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CONGRESSIONAL TESTIMONY

How to Protect Consumers in the Financial Marketplace: An Alternate Approach

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My name is David C. John. I am a Senior Research Fellow in Retirement Security and Financial Institutions at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The Treasury Department has proposed consolidating the existing consumer protection divisions of the various federal financial regulatory agencies into a new and powerful Consumer Financial Protection Agency (CFPA). The CFPA would be responsible for creating and enforcing the regulation of consumer financial products.[1] On July 9, House Financial Services Committee Chairman Barney Frank introduced a slightly revised version of the Treasury proposal as H.R. 3126[2] and announced his intention to pass the bill as rapidly as possible. Just last week, Chairman Frank issued a revised version of this proposal.

Even with the most recent changes, creating a new agency would be a huge mistake that would hurt consumers far more than it helps them. A CFPA would raise costs for consumers, reduce the number and kind of products available to them, increase the micro-management of financial-services firms, and greatly increase the confusion caused by differing and conflicting consumer laws in the different states.

A far better approach would be to coordinate the consumer activities of existing state and federal financial regulators by creating a coordinating council designed to promote equal standards of consumer protection using agencies' existing powers. Critics of the current regulatory system justify the need for a CFPA by citing instances where different agencies applied different regulatory standards to similar products, and pointing to unregulated entities or products that took advantage of consumers. But these problems could just as easily be solved by a coordinating council as by creating a massive new

[1]A Treasury Department fact sheet, "Strengthening Consumer Protection," on the proposed new agency is available at *http://www.financialstability.gov/docs/regulatoryreform/strengthening_consumer_protection.pdf* (September 1, 2009).

[2]H.R. 3126, at *http://www.house.gov/apps/list/press/financialsvcs_dem/21frank_011_xml.pdf* (September 1, 2009).

regulator. The council would be managed and staffed by the agencies with an oversight panel of outside experts to monitor its activities and ensure that coverage is universal.

Consumer protections need to be both more effective and to apply to all consumers, regardless of the presence of unregulated products or segments of the industry, but there is no need for a massive new agency. Given the right instructions and oversight, the existing state and federal regulators could effectively deal with abuses and gaps between different types of financial institutions. As discussed below, the proposed CFPA could actually make matters worse for consumers by causing chaos while it re-arranges the existing regulators into a cumbersome, unresponsive bureaucracy.

A Better Approach to Consumer Protection

A better way to improve consumer financial regulation would be to create a council of regulators similar to the one charged with creating uniform standards for the examination of financial institutions, the Federal Financial Institutions Examination Council (FFIEC).[3] The council of consumer financial regulators would be charged with ensuring that existing state and federal regulators have uniform regulatory standards that apply to all types of financial institutions and can meet the challenges posed by complex new financial products. But it leaves the day-to-day enforcement to regulators that understand that type of financial institution and its operational necessities. Such a council has the advantage of neither creating a vast new all-powerful bureaucracy nor completely disrupting current regulatory efforts by merging parts of different agencies.

The council would consist of one representative from each federal agency[4] and elected representatives from councils of the various types of state regulators[5]. In addition,

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[3]The FFIEC "is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), and to make recommendations to promote uniformity in the supervision of financial institutions. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC includes representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State Savings Supervisors (ACSSS), and the National Association of State Credit Union Supervisors (NASCUS)." See *http://www.ffiec.gov/* (September 1, 2009).

[4]If existing federal financial regulatory agencies are merged, or new ones are created, the membership of the council would change, but not its purpose or ongoing efforts.

[5] Thus, there would be one individual representing state credit union administrators, another representing state banking regulators and so forth.

it would have a fully participating chairman[6] appointed by the president and a board of outside expert advisors, who would monitor consumer regulatory activities. Staffing would come from within the agencies except for a very small support staff for the chairman and advisors.

The inclusion of state regulators in the council would make coverage even more universal than it would be under the proposed CFPA. Standards agreed to by the council would apply to insurance companies (exempted under the CFPA approach) and as states move to license them, the unregulated mortgage brokers and others who were often responsible for abuses in mortgage lending. Instead of a one-size-fits-all policy dictated by Washington, states would continue to have flexibility in implementing regulations, subject to the oversight of the council and its expert advisors, who could issue public statements and studies to make sure that consumers are aware of states with poor coverage or enforcement. Failure to act could make loans issued in those states ineligible for securitization or sale to investors in other states. This approach would preserve state regulation of those entities that are currently state-regulated rather than attempting to federalize all aspects of consumer financial relationships.[7] The council would also include both the Securities and Exchange Commission and Commodity Futures Trading Commission, thus closing other gaps in the CFPA as proposed, including the regulation of retirement savings accounts.

The council would be responsible for developing broad standards for consumer regulation while leaving the writing and enforcement of specific regulations to those agencies with responsibilities for that area. This ensures that the regulations take into consideration the operational realities of the regulated institutions as well as any special characteristics of regional markets.[8]

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[6] Council guidelines would be developed by consensus. The outside advisors would submit reports and provide advice to the council, but would not participate in its deliberations.

[7] Currently the Uniform Commercial Code, recommended language created by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) and passed by the individual states, sometimes with changes to reflect the circumstances of specific states, ensures that businesses with interstate operations face roughly the same legal climate in all states. Should it be necessary, a similar mechanism could recommend model financial regulatory standards to state legislatures.

[8] Since decisions of the council would not have the force of law, implementation of decisions may require the individual agencies to alter their regulations, or even to seek a change to statutes from the relevant state or federal legislative body. Agencies that failed to implement council guidelines would be identified

Another key advantage of the council is that by using existing regulators and their current authority, the regulators' individual efforts can be better monitored than the results of the proposed vast new bureaucracy's vague and almost unlimited powers. Through proper congressional oversight and the reports from the new council's expert advisors, Congress can better pinpoint successes and failures than it could by attempting to keep track of the efforts of one massive agency.

New Federal Agency Is Not the Best Way to Help Consumers

While some Members of Congress and the Obama Administration seem to believe that only the creation of a new agency will prove their commitment to ensuring that customers receive both the information and financial product choice that they need, this is not the case. Financial products can be confusing, and consumers can be manipulated into making poor choices. However, improved disclosures and requiring financial institutions to offer basic products to all of their customers with the appropriate credit history, does not mean a whole new federal agency needs to be created. The draft credit card regulations issued by the Federal Reserve last year,[9] for instance, were an effective response to problems in that industry. Although Congress chose to go beyond the Fed's regulations, the quality of the draft regulations demonstrate the ability of the current financial regulators to effectively handle consumer issues[10].

The CFPA proposal is filled with poorly considered departures from existing law and practice that are as likely to damage consumers' interests as improve them. Giving any agency such wide powers makes little sense, and encouraging the individual states to create their own higher standards will damage the national market in financial services. Congress should avoid the bad policies contained in the proposed CFPA. The same goals supported by those who propose the creation of a new agency can be better achieved through a coordinating council of existing regulatory agencies instead. There is no need

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through its reports, and in some cases those reports could recommend that the relevant legislative body impose those decisions through changes in the law.

[9]For a summary of the credit card rules approved by the Federal Reserve Board of Governors on December 18, 2008, see "Highlights of Rules Regarding Credit Card Accounts," at *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a1.pdf* (September 1, 2009).

[10]David C. John, "Senate Credit Card Bill Would Restrict Credit for Those Who Need It Most," Heritage Foundation *WebMemo* No. 2435, May 12, 2009 at *http://www.heritage.org/Research/Regulation/wm2435.cfm*

for a massive new agency when existing agencies could work better, faster, and at little additional cost.

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