Testimony
Of

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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. 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.

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.

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 economy.

In assessing the key problems leading to the crisis, significant attention has focused on issues such as excessive investment leverage ratios and institutions perceived to be too big to fail, complex financial instruments and vehicles, unregulated financial entities, and perverse pay incentives to name a few.

These problems are critical to understanding the current situation. But they constitute only one of three issues that together explain the financial system's meltdown, the extraordinary costs to tax payers, and the contagion effects on the broader economy. The other two key issues are failure to protect consumers from unfair and deceptive financial products and practices and 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.

Role of Consumer Protection

Safety and soundness and 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 financial products exploit consumers – even if they are highly profitable – the financial system is in jeopardy.

In short, one way, perhaps the most meaningful way, to manage systemic risk is to better protect the public from unfair, deceptive, fraudulent, and otherwise predatory financial services practices.

Deception as Business Model

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

Elizabeth Warren, Professor of Law at Harvard University and Chair of the Congressional Oversight Panel on the TARP, 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 and to build unjustified and unethical fees and penalties into the terms and conditions of such products.

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 fill up to thirty pages. 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 financial decision about the most appropriate mortgage product for their individual 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

And nowhere was this irresponsible and reckless behavior by financial institutions more prevalent than in communities of color. 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 mortgage market.

Unfortunately, nothing was done to address these repeated concerns. The result today is that the foreclosure crisis is having its most damaging impact on communities of color in two ways.

First, communities of color are experiencing disproportionate levels of foreclosures and second, they are most negatively impacted by rising unemployment.

More than 3 million jobs have been lost since the start of this year bringing the national unemployment rate to an uncomfortable 9.5 percent as of June. While of great concern, the rate of job loss for African Americans exceeds 15 percent, and for Latinos unemployment is approaching 13 percent.

Moreover, because African Americans and Latinos have comparatively few savings, they are poorly positioned to survive a lengthy bout of unemployment. As a result, potentially millions of African-Americans 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 to deceptive toxic mortgage loans has also resulting to those consumers being over-represented in foreclosure statistics. African Americans, for example, have experienced a full three-percentage point drop in their homeownership rate since the crisis began.

Banks, independent mortgage companies, and non-bank financial institutions routinely targeted substandard, poorly underwritten, over-appraised, unsustainable loans at African-American and Latino consumers in violation of 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 U.S. Department of Housing and Urban Development, subprime loans are five times more likely in African-American communities than in white neighborhoods, and homeowners in high-income black areas are twice as likely as borrowers in lower-income white communities to have subprime loans. The result is that blacks and Latinos are over-represented in the foreclosure statistics. African Americans, for example, have experienced a full three-percentage point drop in their homeownership rate since the crisis began.

Further, NCRC, in its “Broken Credit System” report, studied high cost lending in ten large metropolitan areas across the country. After controlling for risk and housing market conditions, that report found that the racial composition of a neighborhood had an independent and strong effect on lending outcomes. The findings in that NCRC’s paper 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 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 incomes.

The disproportionate impact of the foreclosure crisis on African-Americans and Hispanics is fueling the expansion of the racial wealth gap. African-Americans and Latinos were the disproportionate targets for the unfair, deceptive and reckless lending practices that triggered the foreclosure collapse and imploded the credit markets.

As a result of this failure to enforce CRA and fair lending laws, communities of color are experiencing the worst financial damage from this current crisis. The situation is so dire within the African-American community that United for a Fair Economy, a Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction.

The Need for a 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.

The CFPA would consolidate experts who share both expertise in consumer protection laws and practices, and commitment to protecting the public. This synergy of expertise and mission 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.

The agency 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, the CFPA would create a federal floor of financial protection and encourage greater state involvement in financial regulatory oversight.

Recently, the House Financial Services Chairman Barney Frank proposed a similar agency. That bill, H.R. 3126, the Consumer Financial Protection Agency Act of 2009, reinforces the President's proposal in many key areas.

Arguments for the creation of a Consumer Financial Protection Agency include that a CFPA would not be susceptible to the same regulatory arbitrage that has characterized the current regulatory regime. Now, 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 CFPA would the best positioned agency to be entrusted with regulatory authority for consumer protection because its highly focused mission would allow it to be independent of the financial institutions in ways that the current banking agencies cannot. Indeed, each of the four current bank regulators has other mission priorities against which consumer protection must be balanced.

Particularly with regard to the Community Reinvestment Act, fragmented regulatory authority has resulted in inconsistent enforcement that too often accommodates the priorities of the industry at the expense of the public. A lack of uniform CRA enforcement means that CRA has not yet realized its full potential in terms of leveraging loans, investments, and services for families and communities.

This crisis has taught us that unless we explicitly devote specific resources to consumer protection, that the public's wellbeing will take a backseat to the demands of the financial industry for short term profits and preferential treatment. With a Consumer Financial Protection Agency streamline and consolidate regulatory authority in an independent agency, it can promote synergies in enforcement across all institutions and all federal banking agencies.

Placing all of the consumer protection and fair lending laws under the jurisdiction of the CFPA would maximize the agency's ability to enforce the laws. The consumer protection and fair lending laws often reference each other, meaning that a violation of one of the laws is also a violation of one or more of the other laws. If different regulatory agencies continue to enforce different aspects of different laws without a coherent cooperative strategy, effective enforcement opportunities will continue to be missed.

Under CRA regulation in particular, a violation of fair lending and anti-predatory lending law can also penalize a bank with a lower 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 they will regularly consult with the CFPA to ascertain if any fair lending or anti-predatory violations have occurred that should impact the CRA rating.

The bank agencies should be coordinated by CFPA to ensure that their fair lending reviews allow for the development of a full understanding of the lending practices and patterns of the banks they are examining. The best way to ensure adequate consultation and collaboration across banking agencies is to consolidate enforcement authority for both fair lending and CRA examination authority within the jurisdiction of the CFPA.

Arguments Against Including CRA In the Consumer Financial Protection Agency

Some stakeholders have recently testified before this Committee offering various arguments against moving CRA to the CFPA. These arguments involve the issues of safety and soundness, community development, and consumer protection. Each of these arguments is not convincing and can be easily addressed and rebutted.

Industry trade associations have asserted that placing CRA under the jurisdiction of the CFPA would divorce CRA enforcement from the examination of safety and soundness, which would remain with the federal bank agencies. The safety and soundness exams result in a CAMELS rating being issued to a bank, which is a rating from 1 to 5 of the overall condition of a bank. CAMELS is an acronym describing the exam elements: C- Capital Adequacy, A – Asset Management, M – Management, E- Earnings, L- Liquidity, and S – Sensitivity to Market Risks. Exams resulting in CAMELS ratings are currently conducted separately from CRA exams and are confidential (the public does not see the rating which is shared between the regulatory agency and the bank).

CRA exams also consider safety and soundness issues but the consideration focuses on lending practices instead of the overall financial condition of the bank. If lending practices are abusive, illegal, and unsafe, the CRA exam is supposed to penalize a bank through a lower rating. An example of this is the FDIC's exam of CIT Bank of May 12, 2008. The FDIC failed this Utah-based industrial bank based on its purchases of predatory loans. Quoting from the FDIC's exam, "CIT Bank engaged in an unsafe and unsound practice by purchasing $3.1 billion in subprime nontraditional mortgage pools with predatory characteristics that resulted in a significant negative impact on the institution's overall CRA performance rating. The subprime nontraditional mortgage loans had undesirable characteristics including pre-payment penalties; stated income loans; and qualifying borrowers at a teaser rate, resulting in payment shock when scheduled resets ultimately occur. The characteristics of the underlying mortgage loans greatly increased the risk that the borrowers would default, or otherwise be in a worse financial position than they were previous to accepting the loan. CIT's purchase of the subprime mortgage pools was made in an unsafe and unsound manner that caused harm to consumers. In doing so, CIT failed in its responsibility to meet a basic tenet of CRA."

As this example illustrates, transferring CRA, fair lending, and consumer protection oversight to CFPA would provide CFPA with the necessary examination tools to conduct similar analyses and ensure that CRA activities are conducted in a safe and sound manner. This skill set is distinct from those necessary to execute overall safety and soundness reviews that generate CAMELS ratings.

Arguments against a CFPA include the idea 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. The CFPA, as conceived either by the Chairman or President, seeks common sense regulation. Its goal is to provide consumers with relevant and understandable information that will enable them to make informed choices. And it proposes the increased use of standard products to eliminate confusion for consumers who simply need a standard product.

Standard products were the hallmark of the housing industry prior to product innovation that shut the system down. The 30 year, fixed rate mortgage was, for decades, the gold standard mortgage product and responsible for America's extraordinarily high rate of 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 uncomplicated is just what's needed.

Others have argued that CRA should not be included in a CFPA even if one is established. They posit that requiring the CFPA to expand its staff capacity to address broad-based community investment, as well as small business issues and serving of populations as borrower groups rather than solely as individuals. This concern holds that this broader (community) focus might dilute the effectiveness of the organization. It also means considerably more resources will be required by the agency.

In fact, this is the major exception between the Chairman's bill and President's recommendation. The Chairman proposes to leave regulatory oversight for the Community Reinvestment Act under the purview of the Federal Reserve. For a variety of reasons, we believe that aspect of the bill should be amended to reflect the President's proposal to shift regulatory oversight of CRA to the new consumer protection agency.

First, for more than a decade, the Federal Reserve has increasingly limited the effectiveness of CRA. As with all other consumer protections under its jurisdiction, CRA has been the neglected stepchild to the of quarterly earnings reports from financial firms. Leaving CRA at the Federal Reserve would greatly limit the effectiveness of CRA, as well as the new Consumer Financial Protection Agency.

Moreover, a long and troubling history of discrimination has resulted in a situation where African American, Latinos, and Native Americans are highly segregated. These communities of color are often targeted for unfair and deceptive products and services because of the race/ethnicity or financially vulnerability of their residents.

The result of this reality of targeting and steering reckless products at the community level means that the new CFPA will need to understand and address this issue. And, one of the single most effective tools with which to address this issue is CRA.

Also, prohibiting reckless and irresponsible products is only half the role of ensuring equal access to responsible financial services. Many financial firms deny access to responsible financial services, for example, by simply not lending at all within specific communities. For example, lack of competition for prime loans in communities of color contributed to the disproportionate exploitation of consumers in those markets with predatory high-cost loans. Redlining—the complete denial of credit to low- and moderate-income, particularly minority, communities en masse—also has a long history in America and should not be ignored by a CFPA.

A major goal of CRA is to promote lending by institutions that might otherwise choose to leave those communities isolated from the financial mainstream. This situation could lead consumers to become pray to even more abusive lenders outside of any formal regulatory channels.

Arguments Against the Creation of a Consumer Financial Protection Agency

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.

The performance of the Federal Reserve with respect to CRA has been abysmal. Rules governing lending for high cost loans were not modified until mid-2008, more than a year into the foreclosure crisis and continue to leave gaps and holes in its coverage. And, its enforcement of CRA is equally lacking.

More must be done to achieve an inclusive financial system. A recent report by the Center for Financial Services Innovation estimates that there are 40 million under-banked households in the

United States. And nearly 10 million households have no relationship with a mainstream financial institution.

At the same time, communities of color that did receive loans were disproportionately targeted for reckless and costly subprime loans three to five times more often than non-Hispanic white communities. Yet, roughly 97 percent of all banks nevertheless are rated as passing their CRA exams. It's difficult to envision how poor lending to communities of color would have to be for banks to actually fail the CRA component on lending in minority communities.

A final argument against a CFPA is that it might cost too much. Yet, the current crisis makes it clear that failure to regulate is itself costly to the American public. Predatory lending in the mortgage markets was allowed to fester for more than a decade without any effective or meaningful response. The cost to have purged those practices years ago, before they had an opportunity to undermine the entire financial system, pales relative to the cost of the current clean up – not to mention the loss of roughly $13 trillion of household wealth.

Why a Modernized CRA is a Vital Component of the CFPA Mission

It seems clear to NCRC that the arguments for the creation of CFPA hold far greater weight than the arguments against it. Furthermore, CFPA should be established with jurisdiction over CRA. CFPA's effectiveness would be further bolstered if CRA was modernized at the same time as it shifts to CFPA's authority.

Modernizing CRA and strengthening how it applies to banks non-bank financial institutions would allow CFPA to more effectively leverage increases in responsible loans and investments in American communities. Enhanced CRA data disclosure on lending, investing, and services would also support CFPA's mission and goals. The Administration'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 financial services, identifying business and community development opportunities, and promoting adherence to the fair lending and consumer protection laws.

The Administration's proposal and H.R. 3126 include the following critical 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 to 51.4 for middle- and upper-income borrowers 1993 and 2002.21 In contrast, a well-developed literature based on national surveys indicates the likely possibility of discrimination against women- and minority-owned small businesses.22 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. This is yet another reason to shift CRA enforcement to CFPA.

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.

Distributing Consumer Protection Responsibilities

Once established, the Consumer Financial Protection Agency will 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.

Role of the Federal Reserve

That the CFPA will take the leading role in consumer protection does not mean that the Federal Reserve should abdicate its entire role in consumer protection. As the central bank of the United States, part of its mandate is to ensure that the financial 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 the CFPA: 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 the CFPA.

The Federal Reserve's consumer protection role should be more limited in the future than it is currently because it has proven itself to be unwilling or unable to monitor and effectively enforce the laws and has also been proactive in protecting financial firms at the expense of consumer wellbeing.

The Federal Reserve's track record on lack of regard for consumers ranges from its involvement in the Community Reinvestment Act to the mortgage lending markets to alternative consumer credit products.

Perhaps the most egregious instance in which the Federal Reserve preferenced 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 did not change their ways.

The Federal Reserve not only did not make full use of its new authority, it declined to issue final HOEPA guidelines. The legislation 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 guidelines.

The Federal Reserve has actually supported unfair and unnecessarily high-cost alternative financial products as they have proliferated 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, it lead the entire financial system the ditch.

Although the leader in promoting poor lending enforcement was the 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 Community Reinvestment Act provisions and enforcement processes.

Moreover, the Federal Reserve also failed to use the most 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, however.

Regarding vulnerable consumers, the Federal Reserve 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.

It is well documented that the Federal Reserve's general treatment of its consumer protection responsibilities was to subordinate it to protecting the interests of financial institutions and even to actively undermine consumers' interests. As we move forward into a new era of stable, sustainable growth, we must take the Federal Reserve's failings seriously.

As CFPA is established, the Federal Reserve should give up its responsibility for enforcing consumer protection, while retaining its duty to provide consumer protection oversight, limited rule making authority, and the power to refer potential consumer protection violations to CFPA.

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 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.

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.

Again, as with the Federal Reserve, there is ample evidence that the other federal banking regulatory agencies were derelict in their duty to ensure that financial institutions operated responsibly and ethically with regard to consumers. As mentioned, the competition among the agencies for the business and fees of firms they were tasked to regulate created perverse incentives for the regulatory agencies, which they did nothing to mitigate or correct.

Particularly with regard to the financial institutions' Community Reinvestment Act (CRA) requirements and exams, the federal regulatory agencies engaged in a race to the bottom. Because institutions are allowed to choose which regulator best meets their needs, no agency wants to develop a reputation as a tough enforcer, or it will risk losing its fees to competitor regulators.

In fact, the Office of Thrift Supervision, which aggressively promoted itself as a lax regulator. Beginning in 2004, OTS implemented exceptionally lenient CRA exams. In response, the other agencies were compelled to relax CRA enforcement for mid-size institutions in order to compete.

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 the Congress was considering sweeping credit card reform legislation earlier this year, for example, the OCC lobbied for additional loopholes to limit disclosure requirements. Conversely, all of the agencies have refused to enforce legislative loopholes that protect certain classes of deposits, such as Social Security benefits and Veterans' benefits, from service fees assessed on recipients. The agencies have demonstrated that their objective is not increased flexibility and discretion in determining how best to implement regulations, but the ability to systematically preference financial institutions at the expense of consumers.

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 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.

Balancing 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 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 reformed 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.

It is possible that the Federal Reserve should receive new resolution authority over non-bank financial institutions. 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.

Because the Federal Reserve has supervisory authority for bank holding companies and other types of non-depositor firms, it may be the agency that is best positioned to be given resolution authority for non-banks. However, more research and analysis of the Federal Reserve's and others' institutional capacity to handle complex unwinding and liquidation processes is necessary before a final determination is made.

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.

Conclusion

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 their engagements with the financial system, everyone – borrowers, communities, financial firms, and the nation as a whole – wins.

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