomberg also created the Cities for Financial Empowerment (CFE) Coalition that

[1] DCA's OFE was the first initiative to be implemented under Mayor Bloomberg's Center for Economic Opportunity (CEO), a comprehensive, research-driven effort to design and implement innovative poverty-reduction strategies.

identifies innovative cities across the country that partner and coordinate at the national level efforts similar to the work OFE does locally.[2]

In addition to our large-scale public education campaigns, we implement innovative asset-building strategies, and coordinate a dynamic network of the City's many financial education service providers. Mayor Bloomberg recently launched a Citywide network of Financial Empowerment Centers that offer the "gold standard" of financial education: one-on-one financial counseling and coaching. And we offer it for free.

While offering services such as these, we've gained on-the-ground insight to inform our education, enforcement, and policy efforts. Significantly, 64% of those seeking help at our Financial Empowerment Centers come for assistance to reduce untenable debt. The median income of those seeking help is only $10,000 per year, and yet median debt levels top $7,000, primarily consisting of revolving debt products like credit cards. One-quarter of clients have debts totaling $20,000 or more. This street-level data has also been the touchstone for our ability to engage successfully the City's financial institutions.

IV. DCA's Active Involvement in the Consumer Financial Products Marketplace

Last year, DCA conducted extensive research on the availability of financial services and consumer needs in two communities in New York City - Jamaica, Queens and Melrose, in the Bronx. The study went beyond classic supply data by focusing on financial product and service demand. We wanted to understand why residents of these communities do or do not choose bank products and services as compared with products

[2] Commissioner Jonathan Mintz co-chairs this Coalition with San Francisco Treasurer José Cisneros, promoting CFE member cities as bustling laboratories of large-scale asset building, financial education, and banking initiatives.

and services provided by other, often fringe, financial service providers. Effective consumer protection efforts must be grounded in market realities.

DCA's study uncovered some startling findings. For example, while 69% of residents in those two low-income communities have bank accounts, 75% of residents regularly depend on check cashers to meet their financial needs.[3] Why are even mainstream bank customers going elsewhere to meet their needs? Clearly, it's not for lack of education about maintaining a bank account, as is too often and too easily suggested. Simply put, banks aren't providing the safe, appropriate products such customers require for their basic financial transactions. Our study revealed that 60% of checking account holders in those communities reported that their landlords would not accept personal checks for rental payments. Yet, while banks across New York City typically charge money order fees ranging from $3 to $10, most check cashers charge about $1. Nearly one-third of the unbanked residents in DCA's study – estimated to represent more than 110,000 people in the two communities - cited excessive fees as the most common reason they avoided mainstream banking, and focus groups reported that unpredictability of fees, was one of the most compelling reasons to avoid banking. Consumers are concerned whether their deposits are safe from the very institutions to which they trust their hard-earned money

The lesson we learned is that educating consumers and investing in financial literacy can only ever be half of the equation. The other half is making sure there are safe and smart products from which to choose.

DCA set out to see how we could use the power and position of government to change this equation. As one example, we negotiated an agreement that attracted ten financial institutions to develop and sell a specialized "safe" starter account for

[3] "Neighborhood Financial Services Study," NYC Department of Consumer Affairs, June 2008.

consumers with low incomes—called our Opportunity NYC account. We also have piloted an innovative tax-linked asset-building savings product, called SaveNYC, which facilitates savings for consumers willing to direct a portion of their tax refund into this special account for a year to qualify for a 50% match.

Our experience in this area is helping us to influence the debate regarding a statewide program in New York, called the Banking Development District program. We have urged that the benefits of this program be judged by the volume of safe products sold, rather than by good intentions or merely the brick and mortar presence of financial institutions in a low-income neighborhood.

V. Principles for Designing an Effective Consumer Protection Agency

With these experiences under our belt, DCA offers a set of recommendations that could inform the promise of the Consumer Financial Protection Agency, and we will outline an idea we have for a user friendly product safety ratings system that could serve as both a clear signal to consumers and a reliable tool for regulators for examinations and oversight.

1. **The Consumer Financial Protection Agency should have broad authority to regulate financial products, including banking and savings products as well as credit products.** Banking and savings products must be within the purview of the Consumer Financial Protection Agency for two reasons. First, they necessarily form a big part of any asset-building effort aimed at low- and moderate-income consumers. Second, they often have features that mimic credit products.

A case in point is "courtesy" overdraft protection plans, included automatically in most bank accounts. These plans, wherein banks automatically cover purchases that exceed account balances and charge huge fees for that service, are essentially costly short-term loans, though they are not regulated as such. Customers rarely know they are enrolled in such programs, let alone that they are under an obligation to opt out of them to avoid their automatic triggers. Surprises are the norm: a bank-authorized debit purchase can trigger the overdraft plans' fees, which are, on average, higher than the purchase amount itself. In fact, financial institutions generated $17.5 billion in fee income in return for extending only $15.8 billion in credit through fee-based overdraft coverage in 2006.[4] The estimated typical effective APR on fees resulting from ATM and point-of-sale (POS) debit transactions is between 1,173% and 3,540%.[5] The burden of these exorbitant fees is concentrated on the least financially stable customers, with 16% of overdraft loan users paying 71% of fee-based overdraft loan fees, with repeat users more often low-income, single, non-white renters.[6] Such predatory practices must be subject to oversight. [7]

Congress should charge the Consumer Financial Protection Agency with regulating not only depository institutions, but also the rapidly expanding non-

[4] Halperin, Eric and Peter Smith, "Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans, " Center for Responsible Lending, July 11, 2007.
[5] FDIC, "Study of Bank Overdraft Programs," November 2008.
[6] Halperin, Eric, "Overdraft Loans Trap Borrowers in Debt," Center for Responsible Lending, March 18, 2008.
[7] As noted earlier in this testimony, DCA has negotiated with banks to offer safe, basic banking products. As part of this process, we have successfully moved banks to offer non-overdraft accounts. At the policy level, in March 2009 and July 2008, both DCA's OFE and the CFE Coalition advocated to the Board of Governors of the Federal Reserve System for regulatory changes focused on ensuring full consumer awareness of the fees associated with overdraft to facilitate informed "opt-in" decisions to accept those fees both at the time of account opening and on a transaction by transaction basis at ATMs and point-of-sale terminals. And we are engaging with rulemakers regarding an analogous "opt in" approach—for credit card over-the-limit fees—recently enacted in credit card legislation.

bank financial services market. This would include prepaid debit cards or other transactional products, as well as potentially destabilizing and often opaque credit products, such as payday, refund anticipation, debt-consolidation and used-car financing loans.

2. **Default "plain vanilla" products are critical.** The Administration's proposal discusses the creation of default, "plain vanilla" products. This feature is attainable, though there are a few "lessons learned" from our work in New York City that also should be considered when developing such products.

First, merely requiring that a product be offered is insufficient to ensure the product actually is marketed and sold. We've learned much from New York State's experience with its mandated basic banking account. Requiring state-chartered financial institutions to offer a low-cost account with a nominal opening deposit and one-cent minimum balance requirement was a great step forward for consumers with low incomes. Unfortunately, financial institutions have not been held accountable for marketing, let alone selling, these accounts – and so they are largely absent from the marketplace.

Second, "plain vanilla" products must be able to keep pace with the market. Again, our experience with the New York State basic banking account is instructive. The practice of fee-based overdraft has emerged since the account's inception, and the basic banking account does not restrict the fees associated with such features.

The Consumer Financial Protection Agency should push beyond the current safe harbors and best-practice disclosure guidance associated with federal Truth

In Lending, Truth In Savings and similar statutory compliance. While still encouraging innovation, the Consumer Financial Protection Agency could require certain financial institutions to offer, market and sell products appropriate for a wide range of consumers. And the Consumer Financial Protection Agency could set the standard for plain-language contracts terms in its basic, "plain vanilla" products.

3. **Branding must be both simple and mandatory.** In order for the Consumer Financial Protection Agency's protections and products to reach their potential, the Consumer Financial Protection Agency must leverage the government's power and reputation to provide uniform branding that achieves universal recognition. We've seen this approach work both at the federal and local level. Take for example, the Department of Energy's "Energy Star" ratings, now universally recognized and, in today's green marketplace, sought-after indicators. In New York City, DCA successfully has branded our Opportunity NYC and SaveNYC products. Consumers need to know who and what to trust, and be able to assess "apples-to-apples" comparison points when choosing among products, services, and institutions. With this boost in education and expectations, consumer demand for trusted, rated products will increase their supply.

4. **Consumer complaints must inform policymaking and be shared with diverse regulators at the state and local level.** Consumer complaints can be a valuable source of information to guide policy and practice. DCA's own experience in our debt collection oversight provides a case in point. Last year, DCA received more than 1,200 complaints against debt collection agencies and

secured more than $2 million in restitution for consumers for debts that weren't actually owed and harassed in ways outlawed by local license regulations. Our mediation of consumer complaints confirmed that debt buyers were a growing force—and increasingly involved in improper collection practices. We worked with local legislators to strengthen our statutory authority to regulate this burgeoning industry incarnation that was skirting existing law. By July, we will license debt buyers and have promulgated rules to ensure that they obey critical consumer protections. Similarly, our experience resolving consumer complaints about home improvement contractors revealed that many were engaging in predatory lending practices, using their interactions with consumers to promote bad loans. We wrote regulations and curbed this abusive practice.

Consumers must be able to direct complaints about financial products and services to a central repository. Complaints should be aggregated into a central and broadly accessible clearinghouse to inform policymaking, enforcement, and consumer awareness campaigns at federal, state and local levels.

5. **State and local consumer protection efforts must not be preempted.** The Administration should be commended for recognizing in their proposal that rules promulgated by federal regulators should establish baseline protections and allow state and local authorities, with on-the-ground experience protecting consumers in areas most relevant to their jurisdiction, to establish and enforce stronger protections.

6. **Financial institutions and non-bank financial service providers should be held accountable for new consumer protections.** As noted above, it is important to know not only what products and services are offered but also what is being sold. New ways of holding firms in the financial services marketplace accountable are necessary. Congress should require regular compliance reviews, integration into the Community Reinvestment Act exam process, linkages to safety and soundness exams and impact litigation, among other enforcement mechanisms.

VI. **Product Ratings: An Idea**

We are faced with several challenges. Beyond outright bans of certain products and services, how can the Consumer Financial Protection Agency exercise broad authority over product features and disclosures, create product defaults and "plain vanilla" products, *and* still remain nimble and responsive to the market experience? How can the Consumer Financial Protection Agency confidently steer consumers towards appropriate and safe financial products, yet leave critical latitude for innovation? How can the Consumer Financial Protection Agency ensure that banks and financial institutions won't just possess safe products, but actually will sell them? And how can the Consumer Financial Protection Agency exercise such broad federal authority while at the same time nurture an environment conducive to state and local collaboration?

A federal consumer financial products ratings system, administered by the Consumer Financial Protection Agency, and linked to the CRA exam process, may hold the promise of meeting these fundamental and diverse challenges. Much like the Medicare quality rating system helps those in need of nursing homes identify facilities with the highest quality of care, this ratings system can help consumers make appropriate choices to fit their financial services needs.

Here's an outline of how this ratings system could work. The Consumer Financial Protection Agency, with Congressional guidance, would work with diverse stakeholders to establish identifiable safety standards for a broad array of consumer financial products and services. These standards could be translated into a nationally-recognized ratings system, such as the simple, A through F letter-grade system, or a green, yellow, red "stoplight" system. Highly rated products would correspond to the "plain vanilla" products all financial services providers would offer. Mid-range ratings would warn consumers that some product features may be risky or inappropriate for certain consumers. Poor product ratings would indicate that one or more product features was deemed predatory or dangerous to most consumers, and should be purchased with extreme caution.

Another possibility is that ratings would be customized for particular consumer profiles or that product data collected through the ratings process would be widely available to consumers through an online database, similar to those currently used in the private sector.

Finally, the Consumer Financial Protection Agency could hold financial institutions accountable using tools such as the Community Reinvestment Act examination process for their product-rating mix, and the actual number of safe products and services sold in low- and moderate-income communities.

This ratings concept would not preclude outright bans of the most egregious or clearly exploitive products. Rather, it would empower consumers to identity products appropriate for their needs, while encouraging innovation within the boundaries required to attain high product ratings.

We understand that creating the type of ratings system conceptualized above requires industry expertise, new reporting and considerable resources. In the end, however, a ratings system has the potential to empower consumers to assess their choices on an "apples-to-apples" basis and restore the confidence of consumers in the financial services marketplace. Similarly, ratings would encourage financial institutions to initiate safe, affordable products that lead to long-term profitability based on a mutually beneficial relationship with the customer.

VII. Conclusion

Thank you for this opportunity to comment on the proposed Consumer Financial Protection Agency. New York City stands ready to offer its local experience, its network of City partners, and its thinking on the power and promise of this Agency at your convenience.

NAFCU
National Association of Federal Credit Unions
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • Fax (703) 522-2734

Fred R. Becker, Jr.
President and CEO

June 23, 2009

The Honorable Barney Frank	The Honorable Spencer Bachus
Chairman	Ranking Member
Committee on Financial Services	Committee on Financial Services
U.S. House of Representatives	U.S. House of Representatives
Washington, D.C. 20515	Washington, D.C. 20515

Dear Chairman Frank and Ranking Member Bachus:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade organization exclusively representing the interests of our nation's federal credit unions, in regards to tomorrow's Financial Services Committee hearing entitled *"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation"* to share our thoughts on this important matter.

We applaud the beginning of this consumer-focused conversation. Representing a consumer-focused industry, we support the creation of a Consumer Financial Protection Agency (CFPA) that would have authority over non-regulated, non-depository companies and institutions that operate in the financial services marketplace. However, we do not believe such an agency should have authority over regulated federally-insured depository institutions and would oppose extending that authority to federally insured credit unions. Giving the CFPA such authority to regulate, examine and supervise credit unions that already are regulated by the National Credit Union Administration (NCUA) would add an additional regulatory burden and cost to credit unions. Additionally, it could lead to situations where institutions regulated by one agency for safety and soundness find their guidance in conflict with their regulator for consumer issues. Such a conflict and burden will surely increase compliance costs to credit unions, leading to diminished services to their members.

As you are aware, credit unions were not the cause of the current economic crisis and have a strong track record in serving their 90 million members. In addition to our mission, there are many consumer protections already built into the Federal Credit Union Act, such as the only federal usury ceiling on financial institutions and prohibition on pre-payment penalties that other institutions often use to trap consumers into products.

E-mail: fbecker@nafcu.org • **Web site:** www.nafcu.org

The Honorable Barney Frank
The Honorable Spencer Bachus
June 23, 2009
Page 2 of 2

Even with these strong consumer protections in place, we recognize that more should be done to help consumers. For that reason, we would propose that, rather than extending the CFPA to federally-insured depository institutions, each functional regulator of federally-insured depository institutions have a new Office of Consumer Protection established. Such an office should report directly to the Presidential appointees at the regulator and be responsible for making sure that the regulator is looking out for consumer concerns in writing rules, supervising and examining institutions' compliance, and administratively enforcing violations. Consumer protection offices at the functional regulators will provide that those regulating the consumer issues at financial institutions have knowledge of the institutions they are examining and knowledge and guidance on consumer protection. This is particularly important to credit unions, as they are regulated and structured differently than others in financial services, and we believe that it is important that any regulator examining credit unions should understand their unique nature. We believe that such approach would strengthen consumer protection while not adding unnecessary regulatory burdens on our nation's financial institutions.

We are also pleased to see that the Administration's proposal would maintain the federal credit union charter and an independent NCUA. NAFCU also believes that the Administration's proposal is well-intentioned in its effort to protect consumers from the predatory practices that led to the current crisis. We feel that there have been many unregulated bad actors that pushed these products onto unsuspecting consumers and applaud efforts to address this abuse.

We thank you for the opportunity to share our thoughts on this important matter. We look forward to working with you and the Committee on the issue of regulatory reform so that the best possible legislative solution can be achieved.

If we can answer any questions or provide you with further information on this matter, please do not hesitate to contact myself or NAFCU's Director of Legislative Affairs, Brad Thaler, at 703-522-4770.

Sincerely,

Fred R. Becker, Jr.
President/CEO

cc: Members of the House Financial Services Committee

PCI Property Casualty Insurers Association of America
Shaping the Future of American Insurance

House Committee on Financial Services
Wednesday, June 24, 2009

Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

Testimony of the Property Casualty Insurers Association of America (PCI)

Chairman Frank, Ranking Member Bachus, and other members of the committee, thank you for the opportunity to present testimony today. The Property Casualty Insurers Association of America (PCI) is the leading property-casualty trade association, representing more than 1,000 insurers, the broadest cross-section of insurers of any national trade association.

PCI's member companies remain committed to providing quality products and services to insurance policyholders and claimants, as well as meeting or exceeding all state statutory and regulatory standards. No additional federal regulation in this area is needed or desirable in this area for the following reasons:

- No other financial services sector offers a stronger system of consumer protections, which provides property-casualty insurance consumers with peace of mind in their decision making process and use of the products.
- P-C insurance is already one of the most heavily regulated financial services sectors. The current state-based system works well and has a proven track record of protecting consumers.
- New federal standards will not improve upon the present state-based system.
- Creating an inefficient system of dual regulation will result in confusion, as well as higher and unnecessary costs for insurance consumers.
- Creating a private right-of-action for alleged violations of a new federal statute would also duplicate existing state protections (already funded by the taxpayers), as well as new federal protections administered by any new agency. This would also add even more costs to the system, with little or no financial benefit to consumers.

Existing State-Based Protections for Insurance Consumers

An extensive and comprehensive array of protections already exists to protect insurance consumers, such as:

Authorized Sellers

Before being permitted to sell products, insurers are required by states to:

- Be financially sound, as verified by a regularly scheduled financial examination process;
- Have a qualified management team based on biographical data and fingerprint checks;
- Employ staff with credentials suitable to conduct the business of insurance; and
- Screen staff that handle policyholder funds to eliminate those with criminal records of dishonesty.

States maintain lists of admitted insurers and licensed agents, which are available to consumers.

Product Regulations

Property-casualty policies for consumers are reviewed by regulators to assure compliance with state law. Among the many requirements are:

- Restrictions on the kinds of insurance that can be sold;
- Readability standards (i.e., limiting the degree of difficulty of words actually used in text, minimum type size, etc.);
- Standards governing covered perils, coverage limits, and reparations;
- Cancellation and nonrenewal restrictions;
- Prohibited exclusions; and
- Refund provisions.

Product regulation keeps personal lines products (i.e. auto and homeowners insurance) consistent over time, which helps producers (i.e. insurance agents) to understand and accurately describe their products at the time of solicitation and sale.

The states also provide Buyers Guides for personal lines products to further assist consumers shopping for a product. Additionally, the National Association of Insurance Commissioners (NAIC) maintains a Consumer Information Source (CIS) for consumers to use before purchasing insurance, providing access to key information about insurance companies, including closed insurance complaints, licensing information, and financial data, as well as a means to file written complaints with the relevant state insurance department. Many individual state insurance department web sites provide similar consumer information.

Post-Sale Safeguards

Insurance coverage is paid for in advance, so extensive rules protect consumers' premium dollars, including:

- Grounds for cancellation and notification to the consumer;
- Extensive financial regulation to ensure the insurer's ability to meet policyholder obligations; and
- Restrictions on unfair claims practices.

Despite these controls, if an insurer does become insolvent, every state has a guaranty fund system that protects consumers and pays their claims, typically up to $300,000.

Other Protections

State courts also review policy provisions to see if they mean what they say, and these interpretations add another layer of certainty and predictability for consumers.

Conclusion

Unlike mortgages or related financial services products, there is no gap or regulatory arbitrage in consumer protections for property-casualty insurance. In fact, with 50+ state insurance departments and the NAIC all focused on overseeing consumer insurance protections, there are already a plethora of government insurance masters. Federal regulation of insurance in this area would inevitably conflict with state policy-making, and only result in more costs and more red tape regulatory burdens that would ultimately be borne by insurance consumers through higher premiums.

Thank you for the opportunity to provide the committee with an overview of the very effective state-based system of insurance consumer protections. PCI looks forward to continuing to be a resource on financial services regulatory reform issues.

1) Can you please provide for the Committee, by July 6th, a sample of a one-page disclosure form for a credit card, a mortgage and an overdraft plan?

Alex J. Pollock, a Resident Fellow at the American Enterprise Institute, has created a one-page disclosure form for a mortgage and a one-page disclosure form for an overdraft plan. The Pew Charitable Trusts has created a two-page credit card disclosure form that they want to update before making public. The first two are enclosed.

2) Why is the Schumer Box an ineffective way of comparing two different credit cards? Are the Federal Reserve's updates to the Schumer Box and other credit card disclosures, completed after years of consumer testing, still insufficient in your eyes? How will your consumer testing lead to a different disclosure form?

The problem with the Schumer Box is not what is included within the box, but that lenders can bury a wide assortment of tricks and traps further down in the contract. The purpose of streamlined disclosure is to get rid of the incomprehensible legalese that hide the true cost of credit.

Today, giant credit card lenders "compete" for business on three terms: 1) nominal interest rate (which is not the true cost of credit); 2) free gifts; and 3) warm and fuzzy institutional branding. At the same time, the fine print hides the things that really yield substantial cash – the so-called "revenue enhancers." Today's business model is about making money through tricks and traps buried deep within the contract.

The Schumer Box made it easier for consumers to compare the nominal interest rate, but it does not address the tricks and traps buried in the fine print that obscure true costs.

While some individual lenders may offer cleaner credit cards, in a world of incomprehensible fine print, they cannot show their customers that their cards are better. For example, in 2007, when Congress was pressing the credit card companies about their deceptive practices, Citibank gathered great praise from several Members of Congress by publicly announcing that it would drop the practice of "universal default." Less than a year later, Citi quietly picked up the practice again. Citi explained that few customers could see the difference between their cleaner card and the cards that continued to use the practice. Pages of incomprehensible text prevented real comparison shopping and the market failed to reward better practices. As a result, the better practice was dropped.

The CFPA will help make markets more competitive by approving templates for "plain vanilla" contracts designed to be read in just a few minutes. This will create a regulatory safe harbor that will reduce the total regulatory burden for most lenders on most products. In addition, lenders could continue to offer more complicated or risky products, so long as the risks are disclosed clearly enough that customers can understand them without a lawyer nearby to interpret. This new paradigm will allow consumers to understand and compare the true costs of different products. This will enable consumers to make smart decisions about their credit, while driving down costs by making the market more competitive.

3) You have identified the problem with complex disclosures, and hidden "tricks and traps." If this is true, it would seem that only improved disclosures would be necessary to fix the problem. Why is a new agency necessary to do this?

Current regulations in the consumer financial area are layered on like pancakes – see a problem and fry up a regulation, but don't integrate it with the earlier regulation. Today, seven different federal agencies have some form of regulations dealing with consumer financial products. The result is a complicated, fragmented, expensive, and ineffective system. The flaws in the current regulatory system contribute both to the absurdity of current disclosures and to the failure of regulators to fix the broken credit market.

If Congress chooses, it can continue to add new pancakes to the stack with each new problem in the years ahead. That approach will increase regulatory burdens over time, but it will not necessarily increase effectiveness of disclosure. Indeed, as the paperwork gets more complicated, additional disclosures may make it harder for consumers to understand an agreement. Alternatively, Congress can adopt a new paradigm by consolidating consumer protection authorities and requiring a new agency – the CFPA – to harmonize and streamline the regulatory system and to make disclosures readable. Consolidation will allow for smarter, more consistent, and more effective regulations.

So long as Congress sticks with the current approach of scattering consumer protection authorities rather than seeking to streamline the regulatory system, it should not expect a different result. Regulatory requirements will continue to be onerous, duplicative, contradictory, and complex – and the burden on industry will continue to be large with relatively little corresponding benefits for consumers.

While Congress could consolidate consumer protection authorities in an already existing agency, that approach has its own flaws. In particular, consumer protection will continue to be poorly staffed, last to be funded, and always a subsidiary to the primary mission of the agencies. At the Federal Reserve, senior officers and staff focus on monetary policy. At the OCC and OTS, agency heads worry about capital adequacy requirements and safety and soundness. As the current crisis demonstrates, even when they have the legal tools to protect families, existing agencies have shown little interest in effective consumer protection.

It is also worth emphasizing that the CFPA will allow for more effective enforcement. Earlier this month, the Government Accountability Office (GAO) released a study that showed that the current regulations relating to "reverse mortgages" are quite detailed, but they are seldom followed by lenders and poorly enforced. The will and intent of Congress relating to consumer financial products will be carried out more effectively if there is an Agency dedicated to enforcement.

Ultimately, the CFPA will develop expertise and serve as a home for regulators who really care about consumer protection. It will be able to respond quickly to new developments in the market and enforce the will of Congress. And it will develop a smarter and simpler regulatory structure that encourages real disclosure and fixes the broken credit market.

4) Congress and the Federal Reserve Board have enacted or are considering a number of new disclosure requirements, seemingly because they believe that if only consumers were better informed, they would have made different decisions about, among other things, the mortgages they have selected, the credit cards they chose, the ATM they used, and the overdraft services they employed.
   - Do you agree with this characterization?
   - What information would have led consumers to make better decisions?

I am a firm believer that real disclosure – and a more level playing field between borrower and lender – will affect consumer behavior.

Throughout my career, I have taught contract law and have been a firm believer in markets. A key underpinning to the market economy, as you know, is the fact that that demand goes down when cost goes up. The supply and demand curve is as instructive here as it is real. Today, the cost of consumer financial credit is systemically hidden and obscured. When consumers see a credit card's nominal interest rate or a mortgage's teaser rate, they are – purposefully – led to believe that the cost of credit is lower than it actually is. This, as any economist will tell you, influences behavior.

I do not believe that a government regulator in Washington or anywhere else should make decisions for consumers. And I don't have biases or predispositions about whether consumers should choose to borrow more or choose to borrow less. I do, however, believe that healthy markets depend on consumers knowing the true costs of products and being able to make choices based on those costs.

To make clear-eyed decisions about their credit, consumers need to understand the contracts they enter into. Today, mortgage disclosure forms take up reams of paper. While the average credit card length was only one page in 1980, it is now 30 pages. That can be changed. With short, understandable agreements, consumers will know the costs of different products, be able to compare those costs, and be able to make choices that work best for them. Once consumers can determine and compare costs, they will choose cheaper products or, in some cases, decide not to take out loans that are too expensive. Once consumers have the ability to compare products and choose the cheaper ones, the cost of credit will also decline as real competition sets in.

5) Some of the Administration proposal seems to be deliberately vague. For example, is it your understanding that the CFPA could regulate and enforce consumer protection rules relating to mortgage insurance and title insurance? If not, should it be involved in those areas? Similarly, is it your understanding that the CFPA could take action regarding the setting of interchange fees? If not, should it?

There would be important benefits to providing the CFPA with holistic jurisdiction over entire credit transactions – including mortgage and title insurance products sold in conjunction with credit. There would also be benefits to making interchange fees more transparent so that consumers fully understood the costs of their credit choices.

THE BASIC FACTS ABOUT YOUR MORTGAGE LOAN

Borrower: ______________________ Property address: ______________________

Lender: ______________________

Amount of loan: $ ______________, which is _____ % of the property's appraised value.

Your loan is for __________ years.

The type of loan you have: ______________________

Your beginning interest rate is __________ %. This rate is good for __________ months/years. The rate and your payment can go higher on ______________ and each ________ months after that.

Today's estimate of how high the rate will go, called the fully indexed rate, is __________ %

The maximum possible rate on your loan is __________ %.

THIS LOAN IS BASED ON YOUR MONTHLY INCOME OF $ ______________

Your beginning rate = a monthly loan payment of $ __________ = ________ % of your income.

-including taxes and insurance this is about $ __________ = ________ % of your income.

The fully-indexed rate = a loan payment of $ __________ = ________ % of your income.

-including taxes and insurance this is about $ __________ = ________ % of your income.*

*This is called your fully indexed housing expense ratio.

Special factors you must be aware of:

-A prepayment fee of __________ must be paid if ______________

-A "balloon payment" of $ __________ to pay off your loan will be due on __________.

-You do/do not have a "payment option" loan. If you do, make sure you really understand what this means. Start with the definition on p. 3.

Total "points" plus estimated other costs and fees due at closing are $______________

FOR QUESTIONS CONTACT: Name: ______________________

Phone: ______________ e-mail ______________

See definitions of underlined terms and guidelines on pages 2–3.

DO NOT SIGN THIS IF YOU DON'T UNDERSTAND IT!

____
Borrower Date

______________________ ______________________
Authorized Signer of Lender Date Borrower Date

The Basic Facts about Your Mortgage Loan

This form gives you the basic facts, but some mortgage forms may use terms not listed here. For a good, borrower-friendly information source, try the Mortgage Professor online (www.mtgprofessor.com), which includes detailed explanations of the technical mortgage terms in its glossary and much other helpful information.

Definitions and Guidelines Used in This Form

The *appraised value* is what a professional appraisal estimates the house could be sold for in today's market.

The *type of loan* determines whether and by how much your interest rate can increase. If it can, your monthly payments will also increase—sometimes by a lot. For example, in a thirty-year fixed rate loan, the interest rate is always the same. In a one-year ARM, it will change every year. Other kinds of loans have various patterns, but the interest rate may go up a lot. Make sure you understand what type of loan you're getting.

The *beginning interest rate* is the interest you are paying at the beginning of the loan. Especially if it is a low introductory or "teaser" rate, it is the rate which you will hear the most about from ads and salespeople. But how long is it good for and when will rates increase? In many types of loans, the rate will go up by a lot. You need to know.

The *fully-indexed rate* is an essential indicator of what will happen to your interest rate and your monthly payments. It is today's estimate of how high the interest rate on an adjustable rate mortgage will go. It is calculated by taking a defined "index rate" and adding a certain number of percentage points, called the "margin." For example, if your formula is the one-year Treasury rate plus 3 percent, and today the one-year Treasury rate is 5 percent, your fully-indexed rate is 5% + 3% = 8%. At the time the loan is being made, the fully indexed rate will *always* be higher than a beginning "teaser" rate.

The index rates are public, published rates, so you can study their history to see how much they change over time. If the index rate stays the same as today, the rate on your loan will automatically rise to the fully-indexed rate over time. Since the index rate itself can go up and down, you cannot be sure what the future adjustable rate will be. In any case, you must *make sure you can afford the fully-indexed rate*, not just the beginning rate, which is often called a "teaser" rate for good reason.

The *maximum possible rate* is the highest your interest rate can go. Most loans with adjustable rates have a defined maximum rate or "lifetime cap." You need to think about what it would take to make your interest rate go this high. How likely do you think that is?

Your *monthly income* means your gross, pre-tax income per month for your household. This should be an amount which you can most probably sustain over many years. Make sure the monthly income shown on this form is correct!

Your *monthly payment including taxes and insurance* is the amount you must pay every month for interest, repayment of loan principal, house insurance premiums, and property taxes. Expressed as a percent of your monthly income, this is called your housing expense ratio. Over time, in addition to any possible increases in your interest rate and how fast you must repay principal, your insurance premiums and property taxes will tend to increase. Of course, your monthly income may also increase. How much do you expect it to?

Your *fully-indexed housing expense ratio* is a key measure of whether you can afford this loan. It is the percent of your monthly income it will take to pay interest at the fully-indexed rate, plus repayment of principal, house insurance, and property taxes. The time-tested market standard for this ratio is 28 percent; the greater your ratio is, the riskier the loan is for you.

A *prepayment fee* is an additional fee imposed by the lender if you pay your loan off early. Most mortgages in America have no prepayment fee. If yours does, make sure you understand how it would work before you sign this form.

A "*balloon payment*" means that a large repayment of loan principal is due at the end of the loan. For example, a seven-year balloon means that the whole remaining loan principal, a very large amount, must be paid at the end of the seventh year. This almost always means that you have to get a new loan to make the balloon payment.

A "*payment option*" *loan* means that in the years immediately after securing a mortgage loan, you can pay even less than the interest you are being charged. The unpaid interest is added to your loan, so the amount you owe gets bigger. This is called "negative amortization." The very low payments in early years create the risk of very large increases in your monthly payment later. Payment option loans are typically advertised using only the very low beginning or "teaser" required payment, which is less than the interest rate. You absolutely need to know four things: (1) How long is the beginning payment good for? (2) What happens then? (3) How much is added to my loan if I pay the minimum rate? (4) What is the fully-indexed rate?

"*Points*" are a fee the borrower pays the lender at closing, expressed as a percent of the loan. For example, two points mean you will pay an upfront fee equal to 2 percent of the loan. In addition, mortgages usually involve a number of *other costs and fees* which must be paid at closing.

Closing is when the loan is actually made and all the documents are signed.

The *For Questions Contact* section gives you the name, phone number, and e-mail address of someone specifically assigned by your lender to answer your questions and explain the complications of mortgage loans. Don't be shy: contact this person if you have any questions.

Finally, *do not sign this form if you do not understand it*. You are committing yourself to pay large amounts of money over years to come and pledging your house as collateral so the lender can take it if you don't pay. Ask questions until you are sure you know what your commitments really are and how they compare to your income. Until then, do not sign.

WHAT HAPPENS IF YOU OVERDRAW YOUR ACCOUNT

An overdraft can occur if you write checks, make ATM withdrawals, have debit card purchases, or have automatic transfers which use up more than the available credit balance in your account.

I. Your Alternatives to Cover an Overdraft

/_/ 1. Transfer funds from another account.
/_/ 2. Borrow under a personal line of credit.
/_/ 3. Use Overdraft Protection to pay the item
/_/ 4. Bounce the check or refuse the payment request

II. How Much Does Each Alternative Cost?

1. Transfer from another account: A fee of $_____ per transfer. [other fees?]

2. Line of credit: [A fee of $_____ per ______?] [plus?] An interest rate on the amount borrowed of ________% per year.

3. Overdraft Protection: A fee of $_______ per item paid. This is equivalent to paying interest for borrowing the overdrawn amount. Example interest rates:

   (a) The overdraft fee for a $25 overdraft for one week is equivalent to an interest rate of __________% per year.

   (b) The overdraft fee for a $50 overdraft for two weeks is equivalent to an interest rate of __________% per year.

4. Bounce the check: A bad check fee of $_______ per check [fee for refused other payments?] You may also get charged a bad check fee by the merchant.

III. Make Your Choice

Go back to Part I. and mark the box to choose which alternative you want. [You can pick an order of actions by putting a "1" and a "2" in the relevant boxes, if appropriate.]

Authorized signer for the bank	Customer signature

Date	Account number	Printed name

AFSA
American Financial Services Association

HOUSE COMMITTEE ON FINANCIAL SERVICES
Hearing on:
Regulatory Restructuring: Enhancing Consumer Financial Products Regulation

June 24, 2009

WRITTEN STATEMENT FROM THE
AMERICAN FINANCIAL SERVICES ASSOCIATION

The American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. The association's 350 member companies include consumer and commercial finance companies, auto finance companies, credit card issuers, mortgage lenders, industrial banks and other financial services firms that lend to consumers and small businesses.

AFSA supports the goal of responsibility, accountability, and transparency in all consumer credit transactions. In general, we believe any regulatory reform effort should strive to provide a balance between sufficient consumer protections and allowing the financial services industry to serve its customers in the best way possible.

As the committee is aware, the president's financial reform proposal includes the creation of a new Consumer Financial Protection Agency (CFPA) that would have very broad rulemaking and enforcement authority, including the potential to set credit terms, conditions and rates. From our perspective, such an agency is the wrong approach for several reasons.

The first has to do with the fact that consumer credit plays a critical role in the economy. Entrusting oversight to just one entity could create major ramifications for the credit granting process, especially when that oversight is left open ended.

As a way to envision the type of consumer protection that the proposed financial agency would provide, its supporters have compared it to the Consumer Product Safety Commission. Credit, however, is the lifeblood of our economy and plays a unique role in people's lives. The terms, conditions and availability for mortgages, credit cards, auto financing and personal loans are dictated by borrower risk factors and market forces. Because of their characteristics, credit products cannot – and should not – be regulated in the same way as toys, power tools and other household items that present potential physical or safety hazards to the public.

The second reason we do not advocate a single regulator for the financial services industry is because it splits the consumer protection function from the safety and soundness function, housing them under different agencies. This approach has proven to be adverse to broader consumer interests, the most recent example being the GSEs and the conflicting interests between the Office of Federal Housing Enterprise Oversight (OFHEO) and HUD.

Finally, there's the question of whether the federal government should have the role of determining which financial services products should be available to consumers and who should get them. The answer is an unequivocal no. The idea of a government-run entity dictating which personal finance products and services can –or cannot—be made available in the marketplace is troubling. So is the notion of limited product access for certain borrowers, such as those considered to be subprime. All consumers should be able to choose from the widest selection possible of credit products so they can find ones that best fit their individual needs.

Regulatory reform should take us forward, not backward. It must be handled carefully to avoid additional upheaval in the credit granting system at a time when the economy remains in a fragile state. A balance must exist that provides sufficient consumer protections while allowing the financial services industry to serve its customers in the best way possible. For all of these reasons, AFSA believes the proposed CFPA is not the answer.

Insured Retirement Institute
1331 L Street NW | Suite 310
Washington, DC 20005
t 202.469.3000
f 202.898.5786
www.IRIonline.org

MEMORANDUM

TO:	Committee on Financial Services
FROM:	John Little, Vice President of Federal Affairs, IRI
DATE:	August 3, 2009
SUBJECT:	Information Submitted for the Record-Hearing June 24, 2009 "Regulatory Restructuring: Enhancing Consumer Financial Products Regulation "

Since providing testimony on June 24, 2009, NAVA has undergone a name change to IRI, the Insured Retirement Institute. During the hearing, Representative Brad Sherman asked the witness for responses to be provided for the record. We have included our answers to these questions below.

Responses to Representative Brad Sherman Questions for the Record

Record p172-173. Rep. Sherman asked questions relating to credit cards and double cycle billing. IRI's members do not offer credit card products and IRI's mission and scope do not include the credit card issues. Therefore, IRI has no response to these questions.

Record p.173-174. Rep. Sherman asked questions relating to the "move to separate consumer protection from prudential or safety and soundness regulation." The question was "whether it is best to sever compliance and prudential oversight?"

We believe that separating financial regulation and consumer protection regulation for insurance products is not prudent and would present significant risks to consumers. Our members use sophisticated actuarial science methodologies to assure investments are properly structured to meet contractual obligations set forth in the designed products. Therefore, product regulation is vitally linked to financial solvency regulation. Bifurcating product regulation and solvency could result in confusion and limit the ability of each regulator to be efficient. Insurance consumers and annuity owners are protected by an existing, comprehensive regulatory structure consisting of the SEC, FINRA, and insurance and securities regulators in over 50 different state and territorial jurisdictions. For banking products, the CFPA proposal contemplates regulatory jurisdiction that is bifurcated between federal banking agencies (with prudential oversight) and the CFPA (with consumer protection oversight). We believe that inclusion of insurance products will result in a duplicative regulatory regime that will increase the potential for different and inconsistently applied consumer protection standards. While additional regulations are intended to protect consumers, an additional layer on top of the existing comprehensive system will prevent new and affordable products from being available for consumers in a timely manner. The focus should not be on adding another layer of regulation, but rather on how the current regulatory structure can be operated in the most effective and efficient manner to achieve our collective consumer protection objectives.

<u>Congresswoman Jackie Speier</u>

<u>**QUESTIONS FOR THE RECORD**</u>

June 24, 2009

Full Committee hearing: *"Regulatory Restructuring: Enhancing Consumer Financial Products Regulation:*

For Mr. Yingling, American Bankers Association:

- **If we strike the administration's proposal to mandate that firms offer defined "plain vanilla" products alongside whatever lawful products a firm chooses to offer, would your organization still oppose creation of the CFPA?**

1. Yes, the ABA would still oppose it for a number of reasons, including the fundamental belief that you cannot separate a business from its products and the incredibly broad and unprecedented powers the agency would be given.

- **We require drug manufacturers to include risk and side effects warnings on drug packaging. Would you object to either a) the new agency publishing warnings about certain classes of more risky financial products, or b) requiring a financial warning label with certain classes of more risky products?**

2. It is more difficult to write warning labels about financial products in many cases because the product may or may not be a problem depending on the customer. However, in general, the financial regulators should, and in fact do, have a broad spectrum of authorities, from banning certain products and practices, to requiring more regulation of certain products and practices, to requiring specific disclosures or warnings about certain products or practices. One example of the latter is the warning required on bank investment product offerings that they are not FDIC-insured.

- **You testified that consumer protection is not just about the financial product, but is also about the financial integrity of the company offering the product. If that is the case, how did we get to the point where the government has had to pour hundreds of billions of dollars into banks that threw risk management and underwriting out the window to offer liar loans, option ARMs and credit cards to sub-prime borrowers?**

3. While some banks, a very small percentage, of banks were involved in practices that contributed to the financial crisis, the great, great majority were not.

- **You testified that banks can only operate safely and soundly if they are treating customers well. You also talk about the longevity of a large percentage of banks. How many of those banks would be alive today without intervention of the federal government and the Federal Reserve?**

4. The great, great majority of banks did not need government support, including the great majority of those who took capital from the Capital Purchase Program because they were asked to do so by their regulators.

- **I will agree that Congress shares some of the blame for its failure to enact stronger consumer protections to head off the mortgage crisis. But isn't that institutional failure the direct result of efforts by the financial industry to prevent regulation of the very products that caused this crisis?**

5. There is plenty of blame to go around. While there were many issues that contributed to the financial crisis -- such as excess leverage on Wall Street, problems with accounting policy, and problems with credit ratings – the primary product that caused the crisis was subprime mortgages. As the Administration's plan points out, 94% of such mortgages occurred outside the banking industry. HOEPA regulations to address this issue were never put forward by the Federal Reserve. As I have testified before the Committee, this was a tragic mistake, and in retrospect we wish we had been more forceful and timely in urging strong regulation of the non-bank subprime market abuses.

July 22, 2009

O