NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Written Testimony of

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On the Subject of Unregulated Markets:
How Regulatory Reform will Shine a Light
In the Financial Sector

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Joint Economic Committee

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Introduction

Good morning, Chair Maloney and distinguished members of the Committee. My name is James H. Carr and I am the Chief Operating Officer for the National Community Reinvestment Coalition. On behalf of our coalition, I am honored to speak with you today about the role of consumer financial protection in the economic crisis.

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities 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 serve on the executive committee of that coalition.

Members of the Committee, today we stand at a crucial junction in the road to recovery. After nearly two years of painful contraction, the economy has begun to grow again. Nevertheless, leading economists of all ideological stripes estimate that the recovery will be jobless, tepid, and prolonged. Millions of the 7.6 million Americans who lost jobs during the Great Recession remain out of work, including 4.1 million workers who have been unemployed for more than six months.[1]

While millions of American workers are suffering, profits on Wall Street are soaring. The largest investment firms on Wall Street have so far earned $23 billion in 2009.[2] Bonuses this year are likely to be the second highest on record, second only to those paid in 2007.[3] So, as the pains of recession continue for most American families, Wall Street is celebrating.

[1] "New U.S. Jobless Claims Decline." *Associated Press*. November 12, 2009. Accessed online at: http://www.nytimes.com/2009/11/13/business/economy/13econ.html.
[2] Kouwe, Zachery. "Wall Street on Track for Record in Profits." *New York Times*. November 17, 2009. Accessed online at: http://www.nytimes.com/2009/11/18/business/18wall.html.
[3] Gralla, Joan. "Wall Street Profits Revive, Bank Bonuses May Jump." *Reuters*. November 17, 2009. Accessed online at: http://www.reuters.com/article/newsOne/idUSTRE5AG2UA20091117.

It is disquieting to contrast the headlines on profits and bonuses on Wall Street with the news that lending in the third quarter of 2009 declined 3 percent, the largest drop since the FDIC started tracking the data in 1984. Seventy-five percent of the decline is attributable to decreased lending at big firms, and the majority of the decline reflects restrictions on credit available to consumers and small businesses.[4] In short, the American people supported Wall Street in its time of need, but the banks have not responded to the American public in kind.

Worse yet, while many of the large institutions that have been most heavily subsidized are now reaping record profits and preparing to pay out near-record bonuses, the rest of the banking sector remains in a precarious state. The FDIC, for example, has entirely depleted its insurance fund.[5] More than 120 banks have failed so far this year, and the FDIC's list of at-risk banks now includes 552 institutions.[6]

Meanwhile, for the nearly 16 million Americans who are unemployed and looking for work,[7] the recession is far from over. Foreclosures continue at a staggering pace, with more than 300,000 new loans receiving a foreclosure filing each month since March.[8] As families exhaust their savings and unemployment benefits, they lose the ability to provide basic necessities. For example, 50 million people experienced food insecurity in 2008.[9] A record 36 million Americans now rely on food stamps: one in eight of the general population and fully one quarter of all children.[10] Despite these staggering statistics demonstrating the ongoing suffering on Main Street, Wall Street continues to operate under the banner of "business as usual."

[4] Paletta, Damian. "Lending Declines as Bank Jitters Persist." *Wall Street Journal*. November 25, 2009. Accessed online at: http://online.wsj.com/article/SB125907631604662501.html?mod=rss_Today%27s_Most_Popular.
[5] Dash, Eric. "As Bank Failures Rise, FDIC Fund Falls into Red." *New York Times*. November 24, 2009. Accessed online at: http://www.nytimes.com/2009/11/25/business/economy/25fdic.html.
[6] Ibid.
[7] "Employment Situation Summary." Bureau of Labor Statistics, U.S. Department of Labor. November 6, 2009. Accessed online at: http://www.bls.gov/news.release/empsit.nr0.htm.
[8] Levy, Dan. "U.S. Foreclosure Filings Top 300,000 for Eighth Straight Month." *Bloomberg News*. November 12, 2009. Accessed online at: http://www.bloomberg.com/apps/news?pid=20601103&sid=aaXO2EVjAjb4.
[9] Goldstein, Amy. "America's Economic Pain Brings Hunger Pangs." *Washington Post*. November 17, 2009. Accessed online at: http://www.washingtonpost.com/wp-dyn/content/article/2009/11/16/AR2009111601598.html.
[10] DeParle, Jason and Robert Gebeloff. "Food Stamp Use Soars, and Stigma Fades." *New York Times*. November 29, 2009. Accessed online at: http://www.nytimes.com/2009/11/29/us/29foodstamps.html.

In the words of Nobel Prize-winning economist Joseph Stiglitz, business as usual meant that when the financial system discovered there was money at the bottom of the wealth pyramid, it did everything it could to ensure that it did not remain there. Stated otherwise, the business model for many financial institutions was to strip consumers of their wealth rather than build and improve their financial security.

Protecting consumers is one of the key elements of governmental reforms that aim to restructure the financial sector to be more accountable to the needs of the public. The new Consumer Financial Protection Agency (CFPA), first proposed by Harvard Law School Professor Elizabeth Warren, now the Chairwoman of the Congressional Oversight Panel on TARP, was formally proposed by President Obama in June 2009. The agency has the support of all the major consumer organizations and the approval of the American public, but is vigorously opposed by financial industry lobby groups.

With powerful and wealthy interests opposing CFPA, the difficult necessity of striking bipartisan compromise, and competing issues—such as health care, the war in Afghanistan, and climate change—demanding time on Congress's agenda, it would be easy to allow consumer protection, and financial regulatory reform in general, to languish. Delay or defeat, however, would have severe negative consequences for the American public.

Could CFPA have Prevented the Financial Crisis?

I have been asked today to discuss whether the Consumer Financial Protection Agency (modeled on any one of the proposals advanced by the President, the House of Representatives, or the Senate), had it existed, would have prevented the proliferation of predatory lending, which eventually led to the implosion of the housing and credit markets that, in turn, caused the sinking of the U.S. economy.

It is, of course, impossible to answer such a question with certainty. However, I am convinced that if a Consumer Financial Protection Agency had been enforcing consumer protection laws and protecting consumers' interests throughout the past decade, much of the predatory lending that fueled the housing and credit crises would have been curtailed.

To evaluate this idea, I have considered the primary causes of the financial crisis and how the CFPA might reasonably have responded to them. In each case, it is likely that a federal agency, with the sole mission to protect consumers' interests within the financial sector, would have taken some action to stop illegal activities and encourage safe and sound lending that was beneficial to the public and lenders alike.

Predatory Mortgage Lending

In 1994, Congress passed the Homeownership and Equity Protection Act (HOEPA) in order to address predatory practices related to high-cost, subprime mortgages. The Federal Reserve was tasked with developing guidelines for financial institutions on how to implement HOEPA, but it declined to do so until 2008. The agency failed to act because it decided to put its core mission to ensure the safety and soundness above its responsibility to protect the public within the lending markets.[11]

In the interim, the subprime lending field grew exponentially. In 2003, for example, subprime mortgages accounted for only 8 percent of all mortgage originations, but by 2006, subprime accounted for 28 percent of all originations.[12] As early as 2006, lenders and policymakers knew that borrowers who received subprime loans were far more likely to default than borrowers with identical financial characteristics who received prime loans. In fact, according to the Center for Responsible Lending's research, as many as one in eight subprime loans made between 1998 and 2004 ended in foreclosure within just five years.[13]

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[11] For a detailed account of the Federal Reserve's actions regarding HOEPA, see the testimony of James H. Carr before the U.S. House of Representatives Committee on Financial Services, Subcommittee on Domestic Monetary Policy and Technology presented at the hearing titled Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve. July 16, 2009. Accessible online at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/carr_testimony.pdf.

[12] "A Snapshot of the Subprime Market." Center for Responsible Lending. November 28, 2007. Accessed online at: http://www.responsiblelending.org/mortgage-lending/tools-resources/snapshot-of-the-subprime-market.pdf.

[13] Schloemer, Ellen, Wei Li, Keith Ernst, and Kathleen Keest. "Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners." Center for Responsible Lending. December 2006. Accessed online at: http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf.

As far back as 1999, the State of North Carolina enacted a comprehensive, statewide anti-predatory lending law. Many states and localities followed in North Carolina's footsteps. But rather than support state actions to purge irresponsible lending from the markets, federal regulatory agencies, principally the OCC, aggressively set aside or preempted state laws to prevent states from protecting their own residents.

The danger to consumers was apparent and yet regulatory agencies, including the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), did not act. By now the regulatory race to the bottom – the competition between regulators to offer the least consumer protection oversight to the institutions they were responsible for supervising – has been well documented.[14] Prudential regulators, who treated consumer protection as a secondary or even tertiary responsibility, did not provide strict supervision. The consolidation of consumer protection responsibilities under the jurisdiction of a single Consumer Financial Protection Agency would have avoided this problem.

The CFPA, had it existed, would have had jurisdiction over the independent mortgage lending companies. These lenders accounted for as much as 70 percent of the market at the height of the housing boom and were virtually unsupervised.[15] Merely extending the regulatory framework that existed to cover this segment of the market would have helped rein in some of the most egregious lending practices, such as subprime, pay option adjustable rate mortgages (ARMs), and interest-only mortgages. Furthermore, the CFPA would have had more incentive than the prudential regulators to actively enforce laws already on the books, such as requirements related to the Community Reinvestment Act (CRA) and the Real Estate Settlement Procedures Act (RESPA).

[14] Carr, James H. "Testimony on Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve." Presented to the U.S. House of Representatives Committee on Financial Services, Subcommittee on Domestic Monetary Policy and Technology. July 16, 2009. See also: Plunkett, Travis and Ed Mierzwinksi. "Testimony on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation." Presented to the U.S. House of Representatives Committee on Financial Services. June 24, 2009. Accessed online at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/plunkett_-_submitted_with__mierzwinski.pdf.

[15] Trehan, Veena. "The Mortgage Market: What Happened?" *National Public Radio*. April 27, 2007. Accessed online at: http://www.npr.org/templates/story/story.php?storyId=9855669.

One of the major challenges that consumers face in applying for a mortgage is their lack of knowledge about financing home purchases relative to the expertise of industry professionals. To that end, numerous laws have attempted to provide consumers with the information they need to make informed decisions that are in their best interests (including RESPA, HOEPA, Truth in Lending Act, and others). Unfortunately, as anyone with a credit card knows, mandatory disclosures are written in language that is nearly impossible to understand. To address this challenge, consumer advocates recommend a "reasonableness standard" be implemented, requiring lenders to provide mandatory disclosures that communicate the terms and conditions of a loan in language that a person can be reasonably be expected to understand.

If the CFPA had been created ten years ago, it would likely have applied such a reasonableness standard to mortgage products to ensure that borrowers were fully aware of the presence and effects of features such as the expiration of low introductory rates and the due dates of balloon payments. Regulations such as a reasonableness standard are not intended to prevent consumers from exercising their own judgment about their interests or stopping consumers from making poor choices, but enabling them to successfully evaluate their options. In other words, a reasonableness standard would not prohibit a lender from offering option ARMs, but it might make some consumers less interested in choosing option ARMs if they qualified for less expensive loans.

The CFPA would also likely have issued guidelines related to "plain vanilla" products. Many consumer advocates support requiring lenders to offer a "plain vanilla," or standard, product alongside whatever exotic alternatives they preferred to pitch to borrowers. The CFPA might have implemented a requirement or provided lenders with boilerplate contract language on a 30 year fixed-rate mortgage and encouraged lenders to use it.

It is well documented that vast numbers of borrowers signed up for high cost loans even though they were qualified for a less expensive 30 year fixed-rate mortgage. In 2006, for example, more than 60 percent of subprime borrowers were qualified to receive a less expensive loan.[16] How

[16] "Snapshot of a Foreclosure Crisis: 15 Fast Facts." Center for Responsible Lending. August 2009. Accessed online at: http://www.responsiblelending.org/mortgage-lending/research-analysis/snapshot-of-foreclosure-crisis.pdf.

many of them knew that they were eligible to receive a less expensive loan? How many would have chosen subprime loans if they had been presented with a choice between subprime and a "plain vanilla" standard product?

The reasonableness standard and "plain vanilla" requirement seem to be matters of common sense, but they have met with fierce opposition from banking lobbyists. In fact, although the President's proposal included both, the House bill passed with an amendment that prohibits CFPA from promulgating any rules related to "plain vanilla" standard products and does not include the reasonableness standard. The manager's draft of the legislation that was introduced in the Senate does not include a reasonableness standard but has a similar provision. The Senate bill requires that mandatory disclosures associated with loan products be communicated clearly and concisely.

Predatory Consumer Credit and Small Business Lending

A major contributing factor to the proliferation of predatory lending over the past decade was the general trend of financial sector deregulation, beginning with the repeal of the New Deal-era Glass Steagall Act in 1999. As oversight and enforcement were relaxed throughout the 2000s, a number of practices emerged that undermined consumer wellbeing. Unfortunately, banking regulatory agencies did little to stop these abusive actions.

The CFPA, with a clear mandate to protect consumers within the financial markets, would likely have responded to issues such as the invention of "fee harvester" credit cards, deceptive interest rate practices, illegal payday lending schemes, kickbacks and markups in automobile lending, and disparate lending outcomes for minority homebuyers and minority-owned businesses.

Of course, it is impossible to know exactly what a CFPA would have done if it had existed during the past decade. However, it is likely that a consumer-focused regulatory agency would have had a significant impact on predatory lending. Indeed, as Travis Plunkett of the Consumer Federation of America put it in testimony before the House Financial Services Committee earlier this year, "had regulators acted to rein in predatory and unsound mortgage lending when problems first began to emerge, the worst of the current crisis could likely have been avoided."[17]

The lesson that should be drawn from this counterfactual analysis of what a CFPA might have done is that existing regulators have held the mistaken belief that the same products that are harmful to consumers could nevertheless be safe and sound lending for the financial institution that offered them. In hindsight, the predatory and reckless lending that characterized the credit markets over the past decade was profitable and safe and sound only in the short term; their negative effects on consumers ultimately contributed to the vulnerability of the entire financial system. As financial regulatory reform proceeds it is essential to craft a regime that aligns prudential regulation, systemic risk, and consumer protections.

Enacting CFPA in 2009: What the New Agency Needs to be Effective

As interesting as it is to question what might have been different if a CFPA had been created a decade ago, the reality is that the crisis *did* happen and two years after the start of the Great Recession, there is still no Consumer Financial Protection Agency.

As Congress continues crafting the legislation to establish a CFPA, it should address several key issues of structure and jurisdiction in order to enact successfully an agency that will be able to protect adequately consumers' interests within the financial sector. The CFPA must be independent, have jurisdiction over all consumer protection laws, authority over all transactions that involve the extension of credit to consumers, and be invested with sufficient power to issue rules and guidelines, supervise, examine, and bring enforcement actions against banks and other financial firms.

Independent Leadership

[17] Plunkett, Travis. "Testimony on Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals." Presented to the U.S. House of Representatives, Committee on Financial Services. July 16, 2009. Accessed online at: http://www.house.gov/apps/list/hearing/financialsvcs_dem/travis_plunkett_fsc_testimony_july_16,_2009.pdf.

The Consumer Financial Protection Agency should be an independent federal agency with an appointed Director who sets the agency's agenda and policies, with the support and guidance of a subordinate advisory board. This will allow the agency to be flexible and decisive but also encourage a variety of perspectives on consumer affairs and finance to have a role in the agency's leadership.

At present, there are four different proposals for the CFPA's board. First, President Obama's white paper on financial regulatory reform put forward a chief executive who is appointed by the President with the advice and consent of the Senate. The director would be supported by a board of directors that included three additional experts in consumer affairs and consumer financial products, as well as the head of the new national bank regulator. Under the President's plan, the CFPA's chief executive would have the ultimate authority to set policy and priorities for the agency.

The House Financial Services Committee's version of the CFPA, as described in H.R. 3126, recommends a slightly different governance structure. The HSFC legislation proposes a strong chief executive, appointed by the President, who is assisted by an oversight board. The board is made up of the seven heads of the banking regulatory agencies, plus five appointed consumer advocates. The Director would have the sole authority to proscribe rules, and issue orders, as well as appoint officers such as an inspector general and general counsel. The oversight board would be limited to an advisory capacity, offering perspectives on how proposed regulations would interact with concerns regarding systemic risk and prudential regulation.

After passing the House Financial Services Committee vote, H.R. 3126 was considered by the Committee on Energy and Commerce, which made a third recommendation regarding the CFPA's governance structure. Representative Henry Waxman, the Chairman of Energy and Commerce, favored a commission-style governance structure similar to that of the Securities and Exchange Commission or the Federal Trade Commission. That would include five members, all of whom would be appointed by the President with the advice and consent of the Senate. None of the five commissioners would be required to be representatives of regulatory agencies or consumer finance experts.

Finally, Senator Chris Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, introduced CFPA legislation that included a five member Board of Directors that would operate by majority rule and wield strong authority. It would be headed by a Director, but this officer would be constrained in setting policy by the need to develop consensus within the board. The only automatic seat on the board would go to the head of the proposed Financial Institutions Regulatory Authority, with the four remaining seats appointed by the President, subject to Senate approval. The Director would have sole authority over personnel hiring, distribution of responsibility across administrative units of the agency, and the distribution and use of agency funds. All other decisions, including setting rules and regulations, would be made through majority vote of the Board of Directors.

Of these various proposed governance structures, the House Financial Services Committee’s comes closest to the best possible outcome, with one important caveat. It is important that the board of directors be composed primarily of consumer representatives rather than regulators. Given that the agency’s mission is exclusively focused on safeguarding consumers’ interests, consumer advocates must be its primary leaders. Including too many prudential regulators on the Board of Directors will diminish the agency’s ability to fairly and fully represent consumer interests.

Another strength of the HFSC’s proposed governance structure is the powerful agency director. A chief executive will be better able to provide the responsive, flexible, and independent leadership that the CFPA will need in order to successfully react to emerging practices in the financial markets. On the other hand, given staggered appointment schedules and occasional vacancies, commission-style federal agencies all too often find themselves in deadlock, unable to reach internal consensus.

Robust, Independent Funding

It is imperative that the CFPA avoid regulatory capture by the firms it oversees. This requires that the agency have a funding stream that is not completely dependent upon fees from these firms.

Dependence on fees from firms has been a serious weakness for the Office of Thrift Supervision and the Office of the Comptroller of the Currency. At OCC, for instance, more than 95 percent of the office's budget comes from fees paid by the banks it supervises.[18] The threat that firms could "charter shop" to choose their regulator contributed to the regulatory race to the bottom by adding an additional factor to the environment favoring light oversight. The need for banking agencies to protect their funding encouraged the regulatory arbitrage that was ultimately detrimental to the health of the financial system as a whole.[19]

NCRC concurs with Consumer Federation of America's recommendation that the CFPA should have stable funding "that is sufficient to support robust enforcement and is not subject to political manipulation by regulated entities."[20] CFA advocates a funding stream supported by a variety of sources, whereby fees paid by regulated firms and priced services such as compliance exams comprise the CFPA's baseline budget and Congressional appropriations are used as supplemental funding; CFA also recommends ensuring stable funding in times when fees decline due to decreased economic activity.[21]

Although the Administration's financial regulatory reform proposal was not explicit on the matter of funding the CFPA, the legislation from both the House of Representatives and the Senate applies exactly the type of blended funding—mixing Congressional appropriations, fees

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[18] Wilmarth, Arthur. "Testimony on Credit Card Practices: Current Consumer and Regulatory Issues." Presented to the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. April 26, 2009. Accessed online at: http://financialservices.house.gov/hearing110/htwilmarth042607.pdf.

[19] For a more detailed history of charter shopping and regulatory arbitrage, please see: Carr, James H. "Testimony on Regulatory Restructuring: Safeguarding Consumer Protection and the Role of the Federal Reserve." Presented to the U.S. House of Representatives Committee on Financial Services, Subcommittee on Domestic Monetary Policy and Technology. July 16, 2009.

[20] Plunkett, Travis and Ed Mierzwinksi. "Testimony on Regulatory Restructuring: Enhancing Consumer Financial Products Regulation." Presented to the U.S. House of Representatives Committee on Financial Services. June 24, 2009.

[21] Ibid.

assessments, and diverting funds from the consumer protection operations at other regulatory agencies—that would provide stability.[22]

Jurisdiction

The CFPA's jurisdiction should include all of the nearly twenty consumer protection laws that are currently enforced by a patchwork of regulatory agencies. These include the Equal Credit Opportunity Act; the Fair Credit Reporting Act; Home Mortgage Disclosure Act; the Right to Financial Privacy Act; the Truth in Savings Act; the Truth in Lending Act; and the Community Reinvestment Act, among others.

The Community Reinvestment Act

The Community Reinvestment Act has been the subject of some debate, because it is the only consumer protection law that relates to communities rather than solely individuals. President Obama's proposal transferred CRA authority from multiple current agencies to the new CFPA, and Senator Dodd proposes to do the same. The House bill, however, does not include CRA in the laws transferred to the jurisdiction of the CFPA. This omission is a mistake.

The principal argument against transferring CRA enforcement to the proposed CFPA is that the new agency should address the targeting and sales of financial products to individuals only. It is argued that expansion of its mission to incorporate financial services at the community level would overwhelm the agency and undermine its effectiveness. This argument ignores the fact that financial services providers have historically and routinely offered products at a community level. Many firms use race as a proxy for financial vulnerability to concentrate their use of high-cost, deceptive and predatory financial products. The excessive concentration of subprime loans in African-American and Latino communities is one example of this phenomenon.

[22] Section 118 of H.R. 3126 and Section 115 of Senator Dodd's Discussion Draft on Comprehensive Financial Reform.

Moreover, geographically targeted predatory lending practices are not limited to the housing market. Payday lenders, check cashers, rent-to-own establishments, title lenders and other alternative financial services institutions also concentrate in communities of color. Until hyper-segregation of communities of color is no longer a common feature of the American residential landscape, lending discrimination by geography will continue. CRA is the single most powerful tool to purge predatory financial practices at a community level.

America has a long history of redlining, or the complete and deliberate failure to meet the legitimate financial services needs of all communities. The absence of competition for mainstream financial services creates the vacuum in which subprime mortgage, payday and other high cost lenders establish themselves. CRA is the most comprehensive law designed to ensure the extension of mainstream financial services in a safe and sound manner to all communities.

Stated otherwise, failure to include CRA enforcement in the CFPA might result in improvements in the design of consumer financial products, but that alone will not ensure that access to those products is provided by financial institutions. In that case, the agency's ability to ensure that communities of color have access to high quality, mainstream financial products and services would be greatly diminished.

Finally, similar to other consumer protection laws with similarly dismal track records for enforcement, CRA has suffered from a lack of commitment from its regulators. Leaving CRA under its current regulators will simply guarantee continued failure to protect the rights of consumers under CRA.

According to the Federal Reserve, nearly 10 million households have no relationship with a mainstream financial institution. Moreover, a recent report by the Center for Financial Services Innovation estimates that there are 40 million under-banked households in the United States.[23] In fact, an *Associated Press* analysis of Census Bureau data reveals that only about ten percent of all new full-service bank branches opened between 2003 and 2008 were located in the urban,

[23] Herrmann, Michael J. "CFSI Underbanked Consumer Study Fact Sheet." Center for Financial Services Innovation. Updated February 2009. Accessed online at: http://www.cfsinnovation.com/underbanked-study-detail.php?article_id=330525.

minority neighborhoods.[24] Yet people of color make up a disproportionate share of the unbanked and under-banked.

Despite the large numbers of under-banked households and the failure of depository institutions to address that lack of access, 97 percent of banks pass their CRA exams. Regulation of CRA under CFPA should 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.

Current regulations pertaining to CRA allow for loopholes, exceptions and opt-outs that enable CRA-covered banks to exempt the activities of their affiliate financial institutions on CRA exams. Loopholes and exceptions have allowed CRA-covered banks to exclude their subprime lending activities from CRA review. In a recent op-ed, Elizabeth Warren cited a Center for Public Integrity study that "found that 21 of the 25 largest subprime issuers leading up to the [foreclosure] crisis were financed by large banks."[25] Investment banks were also a major funder of irresponsible subprime loans. In addition to transferring CRA to the new CFPA, strengthening and expanding CRA is also essential. CRA should be expanded to cover non-depository institutions, particularly independent mortgage companies, non-depository lending affiliates of large banks, and investment banks, as well as traditional retail banks and credit unions.

Although the chambers of Congress currently differ on whether to transfer CRA authority to the CFPA, the conference committee process is an opportunity to ensure that the new regulatory regime is as supportive of the needs of residents of underserved communities as it is of the interests of individual consumers in general.

Office of Fair Lending

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[24] Frank and Linda Stuart Ball. "Banks Added 10,000 Branches During Boom but Left Inner Cities Behind." *Huffington Post*. August 17, 2009. Accessed on September 4, 2009 at http://www.huffingtonpost.com/2009/08/17/banks-added-10000-branche_n_261267.html.

[25] Warren, Elizabeth. "Real Change: Turning Up the Heat on Non-Bank Lenders." *Huffington Post*. September 4, 2009. Accessed online at http://www.huffingtonpost.com/elizabeth-warren/real-change-turning-up-th_b_276887.html.

In recognition of the lending disparities that persist in the mortgage market, consumer credit market, and other lending markets, the CFPA must not only have jurisdiction over CRA, but also have an Office of Fair Lending. This office would ensure that lenders do not behave in ways that perpetuate discrimination, and would liaise with the offices of fair lending and office of civil rights in other federal agencies, including the prudential regulators and the Department of Housing and Urban Development.

Both the House and Senate versions of the CFPA legislation include an Office of Fair Lending or a similarly titled entity with a specific focus on civil rights. The legislation is ambiguous, however, as to the exact responsibilities and activities of the office. Americans for Financial Reform has conducted a detailed analysis of the President's proposal on financial regulatory reform and described ways to bolster civil rights protection. Among its recommendations is that the other regulators should refer all potential fair lending violations directly to the CFPA's Office of Fair Lending, which should coordinate investigations with the Department of Justice and, as appropriate, HUD.[26]

Close Loopholes, Deny Exemptions

Another concern is the number of exemptions and loopholes that have already begun to make their way into the legislation to create the Consumer Financial Protection Agency. Despite the strong discussion draft introduced to the House Financial Services Committee, industry groups and lobbyists successfully convinced members of the Committee to introduce and support amendments during markup that would leave large swaths of the consumer credit landscape unsupervised by federal regulators. The Senate Committee on Banking, Housing, and Urban Affairs has yet to complete markup of Senator Dodd's draft, which means that it is still possible to enact strong legislation whose integrity is not undermined by unwise or otherwise unnecessary exemptions and concessions.

[26] "Civil Rights Policy Paper Comparison Matrix." Americans for Financial Reform. October 2009. Accessed online at: http://ourfinancialsecurity.org/wp-content/uploads/2009/10/civilrights-comparison.pdf.

The HSFC bill exempts from oversight and examination all banks with assets of less than $10 billion and credit unions with less than $2 billion—in other words, 8,000 of the nation's roughly 8,200 depository institutions (98%). By requiring regular examinations of only the largest financial institutions, the bill fails to ensure adequate protection for working families that bank with small and midsize financial firms.

It is understandable to want to spare small and regional banks from potentially costly routine examinations, as they were not as responsible for the bulk of the reckless lending that created the crisis. The fact that they were not the worst predatory lenders, however, does not mean that smaller banks do not participate in their fair share of abuse. In October 2009, for example, the Department of Justice settled a discrimination case that it had brought against First United Security Bank ($658 million in assets, 19 branches throughout Alabama).

The DOJ case was based on a 2005 referral from the FDIC, which determined that First United Security Bank was in violation of the Community Reinvestment Act, the Equal Credit Opportunity Act, and the Fair Housing Act. First United Security Bank's discretionary loan pricing policies charged African American borrowers more than white borrowers. The price difference was an average of 0.62%. First United Security Bank also practiced redlining by locating its branches only in majority-white neighborhoods and restricting lending for businesses and homes located in majority-minority communities.[27] This case was settled out of court but the full terms have not been made public.[28]

Small and regional banks also engage in predatory lending outside of the mortgage market. Consumer Federation of America documents the facts in a memo titled, "Abusive Lending Practices by Smaller Banks and Thrifts."[29] According to CFA, 75 percent of state-chartered banks automatically enroll customers in overdraft "courtesy loan" programs, and some banks do

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[27] See text of DOJ complaint at http://www.usdoj.gov/crt/housing/documents/fusbcomp.pdf.

[28] "United Security Bancshares, Inc. Announces Settlement Agreement with Department of Justice." *Urban Mecca*. October 8, 2009. Accessed online at: http://urbanmecca.net/news/?p=9202.

[29] Consumer Federation of America. "Abusive Lending Practices by Smaller Banks and Thrifts." July 21, 2009. Accessed online at: http://consumerfed.org/elements/www.consumerfed.org/File/Small_Banks_Abusive_Lending_Practices_Fact_Sheet.pdf.

not allow customers to opt out. The median fee for an overdraft loan from these small banks was $27, which exceeds the average debit card transaction amount of $20.

Small banks also charge more than large banks for high-cost refund anticipation loans (RALs). RALs are marketed primarily in low-income and minority neighborhoods and provide cash advances on anticipated income tax refunds and Earned Income Tax Credit payments. The average APR for a $3,000 refund anticipation loan from a small bank in 2008 was 134%-187%.[30]

Moreover, small banks are the leading issuers of "fee harvester" credit cards. These are low limit credit cards marketed to consumers with poor credit. They come "loaded with high fees that use up most of the card's capacity, leaving consumers with minimal credit at an exorbitant price."[31] CFA documents the total fees on two such cards, including a $300 limit card issued by Continental Finance that started with a $99 initiation fee; $89 participation fee; $49 annual fee; and $10 monthly maintenance fee. The first day a consumer received this $300 limit credit card, she had only $53 in available credit.

Rather than exempting smaller banks from routine oversight and examination altogether, the better solution would be to institute a lighter oversight and examination burden for small banks that have proven to be consumer friendly, and reserve rigorous supervision for those whose actions necessitate greater regulatory involvement.

Another exemption with serious potential to undermine the CFPA's effectiveness has been carved out for automobile dealers. Shielding car dealers from oversight and examination by the new CFPA allow a lending market to remain unregulated despite evidence that this market is particularly discriminatory toward people of color, the elderly, and military personnel. According to Demos, a non-partisan research and advocacy organization, markups, kickbacks, and discriminatory discretionary pricing cost automobile buyers more than $20 billion per year.[32] Furthermore, dealer-originated financing accounts for almost 80% of all financing for car

[30] Ibid.
[31] "Abusive Lending Practices by Smaller Banks and Thrifts."
[32] "Demos Calls Consumer Protection Loophole for Car Dealers "Bad Policy, Pure Politics."" Demos. November 25, 2009. Accessed online at: http://www.demos.org/press.cfm?currentarticleID=2C4C5F25-3FF4-6C82-541D966839786FC9.

purchases[33] and car dealers are the most frequently cited businesses against which complaints are filed with state and local consumer protection agencies.[34]

In fact, as recent federal discrimination cases show, auto dealers and small banks often collaborate to charge consumers more for car loans. Most dealerships that originate loans have arrangements with local and regional banks. The dealer originates the loan and then sells it to the bank on the secondary market; the difference between the interest rate charged by the dealer and the best rate customer could have received based on his credit is split between the dealership and the bank.

In 2006, the Federal Reserve Bank determined that Nara Bank ($2.1 billion in assets, 18 branches—14 in the Los Angeles area) was in violation of the Equal Credit Opportunity Act because it knowingly approved and purchased loans from two automobile dealership companies that charged Asian customers less than non-Asian customers.[35] While full terms of the settlement have not been made public, Nara Bank will make financial restitution to victims, pay fines, and change its policies.[36]

These cases and others like them illustrate several key points. First, the banks' discriminatory practices were detected through routine compliance examinations; under the House Financial Services Committee version, the new Consumer Financial Protection Agency would not have authority to conduct regular compliance exams at these banks, because they hold less than $10 billion in assets. Second, although the banks' current regulators (FDIC and Federal Reserve) have demonstrated that consumer protection is such a low priority for them that it takes years to

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[33] "Auto Race to the Bottom: Free Markets and Consumer Financial Protection in Auto Finance," Research note. Cambridge Winters Center for Financial Institutions Policy. November 16, 2009. Accessed online at: http://cambridgewinter.org/Cambridge_Winter/Welcome_files/auto%20finance%20111609.pdf.

[34] Annual Consumer Complaint Survey. Consumer Federation of America, in partnership with the National Association of Consumer Agency Administrators and the North American Consumer Protection Investors. Summary of 2009 survey accessible online at: http://consumerfed.org/elements/www.consumerfed.org/File/Consumer%20Complaint%20Survey%20Report%20PR%207-30-09.pdf.

[35] See text of DOJ complaint at http://www.usdoj.gov/crt/housing/documents/narabankcomp.pdf.

[36] "Nara Bancorp Settles Department of Justice Dispute." *Reuters*. October 1, 2009. Accessed online at: http://www.reuters.com/article/pressRelease/idUS207164+01-Oct-2009+BW20091001.

detect violations of the law and years to prepare a case, under the HFSC version of the CFPA, they would maintain the primary regulators for these banks.

Finally, automobile dealers involved in both of these cases, but the HFSC exempts auto dealers from consumer protection oversight. The exemption of 98% of banks, automobile dealers, and others from CFPA examinations and/or oversight will leave the new agency unable to fulfill its obligations to protect consumers from the unscrupulous and illegal practices that have devastated American households and the nation's economy.

Setting a Minimum Federal Standard

One of the greatest inhibiting factors to robust consumer protection throughout the past decade has been the federal policy of preempting state consumer laws that were tougher than federal standards. Starting in 1999, the OCC led the way in preempting virtually every state regulation that attempted to address predatory lending, payday lending, and consumer credit practices.

The Obama Administration's proposal and the manager's draft introduced in the Senate recognized the valuable role that state consumer protection laws can play and explicitly stated that preemption of state laws was no longer to be the automatic response of federal regulators. However, preemption is a favorite tool that powerful financial interest groups such as the American Securitization Forum and the Financial Services Roundtable have used to perpetuate predatory and abusive lending practices. These groups are fighting to maintain federal preemption of state laws as CFPA legislation moves through Congress.

According to the House version of the CFPA legislation, the OCC and the OTS will have the right to preempt state laws under certain circumstances. The Financial Services Committee passed an amendment offered by Congressmen Melvin Watt of North Carolina and Dennis Moore of Kansas that allows for preemption when a state law significantly interferes with the ability of nationally-charted banks or thrifts to engage in the business of banking. While case-by-case preemption is preferable to sweeping and automatic preemption of all state laws, OCC and OTS should not be the agencies with the authority to preempt state law. During the past fifteen years, these agencies, particularly the OCC, engaged in large-scale preemption of state law, and did not carefully consider the ramifications of overriding state law protections against abusive lending.

The National Association of Attorneys General has documented the benefits that states bring to the consumer protection field, particularly in the areas of retail sales and insurance markets. NAAG describes the value of allowing interested states to "test drive" innovative consumer protection policies; when the federal government decides to craft new regulations, it can benefit from learning experiences at the state level and tailor its rules accordingly.[37]

In a letter sent to Senators Dodd and Shelby and Representatives Frank and Bachus, 40 of the nation's Attorneys General wrote that "states have the infrastructure and expertise to respond to and resolve consumer complaints." The signatories "[urged] members of Congress to provide states with concurrent authority to enforce federal law; and to allow states to enforce their own consumer protection laws… subject to minimum federal standards."[38]

Improved Data Collection

One bright spot to emerge from the legislative processes underway to create CFPA is that consensus has emerged that consumer protection efforts will be greatly enhanced by improved data collection. Under the President's proposal, the House's legislation, and the manager's draft introduced in the Senate, there are mandates to enhance data collection and disclosure related to deposit accounts, small business loans, and the Home Mortgage Disclosure Act (HMDA).

Banks and credit unions would be required to maintain and report data on their branches, ATMs, and other depository facilities, as well as maintain and report the census tract locations of their depository facilities. 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

[37] "Attorneys General Support State Enforcement of Consumer Financial Protection Agency Rules." National Association of Attorneys General. November 4, 2009. Accessed online at: http://www.naag.org/attorneys-general-support-state-enforcement-of-consumer-financial-protection-agency-rules.php.
[38] Ibid.

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 characteristics of the census tracts of these customers.

Financial institutions would be required to collect and report data on the race and gender of its small business borrowers, similar to requirements under the Home Mortgage Disclosure Act (HMDA). In addition to collecting race and gender data, financial institutions would be required to collect the type and purpose of the loan for which the businesses apply, the actions taken with respect to the applications, the gross annual revenue of the small business applicants, the census tract location of the businesses, 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.

In addition to the demographic characteristics they already collect in HMDA data, financial institutions would be required to collect the age of the borrower. NCRC and others have documented that elderly borrowers experience lending disparities; this additional data 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.

Conclusion

Instituting an effective CFPA is arguably the most important element of financial system reform, since treating consumers in a safe and sound manner will result in a more safe and sound financial system. The three major proposals for regulatory reform now under discussion—President Obama's regulatory reform proposal, the House Financial Services Committee's legislation, and the Senate Committee on Banking, Housing and Urban Affair's bill—all recognize, to varying degrees, the necessity of such an agency. What remains to be done now is to work out the differences between the proposals and create a strong Consumer Financial Protection Agency.

If Congress takes action now to create an agency that has sufficient authority, funding, jurisdiction, and independence, it will facilitate the development of an environment that encourages innovations that benefit both firms *and* consumers.