NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
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On behalf of the
National Community Reinvestment Coalition

On the topic of
"Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve"

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Good afternoon, Chairman Watt, Ranking Member Paul, and other distinguished Members of the Committee. I am James H. Carr and I am the Chief Operating Officer at the National Community Reinvestment Coalition (NCRC). On behalf of our coalition, I am honored to speak with you today on the topic of "Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve."

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services for America's working families. NCRC is also pleased to be a member of a new coalition of more than 200 consumer, civic, labor, and civil rights organizations – Americans for Financial Reform – that is working to cultivate integrity and accountability within the US financial system.

I. Introduction

Members of the Committee, financial regulatory system design flaws, gaps in oversight, conflicts of interest, weaknesses in enforcement, and failed philosophical perspectives on the functioning of the markets combined to lead to the virtual implosion of the credit markets and collapse of the US economy.

In assessing the key problems leading to the crisis, considerable attention has been focused on issues such as excessive investment leverage ratios and institutions perceived as being too big to fail, complex financial instruments and vehicles, unregulated financial entities, and perverse pay incentives to executives who engaged in risky lending and reckless financial practices.

These problems are critical to understanding the current situation that is increasingly destabilizing the housing and credit markets. But they constitute only one of three issues that together explain the financial system's meltdown, the extraordinary costs to American tax payers, and the contagion effects on the broader economy. The other two key issues are 1)

failure to protect consumers from unfair and deceptive financial products and practices, and 2) inadequate resolution authority to manage insolvent financial institutions.

At the request of the Committee, I will devote my time today to the issue of consumer protection. In my written testimony, I expand on my consumer protection comments and touch briefly on the other two pieces of the regulatory failure puzzle.

The Role of Consumer Protection in the Financial System

Financial safety and soundness and adequate consumer protection are most often discussed as wholly separate issues. Yet, the safety and soundness of the financial system begins with and relies heavily on the safety and soundness of the products offered to the public.

If the extension of credit by a financial firm promotes the economic wellbeing and financial security of the consumer, the system is at reduced risk of failure. If, however, financial products exploit consumers – even if they are highly profitable – the financial system is in jeopardy. The most meaningful way to manage systemic risk is to better protect the public from unfair, deceptive, fraudulent, and otherwise predatory policies and practices in the financial services industry.

Deception As Business Model

For more than a decade, financial institutions have increasingly engaged in practices intended to mislead, confound, and otherwise limit a consumer's ability to judge the value of financial products offered in the market and make informed decisions.

Elizabeth Warren, a Professor of Law at Harvard University and Chair of the Congressional Oversight Panel on the Troubled Asset Relief Program, has developed a detailed list of the

"tricks and traps" that financial institutions, particularly consumer credit lenders, use to make unsafe financial products appear attractive to consumers. She also adds that these financial institutions build unjustified and unethical fees and penalties into the terms and conditions of such products to turn a profit at the expense of trusting borrowers.

For example, only a few years ago, the typical terms and conditions statement for a credit card was only a single page. Today, terms and conditions sheets are steeped in complex legal jargon and can number at least 30 pages. In response to this, Congress has had to mandate a minimum type size because credit card companies were sending their required disclosures to consumers with such small print that a magnifying glass was required to read them.

Outside of the consumer credit arena, the proliferation of unfair and deceptive mortgage products led directly to the current foreclosure crisis and massive destruction of US household wealth. The "tricks and traps" used to market these high-cost, unsustainable home loans greatly complicated, if not impaired, the ability of a consumer to make an informed decision about the most appropriate mortgage product for his or her individual need and financial circumstances.

To quote Professor Warren in the Congressional Oversight Panel's "Special Report on Regulatory Reform," "the available evidence suggests that the costs of deceptive financial products are high, [and] quickly climbing into the billions of dollars" per year.

Not an Equal Opportunity Economic Crisis

Financial institutions targeted their toxic products of communities of color in particular. For more than a decade, federal agencies, independent research institutes, and nonprofit organizations described and discussed the multiple ways in which people of color were being financially exploited in the housing and credit markets.

Unfortunately, nothing substantial has been done to address these growing concerns. The result today is that the foreclosure crisis is having a disproportionately devastating effect on communities of color in two ways. First, communities of color are experiencing higher levels of foreclosures than their white counterparts; and second, they are most negatively impacted by rising unemployment.

Since the beginning of this year alone, more than 3 million jobs have been cut, bringing the national unemployment rate to an uncomfortable 9.5 percent (as of June 2009). While of great concern, the rate of job loss for African Americans is 15 percent, and for Latinos, approaches 13 percent.

Because African Americans and Latinos have comparatively few savings, they are poorly positioned to survive a lengthy period of unemployment. As a result, potentially millions of African-American and Latino households could find themselves falling out of the middle class by the time the economy recovers.

The steering of African Americans and Latinos into deceptive mortgage loans has also contributed to these communities being over-represented in foreclosure statistics. African Americans, for example, have experienced a full three-percentage point drop in their homeownership rate since the foreclosure crisis began.

Brokers, banks, and independent mortgage companies routinely pushed substandard, poorly underwritten, over-appraised, and unsustainable loans at African-American and Latino consumers in violation of federal fair housing and fair lending laws. Subprime loans, particularly subprime adjustable rate mortgage (ARM) loans, have significantly higher default and delinquency rates than prime loans.

According to a study by the US Department of Housing and Urban Development, subprime loans are five times more likely in African-American households than in white, and homeowners in high-income African-American areas are twice as likely as borrowers in lower-income white

communities to receive subprime loans. Further, NCRC's report "Broken Credit System" studied high-cost lending in ten large metropolitan areas across the country. After controlling for risk and housing market conditions, that report cites that the racial composition of a neighborhood had an independent and strong effect on lending outcomes. The findings in this report are consistent with other studies of subprime lending and race.

Paul Calem of the Federal Reserve, and Kevin Gillen and Susan Wachter of the Wharton School also used credit-scoring data to conduct econometric analysis. They found that after controlling for creditworthiness and housing market conditions, the level of subprime refinance and home purchase loans increased in a statistically significant manner as the portion of African Americans increased on a census tract level in Philadelphia and Chicago. The Center for Responsible Lending also used the 2004 Home Mortgage Disclosure Act data with pricing information to reach the same troubling conclusions.

Lenders also steered minority borrowers who qualified for prime loans into high-cost loans, resulting in equity stripping and contributing to wealth inequalities. A 2008 study by the *Wall Street Journal* found that more than 60 percent of borrowers with high-cost subprime loans had credit scores sufficient for them to have qualified for a prime market home loan.

Over the past three years, NCRC has released a series of studies titled "Income is No Shield against Racial Disparities in Lending," which documents that racial/ethnic disparities in lending increase when comparing middle- and upper-income minorities against middle- and upper-income whites. The most recent study ("Income Is No Shield, Part III: Assessing the Double Burden: Examining Racial and Gender Disparities in Lending, June 2009) highlights the prevalence of high-cost lending and its devastating consequences for women of color, particularly African-American women of all income levels. And, because African-American children are more likely to reside in female-headed households, black children are also disproportionately harmed as a result of the foreclosure crisis and its attendant stresses.

If a black family lost their home to foreclosure and could not find a suitable apartment in the neighborhood from which they were evicted, black children may be forced to leave their school, social networks, and familiar community surroundings, all of which can hinder their educational performance and long-term socio-economic wellbeing.

The situation is so dire within the African-American community that United for a Fair Economy, a Boston-based policy group, estimates that 41 percent of African Americans are at risk of falling into poverty, and that African Americans could experience the greatest loss of wealth since Reconstruction.

II. Goals and Purposes for the Proposed Consumer Financial Protection Agency

The Obama Administration notes in its paper "Financial Regulatory Reform: A New Foundation," that "consumer protection is a critical foundation for our financial system. It gives the public confidence that the financial markets are fair and enables policy makers and regulators to maintain stability in regulation." In order to elevate the importance of consumer protection as a core element of the new regulatory regime, the President proposes the establishment of a Consumer Financial Protection Agency. That new institution would consolidate a highly fragmented system of consumer financial protection laws currently enforced by six separate agencies.

CFPA would consolidate experts who share both expertise in consumer protection laws and practices and a commitment to protecting the public. This synergy of mission and expertise would greatly enhance the effectiveness of regulators seeking to employ best-practices related to measuring and monitoring institution behavior, and enforcing the nation's consumer protection laws. There would also be better understanding of the intersections and overlaps of potentially conflicting or mutually reinforcing consumer protection law and regulations. CFPA would have broad authority to oversee products like home mortgages and credit cards, and services including

real estate appraisals, tax preparation, and debt collection. It would promote clear and understandable terms in contracts, and fair, safe, and reliable financial products and services.

Finally, rather than hampering states' efforts to protect their own citizens (which was the approach of the Office of the Comptroller of Currency and the Office of Thrift Supervision), CFPA would create a federal floor of financial protection and encourage greater state involvement in financial regulatory oversight.

Recently, the House Financial Services Committee Chairman Barney Frank proposed a similar agency. That bill, the Consumer Financial Protection Agency Act of 2009 (H.R. 3126), reinforces the President's proposal in many key areas. First, a proposed CFPA would not be susceptible to the same regulatory arbitrage that has characterized the current regulatory regime. Currently, four federal banking agencies—the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC)—compete against one another for fees paid by the institutions they are supposed to regulate.

Competition is an essential element of a free market, but oversight and enforcement of the law is not, nor should it be, available for purchase in a free market. In fact, regulation is one of the few instances in which a monopoly market will most efficiently deliver the desired results. Second, a proposed CFPA would be the best-positioned agency with regulatory authority for consumer protection because it would be independent of the financial institutions that bank agencies regulate.

Specific resources must be devoted to enhancing consumer protection. Placing federal fair lending laws and all aspects of consumer protection under the jurisdiction of CFPA would maximize the agency's ability to monitor and enforce the law. Because fair lending laws and consumer protection laws often reference each other, a violation of one constitutes a violation of the other(s). If multiple regulatory agencies continue to enforce different aspects of different fair

lending and consumer protection laws without a coordinated strategy, effective enforcement opportunities will continue to be missed and vulnerable communities will continue to suffer. Arguments against the creation of a CFPA include the notion that product innovation would be stifled and that consumers would lack access to financial services that meet their unique consumer needs. These propositions are without merit. CFPA, as conceived in H.R. 3126 or by the President, seeks commonsense regulation. Its goal is to provide consumers with relevant and understandable information that will enable them to make better financial decisions in their best interests. It also proposes the increased use of standard products to eliminate confusion for consumers who need standard financial products.

Standard products were the hallmark of the housing industry prior to the "product innovation" that detonated the system. The 30-year fixed-rate mortgage was, for decades, the gold standard of mortgage products, and was responsible for America's extraordinarily high rate of sustainable homeownership. And, homeownership anchored by the 30-year fixed-rate mortgage was the cornerstone of wealth attainment for the typical American household. In short, sometimes the best "product innovation" is a good standard product.

A final argument against a proposed CFPA is that it might cost the American taxpayer too much money. However, the current economic crisis demonstrates that a failure to adequately regulate the financial marketplace has already cost the American taxpayer heavily. To date, nearly $13 trillion in household wealth has been lost.

III. The Challenges of Community Lending

Some have argued that CRA should not be included in a proposed CFPA. They assert that requiring CFPA to expand its staff capacity to address broad-based community reinvestment and serving populations as borrower groups rather than solely as individuals will dilute the agency's mission. In fact, a major difference between H.R. 3126 and the President's recommendation is that H.R. 3126 proposes to leave regulatory oversight for CRA under the purview of the Federal

Reserve. Failing to relocate CRA oversight to the CFPA would weaken the CFPA's ability to carry out its mission and undermine the effectiveness of CRA.

Reckless and predatory lending often occurs at the community level. The targeting of African-American and Latino neighborhoods, for example, was a common practice of high-cost subprime lenders. CFPA must have the ability to examine and address the community context of adequate access to capital. Moreover, prohibiting unfair or deceptive financial products addresses only half the problem the CFPA will encounter in its attempts to ensure access to safe and fair financial products. America has a long and troubling history of redlining, which is the denial of access to credit at the community level. Redlining breeds a lack of competition for prime loans and other mainstream financial services in "excluded" neighborhoods (usually communities of color), and leads to a disproportionate exploitation of consumers within these markets. CRA is designed specifically to ensure that banks meet the legitimate credit and other financial services needs of communities.

Moreover, according to the Federal Reserve, nearly 10 million households have no relationship with a mainstream financial institution. And, a recent report by the Center for Financial Services Innovation estimates that there are 40 million under-banked households in the United States. Yet 97 percent of banks pass their CRA exam. Regulation of CRA under CFPA will hopefully improve the rating system for CRA so that assessments of the banking industry better reflect the reality of access to viable financial services by the American public.

Finally, from a practical implementation standpoint, it is imperative that CRA regulation be transferred to the CFPA. H.R. 3126 transfers principal fair lending authority to the new agency. Fair lending is a key element to CRA exams. A violation of fair lending and anti-predatory lending laws can lower bank's CRA rating if the violation is widespread and substantial. Yet, if the current bank agencies retain the authority to conduct CRA exams, it is not guaranteed (nor given the agencies past performance, expected) that bank agencies would regularly consult with CFPA to determine whether fair lending or anti-predatory lending violations have occurred that

should impact their CRA rating. As a result, separating fair lending oversight from CRA examinations would undermine both fair lending and CRA enforcement.

Safety and Soundness Not Impeded

An argument against transferring CRA enforcement to CFPA is that having the CRA exam separate from the safety and soundness exam would undermine safety and soundness considerations by the regulatory agencies. Separating the CRA exam from the safety and soundness exams would have no greater impact on the safety and soundness of banks than separating any other consumer protection from safety and soundness exams. Rules governing credit card terms or mortgage products, for example, are no less key to the safe and sound operations of a bank than its CRA obligations.

IV. CRA Modernization Is Vital to CFPA's Mission

NCRC's support for the creation of a CFPA that would be responsible for enforcing CRA is critical to promoting the economic wellbeing of America's working families and communities. In addition, CFPA's effectiveness would be further increased with a modernized CRA. Modernizing CRA, strengthening how it applies to banks, and applying CRA to non-bank financial institutions would allow CFPA to better leverage increases in responsible loans and investments in low- to moderate-income areas. Enhanced CRA data disclosure on lending, investing, and services would also support CFPA's overall mission and goals.

The President's proposal and H.R. 3126 are particularly strong on data disclosure. They recognize that data enhancements are critical to promoting access to responsible credit and other financial services, identifying business and community development opportunities, and promoting adherence to fair lending and consumer protection laws.

The President's proposal and H.R. 3126 include the following enhancements to data disclosure:

Collection of Deposit Account Data

Banks and credit unions would be required to maintain and disseminate data on their branches, ATMs, and other depository facilities, as well as maintain and disseminate the census tract locations of their depository facilities. (Note: Deposit accounts include checking, savings, credit union share accounts and other types of account as defined by CFPA.) The number and dollar amount of deposit accounts for the residential and commercial customers for each deposit facility would also be collected. The place of residence/business of bank/credit union customers would be provided on a census tract basis, making it possible to analyze the income level and race/ethnicity percentage of the census tracts of these customers. These data should be used as part of CRA exam analysis as proposed by the Administration.

Small Business Loan Data Collection

Financial institutions would be required to collect Home Mortgage Disclosure Act (HMDA)-like data on small businesses to determine whether a business is minority- and/or women-owned. In addition to collecting race and gender data, the financial institution would be required to collect the type and purpose of the loan for which the business is applying, the type of action taken with respect to the application, the gross annual revenue of the small business, the census tract location of the business, and any other information CFPA deems appropriate.

Financial institutions that would be required to collect and report these data include any partnership, company, corporation, and cooperative organization. This requirement extends beyond banks that have a current obligation to report small business loan data under CRA. CFPA does, however, reserve the right to exempt any class of financial institutions from this reporting requirement.

The importance of this data cannot be understated. The addition of race and gender data in HMDA facilitated a dramatic expansion of prime lending to minorities and women in the 1990s before the explosion of subprime lending from 2003-2007. For example, home lending to African Americans and Hispanics increased 79.5 percent and 185.8 percent, respectively, compared with 51.4 for middle- and upper-income borrowers between 1993 and 2002. In contrast, a well-developed literature based on national surveys indicates the likely possibility of discrimination against women- and minority-owned small businesses. A lack of publicly available data on small business lending by race and gender has inhibited lending to women- and minority-owned businesses by preventing stakeholders from identifying missed opportunities to serve minority- and women-owned businesses and by enabling discriminating lenders to remain undetected when violating the fair lending laws.

The Federal Reserve Board has inhibited rather than facilitated the promotion of additional data collection of small business lending. The Federal Reserve has prevented lenders from voluntarily collecting race and gender data for small business borrowers by failing to lift the current prohibition in Regulation B (that implements the Equal Credit Opportunity Act) against collecting this data. In addition, the Federal Reserve discontinued the periodic national survey that enabled researchers to document disparities and likely discrimination in small business lending. In total, the Federal Reserve's actions discouraged debate and discussion on small business data disclosure, which is inconsistent for an agency that has been responsible for enforcing CRA and the fair lending laws.

Enhancements to Home Mortgage Disclosure Act (HMDA) Data

In addition to the demographic characteristics they already collect in HMDA data, financial institutions would be required to collect the age of the borrower under the Administration's proposal and H.R. 3126. NCRC and others have found that elderly borrowers experience lending disparities; this additional data element will allow for a more systematic investigation of these disparities. Several loan terms and conditions would also be collected, including total points and fees, the difference between the annual percentage rate and a benchmark rate for all

loans, prepayment penalties, the value of the real property pledged as collateral, whether the loan is a hybrid loan with a lower teaser rate, whether the loan is a negative amortization loan, whether the application was received by a broker or other retail channel, and the credit score of the borrower.

V. Distribute Consumer Protection Responsibilities

Role of the Federal Reserve

Once established, CFPA would become the primary agency responsible for coordinating consumer protection at the federal level, monitoring the financial industry's consumer protection activities, interpreting the consumer protection laws through issuing rules, and enforcing consumer protection laws. Because CFPA would take the lead role in consumer protection does not mean that the Federal Reserve should abdicate its needed role in consumer protection. As the central bank of the United States, part of its mandate is to ensure that the financial services sector serves as an engine of growth for the entire economy, which in turn requires ensuring positive consumer outcomes.

The Federal Reserve's consumer protection role should be subordinate to that of CFPA's: it should retain oversight over the institutions for which it is the primary regulator, and retain authority to investigate potential consumer abuse and refer violations of consumer protection laws to CFPA. The Federal Reserve's consumer protection role should also be more limited in the future because it has proven to be unwilling or unable to adequately monitor and effectively enforce the laws. The Federal Reserve's track record on lack of regard for the American consumer ranges from its involvement in the Community Reinvestment Act, to the mortgage lending markets, and to alternative consumer credit products.

Perhaps the most egregious instance in which the Federal Reserve protected the interests of financial institutions at the expense of consumers is in the mortgage lending markets. With the passage of the Home Ownership and Equity Protection Act (HOEPA) in 1994, the Federal

Reserve was granted extraordinary powers to prevent predatory lending and punish predatory lenders who engaged in these practices. Not only did the Federal Reserve not make full use of its new authority, it declined to issue final HOEPA guidelines. HOEPA created a critical opportunity to purge predatory lending from the markets, but the lack of oversight and enforcement undermined the ability of banks and mortgage companies to comply fully with fair lending regulations. It was not until July 2008, after the housing bubble had burst and begun to wreak havoc on the financial services sector and the economy as a whole, that the Federal Reserve finally issued revisions to its HOEPA regulations.

Inconceivably, the Federal Reserve has supported unfair and unnecessarily high-cost alternative financial products as they were becoming more pervasive over the past decade. For example, although the Truth in Lending Act (TILA) requires banks to notify account holders before extending a fee-based "courtesy loan" to cover overdrafts, the Federal Reserve has refused to enforce this requirement. According to the FDIC, banks with automatic overdraft loans earned $1.77 billion in fees on those loans in 2006. The Federal Reserve has not addressed this practice, and has declined even require banks to allow consumers to opt out of automatic overdraft loan programs.

The Federal Reserve also engaged in the "race to the bottom" of regulatory enforcement as financial institutions took advantage of their ability to "charter shop" and choose the federal regulatory agency that best fit their needs. That race was so competitive that it plunged the entire financial system into a ditch.

Although the leader in promoting poor lending enforcement was the Office of Thrift Supervision (OTS), the Federal Reserve followed OTS's lead along with the other banking agencies. This was particularly harmful to low- and moderate-income communities and minority consumers, as years of regulatory competition for financial industry business led to the weakening of CRA provisions and enforcement. Moreover, the Federal Reserve also failed to use a critical enforcement tool of CRA: the law's requirement of public meetings at the time of proposed mergers. In Congressional testimony in 2007, an official representing the Federal Reserve

testified that the Federal Reserve had held only 13 public meetings on mergers since 1990. This is less than one meeting per year in an era in which consolidations have profoundly changed the banking industry. In addition, of the 13,500 applications for the formation of banks or the merger of institutions that the Federal Reserve has received since 1988, only 25 applications were denied.

More recently, the federal banking agencies declined to solicit the public's input regarding the emergency mergers involving JP Morgan Chase/Washington Mutual and Wells Fargo/Wachovia. If the agencies believed that the usual application process and public comment period was not possible in those cases, they could have held post-merger meetings and public hearings, as requested by NCRC member organizations. None of the agencies has scheduled post-merger meetings.

The Federal Reserve also failed in its duty to enforce fair lending and non-discrimination. Between 2004 and 2006, the Federal Reserve identified approximately 470 lenders whose practices were possibly in violation of civil rights and fair lending laws. Instead of investigating the lenders to determine the presence and extent of actual violations, the Federal Reserve referred all 470 cases to other regulatory agencies, and did not follow up when the other agencies similarly declined to investigate. Moreover, from 2004-June 2008, the Federal Reserve referred only four cases involving mortgage lending discrimination to the US Department of Justice.

In particular, the Federal Reserve should maintain its Office of Civil Rights and Fair Lending Compliance. This office should work to ensure that the Federal Reserve's own activities affirmatively promote fair housing. It should be responsible for monitoring the civil rights dimensions of consumers' experiences with financial institutions under its regulatory purview. The Federal Reserve's Office of Civil Rights and Fair Lending Compliance should also retain its power to encourage compliance by denying non-compliant institutions the ability to participate in economic recovery programs. This would require the Federal Reserve to cooperate more amiably and openly with other banking agencies, HUD, DOJ, and CFPA to enforce non-discrimination and ensure fairness.

The Federal Reserve should also retain limited consumer protection rule making authority over institutions for which it is the primary regulator, but its authority ought to be subordinate to the rule making authority of the CFPA and should not preempt states from instituting more rigorous consumer protection policies. Any time that CFPA issues a ruling or guidelines on consumer protection, the Federal Reserve should immediately communicate its intent to align its policies with CFPA's judgment and take steps to adjust its implementation to align with CFPA's requirements.

VI. The Role of Other Federal Banking Regulatory Agencies

While the Federal Reserve is the primary focus of today's hearing, it is important not to lose sight of the other Federal banking regulatory agencies, particularly the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), and the Federal Insurance Deposit Corporation (FDIC). Currently, these agencies all share responsibility among themselves and the Federal Reserve for oversight, implementation, and enforcement of consumer protection laws.

Like the Federal Reserve, the other banking agencies have routinely failed to look out for consumers' interests in order to champion financial institutions. For that reason, these other banking agencies should also have limits placed on their roles in consumer protection once CFPA is established. They should be subordinate to CFPA on all matters related to consumer financial products and services. Each agency should retain oversight over the institutions for which it is the primary regulator and retain authority to investigate potential consumer abuse and refer violations of consumer protection laws to the CFPA.

There is ample evidence that the other federal banking regulatory agencies were derelict in their duties to ensure that financial institutions operated responsibly and ethically. Regarding CRA requirements and exams in particular, lending institutions chose which regulator would best meets their needs with lax enforcement. In fact, OTS, which aggressively promoted itself as a

“lax” regulator, implemented in 2004 exceptionally lenient CRA exams. In response to this, the other agencies were compelled to relax their CRA enforcement for mid-size institutions in order to compete with OTS.

Even in the depths of this current credit market and economic crisis, the federal banking agencies have actively worked to weaken consumer protection laws. As Congress considered sweeping credit card reform legislation earlier this year, for example, the OCC lobbied for additional loopholes to limit disclosure requirements.

The banking agencies priorities are perhaps most clearly demonstrated through their activities related to preemption of state laws. In 2003, the OCC preempted Georgia’s newly enacted comprehensive anti-predatory lending law. The law would have curtailed many of the predatory practices that allowed lenders to saddle consumers with unsustainable home mortgages without suffering losses when the loans went bad- a major contributing factor in the foreclosure crisis. OCC preempted the law because the agency agreed with arguments that it would have been expensive for banks to implement and would have required secondary market participants to conduct more due diligence to ensure that they did not purchase loans with predatory features.

Preemption efforts by OCC, OTS, and the National Credit Union Association have prevented states from implementing more rigorous consumer protection laws to benefit their residents. Preempted policies include banning ATM fees, expanding regulation of insurance policies, requiring enhanced disclosure of terms and conditions, and capping interest rates.

Finally, none of the federal banking agencies have been supportive of minority consumers and have generally ignored financial institutions’ practices that violated civil rights and fair lending legislation. Forty years after the first fair housing and fair lending laws were enacted, minority borrowers continue to be harmed by unfair practices and unequal treatment within the financial system.

As with the Federal Reserve, the other banking agencies should maintain their Offices of Civil Rights and Fair Lending Compliance. These offices should work to ensure that the agencies' activities affirmatively promote fair housing. They should also actively collaborate among each other to monitor the civil rights dimensions of the products and services offered by financial institutions, and follow up with one another in investigating potential civil rights violations.

Each banking agency should also retain rule making authority over the institutions for which it is the primary regulator, but its authority ought to be subordinate to the rule making authority of the CFPA and should in no way preempt states from instituting more rigorous consumer protection policies. Any time that CFPA issues a ruling or guidelines on consumer protection, all federal banking regulatory agencies should immediately communicate their intent to align their policies with CFPA's judgment.

VII. Balance Consumer Protection, Systemic Risk, and Monetary Policy

As of today, the creation of a CFPA remains a proposal. Its failure to be enacted would mean that regulatory agencies would maintain their current authority over consumer protection, systemic risk and monetary policy. Even if that is the case, the public must nevertheless expect, demand, and receive improved performance from those agencies.

If the Consumer Financial Protection Act is not passed, it would be imperative that the Federal Reserve recognize that consumer protection and safety and soundness are two sides of the same coin. Judging from the Federal Reserve's own leadership, this will be a difficult hill to climb. Testifying to this subcommittee on July 9, 2009, former Federal Reserve Governor Frederic Mishkin stated that "the skills and mindset required to operate as a consumer protection regulator [are] fundamentally different from those required by a systemic regulator."

Also testifying to this committee last week, former Federal Reserve Governor Lawrence Meyer said that if the Federal Reserve is to give anything up, "the most obvious choice is consumer protection and community affairs [because]….These are not seen around the world as core responsibilities of central banks."

If the Federal Reserve is to balance consumer protection, monetary policy, and systemic risk responsibilities, it would have to take its consumer protection rule writing authority more seriously to create uniform standards across the financial industry. It would then need more effectively to enforce those protections. And, based on the statements of its own leadership, it should hire new staff and reorganize its leadership in a manner that advances those within the institution who understand and appreciate more fully the imperative of consumer protection.

Moreover, the role that banks currently play in determining Federal Reserve makeup and policy needs to be curtailed. Local banks have a large say in picking the presidents of each of the 12 district banks, who sit on the Open Market Committee that creates monetary policy and wields other significant regulatory powers. As long as the Federal Reserve, by design, overwhelmingly prioritizes the interests of banks, consumer protection will lose when it comes into conflict with other concerns, such as short-term profits or bank solvency.

Ultimately, Federal Reserve policies need to take a long-term view of the financial industry in order to recognize that consumer protection, sound monetary policy, and limiting financial risk are aligned interests. The Federal Reserve should clearly articulate what systemic healthiness of the financial system ideally looks like; enumerate the activities and analysis it will use to measure system-wide health, including examining consumer risks; develop rigorous processes to address systemic risks when they are identified; and tailor those processes to meet the demands of different types of risks, including behaviors, products, and institutional size and complexity.

Recommendations for General Federal Reserve Reform

As a member of the Americans for Financial Reform, NCRC supports the coalition's recommendations to create a more neutral Federal Reserve that better balances its sometimes conflicting duties of consumer protection, systemic risk regulation, and monetary policy. Those recommendations include:

- Make all of the district bank presidents appointees of the President, subject to congressional approval. The current practice of appointing Federal Reserve governors to very long terms (14 years) should preserve the necessary degree of independence.

- The Federal Reserve should move away from the "disclosure-based consumer protection" to the creation and enforcement of industry-wide uniform standards that prohibit harmful or abusive products and require that loans be made based on reasonably established ability to repay.

- The rules and regulations established by the Federal Reserve should not preempt state laws, but provide a floor upon which states can add extra protections for institutions under their jurisdiction.

- Monetary policy should be designed to address the concerns of ordinary workers instead of the banks. This would mean more emphasis on maintaining high levels of employment and less concern about modest rates of inflation.

- The Federal Reserve should be required to be more open in its proceedings. As it stands now, the Federal Reserve provides summary minutes of the meetings of the Open Market Committee with a six-week lag. Full transcripts are made available with a 5-year lag. There is no reason that these lags cannot be reduced. In principle, the meetings could be televised live so that the public could immediately understand the factors underlying the Federal Reserve's decisions on monetary policy.

- The Federal Reserve should establish a Consumer Advocate which reports to Congress regularly on agency effectiveness.

- A council made up of the heads of the major federal financial regulatory agencies – including the Federal Reserve – should monitor and manage systemic risk, as no single agency or institution can effectively monitor and prevent or resolve systemic risks. This council should be fully accountable and transparent to the public and have a dedicated staff and sufficient resources. The council should also have the power to preempt consumer and investor protections.

Resolution Authority to Be Expanded at the FDIC

Greater resolution authority over non-bank financial institutions is essential. This power would augment its ability to create industry-wide uniform standards. It would also provide the necessary authority to take non-bank financial institutions into receivership when they are in danger of failing, to ensure that, unlike AIG, future failed firms are unwound in a manner that is timely, responsible, and less expensive for taxpayers. Therefore, NCRC supports the Administration's proposal that this resolution authority be placed under the purview of the FDIC.

Conclusion

In response to the idea of a separate consumer protection agency, there has been considerable push back, primarily from financial institutions, that such an agency would limit access to credit and discourage lending to families most in need of access. That argument should be considered as having the same merit as the declaration that the markets are self-regulating. We have seen the folly of self-regulated markets and the American people are feeling the pain of failed consumer protection.

To date, more than $12.8 trillion of financial support in the form of investments, loans, and guarantees, has been advanced to prop up the financial system -- but this approach has had limited effectiveness because consumers continue to struggle in a virtual sea of deceptive debt and a financial system that remains unaccountable to the American public.

At the end of the day, the effectiveness of consumer protections – whether they be located in their current regulatory agencies or consolidated in a new CFPA – will depend largely on how those institutions are staffed going forward, the transparency in their work, lack of conflicts in their decision making authority, and the manner and extent of their funding.

Simply consolidating the existing consumer regulatory infrastructure to another building in Washington but leaving these critical issues of structure, authority, and autonomy unaddressed will not have a meaningful impact on protecting the public. And failure to place the appropriate regulatory structure in place at this time, could ultimately lead to another crisis in the future for which recovery may be even more protracted and painful.

Now is the time to enact strong legislation that establishes the financial health of the American public as the first priority of the financial system. When the public benefits from its engagements with the financial system, every one – borrowers, communities, financial firms, and the nation as a whole – wins.

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