Testimony of

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And Edmund Mierzwinski, U.S. PIRG

On Behalf of

ACORN
Americans for Fairness in Lending
Center for Digital Democracy
Consumer Action
Consumer Federation of America
Consumers Union
Demos
National Association of Consumer Advocates
National Consumer Law Center (on behalf of its low-income clients)
National Fair Housing Alliance
National People's Action
Public Citizen
U.S. PIRG

Before the Committee on Financial Services
U.S. House of Representatives
The Honorable Barney Frank, Chairman

Hearing on
Regulatory Restructuring:
Enhancing Consumer Financial Products Regulation

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SUMMARY

Thank you, Chairman Frank, Rep. Bachus and members of the committee. We are pleased to be able to offer the views of leading consumer groups[1] in support of the establishment of a Consumer Financial Protection Agency, as proposed first by Reps. Delahunt and Brad Miller and later by President Obama. The testimony is being delivered by Travis Plunkett, Legislative Director of the Consumer Federation of America,[2] and Edmund Mierzwinski, Consumer Program Director of U.S. PIRG,[3] also on behalf of ACORN,[4] Americans for Fairness in Lending,[5] Consumer Action,[6] Center for Digital Democracy,[7] Consumers Union,[8] Demos,[9] National Association of Consumer Advocates,[10] National Consumer Law Center (on behalf of its low-income clients),[11] National Fair Housing Alliance,[12] National People's Action,[13] and Public Citizen.[14]

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1 The testimony was drafted by Travis Plunkett and Jean Ann Fox of the Consumer Federation of America, Gail Hillebrand of Consumers Union, Lauren Saunders of the National Consumer Law Center and Ed Mierzwinski of U.S. PIRG.

2 The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

3 The **U.S. Public Interest Research Group** serves as the federation of and federal advocacy office for the state PIRGs, which are non-profit, non-partisan public interest advocacy groups that take on powerful interests on behalf of their members.

4 **ACORN**, the **Association of Community Organizations for Reform Now**, is the nation's largest community organization of low- and moderate-income families, working together for social justice and stronger communities.

5 **Americans for Fairness in Lending** works to reform the lending industry to protect Americans' financial assets. AFFIL works with its national Partner organizations, local ally organizations, and individual members to advocate for reform of the lending industry.

6 **Consumer Action**, founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles and Washington, DC. For more than two decades, Consumer Action has conducted a survey of credit card rates and charges to track trends in the industry and assist consumers in comparing cards.

7 **The Center for Digital Democracy** is dedicated to ensuring that the public interest is a fundamental part of the new digital communications landscape. CDD is especially concerning with the growing role of the Internet, online media and mobile platforms such as cell phones in the provision of consumer financial services.

8 **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with more than 5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

9 Demos is a New York City-based non-partisan public policy research and advocacy organization founded in 2000.A multi-issue national organization, Demos combines research, policy development, and advocacy to influence public debates and catalyze change.

10 The **National Association of Consumer Advocates**, Inc. is a nonprofit 501(c) (3) organization founded in 1994. NACA's mission is to provide legal assistance and education to victims of consumer abuse. NACA, through educational programs and outreach initiatives protects consumers, particularly low income consumers, from fraudulent, abusive and predatory business practices. NACA also trains and mentors a national network of over 1400 attorneys in representing consumers' rights.

11 The **National Consumer Law Center**, Inc. is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys

In the testimony we present today, we outline the case for establishment of a robust, independent federal Consumer Financial Protection Agency to protect consumers from unfair credit, payment and debt management products, no matter what company or bank sells them and no matter what agency may serve as the prudential regulator for that company or bank. We describe the many failures of the current federal financial regulators. We discuss the need for a return to a system where federal financial protection law serves as a floor not as a ceiling, and consumers are again protected by the three-legged stool of federal protection, state enforcement and private enforcement. We rebut anticipated opposition to the proposal, which we expect will come from the companies and regulators that are part of the system that has failed to protect us. We offer detailed suggestions to shape the development of the agency in the legislative process. We believe that, properly implemented, a Consumer Financial Protection Agency will encourage innovation by financial actors, increase competition in the marketplace and lead to better choices for consumers.

We look forward to working with you and committee members to enact a strong Consumer Financial Protection Agency bill through the House and into law. We also look forward to working with you on other necessary aspects of financial regulatory reform to restore the faith and confidence of American families that the financial system will protect their homes and their economic security

SECTION 1. LEARNING FROM EXPERIENCE TO CREATE A FEDERAL CONSUMER FINANCIAL PROTECTION AGENCY

It has become clear that a major cause of the most calamitous worldwide recession since the Great Depression was the result of the simple failure of federal regulators to stop abusive lending, particularly unsustainable home mortgage lending. Such action would not only have

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representing low-income consumers across the country. NCLC publishes and regularly updates a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, Cost of Credit, Consumer Banking and Payments Law, Foreclosures, and Consumer Bankruptcy Law and Practice, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws.

12 Founded in 1988, the **National Fair Housing Alliance** is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

[13] **National People's Action** is a national network of metro and statewide organizations that builds grassroots power to create a society in which racial and economic justice are realized.

14 **Public Citizen** is a national nonprofit membership organization that has advanced consumer rights in administrative agencies, the courts, and the Congress, for thirty-eight years.

protected many families from serious financial harm but would likely have stopped or slowed the chain of events that has led to the current economic crisis.

The idea of a federal consumer protection agency focused on credit and payment products has gained broad and high-profile support because it targets the most significant underlying causes of the massive regulatory failures that occurred. First, federal agencies did not make protecting consumers their top priority and, in fact, seemed to compete against each other to keep standards low, ignoring many festering problems that grew worse over time. If agencies did act to protect consumers (and they often did not), the process was cumbersome and time-consuming. As a result, agencies did not act to stop some abusive lending practices until it was too late. Finally, regulators were not truly independent of the influence of the financial institutions they regulated.

Meanwhile, despite an unprecedented government intervention in the financial sector, the passage of mortgage reform legislation in the House of Representatives and the enactment of a landmark law to prevent abusive credit card lending, problems with the sustainability of home mortgage and consumer loans keep getting worse. With an estimated two million households having already lost their homes to foreclosure because of the inability to repay unsound loans, Credit Suisse now predicts that foreclosures will exceed eight million through 2012.[15] The amount of revolving debt, most of which is credit card debt, is approaching $1 trillion.[16] Based on the losses that credit card issuers are now reporting, delinquencies and defaults are expected to peak at their highest levels ever within the next year.[17] One in two consumers who get payday loans default within the first year, and consumers who receive these loans are twice as likely to enter bankruptcy within two years as those who seek and are denied them.[18] Overall, personal bankruptcies have increased sharply, up by one-third in the last year.[19]

The failure of federal banking agencies to stem sub-prime mortgage lending abuses is fairly well known. They did not use the regulatory authority granted to them to stop unfair and deceptive lending practices before the mortgage foreclosure crisis spun out of control. In fact, it wasn't until July of 2008 that these rules were finalized, close to a decade after analysts and experts started warning that predatory sub-prime mortgage lending would lead to a foreclosure epidemic.

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[15] "Foreclosures could top 8 million: Credit Suisse," 9 December 2008, MarketWatch, available at http://www.marketwatch.com/story/more-than-8-million-homes-face-foreclosure-in-next-4-years (last visited 21 June 2009).

[16] See the Federal Reserve statistical release G-19, Consumer Credit, available at http://www.federalreserve.gov/releases/g19/

[17] "Fitch Inc. said it continues to see signs that the credit crunch will escalate into next year, and it said card chargeoffs may approach 10% by this time next year." "Fitch Sees Chargeoffs Nearing 10%," Dow Jones, May 5, 2009.

[18] Paige Marta Skiba and Jeremy Tobacman, "Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default," August 21, 2008. http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=1636 and Paige Marta Skiba and Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" October 10, 2008 http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221 (last visited 21 June 2009).

[19] "Bankruptcy Filings Continue to Rise" Administrative Office of the U.S. Courts, news release, 8 June 2009, available at http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsMar2009.cfm (last visited 21 June 2009).

Less well known are federal regulatory failures that have contributed to the extension of unsustainable consumer loans, such as credit card, overdraft and payday loans, which are now imposing a crushing financial burden on many families. As with problems in the mortgage lending market, failures to rein in abusive types of consumer loans were in areas where federal regulators had existing authority to act, and either chose not to do so or acted too late to stem serious problems in the credit markets.

Combining safety and soundness supervision – with its focus on bank profitability – in the same institution as consumer protection magnified an ideological predisposition or anti-regulatory bias by federal officials that led to unwillingness to rein in abusive lending before it triggered the housing and economic crises. Though we now know that consumer protection leads to effective safety and soundness, structural flaws in the federal regulatory system compromised the independence of banking regulators, encouraged them to overlook, ignore and minimize their mission to protect consumers. This created a dynamic in which regulatory agencies competed against each other to weaken standards and ultimately led to an oversight process that was cumbersome and ineffectual. These structural weaknesses threatened to undermine even the most diligent policies and intentions. They complicated enforcement and vitiated regulatory responsibility to the ultimate detriment of consumers.

These structural flaws include: a narrow focus on "safety and soundness" regulation to the exclusion of consumer protection; the huge conflict-of-interest that some agencies have because they rely heavily on financial assessments on regulated institutions that can choose to pay another agency to regulate them; the balkanization of regulatory authority between agencies that often results in either very weak or extraordinarily sluggish regulation (or both); and a regulatory process that lacks transparency and accountability. Taken together, these flaws severely compromised the regulatory process and made it far less likely that agency leaders would either act to protect consumers or succeed in doing so.

SECTION 2. CORRECTING REGULATORY SHORTCOMINGS BY CREATING A CONSUMER FINANCIAL PROTECTION AGENCY

Although a Consumer Financial Protection Agency (CFPA) would not be a panacea for all current regulatory ills, it would correct many of the most significant structural flaws that exist, realigning the regulatory architecture to reflect the unfortunate lessons that have been learned in the current financial crisis and sharply increasing the chances that regulators will succeed in protecting consumers in the future. A CFPA would be designed to achieve the regulatory goals of elevating the importance of consumer protection, prompting action to prevent harm, ending regulatory arbitrage, and guaranteeing regulatory independence.

A. Put Consumer Protection at the Center of Financial Regulation.

Right now, four federal regulatory agencies are required both to ensure the solvency of the financial institutions they regulate and to protect consumers from lending abuses.[20] Jurisdiction

[20] The Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTC) charter and supervise national banks, and thrifts, respectively. State chartered banks can choose whether to join and be examined and supervised by either the Federal Reserve System or the Federal Deposit Insurance Corporation

over consumer protection statutes is scattered over several more agencies, with rules like RESPA and TILA, which both regulate mortgage disclosures, in different agencies.

Within agencies in which these functions are combined, regulators have often treated consumer protection as less important than their safety and soundness mission or even in conflict with that mission.[21] For example, after more than 6 years of effort by consumer organizations, federal regulators are just now contemplating incomplete rules to protect consumers from high-cost "overdraft" loans that financial institutions often extend without the knowledge of or permission from consumers. Given the longstanding inaction on this issue, it is reasonable to assume that regulators were either uninterested in consumer protection or viewed restrictions on overdraft loans as an unnecessary financial burden on banks that extend this form of credit, even if it is deceptively offered and financially harmful to consumers. In other words, because regulators apparently decided that their overriding mission was to ensure that the short-term balance sheets of the institutions they regulated were strong, they were less likely to perceive that questionable products or practices (like overdraft loans or mortgage pre-payment penalties) were harmful to consumers.

As mentioned above, recent history has demonstrated that this shortsighted view of consumer protection and bank solvency as competing objectives is fatally flawed. If regulatory agencies had acted to prevent loan terms or practices that harmed consumers, they would also have vastly improved the financial solidity of the institutions they regulated. Nonetheless, the disparity in agencies' focus on consumer protection versus "safety and soundness" has been obvious, both in the relative resources that agencies devoted to the two goals and in the priorities they articulated. These priorities frequently minimized consumer protection and included reducing regulatory restrictions on the institutions they oversaw.[22]

Though the link between consumer protection and safety and soundness is now obvious, the two functions are not the same, and do conflict at times. In some circumstances, such as with overdraft loans, a financial product might well be profitable, even though it is deceptively offered and has a financially devastating effect on a significant number of consumers.[23]

(FDIC). The FTC is charged with regulating some financial practices (but not safety and soundness) in the non-bank sector, such as credit cards offered by department stores and other retailer.

[21] Occasionally, safety and soundness concerns have led regulators to propose consumer protections, as in the eventually successful efforts by federal banking agencies to prohibit "rent-a-charter" payday lending, in which payday loan companies partnered with national or out-of-state banks in an effort to skirt restrictive state laws. However, from a consumer protection point-of-view, this multi-year process took far too long. Moreover, the outcome could have been different if the agencies had concluded that payday lending would be profitable for banks and thus contribute to their soundness.

[22] For example, in 2007 the OTS cited consumer protection as part of its "mission statement" and "strategic goals and vision." However, in identifying its eight "strategic priorities" for how it would spend its budget in Fiscal Year 2007, only part of one of these priorities appears to be directly related to consumer protection ("data breaches"). On the other hand, OTS identified both "Regulatory Burden Reduction" and "Promotion of the Thrift Charter" as major strategic budget priorities. Office of Thrift Supervision, "OMB FY2007 Budget and Performance Plan," January 2007.

[23] Testimony of Travis Plunkett, Legislative Director, Consumer Federation of America and Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, Before the Subcommittee on Financial Institutions and Consumer Credit of the U.S. House of Representatives, Committee of Financial Services, March 19, 2009.

Until recently, regulatory agencies have also focused almost exclusively on bank examination and supervision to protect consumers, which lacks transparency. This process gives bank regulators a high degree of discretion to decide what types of lending are harmful to consumers, a process that involves negotiating behind-the-scenes with bank officials.[24] Given that multiple regulators oversee similar institutions, the process has also resulted in different standards for products like credit cards offered by different types of financial institutions. In fact, widespread abusive lending in the credit markets has discredited claims by bank regulators like the Comptroller of the Currency that a regulatory process consisting primarily of supervision and examination results in a superior level of consumer protection compared to taking public enforcement action against institutions that violate laws or rules.[25] Financial regulatory enforcement actions are a matter of public record which has a positive impact on other providers who might be engaged in the same practices and provides information to consumers on financial practices sanctioned by regulators.

Additionally, the debate about the financial and foreclosure crisis often overlooks the fact that predatory lending practices and the ensuing crisis have had a particularly harsh impact on communities of color. African Americans and Latinos suffered the brunt of the predatory and abusive practices found in the subprime market. While predatory and abusive lending practices were not exclusive to the subprime market, because of lax regulation in that sector, most abuses were concentrated there. Several studies have documented pervasive racial discrimination in the distribution of subprime loans. One such study found that borrowers of color were more than 30 percent more likely to receive a higher-rate loan than White borrowers even after accounting for differences in creditworthiness.[26] Another study found that *high-income* African-Americans in predominantly Black neighborhoods were three times more likely to receive a subprime purchase loan than *low-income* White borrowers.[27]

African-Americans and Latinos receive a disproportionate level of high cost loans, even when they qualify for a lower rate and/or prime mortgage. Fannie Mae and Freddie Mac estimated that up to 50 percent of those who ended up with a subprime loan would have qualified for a mainstream, "prime-rate" conventional loan in the first place.[28] According to a study conducted

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[24] "Findings made during compliance examinations are strictly confidential and are not made available to the public except at the OCC's discretion. Similarly, the OCC is not required to publish the results of its safety-and-soundness orders….Thus, the OCC's procedures for compliance examinations and safety-and-soundness orders do not appear to provide any public notice or other recourse to consumers who have been injured by violations identified by the OCC." Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, April 26, 2007.

[25] "…ours is not an 'enforcement-only' compliance regime – far better to describe our approach as 'supervision first, enforcement if necessary,' with supervision addressing so many early problems that enforcement is not necessary." Testimony of John C. Dugan, Comptroller of the Currency, Before the Committee on Financial Services of the U.S. House of Representatives, June 13, 2007.

26 See Bocian, D. G., K. S. Ernst, and W. Li, Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages, Center for Responsible Lending, May 2006.

27 Unequal Burden: Income and Racial Disparities in Subprime Lending in America (Washington, D.C.: HUD, 2000).

28 See the Center for Responsible Lending's Fact Sheet on Predatory Mortgage Lending at http://www.responsiblelending.org/pdfs/2b003-mortgage2005.pdf, and The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities, ACORN, August 15, 2006, available at www.acorn.org.

by the Wall Street Journal, as much as 61% of those receiving subprime loans would "qualify for conventional loans with far better terms."[29] Moreover, racial segregation is linked with the proportion of subprime loans originated at the metropolitan level, even after controlling for percent minority, low credit scores, poverty, and median home value.[30] The resulting flood of high cost and abusive loans in communities of color has artificially elevated the costs of homeownership, caused unprecedented high rates of foreclosures, and contributed to the blight and deterioration of these neighborhoods. It is estimated that communities of color will realize the greatest loss of wealth as a result of this crisis, since Reconstruction.

A CFPA, by contrast, would have as its sole mission the development and effective implementation of standards that ensure that all credit products offered to borrowers are safe and not discriminatory. The agency would then enforce these standards for the same types of products in a transparent, uniform manner. Ensuring the safety and fairness of credit products would mean that the CFPA would not allow loans with terms that are discriminatory, deceptive or fraudulent. The agency should also be designed to ensure that credit products are offered in a fair and sustainable manner. In fact, a core mission of the CFPA would be to ensure the suitability of classes of borrowers for various credit products, based on borrowers' ability to repay the loans they are offered – especially if the cost of loans suddenly or sharply increase, and that the terms of loans do not impose financial penalties on borrowers who try to pay them off. As we've learned in the current crisis, focusing exclusively on consumer and civil rights protection would often be positive for lenders' stability and soundness over the long term. However, the agency would be compelled to act in the best interest of consumers even if measures to restrict certain types of loans would have a negative short-term financial impact on financial institutions.

B. Prevent Regulatory Arbitrage. Act Quickly to Prevent Unsafe Forms of Credit.

The present regulatory system is institution-centered, rather than consumer-centered. It is structured according to increasingly irrelevant distinctions between the type of financial services company that is lending money, rather than the type of product being offered to consumers. Right now, financial institutions are allowed (and have frequently exercised their right) to choose the regulatory body that oversees them and to switch freely between regulatory charters at the federal level and between state and federal charters. Many financial institutions have switched charters in recent years seeking regulation that is less stringent. Two of the most notorious examples are Washington Mutual and Countrywide,[31] which became infamous for promoting dangerous sub-prime mortgage loans on a massive scale.[32] Both switched their charters to

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[29] See "Subprime Debacle Traps Even Very Creditworthy," *Wall Street Journal*, December 3, 2007.

30 Squires, Gregory D., Derek S. Hyra, and Robert N. Renner, "Segregation and the Subprime Lending Crisis," Paper presented at the 2009 Federal Reserve System Community Affairs Research Conference, Washington, DC (April 16, 2009).

[31] Of course, following their stunning collapses, Countrywide was acquired by Bank of America and Washington Mutual by Chase, both in regulator-ordered winding-downs.

[32] In fact, several other large national banks have chosen in recent years to convert their state charter to a national charter. Charter switches by JP Morgan Chase, HSBC and Bank of Montreal (Harris Trust) alone in 2004-05 moved over $1 trillion of banking assets from the state to the national banking system, increasing the share of assets held by national banks to 67 percent from 56 percent, and decreasing the state share to 33 percent from 44 percent. Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Threaten to Undermine the Dual Banking System, Consumer

become thrifts regulated by the Office of Thrift Supervision (OTS). At the federal level, where major agencies are funded by the institutions they oversee, this ability to "charter shop," has undeniably led regulators like the OTS to compete to attract financial institutions by keeping regulatory standards weak. It has also encouraged the OTS and OCC to expand their preemptive authority and stymie efforts by the states to curb predatory and high-cost lending. The OCC in particular appears to have used its broad preemptive authority over state consumer protections and its aggressive legal defense of that authority as a marketing tool to attract depository institutions to its charter.[33]

When agencies do collaborate to apply consumer protections consistently to the institutions they regulate, the process has been staggeringly slow. As cited in several places in this testimony, federal regulators dithered for years in implementing regulations to stop unfair and deceptive mortgage and credit card lending practices. One of the reasons for these delays has often been that regulators disagree among themselves regarding what regulatory measures must be taken. The course of least resistance in such cases is to do nothing, or to drag out the process. Although the credit card rule adopted late last year by federal regulators was ultimately finalized over protests from the OCC, these objections were likely one of the reasons that federal regulators delayed even *beginning* the process of curbing abusive credit card lending practices until mid-2008.

The "charter shopping" problem would be directly addressed through the creation of a single CFPA with regulatory authority over all forms of credit. Federal agencies would no longer compete to attract institutions based on weak consumer protection standards or anemic enforcement of consumer rules. The CFPA would be required to focus on the safety of credit products, features and practices, no matter what kind of lender offered them. As for regulatory competition with states, it would only exist to improve the quality of consumer protection. Therefore, the CFPA should be allowed to set minimum national credit standards, which states could then enforce (as well as victimized consumers). States would be allowed to exceed these standards if local conditions require them to do so. If the CFPA sets "minimum" standards that are sufficiently strong, a high degree of regulatory uniformity is likely to result. With strong national minimum standards in place, states are most likely to act only when new problems develop first in one region or submarket. States would then serve as an early warning system, identifying problems as they develop and testing policy solutions, which could then be adopted nationwide by the CFPA if merited. Moreover, the agency would have a clear incentive to stay abreast of market developments and to act in a timely fashion to rein in abusive lending because it will be held responsible for developments in the credit market that harm consumers.

Protection and the Federal Reserve Board's role in Bank Supervision," Proceedings of the 42nd Annual Conference on Bank Structure and Competition (Fed. Res. Bank of Chicago, 2006) at 102, 105-106.

[33] For a detailed analysis, see brief amicus curiae of Center for Responsible Lending et al in the case currently before the Supreme Court, Cuomo v. Clearinghouse and OCC (08-453) available at http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/08-453_PetitionerAmCu10ConsumerProtectionOrgs.pdf (last visited 21 June 2009) at pages 20-39.

C. Create an Independent Regulatory Process.

The ability of regulated institutions to "charter shop" combined with aggressive efforts by federal regulators to preempt state oversight of these institutions has clearly undermined the independence of the OTS and OCC. This situation is made worse by the fact that large financial institutions like Countrywide were able to increase their leverage over regulators by taking a significant chunk of the agency's budget away when it changed charters and regulators. The OTS and OCC are almost entirely funded through assessments on the institutions they regulate (see Appendix 4). The ability to charter shop combined with industry funding has created a significant conflict-of-interest that has contributed to the agencies' disinclination to consider upfront regulation of the mortgage and consumer credit markets.

Given that it supervises the largest financial institutions in the country, the OCC's funding situation is the most troublesome.

> *More than 95% of the OCC's budget is financed by assessments paid by national banks, and the twenty biggest national banks account for nearly three-fifths of those assessments. Large, multi-state banks were among the most outspoken supporters of the OCC's preemption regulations and were widely viewed as the primary beneficiaries of those rules. In addition to its preemption regulations, the OCC has frequently filed amicus briefs in federal court cases to support the efforts of national banks to obtain court decisions preempting state laws. The OCC's effort to attract large, multi-state banks to the national system have already paid handsome dividends to the agency….Thus, the OCC has a powerful financial interest in pleasing its largest regulated constituents, and the OCC therefore faces a clear conflict of interest whenever it considers the possibility of taking an enforcement action against a major national bank.*[34]

The leadership of a CFPA would be held to account based on its ability to inform consumers and help protect them from unsafe products. In order to function effectively, the leadership would need to show expertise in and commitment to consumer protection. Crucial to the success of the agency would be to ensure that its funding is adequate, consistent and does not compromise this mission. Congress could also ensure that the method of agency funding that is used does not compromise the CFPA's mission by building accountability mechanisms into the authorizing statute and exercising effective oversight of the agency's operations. (See section 4 below.)

Recent history has demonstrated that even an agency with an undiluted mission to protect consumers can be undermined by hostile or negligent leadership or by Congressional meddling on behalf of special interests. However, unless the structure of financial services regulation is realigned to change not just the focus of regulation but its underlying philosophy, it is very unlikely that consumers will be adequately protected from unwise or unfair credit products in the future. The creation of a CFPA is necessary because it ensures that the paramount priority of

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[34] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, April 26, 2007.

federal regulation is to protect consumers, that the agency decision-making is truly independent, and that agencies do not have financial or regulatory incentives to keep standards weaker than necessary.

SECTION 3: ERRORS OF OMISSION AND COMMISSION BY THE FEDERAL BANK REGULATORS

Current regulators may already have some of the powers that the new agency would be given, but they haven't used them. Conflicts of interest and a lack of will work against consumer enforcement. In this section, we detail numerous actions and inactions by the federal banking regulators that have led to or encouraged unfair practices, higher prices for consumers, and less competition.

A. The Federal Reserve Board ignored the growing mortgage crisis for years after receiving Congressional authority to enact anti-predatory mortgage lending rules in 1994.

The Federal Reserve Board was granted sweeping anti-predatory mortgage regulatory authority by the 1994 Home Ownership and Equity Protection Act (HOEPA). Final regulations were issued on 30 July 2008 only after the world economy had collapsed due to the collapse of the U.S. housing market triggered by predatory lending.[35]

B. At the same time, the Office of the Comptroller of the Currency engaged in an escalating pattern of preemption of state laws designed to protect consumers from a variety of unfair bank practices and to quell the growing predatory mortgage crisis, culminating in its 2004 rules preempting both state laws and state enforcement of laws over national banks and their subsidiaries.

In interpretation letters, amicus briefs and other filings, the OCC preempted state laws and local ordinances requiring lifeline banking (NJ 1992, NY, 1994), prohibiting fees to cash "on-us" checks (par value requirements) (TX, 1995), banning ATM surcharges (San Francisco, Santa Monica and Ohio and Connecticut, 1998-2000), requiring credit card disclosures (CA, 2003) and opposing predatory lending and ordinances (numerous states and cities).[36] Throughout, OCC ignored Congressional requirements accompanying the 1994 Riegle-Neal Act not to preempt without going through a detailed preemption notice and comment procedure, as the Congress had found many OCC actions "inappropriately aggressive."[37]

In 2000-2004, the OCC worked with increasing aggressiveness to prevent the states from enforcing state laws and stronger state consumer protection standards against national banks and their operating subsidiaries, from investigating or monitoring national banks and their operating subsidiaries, and from seeking relief for consumers from national banks and subsidiaries.

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[35] 73 FR 147, Page 44522, Final HOEPA Rule, 30 July 2008

[36] "Role of the Office of Thrift Supervision and Office of the Comptroller of the Currency in the Preemption of State Law," USGAO, prepared for Financial Services Committee Chairman James Leach, 7 February 2000, available at http://www.gao.gov/corresp/ggd-00-51r.pdf (last visited 21 June 2009).

[37] [Statement of managers filed with the conference report on H.R. 3841, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Congressional Record Page S10532, 3 August 1994

These efforts began with interpretative letters stopping state enforcement and state standards in the period up to 2004, followed by OCC's wide-ranging preemption regulations in 2004 purporting to interpret the National Bank Act, plus briefs in court cases supporting national banks' efforts to block state consumer protections.

We discuss these matters in greater detail below, in Section 5, rebutting industry arguments against the CFPA.

C. The agencies took little action except to propose greater disclosures, as unfair credit card practices increased over the years, until Congress stepped in.

Further, between 1995 and 2007, the Office of the Comptroller of Currency issued only one public enforcement action against a Top Ten credit card bank (and then only after the San Francisco District Attorney had brought an enforcement action). In that period, "the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws."[38] The OCC's failure to act on rising credit card complaints at the largest national banks triggered Congress to investigate, resulting in passage of the 2009 Credit Card Accountability, Responsibility and Disclosure Act (CARD Act).[39] While this committee was considering that law, other federal regulators finally used their authority under the Federal Trade Commission Act to propose and finalize a similar rule.[40] By contrast, the OCC requested the addition of two significant loopholes to a key protection of the proposed rule.

Meanwhile, this committee and its Subcommittee on Financial Institutions and Consumer Credit had conducted numerous hearings on the impact of current credit card issuer practices on consumers. The Committee heard testimony from academics and consumer representatives regarding abusive lending practices that are widespread in the credit card industry, including:

- The unfair application of penalty and "default" interest rates that can rise above 30 percent;
- Applying these interest rate hikes retroactively on existing credit card debt, which can lead to sharp increases in monthly payments and force consumers on tight budgets into credit counseling and bankruptcy;
- High and increasing "penalty" fees for paying late or exceeding the credit limit. Sometimes issuers use tricks or traps to illegitimately bring in fee income, such as requiring that payments be received in the late morning of the due date or approving purchases above the credit limit;
- Aggressive credit card marketing directed at college students and other young people;

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[38] Testimony of Professor Arthur Wilmarth, 26 April 2007, before the Subcommittee on Financial Institutions and Consumer Credit, hearing on Credit Card Practices: Current Consumer And Regulatory Issues http://www.house.gov/financialservices/hearing110/htwilmarth042607.pdf

[39] HR 627 was signed into law by President Obama as Public Law No: 111-24 on 22 May 2009.

[40] The final rule was published in the Federal Register a month later. 74 FR 18, page 5498 Thursday, January 29, 2009

- Requiring consumers to waive their right to pursue legal violations in the court system and forcing them to participate in arbitration proceedings if there is a dispute, often before an arbitrator with a conflict of interest; and
- Sharply raising consumers' interest rates because of a supposed problem a consumer is having paying another creditor. Even though few credit card issuers now admit to the discredited practice of "universal default," eight of the ten largest credit card issuers continue to permit this practice under sections in cardholder agreements that allow issuers to change contract terms at "any time for any reason."[41]

> *In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates, including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US Bancorp – for a wide variety of abusive practices over the past decade…*[42]

The OCC and FRB were largely silent while credit card issuers expanded efforts to market and extend credit at a much faster speed than the rate at which Americans have taken on credit card debt. This credit expansion had a disproportionately negative effect on the least sophisticated, highest risk and lowest income households. It has also resulted in both relatively high losses for the industry and record profits. That is because, as mentioned above, the industry has been very aggressive in implementing a number of new – and extremely costly – fees and interest rates.[43] Although the agencies did issue significant guidance in 2003 to require issuers to increase the size of minimum monthly payments that issuers require consumers to pay,[44] neither agency has proposed any actions (or asked for the legal authority to do so) to rein in aggressive lending or unjustifiable fees and interest rates.

In addition, in 1995 the OCC amended a rule, with its action later upheld by the Supreme Court,[45] that allowed credit card banks to export fees nationwide, as if they were interest, resulting in massive increases in the size of penalty late and overdraft fees.

D. The Federal Reserve has Allowed Debit Card Cash Advances ("Overdraft Loans") without Consent, Contract, Cost Disclosure or Fair Repayment Terms

The FRB has refused to require banks to comply with the Truth in Lending Act (TILA) when they loan money to customers who are permitted to overdraw their accounts. While the FRB issued a staff commentary clarifying that TILA applied to payday loans, the Board refused to

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[41] Testimony of Linda Sherry of Consumer Action, House Subcommittee on Financial Institutions and Consumer Credit, April 26, 2007.

[42] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, April 26, 2007.

[43] Testimony of Travis B. Plunkett of the Consumer Federation of America, Senate Banking Committee, January 25, 2007.

[44] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.

[45] The rule is at 12 C.F.R. § 7.4001(a)). The case is Smiley v. Citibank, 517 U.S. 735.

apply the same rules to banks that make nearly identical loans. As a result, American consumers spend at least $17.5 billion per year on cash advances from their banks without signing up for the credit and without getting cost-of-credit disclosures or a contract that the bank would in fact pay overdrafts. Consumers are induced to withdraw more cash than they have in their account at ATMs and spend more than they have with debit card purchases at point of sale. In both cases, the bank could simply deny the transaction, saving consumers average fees of $35 each time.

The FRB has permitted banks to avoid TILA requirements because bankers claim that systematically charging unsuspecting consumers very high fees for overdraft loans they did not request is the equivalent to occasionally covering the cost of a paper check that would otherwise bounce. Instead of treating short term bank loans in the same manner as all other loans covered under TILA, as consumer organizations recommended, the FRB issued and updated regulations under the Truth in Savings Act, pretending that finance charges for these loans were bank "service fees." In several dockets, national consumer organizations provided well-researched comments, urging the Federal Reserve to place consumer protection ahead of bank profits, to no avail.

As a result, consumers unknowingly borrow billions of dollars at astronomical interest rates. A $100 overdraft loan with a $35 fee that is repaid in two weeks costs 910 percent APR. The use of debit cards for small purchases often results in consumers paying more in overdraft fees than the amount of credit extended. The FDIC found last year that the average debit card point of purchase overdraft is just $20, while the sample of state banks surveyed by the FDIC charged a $27 fee. If that $20 overdraft loan were repaid in two weeks, the FDIC noted that the APR came to 3,520 percent.[46]

As the Federal Reserve has failed to protect bank account customers from unauthorized overdraft loans, banks are raising fees and adding new ones. In the most recent survey of the sixteen largest banks included in comments to the Federal Reserve and testimony before this Committee, CFA found that nine of the sixteen largest banks charge $35 for repeat overdrafts and half of the largest banks use a tiered fee structure to escalate fees over the year. For example, US Bank charges $19 for the first overdraft in a year, $35 for the second to fourth overdraft, and $37.50 thereafter. Ten of the largest banks charge a sustained overdraft fee, imposing additional fees if the overdraft and fees are not repaid within days. Bank of America began in June to impose a second $35 fee if an overdraft is not repaid within five days. As a result, a consumer who is permitted by her bank to overdraw by $20 with a debit card purchase can easily be charged $70 for a five day extension of credit.[47]

Cash advances on debit cards are not protected by the Truth in Lending Act prohibition on banks using set off rights to collect payment out of deposits into their customers' accounts. If the purchase involved a credit card, on the other hand, it would violate federal law for a bank to pay

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[46] FDIC Study of Bank Overdraft Programs, Federal Deposit Insurance Corporation, November 2008 at v.

[47] Testimony of Travis B. Plunkett and Edmund Mierzwinski, Subcommittee on Financial Institutions and Consumer Credit, Legislative Hearing Regarding H. R. 627 and H. R. 1456, Appendix C. See also, Bank of America, "Important Information Regarding Changes to Your Account, page 2. Accessed online June 15, 2009. "Extended Overdrawn Balance Charge, June 5, 2009: For each time we determine your account is overdrawn by any amount and continues to be overdrawn for five or more consecutive business days, we will chage one fee of $35. This fee is in addition to applicable Overdraft Item Fees and NSF Returned Item Fees."

the balance owed from a checking account at the same bank. Banks routinely pay back debit card cash advances to themselves by taking payment directly out of consumers' checking accounts, even if those accounts contain entirely exempt funds such as Social Security.

The Federal Reserve is considering comments filed in yet another overdraft loan docket, this time considering whether to require banks to permit consumers to opt-out of fee-based overdraft programs, or, alternatively, to require banks to get consumers to opt in for overdrafts. This proposal would change Reg E which implements the Electronic Fund Transfer Act and would only apply to overdrafts created by point of sale debit card transactions and to ATM withdrawals, leaving all other types of transactions that are permitted to overdraw for a fee unaddressed. Consumer organizations urged the Federal Reserve to require banks to get their customers' affirmative consent, the same policy included in the recently-enacted credit card bill which requires affirmative selection for creditors to permit over-the-limit transactions for a fee.[48]

E. The Fed is Allowing A Shadow Banking System (Prepaid Cards), Outside of Consumer Protection Laws To Develop and Target the Unbanked and Immigrants; The OTS is Allowing Bank Payday Loans (Which Preempt State Laws) on Prepaid Cards.

The Electronic Funds Transfer Act requires key disclosures of fees and other practices, protects consumer bank accounts from unauthorized transfers, requires resolution of billing errors, gives consumers the right to stop electronic payments, and requires statements showing transaction information, among other protections. The EFTA is also the statute that will hold the new protections against overdraft fee practices that the Fed is writing.

Yet the Fed has failed to include most prepaid cards in the EFTA's protections, even while the prepaid industry is growing and is developing into a shadow banking system. In 2006, the Fed issued rules including payroll cards – prepaid cards that are used to pay wages instead of a paper check for those who do not have direct deposit to a bank account -- within the definition of the "accounts" subject to the EFTA. But the Fed permitted payroll card accounts to avoid the statement requirements for bank accounts, relying instead on the availability of account information on the internet. Forcing consumers to monitor their accounts online to check for unauthorized transfers and fees and charges is particularly inappropriate for the population targeted for these cards: consumers without bank accounts, who likely do not have or use regular internet access.

Even worse, the Fed refused to adopt the recommendations of consumer groups that self-selected payroll cards – prepaid cards that consumers shop for and choose on their own as the destination for direct deposit of their wages – should receive the same EFTA protections that employer designated payroll cards receive. The Fed continues to take the position that general prepaid cards are not protected by the EFTA.

This development has become all the more glaring as federal and state government agencies have moved to prepaid cards to pay many government benefits, from Social Security and Indian Trust Funds to unemployment insurance and state-collected child support. Some agencies, such as the Treasury Department when it created the Social Security Direct Express Card, have included in

[48] Federal Reserve Board, Docket No. R-1343, comments were due March 30, 2009.

their contract requirements that the issuer must comply with the EFTA. But not all have, and compliance is uneven, despite the fact that the EFTA itself clearly references and anticipates coverage of electronic systems for paying unemployment insurance and other non-needs tested government benefits.

The Fed's failure to protect this shadow banking system is also disturbing as prepaid cards are becoming a popular product offered by many predatory lenders, like payday lenders.

Indeed, the Fed is not the only one that has recently dropped the ball on consumer protection on prepaid cards. One positive effort by the banking agencies in the past decade was the successful effort to end rent-a-bank partnerships that allowed payday lenders to partner with depositories to use their preemptive powers to preempt state payday loan laws.[49] But more recently, one prepaid card issuer, Meta Bank, has developed a predatory, payday loan feature – iAdvance -- on its prepaid cards that receive direct deposit of wages and government benefits. At a recent conference, an iAdvance official boasted that Meta Bank's regulator – the OTS – has been very "flexible" with them and "understands" this product.

F. Despite Advances in Technology, the Federal Reserve has Refused to Speed up Availability of Deposits to Consumers.

Despite rapid technological changes in the movement of money electronically, the adoption of Check 21 to speed check processing, and electronic check conversion at the cash register, the Federal Reserve has failed to shorten the amount of time that banks are allowed to hold deposits before they are cleared. Money flies out of bank accounts at warp speed. Deposits crawl in. Even cash that is deposited over the counter to a bank teller can be held for 24 hours before becoming available to cover a transaction. The second business day rule for local checks means that a low-income worker who deposits a pay check on Friday afternoon will not get access to funds until the following Tuesday. If the paycheck is not local, it can be held for five business days. This long time period applies even when the check is written on the same bank where it is deposited. Consumers who deposit more than $5,000 in one day face an added wait of about five to six more business days. Banks refuse to cash checks for consumers who do not have equivalent funds already on deposit. The combination of unjustifiably long deposit holds and banks' refusal to cash account holders' checks pushes low income consumers towards check cashing outlets, where they must pay 2 to 4 percent of the value of the check to get immediate access to cash.

Consumer groups have called on the Federal Reserve to speed up deposit availability and to prohibit banks from imposing overdraft or NSF fees on transactions that would not have overdrawn if deposits had been available. The Federal Reserve vigorously supported Check 21 which has speeded up withdrawals but has refused to reduce the time period for local and nonlocal check hold periods for consumers.

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[49] Payday lending is so egregious that even the Office of the Comptroller of the Currency refused to let storefront lenders hide behind their partner banks' charters to export usury.

G. The Federal Reserve Has Supported the Position of Payday Lenders and Telemarketing Fraud Artists by Permitting Remotely Created Checks (Demand Drafts) to Subvert Consumer Rights Under the Electronic Funds Transfer Act.

In 2005, the National Association of Attorneys General, the National Consumer Law Center, Consumer Federation of America, Consumers Union, the National Association of Consumer Advocates, and U. S. Public Interest Research Group filed comments with the Federal Reserve in Docket No. R-1226, regarding proposed changes to Regulation CC with respect to demand drafts. Demand drafts are unsigned checks created by a third party to withdraw money from consumer bank accounts. State officials told the FRB that demand drafts are frequently used to perpetrate fraud on consumers and that the drafts should be eliminated in favor of electronic funds transfers that serve the same purpose and are covered by protections in the Electronic Funds Transfer Act. Since automated clearinghouse transactions are easily traced, fraud artists prefer to use demand drafts. Fraudulent telemarketers increasingly rely on bank debits to get money from their victims. The Federal Trade Commission earlier this year settled a series of cases against telemarketers who used demand drafts to fraudulently deplete consumers' bank accounts. Fourteen defendants agreed to pay a total of more than $16 million to settle FTC charges while Wachovia Bank paid $33 million in a settlement with the Comptroller of the Currency.[50]

Remotely created checks are also used by high cost lenders to remove funds from checking accounts even when consumers exercise their right to revoke authorization to collect payment through electronic funds transfer. CFA first issued a report on Internet payday lending in 2004 and documented that some high-cost lenders converted debts to demand drafts when consumers exercised their EFTA right to revoke authorization to electronically withdraw money from their bank accounts. CFA brought this to the attention of the Federal Reserve in 2005, 2006 and 2007. No action has been taken to safeguard consumers' bank accounts from unauthorized unsigned checks used by telemarketers or conversion of a loan payment from an electronic funds transfer to a demand draft to thwart EFTA protections or exploit a loophole in EFTA coverage.

The structure of online payday loans facilitates the use of demand drafts. Every application for a payday loan requires consumers to provide their bank account routing number and other information necessary to create a demand draft as well as boiler plate contract language to authorize the device. The account information is initially used by online lenders to deliver the proceeds of the loan into the borrower's bank account using the ACH system. Once the lender has the checking account information, however, it can use it to collect loan payments via remotely created checks per boilerplate contract language even after the consumer revokes authorization for the lender to electronically withdraw payments.

The use of remotely created checks is common in online payday loan contracts. ZipCash LLC "Promise to Pay" section of a contract included the disclosure that the borrower may revoke authorization to electronically access the bank account as provided by the Electronic Fund Transfer Act. However, revoking that authorization will not stop the lender from unilaterally

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[50] Press Release, "Massive Telemarketing Scheme Affected Nearly One Million Consumers Nationwide; Wachovia Bank to Provide an Additional $33 Million to Suntasia Victims," Federal Trade Commission, January 13, 2009, viewed at http://www.ftc.gov/opa/2009/01/suntasia.shtm.

withdrawing funds from the borrower's bank account. The contract authorizes creation of a demand draft which cannot be terminated. "While you may revoke the authorization to effect ACH debit entries at any time up to 3 business days prior to the due date, *you may not revoke the authorization to prepare and submit checks on your behalf until such time as the loan is paid in full."* (Emphasis added.)[51]

H. The Federal Reserve Has Taken No Action to Safeguard Bank Accounts from Internet Payday Lenders.

In 2006, consumer groups met with Federal Reserve staff to urge them to take regulatory action to protect consumers whose accounts were being electronically accessed by Internet payday lenders. We joined with other groups in a follow up letter in 2007, urging the Federal Reserve to make the following changes to Regulation E:

- Clarify that remotely created checks are covered by the Electronic Funds Transfer Act.
- Ensure that the debiting of consumers' accounts by internet payday lenders is subject to all the restrictions applicable to preauthorized electronic funds transfers.
- Prohibit multiple attempts to "present" an electronic debit.
- Prohibit the practice of charging consumers a fee to revoke authorization for preauthorized electronic funds transfers.
- Amend the Official Staff Interpretations to clarify that consumers need not be required to inform the payee in order to stop payment on preauthorized electronic transfers.

While FRB staff was willing to discuss these issues, the FRB took no action to safeguard consumers when Internet payday lenders and other questionable creditors evade consumer protections or exploit gaps in the Electronic Fund Transfer Act to mount electronic assaults on consumers' bank accounts.

As a result of inaction by the Federal Reserve, payday loans secured by repeat debit transactions undermine the protections of the Electronic Fund Transfer Act, which prohibits basing the extension of credit with periodic payments on a requirement to repay the loan electronically.[52] Payday loans secured by debit access to the borrower's bank account which cannot be cancelled also functions as the modern banking equivalent of a wage assignment – a practice which is prohibited when done directly. The payday lender has first claim on the direct deposit of the borrower's next paycheck or exempt federal funds, such as Social Security, SSI, or Veterans Benefit payments. Consumers need control of their accounts to decide which bills get paid first and to manage scarce family resources. Instead of using its authority to safeguard electronic access to consumers' bank accounts, the Federal Reserve has stood idly by as the online payday loan industry has expanded.

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[51] Loan Supplement (ZipCash LLC) Form #2B, on file with CFA.
[52] Reg E, 12 C.F.R. § 205.10(e). 15 U.S.C. § 1693k states that "no person" may condition extension of credit to a consumer on the consumer's repayment by means of a preauthorized electronic fund transfer.

I. The Banking Agencies Have Failed to Stop Banks from Imposing Unlawful Freezes on Accounts Containing Social Security and Other Funds Exempt from Garnishment.

Federal benefits including Social Security and Veteran's benefits (as well as state equivalents) are taxpayer dollars targeted to relieve poverty and ensure minimum subsistence income to the nation's workers. Despite the purposes of these benefits, banks routinely freeze bank accounts containing these benefits pursuant to garnishment or attachment orders, and assess expensive fees – especially insufficient fund (NSF) fees – against these accounts.

The number of people who are being harmed by these practices has escalated in recent years, largely due to the increase in the number of recipients whose benefits are electronically deposited into bank accounts. This is the result of the strong federal policy to encourage this in the Electronic Funds Transfer Act. And yet, the banking agencies have failed to issue appropriate guidance to ensure that the millions of federal benefit recipients receive the protections they are entitled to under federal law.

J. The Comptroller of the Currency Permits Banks to Manipulate Payment Order to Extract Maximum Bounced Check and Overdraft Fees, Even When Overdrafts are Permitted.

The Comptroller of the Currency permits national banks to rig the order in which debits are processed. This practice increases the number of transactions that trigger an overdrawn account, resulting in higher fee income for banks. When banks began to face challenges in court to the practice of clearing debits according to the size of the debit -- from the largest to the smallest -- rather than when the debit occurred or from smallest to largest check, the OCC issued guidelines that allow banks to use this dubious practice.

The OCC issued an Interpretive Letter allowing high-to-low check clearing when banks follow the OCC's considerations in adopting this policy. Those considerations include: the cost incurred by the bank in providing the service; the deterrence of misuse by customers of banking services; the enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and the maintenance of the safety and soundness of the institution.[53] None of the OCC's considerations relate to consumer protection.

The Office of Thrift Supervision (OTS) addressed manipulation of transaction-clearing rules in the Final Guidance on Thrift Overdraft Programs issued in 2005. The OTS, by contrast, advised thrifts that transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees.[54] The Guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies. The Interagency "Best Practices" state: "Clearly explain to consumers that transactions may not be processed in the order in which they occurred, and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumers."[55]

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[53] 12 C.F.R. 7.4002(b).
[54] Office of Thrift Supervision, Guidance on Overdraft Protection Programs, February 14, 2005, p. 15.
[55] Dept. of Treasury, Joint Guidance on Overdraft Protection Programs, February 15, 2005, p. 13.

CFA and other national consumer groups wrote to the Comptroller and other federal bank regulators in 2005 regarding the unfair trade practice of banks ordering withdrawals from high-to-low, while at the same time unilaterally permitting overdrafts for a fee. One of the OCC's "considerations" is that the overdraft policy should "deter misuse of bank services." Since banks deliberately program their computers to process withdrawals high-to-low and to permit customers to overdraw at the ATM and Point of Sale, there is no "misuse" to be deterred.

No federal bank regulator took steps to direct banks to change withdrawal order to benefit low-balance consumers or to stop the unfair practice of deliberately causing more transactions to bounce in order to charge high fees. CFA's survey of the sixteen largest banks earlier this year found that all of them either clear transactions largest first or reserve the right to do so.[56] Since ordering withdrawals largest first is likely to deplete scarce resources and trigger more overdraft and insufficient funds fees for many Americans, banks have no incentive to change this practice absent strong oversight by bank regulators.

K. The regulators have failed to enforce the Truth In Savings Act requirement that banks provide account disclosures to prospective customers.

According to a 2008 GAO report[57] to Rep. Carolyn Maloney, then-chair of the Financial Institutions and Consumer Credit subcommittee, based on a secret shopper investigation, banks don't give consumers access to the detailed schedule of account fee disclosures as required by the 1991 Truth In Savings Act. From GAO:

> *Regulation DD, which implements the Truth in Savings Act (TISA), requires depository institutions to disclose (among other things) the amount of any fee that may be imposed in connection with an account and the conditions under which such fees are imposed. […] GAO employees posed as consumers shopping for checking and savings accounts […] Our visits to 185 branches of depository institutions nationwide suggest that consumers shopping for accounts may find it difficult to obtain account terms and conditions and disclosures of fees upon request prior to opening an account. Similarly, our review of the Web sites of the banks, thrifts, and credit unions we visited suggests that this information may also not be readily available on the Internet. We were unable to obtain, upon request, a comprehensive list of all checking and savings account fees at 40 of the branches (22 percent) that we visited. […]The results are consistent with those reported by a consumer group [U.S. PIRG] that conducted a similar exercise in 2001.*

This, of course, keeps consumers from being able to shop around and compare prices. As cited by GAO, U.S. PIRG then complained of these concerns in a 2001 letter to then Federal Reserve

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[56] Consumer Federation of America, Comments to Federal Reserve Board, Docket No. R-1343, Reg. E, submitted March 30, 2009.

[57] "Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts," GAO-08-281, January 2008, available at http://www.gao.gov/new.items/d08281.pdf (last visited 21 June 2009).

Board Chairman Alan Greenspan.[58] No action was taken. The problem is exacerbated by a 2001 Congressional decision to eliminate consumers' private rights of action for Truth In Savings violations.

L. The Federal Reserve actively campaigned to eliminate a Congressional requirement that it publish an annual survey of bank account fees.

One of the consumer protections included in the 1989 savings and loan bailout law known as the Financial Institutions Reform, Recovery and Enforcement Act was Section 1002, which required the Federal Reserve to publish an annual report to Congress on fees and services of depository institutions. The Fed actively campaigned in opposition to the requirement and succeeded in convincing Congress to sunset the survey in 2003.[59] Most likely, the Fed was unhappy with the report's continued findings that each year bank fees increased, and that each year, bigger banks imposed the biggest fees.

SECTION 4. STRUCTURE AND JURISDICTION OF A CONSUMER FINANCIAL PROTECTION AGENCY

If the CFPA is to be effective in its mission, it must be structured so that it is strong and independent with full authority to protect consumers. Our organizations have strongly endorsed two complementary proposals regarding what should be the agency's jurisdiction, responsibilities, rule-writing authority, enforcement powers and methods of funding. Earlier this year, Representatives Delahunt and Brad Miller proposed H.R. 1705, which would create a new Financial Product Safety Commission with jurisdiction over credit, savings and payment products. (Senator Richard Durbin has offered the same proposal, S. 566.) Just last week, President Obama offered a very strong and detailed proposal to create a CFPA with a broad jurisdiction to include not only the above-mentioned products, but also existing fair lending and community reinvestment laws.[60]

In its work to protect consumers and the marketplace from abuses, the CFPA as envisioned by the Administration would have a full set of enforcement and analytical tools. The first tool would be that the CFPA could gather information about the marketplace so that the agency itself could understand the impact of emerging practices in the marketplace. The agency could use this information to improve the information that financial services companies must offer to customers about products, features or practices or to offer advice to consumers directly about the risk of a variety of products on the market. For some of these products, features or practices, the agency might determine that no regulatory intervention is warranted. For others, this information about the market will inform what tools are used. A second tool would be to address and rein in

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[58] The 1 November 2001 letter from Edmund Mierzwinski, U.S. PIRG, to Greenspan is available at http://static.uspirg.org/reports/bigbanks2001/greenspanltr.pdf (last visited 21 June 2009). In that letter, we also urged the regulators to extend Truth In Savings disclosure requirements to the Internet. No action was taken.

[59] The final 2003 report to Congress is available here http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf (last visited 21 June 2009). The 1997-2003 reports can all be accessed from this page, http://www.federalreserve.gov/pubs/reports_other.htm (last visited 21 June 2009).

[60] "Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation," Department of the Treasury, June 17, 2009, pages 55-70.

deceptive marketing practices or require improved disclosure of terms. The third tool would be the identification and regulatory facilitation of "plain vanilla," low risk products that should be widely offered. The fourth tool would be to restrict or ban specific product features or terms that are harmful or not suitable in some circumstances, or that don't meet ordinary consumer expectations. Finally, the CFPA would also have the ability to prohibit dangerous financial products. We can only wonder how much less pain would have been caused for our economy if a regulatory agency had been actively exercising the latter two powers during the run up to the mortgage crisis.

A. Agency Jurisdiction. Under the Administration proposal, the agency will govern the sale and marketing of credit, deposit and payment products and services and related products and services, and will ensure that they are being offered in a fair, sustainable and transparent manner. This should include debit, pre-paid debit, and stored value cards; loan servicing, collection, credit reporting and debt-related services (such as credit counseling, mortgage rescue plans and debt settlement) offered to consumers and small businesses. Our organizations support this jurisdiction because credit products can have different names and be offered by different types of entities, yet still compete for the same customers in the same marketplace. Putting the oversight of competing products under one set of minimum federal rules regardless of who is offering that product will protect consumers, as well as promote innovation provides consumers with valuable options and spurs vigorous competition

As with the Administration and H.R. 1705, we recommend against granting this agency jurisdiction over investment products that are marketed to retail investors, such as mutual funds. While there is a surface logic to this idea, we believe it is impractical and could inadvertently undermine investor protections. Giving the agency responsibility for investment products that is comparable to the proposed authority it would have over credit products would require the agency to add extensive additional staff with expertise that differs greatly from that required for oversight of credit products. Apparently simple matters, such as determining whether a mutual fund risk disclosure is appropriate or a fee is fair, are actually potentially quite complex and would require the new agency to duplicate expertise that already exists within the SEC. Moreover, it would not be possible simply to transfer the staff with that expertise to the new agency, since the SEC would continue to need that expertise on its own staff in order to fulfill its responsibilities for oversight of investment advisers and mutual fund operations. In addition, unless the new agency was given responsibility for all investment products and services a broker might recommend, brokers would be able to work around the new protections with potentially adverse consequences for investors. A broker who wanted to avoid the enhanced disclosures and restrictions required when selling a mutual fund, for example, could get around them by recommending a separately managed account. The investor would likely pay higher fees and receive fewer protections as a result. For these reasons, we believe the costs and risks of this proposal outweigh the potential benefits.

The Administration plan is silent on whether the agency should have any authority over insurance products. We would recommend that strong consideration be given to providing the agency with jurisdiction over insurance products that are central or ancillary to credit transactions, such as credit, title, mortgage and forced place insurance. This would provide the agency with holistic jurisdiction over the entire credit transaction, including ancillary services

often sold with or in connection with the credit. Additionally, there is ample evidence of significant consumer abuses in many of these lines of insurance, including low loss ratios, high mark ups, and “reverse competition” where the insurer competes for the business of the lender, rather than of the insurance consumer.[61] This federal jurisdiction could apply without interfering with the licensing and rate oversight role of the states.

The United States has never sufficiently addressed the problems and challenges of lending discrimination and redlining practices, the vestiges of which include the present day unequal, two-tiered financial system that forces minority and low-income borrowers to pay more for financial services, get less value for their money, and exposes them to greater risk. It is therefore, imperative that the Consumer Financial Protection Agency also focus in a concentrated way on fair lending issues. To that end, the Agency must have a comprehensive Office of Civil Rights which would ensure that no federal agency perpetuated unfair practices and that no member of the financial industry practices business in a way that perpetuates discrimination. Compliance with civil rights statutes and regulations must be a priority at each federal agency that has financial oversight or that enforces a civil rights statute. There must be effective civil rights enforcement of all segments of the financial industry. Moreover, each regulatory and enforcement agency must undertake sufficient reporting and monitoring activities to ensure transparency and hold the agencies accountable. A more detailed description of the civil rights functions that must be undertaken at the CFPA and at other regulatory and enforcement agencies can be found in the Civil Rights Policy Paper available at www.ourfinancialsecurity.org.[62]

B. Rule-Writing . Under the Administration proposal and H.R. 1705, the agency will have broad rule-making authority to effectuate its purposes, including the flexibility to set standards that are adequate to address rapid evolution and changes in the marketplace. Such authority is not a threat to innovation, but rather levels the playing field and protects honest competition, as well as consumers and the economy.

The Administration’s plan also provides rule-making authority for the existing consumer protection laws related to the provision of credit would be transferred to this agency, including the Truth in Lending Act (TILA), Truth in Savings Act (TISA), Home Ownership and Equity Protection Act (HOEPA), Real Estate Protection Act (RESPA), Fair Credit Reporting Act (FCRA), Electronic Fund Transfer Act (EFTA), and Fair Debt Collection Practices Act (FDCPA). (H.R. 1705 is not explicit on this matter.) Current rule-writing authority for nearly 20 existing laws is spread out among at least seven agencies. Some authority is exclusive, some joint, and some is concurrent. However, this hodge-podge of statutory authority has led to fractured and often ineffectual enforcement of these laws. It has also led to a situation where federal rule-writing agencies may be looking at just part of a credit transaction when writing a rule, without considering how the various rules for different parts of the transaction effect the marketplace and the whole transaction. The CFPA with expertise, jurisdiction and oversight that cuts across all segments of the financial products marketplace, will be better able to see

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[61] Testimony of J. Robert Hunter, Director of Insurance, Consumer Federation of America, before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the U.S. House Financial Services Committee, October 30, 2007, pages 8-9.
[62] http://ourfinancialsecurity.org/issues/leveling-the-playing-field/

inconsistencies, unnecessary redundancies, and ineffective regulations. As a market-wide regulator, it would also ensure that critical rules and regulations are not evaded or weakened as agencies compete for advantage for the entities they regulate.

Additionally the agency would have exclusive "organic" federal rule-writing authority within its general jurisdiction to deem products, features, or practices unfair, deceptive, abusive or unsustainable, and otherwise to fulfill its mission and mandate. The rules may range from placing prohibitions, restrictions or conditions on practices, products or features to creating standards, and requiring special monitoring, reporting and impact review of certain products, features or practices.

C. Enforcement. A critical element of a new consumer protection framework is ensuring that consumer protection laws are consistently and effectively enforced. As mentioned above, the current crisis occurred not only because of gaps and weakness in the law, but primarily because the consumer protection laws that we do have were not always enforced. For regulatory reform to be successful, it must encourage compliance by ensuring that wrongdoers are held accountable.

A new CFPA will achieve accountability by relying on a three-legged stool: enforcement by the agency, by states, and by consumers themselves.

First, the CFPA itself will have the tools, the mission and the focus necessary to enforce its mandate. The CFPA will have a range of enforcement tools under the Administration proposal and H.R. 1705. The Administration, for example, would give the agency examination and primary compliance authority over consumer protection matters. This will allow the CFPA to look out for problems and address them in its supervisory capacity. But unlike the banking agencies, whose mission of looking out for safety and soundness led to an exclusive reliance on supervision, the CFPA will have no conflict of interest that prevents it from using its enforcement authority when appropriate. Under both the Administration proposal and H.R. 1705, the agency will have the full range of enforcement powers, including subpoena authority; independent authority to enforce violations of the statues it administers; and civil penalty authority.

Second, both proposals allow states to enforce federal consumer protection laws and the CFPA's rules. As stated in detail in Section 5, states are often closer to emerging threats to consumers and the marketplace. They routinely receive consumer complaints and monitor local practices which will permit state financial regulators to see violations first, spot local trends, and augment the CFPA's resources. The CFPA will have the authority to intervene in actions brought by states, but it can conserve its resources when appropriate. As we have seen in this crisis, states were often the first to act.

Finally, consumers themselves are an essential, in some ways the most essential, element of an enforcement regime. Recourse for individual consumers must, of course, be a key goal of a new consumer protection system. The Administration's plan appropriately states that the private enforcement provisions of existing statutes will not be disturbed, and H.R. 1705 also leaves these protections intact.

The Administration's plan does not address the enforceability of new CFPA rules, but it is equally critical that the consumers who are harmed by violations of these rules be able to take action to protect themselves. H.R. 1705 provides a right of action for consumers to enforce these rules.

Consumers must have the ability to hold those who harm them accountable for numerous reasons:

- No matter how vigorous and how fully funded a new CFPA is, it will not be able to directly redress the vast majority of violations against individuals. The CFPA will likely have thousands of institutions within its jurisdiction. It cannot possibly examine, supervise or enforce compliance by all of them.

- Individuals have much more complete information about the affect of products and practices, and are in the best position to identify violations of laws, take action, and redress the harm they suffer. An agency on the outside looking in often will not have sufficient details to detect abusive behavior or to bring an enforcement action.

- Individuals are an early warning system that can alert states and the CFPA of problems when they first arise, before they become a national problem requiring the attention of a federal agency. The CFPA can monitor individual actions and determine when it is necessary to step in.

- Bolstering public enforcement with private enforcement conserves public resources. A federal agency cannot and should not go after every individual violation.

- Consumer enforcement is a safety net that ensures compliance and accountability after this crisis has passed, when good times return, and when it becomes more tempting for regulators to think that all is well and to take a lighter approach.

- The Administration's plan rightly identifies mandatory arbitration clauses as a barrier to fair adjudication and effective redress. We strongly agree -- but it is also critically important to access to justice that consumers have the right to enforce a rule.

Private enforcement is the norm and has worked well as a complement to public enforcement in the vast majority of the consumer protection statutes that will be consolidated under the CFPA, including TILA, HOEPA, FDCPA, FCRA, EFTA and others.

Conversely, the statutes that lack private enforcement mechanisms are notable for the lack of compliance. The most obvious example is the prohibition against unfair and deceptive practices in Section 5 of the FTC Act. Though the banking agencies eventually identified unfair and deceptive mortgage and credit card practices that should be prohibited (after vigorous congressional prodding), individuals were subject to those practices for years with no redress because they could not enforce the FTC Act. Not only consumers, but the entire economy and

even financial institutions would have been much better off if consumers had been able to take action earlier on, when the abusive practices were just beginning.

Two other statutes that lack private enforcement mechanisms are also notable for the lack of compliance. The right of action under the Truth in Saving Act was eliminated in 2001. As discussed above, a 2008 GAO survey found that 22% of depositories were not complying with TISA's simple disclosure requirements. That is a shockingly high number and shows the effect of the lack of enforcement.

Similarly, RESPA's requirement that homebuyers be given a good faith estimate of closing costs ahead of time also lacks private enforcement, with predictable results: it is honored in the breach. Estimates are often given to homebuyers only moments before a closing, too late to do any good, and when they are given in advance they often bear little resemblance to the actual closing costs. In HUD's latest proposed rulemaking, it cites as one reason the need to make the GFE binding is the prevalence of "surprise 'junk fees'" at closing.[63]

In the debt collection area, the FTC received 78,000 complaints against debt collectors last year, an industry that consistently tops the FTC's list of complaints. Though the weak penalties in the Act are insufficient to deter wrongdoing, consumers at least have the ability to seek redress directly without waiting for the FTC to Act.

The CFPA will have the ability to craft its rules and enforcement regime to protect those who comply. The agency can define "plain vanilla," safe products that are presumptively in compliance. The agency will also be able to craft exemptions from its regulations. But products outside parameters determined to be safe may be subject to principles that carry the risk of significantly higher penalties for violations. Where the agency promulgates a rule addressing features or practices in certain products, private enforcement will be one tool to see that the rule is followed, benefiting both the individuals who use the product and the honest competitors who follow the rules.

This three-legged stool of federal, state, and individual enforcement is critical to making the consumer protection regime work in practice. It ensures that there are no gaps in protections and that lagging attention in one location does not bring down the system. This tripartite approach ensures a friendly competition, a race to the top, not a dangerous scheme of eggs all in one basket.

D. Product evaluation, approval and monitoring. Under the Administration's proposal and HR. 1705, the agency would have significant enforcement and data collection authority to evaluate and to remove, restrict or prevent unfair, deceptive, abusive, discriminatory or unsustainable products, features or practices. The agency could also evaluate and promote practices, products and features that facilitate responsible and affordable credit, payment devices, asset-building and savings. Finally, the agency could assess the risks of both specific products and practices and overall market developments for the purpose of identifying, reducing and preventing excessive risk, (e.g. monitoring longitudinal performance of mortgages with certain

[63] 73 F.R. 14020, 14034

features for excessive failure rates; and monitoring the market share of products and practices that present greater risks, such as weakening underwriting.)

Specifically, we would recommend that the agency take the following approach to product evaluation, approval and monitoring under the proposal offered by the Administration and H.R. 1705:

- Providers of covered products and services could be required to file adequate data and information to allow the agency to make a determination regarding the fairness, sustainability and transparency of products, features and practices. This could include data on product testing, risk modeling, credit performance over time, customer knowledge and behavior, target demographic populations, etc. Providers of products and services that are determined in advance to represent low risk would have to provide de minimus or no information to the agency.
- "Plain vanilla" products, features or practices that are determined to be fair, transparent and sustainable would be determined to be presumptively in compliance and face less regulatory scrutiny and fewer restrictions.
- Products, features or practices that are determined to be potentially unfair, unsustainable, discriminatory, deceptive or too complex for its target population might be required to meet increased regulatory requirements and face increased enforcement and remedies.
- In limited cases, products, features or practices that are deemed to be particularly risky could face increased filing and data disclosure requirements, limited roll-out mandates, post-market evaluation requirements and, possibly, a stipulation of pre-approval before they are allowed to enter or be used in the marketplace. Harvard Professor Daniel Carpenter has offered some thoughtful ideas on how such an ex ante approval process might work fairly and effectively.[64]
- The long-term performance of various types of products and features would be evaluated, and results made transparent and available broadly to the public, as well as to providers, Congress, and the media to facilitate informed choice.
- The Agency should hold periodic public hearings to examine products, practices and market developments to facilitate the above duties, including the adequacy of existing regulation and legislation, and the identification of both promising and risky market developments. These hearings would be especially important in examination of new market developments, such as, for example, where credit applications will soon be submitted via a mobile phone, for example, and consumer dependence on the Internet for conducting financial transactions is expected to grow dramatically. In such hearings, in rule-makings, and in other appropriate circumstances, the Agency should ensure that there is both opportunity and means for meaningful public input, including consideration of existing models such as funded public interveners.

E. Funding. The Administration proposal is fairly vague on how it should be funded. H.R. 1705 would fund the agency through Congressional appropriations. The major goals for the agency would be to have a stable (not volatile) funding base that is sufficient to support robust

[64] "Particulars of a Financial Product Safety Commission," Professor Daniel Carpenter, Director of the Center for Political Studies, Harvard University, The Tobin Project.

enforcement and is not subject to political manipulation by regulated entities. Funding from a variety of sources, as well as a mix of these sources, should be considered, including Congressional appropriations, user fees or industry assessments, filing fees, priced services (such as for compliance examinations) and transaction-based fees. See Appendix 4 for a comparison of current agency funding and fee structures.

None of these funding sources is without serious weaknesses. Industry assessments or user fees can provide the regulated entity with considerable leverage over the budget of the agency and facilitate regulatory capture of the agency, especially if the regulated party is granted any discretion over the amount of the assessment (or is allowed to decide who regulates them and shift its assessment to another agency.) Transaction-based fees can be volatile and unpredictable, especially during economic downturns. Filing fees can also decline significantly if economic activity falls. Congressional appropriations, as we have seen with other federal consumer protection agencies over the last half-century, can be fairly easily targeted for reduction or restriction by well funded special interests if these interests perceive that the agency has been too effective or aggressive in pursing its mission.

If an industry-based funding method is used, it should ensure that all providers of covered products and services are contributing equally based on their size and the nature of the products they offer. A primary consideration in designing any industry-based funding structure is that certain elements of these sectors should not be able to evade the full funding requirement, through charter shopping or other means. If such requirements can be met, we would recommend a blended funding structure from multiple sources that requires regulated entities to fund the baseline budget of the agency and Congressional appropriations to supplement this budget if the agency demonstrates an unexpected or unusual demand for its services.

F. Consumer Complaints. As the Administration proposal details, the agency should receive, analyze and work to resolve all federally-directed complaints regarding credit or payment products, features or practices under the agency's jurisdiction. Ideally, the agency should be the sole repository of consumer complaints on products, features or practices within its jurisdiction, and should ensure that this is a role that is readily visible to consumers, simple to access and responsive. The agency should also be required to conduct real-time analysis of consumer complaints regarding patterns and practices in the credit and payment systems industries and to apply these analyses when writing rules and enforcing rules and laws. From the Foundation document:

> *The CFPA should have responsibility for collecting and tracking complaints about consumer financial services and facilitating complaint resolution with respect to federally-supervised institutions. Other federal supervisory agencies should refer any complaints they receive on consumer issues to the CFPA; complaint data should be shared across agencies....*[65]

G. Federal preemption of state laws. As the Administration proposal states, the agency should establish minimum standards within its jurisdictions. CFPA rules would preempt weaker state laws, but states that choose to exceed the standards established by the CFPA could do so. The

[65] "A New Foundation", Pages 59-60, The Obama Administration, June 2009

agency's rules would preempt statutory state law only when it is impossible to comply with both state and federal law.

We also strongly agree with the Administration recommendation that federally chartered institutions be subject to nondiscriminatory state consumer protection and civil rights laws to the same extent as other financial institutions. A clear lesson of the financial crisis, which pervades the Administration's plan, is that protections should apply consistently across the board, based on the product or service that is being offered, not who is offering it.

Restoring the viability of our background state consumer protection laws is also essential to the flexibility and accountability of the system in the long run. The specific rules issued by the CFPA and the specific statutes enacted by Congress will never be able to anticipate every innovative abuse designed to avoid those rules and statutes. The fundamental state consumer protection laws, both statutory and common law, against unfair and deceptive practices, fraud, good faith and fair dealing, and other basic, longstanding legal rules are the ones that spring up to protect consumers when a new abuse surfaces that falls within the cracks of more specific laws. We discuss preemption in greater detail in the next section.

H. Consumer Empowerment: As discussed briefly above, the CFPA should have the authority to grant intervener funding to consumer organizations to fund expert participation in its stakeholder activities. The model has been used successfully to fund consumer group participation in state utility ratemaking. Second, a government-chartered consumer organization should be created by Congress to represent consumers' financial services interests before regulatory, legislative, and judicial bodies, including before the CFPA. This organization could be financed through voluntary user fees such as a consumer check-off included in the monthly statements financial firms send to their customers. It would be charged with giving consumers, depositors, small investors and taxpayers their own financial reform organization to counter the power of the financial sector, and to participate fully in rulemakings, adjudications, and lobbying and other activities now dominated by the financial lobby.[66]

SECTION 5. REBUTTAL TO ARGUMENTS AGAINST THE CFPA

Proactive, affirmative consumer protection is essential to modernizing financial system oversight and to reducing risk. The current crisis illustrates the high costs of a failure to provide effective consumer protection. The complex financial instruments that sparked the financial crisis were based on home loans that were poorly underwritten; unsuitable to the borrower; arranged by persons not bound to act in the best interest of the borrower; or contained terms so complex that many individual homeowners had little opportunity to fully understand the nature or magnitude of the risks of these loans. The crisis was magnified by highly leveraged, largely unregulated financial instruments and inadequate risk management.

Opponents of reform of the financial system have made several arguments against the establishment of a strong independent Consumer Financial Protection Agency. Indeed, the new CFPA appears to be among their main targets for criticism, compared with other elements of the

[66] As his last legislative activity, in October 2002. , Senator Paul Wellstone proposed establishment of such an organization, the Consumer and Shareholder Protection Association, S 3143.

reform plan. They have basically made six arguments. They have argued that regulators already have the powers it would be given, that it would be a redundant layer of bureaucracy, that consumer protection cannot be separated from supervision, that it will stifle innovation, that it would be unfair to small institutions and that its anti-preemption provision would lead to balkanization. Each of these arguments is wrong.

A. Opponents argue that regulators already have the powers that the CFPA would be given.

This argument is effectively a defense of the status quo, which has led to disastrous results. Current regulators already have between them some of the powers that the new agency would be given, but they haven't used them. Conflicts of interest and missions and a lack of will have worked against consumer enforcement. While our section above goes into greater detail on the failures of the regulators, two examples will illustrate:

- **NO HOEPA RULES UNTIL 2008:** The Federal Reserve Board was granted sweeping anti-predatory mortgage regulatory authority by the 1994 Home Ownership and Equity Protection Act (HOEPA). Final regulations were issued on 30 July 2008 only after the world economy had collapsed due to the collapse of the U.S. housing market triggered by predatory lending.[67]

- **NO ACTION ON ABUSIVE CREDIT CARD PRACTICES UNTIL LATE 2008:** Further, between 1995 and 2007, the Office of the Comptroller of Currency issued only one public enforcement action against a Top Ten credit card bank (and then only after the San Francisco District Attorney had brought an enforcement action) and only one other public enforcement order against a mortgage subsidiary of a large national bank (only after HUD initiated action). In that period, "the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws.[68]" The OCC's failure to act on rising credit card complaints at the largest national banks triggered Congress to investigate, resulting in passage of the 2009 Credit Card Accountability, Responsibility and Disclosure Act (CARD Act).[69] While that law was under consideration, other federal regulators used their authority under the Federal Trade Commission Act to propose and finalize a similar rule.[70] By contrast, the OCC requested the addition of two significant loopholes to a key protection of the proposed rule.

Federal bank regulators currently face at least two conflicts. First, their primary mission is prudential supervision, with enforcement of consumer laws taking a back seat. Second, charter shopping in combination with agency funding by regulated entities encourages a regulatory race to the bottom as banks choose the regulator of least resistance. In particular, the Office of the Comptroller of the Currency and the Office of Thrift Supervision have failed utterly to protect

[67] 73 FR 147, Page 44522, Final HOEPA Rule, 30 July 2008
[68] Testimony of Professor Arthur Wilmarth, 26 April 2007, before the Subcommittee on Financial Institutions and Consumer Credit, hearing on Credit Card Practices: Current Consumer And Regulatory Issues http://www.house.gov/financialservices/hearing110/htwilmarth042607.pdf
[69] HR 627 was signed into law by President Obama as Public Law No: 111-24 on 22 May 2009.
[70] The final rule was published in the Federal Register a month later. 74 FR 18, page 5498 Thursday, January 29, 2009

consumers, let alone the safety and soundness of regulated entities. Instead, they competed with each other to minimize consumer protection standards as a way of attracting institutions to their charters, which meant that they tied their own hands and failed to fulfill their missions. (Note: they weren't trying to fail, but that was a critical side effect of the charter competition).

Establishing a new consumer agency that has consumer protection as its only mission and that regulated firms cannot hide from by charter-shopping is the best way to guarantee that consumer laws will receive sustained, thoughtful, proactive attention from a federal regulator.

B. Opponents argue that the CFPA would be a redundant layer of bureaucracy.

We do not propose a new regulatory agency because we seek more regulation, but because we seek better regulation. The very existence of an agency devoted to consumer protection in financial services will be a strong incentive for institutions to develop strong cultures of consumer protection.

-- The Obama Administration, *Financial Regulatory Reform: A New Foundation,* page 57

The new CFPA would *not* be a redundant layer of bureaucracy. To the contrary, the new agency would consolidate and streamline federal consumer protection for credit, savings and payment products that is now required in almost 20 different statutes and divided between seven different agencies. As the New Foundation document continues:

> *The core of such an agency can be assembled reasonably quickly from discrete operations of other agencies. Most rule writing authority is concentrated in a single division of the Federal Reserve, and three of the four federal banking agencies have mostly or entirely separated consumer compliance supervision from prudential supervision. Combining staff from different agencies is not simple, to be sure, but it will bring significant benefits for responsible consumers and institutions, as well as for the market for consumer financial services and products.*[71]

And today, a single transaction such as a mortgage loan is subject to regulations promulgated by several agencies and may be made or arranged by an entity supervised by any of several other agencies. Under the CFPA, one federal agency will write the rules and see that they are followed.

C. Opponents argue that consumer protection cannot be separated from supervision.

The current regulatory consolidation of both of these functions has led to the subjugation of consumer protection in most cases, to the great harm of Americans and the economy. Nevertheless, trade associations for many of the financial institutions that have inflicted this harm claim that a new approach that puts consumer protection at the center of financial regulatory efforts will not work. The American Bankers Association, for example, states that

[71] The Obama Administration, Financial Regulatory Reform: A New Foundation, page 57

while the length of time banks hold checks under Regulation CC may be a consumer issue, "fraud and payments systems operational issues" are not.[72]

Again, as the administration points out in its carefully thought-out blueprint for the new agency:

> *The CFPA would be required to consult with other federal regulators to promote consistency with prudential, market, and systemic objectives. Our proposal to allocate one of the CFPA's five board seats to a prudential regulator would facilitate appropriate coordination*.[73]

We concur that the new agency should have full rulemaking authority over all consumer statutes. The checks and balances proposed by the administration, including the consultative requirement and the placement of a prudential regulator on its board and its requirement to share confidential examination reports with the prudential regulators will address these concerns. In addition, the Administration's plan provides the CFPA with full compliance authority to examine and evaluate the impact of any proposed consumer protection measure on the bottom line of affected financial institutions. While collaboration between regulators will be very important, it should not be used as an excuse by either the CFPA or other regulators to unnecessarily delay needed action. The GAO, for example, has identified time delays in interagency processes as a contributor to the mortgage crisis.[74] This is why it is important that the CFPA retain final rulemaking authority, as proposed under the Administration's plan. Such authority, along with the above mentioned mandates, will ensure that both the CFPA and the federal prudential regulator collaborate on a timely basis.

For most of the last twenty years, bank regulators have shown little understanding of consumer protection and have not used powers they have long held. OCC's traditional focus and experience has been on safety and soundness, rather than consumer protection.[75] Its record on consumer protection enforcement is one of little experience and little evidence of expertise. In contrast, as already noted, the states have long experience in enforcement of non-preempted state consumer protection laws. OCC admits that it was not until 2000 that it invoked long-dormant consumer protection authority provided by the 1975 amendments to the Federal Trade Commission Act.[76]

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[72] Letter of 28 May 2009 from the American Bankers Association to Treasury Secretary Tim Geithner, available at http://www.aba.com/NR/rdonlyres/4640E4F1-4BC9-4187-B9A6-E3705DD9B307/60161/GeithnerMay282009.pdf (last viewed 21 June 2009).

[73] The Obama Administration, Financial Regulatory Reform: A New Foundation, page 59

[74] "As we note in our report, efforts by regulators to respond to the increased risks associated with the new mortgage products were sometimes slowed in part because of the need for five federal regulators to coordinate their response." "Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System, Testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs, February 4, 2009, pages 15-16.

[75] *See* Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 Temp. L. Rev. 1, 73 (2005).

[76] *See* Julie L. Williams & Michael L. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1244, 1246 & n.25, 1253 (2003) (citing authority from the early 1970s indicating that OCC had the authority to bring such an action under Section 8 of the Federal Deposit Insurance Act, noting that OCC brought its first such case in 2000, and conceding that "[a]n

D. Opponents argue that a single agency focused on consumer protection will "stifle innovation" in the financial services marketplace.

To the contrary, protecting consumers from traps and tricks when they purchase credit, savings or payment products should encourage confidence in the financial services marketplace and spur innovation. As Nobel Laureate Joseph Stiglitz has said:

> *There will be those who argue that this regulatory regime will stifle innovation. However, a disproportionate part of the innovations in our financial system have been aimed at tax, regulatory, and accounting arbitrage. They did not produce innovations which would have helped our economy manage some critical risks better—like the risk of home ownership. In fact, their innovations made things worse. I believe that a well-designed regulatory system, along the lines I've mentioned, will be more competitive and more innovative—with more of the innovative effort directed at innovations which will enhance the productivity of our firms and the well-being, including the economic security, of our citizens.*[77]

E. Opponents argue that the CFPA would place an unfair regulatory burden on small banks and thrifts.

Small banks and thrifts that offer responsible credit and payment products should face a lower regulatory burden under regulation by a CFPA. Members of Congress, the media and consumer organizations have properly focused on the role of large, national banks and thrifts in using unsustainable, unfair and deceptive mortgage and credit card lending practices. In contrast, many smaller banks and thrifts have justifiably been praised for their more responsible lending practices in theses areas. In such situations, the CFPA would promote fewer restrictions and less oversight for "plain vanilla" products that are simple, straight-forward and fair.

However, it is also important to note that some smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA. More than 75 percent of state chartered banks surveyed by the FDIC, for example, automatically enrolled customers in high-cost overdraft loan programs without consumers' consent. Some of these banks deny consumers the ability to even opt out of being charged high fees for overdraft transactions that the banks chose to permit. Smaller banks have also been leaders in facilitating high-cost refund anticipation loans, in helping payday lenders to evade state loan restrictions and in offering deceptive and extraordinarily expensive "fee harvester" credit cards. (See appendix 1 for more information.)

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obvious question is why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act").

[77] "Too Big to Fail or too Big to Save? Examining the Systemic Threats of Large Financial Institutions," Joseph E. Stiglitz, April 21, 2009, page 10.

F. Opponents argue that the agency's authority to establish only a federal floor of consumer protection would lead to regulatory inefficiency and balkanization.

The loudest opposition to the new agency will likely be aimed at the administration's sensible proposal that CFPA's rules be a federal floor and that the states be allowed to enact stronger consumer laws that are not inconsistent, as well as to enforce both federal and state laws. This proposed return to common sense protections is strongly endorsed by consumer advocates and state attorneys general.

We expect the banks and other opponents to claim that the result will be 51 balkanized laws that place undue costs on financial institutions that are then passed onto consumers in the form of higher priced or less available loans. In fact, this approach is likely to lead to a high degree of regulatory uniformity (if the CFPA sets high minimum standards,) greater protections for consumers without a significant impact on cost or availability, increased public confidence in the credit markets and financial institutions, and less economic volatility. For example, comprehensive research by the Center for Responsible Lending found that subprime mortgage loans in states that acted vigorously to rein in predatory mortgage lending before they were preempted by the OCC had fewer abusive terms. In states with stronger protections, interest rates on subprime mortgages did not increase, and instead, sometimes decreased, without reducing the availability of these loans.[78] Additionally, as Nobel Laureate Joseph Stiglitz has pointed out, the cost of regulatory duplication is miniscule to the cost of the regulatory failure that has occurred.[79]

It is also clear that the long campaign of preemption by the OTS and OCC, culminating in the 2004 OCC rules, contributed greatly to the current predatory lending crisis. After a discussion of the OCC's action eliminating state authority, we will discuss more generally why federal consumer law should always be a floor.

F.1 The OCC's Preemption of State Laws Exacerbated The Crisis

In 2000-2004, the OCC worked with increasing aggressiveness to prevent the states from enforcing state laws and stronger state consumer protection standards against national banks and their operating subsidiaries, from investigating or monitoring national banks and their operating subsidiaries, and from seeking relief for consumers from national banks and subsidiaries.

These efforts began with interpretative letters stopping state enforcement and state standards in the period up to 2004, followed by OCC's wide-ranging preemption regulations in 2004 purporting to interpret the National Bank Act, plus briefs in court cases supporting national banks' efforts to block state consumer protections.

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[78] Wei Li and Keith S. Ernst, Center for Responsible Lending, The Best Value in the Subprime Market: State Predatory Lending Reforms, February, 23, 2006, page 6.

[79] "Some worry about the cost of duplication. But when we compare the cost of duplication to the cost of damage from inadequate regulation—not just the cost to the taxpayer of the bail-outs but also the costs to the economy from the fact that we will be performing well below our potential—it is clear that there is not comparison," Testimony of Dr. Joseph E. Stiglitz, Professor, Columbia University, before the House Financial Services Committee, October 21, 2008, page 16.

In a letter to banks on November 25, 2002, the OCC openly instructed banks that they "should contact the OCC in situations where a State official seeks to assert supervisory authority or enforcement jurisdiction over the bank."[80] The banks apparently accepted this invitation, notifying the OCC of state efforts to investigate or enforce state laws. The OCC responded with letters to banks and to state banking agencies asserting that the states had no authority to enforce state laws against national banks and subsidiaries, and that the banks need not comply with the state laws.[81]

For example, the OCC responded to National City Bank of Indiana, and its operating subsidiaries, National City Mortgage Company, First Franklin Financial Corporation, and Altegra Credit Company, regarding Ohio's authority to monitor their mortgage banking and servicing businesses. That opinion concluded that "the OCC's exclusive visitorial powers preclude States from asserting supervisory authority or enforcement jurisdiction over the Subsidiaries."[82]

The OCC responded to Bank of America, N.A., and its operating subsidiary, BA Mortgage LLC, regarding California's authority to examine the operating subsidiary's mortgage banking and servicing businesses and whether the operating subsidiary was required to maintain a license under the California Residential Mortgage Lending Act. That opinion concluded that "the Operating Subsidiary also is not subject to State or local licensing requirements and is not required to obtain a license from the State of California in order to conduct business in that State." [83]

The OCC wrote the Pennsylvania Department of Banking, stating that Pennsylvania does not have the authority to supervise an unnamed national bank's unnamed operating subsidiary which engages in subprime mortgage lending.[84] (The national bank and operating subsidiary were not named because this interpretive letter was unpublished.)

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80. Office of the Comptroller of the Currency, Interpretive Letter No. 957 n.2 (Jan. 27, 2003) (citing OCC Advisory Letter 2002-9 (Nov. 25, 2002)) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int957.doc , and available at 2003 OCC Ltr. LEXIS 11).

81. *E.g.*, Office of the Comptroller of the Currency, Interpretive Letter No. 971 (Jan. 16, 2003) (letter to Pennsylvania Department of Banking, that it does not have the authority to supervise an unnamed national bank's unnamed operating subsidiary which engages in subprime mortgage lending (unnamed because the interpretive letter is unpublished) (viewed Jun. 19, 2009, at http://comptrollerofthecurrency.gov/interp/sep03/int971.doc, and available at 2003 OCC QJ LEXIS 107).

82. Office of the Comptroller of the Currency, Interpretive Letter No. 958 (Jan. 27, 2003) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int958.pdf, and available at 2003 OCC Ltr. LEXIS 10).

83. The OCC's exclusive visitorial powers preclude States from asserting supervisory authority or enforcement jurisdiction over the Subsidiaries (Jan. 27, 2003) (viewed Jun. 19, 2009, at http://www.occ.treas.gov/interp/mar03/int957.doc), and available at 2003 OCC Ltr. LEXIS 11).

84. Office of the Comptroller of the Currency, Interpretive Letter No. 971 (unpublished) (Jan. 16, 2003) (viewed Jun. 19, 2009, at http://comptrollerofthecurrency.gov/interp/sep03/int971.doc, and available at 2003 OCC QJ LEXIS 107).

The OCC even issued a formal preemption determination and order, stating that "the provisions of the GFLA [Georgia Fair Lending Act] affecting national banks' real estate lending are preempted by Federal law" and "issuing an order providing that the GFLA does not apply to National City or to any other national bank or national bank operating subsidiary that engages in real estate lending activities in Georgia."[85]

As Business Week pointed out in 2003, not only did states attempt to pass laws to stop predatory lending, they also attempted to warn federal regulators that the problem was getting worse.[86]

> *A number of factors contributed to the mortgage disaster and credit crunch. Interest rate cuts and unprecedented foreign capital infusions fueled thoughtless lending on Main Street and arrogant gambling on Wall Street. The trading of esoteric derivatives amplified risks it was supposed to mute. One cause, though, has been largely overlooked: the stifling of prescient state enforcers and legislators who tried to contain the greed and foolishness. They were thwarted in many cases by Washington officials hostile to regulation and a financial industry adept at exploiting this ideology.*

Under the proposal, critical authority will be returned to those attorneys general, who have demonstrated both the capacity and the will to enforce consumer laws. In addition to losing the states' experience in enforcing such matters, depriving the states of the right to enforce their non-preempted consumer protection laws raises serious concerns of capacity. According to a recent congressional report, state banking agencies and state attorneys general offices employ nearly 700 full time staff to monitor compliance with consumer laws, more than seventeen times the number of OCC personnel then allocated to investigate consumer complaints.[87]

Earlier this year, Illinois Attorney General Lisa Madigan testified before this committee and outlined the numerous major, multi-state cases against predatory lending that have been brought by her office and other state offices of attorneys general. However, she included this caveat:

> *State enforcement actions have been hamstrung by the dual forces of preemption of state authority and lack of federal oversight. The authority of state attorneys general to enforce consumer protection laws of general applicability was challenged at precisely the time it was most needed – when the amount of subprime lending exploded and riskier and riskier mortgage products came into the marketplace.*[88]

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[85] Office of the Comptroller of the Currency, Preemption Determination and Order, 68 Fed. Reg. 46,264, 46,264 (Aug. 5, 2003).

[86] Robert Berner and Brian Grow, "They Warned Us About the Mortgage Crisis," Business Week, 9 October 2008, available at http://www.businessweek.com/magazine/content/08_42/b4104036827981.htm, (last visited 21 June 2009).

[87] See H. Comm. on Financial Services, 108th Cong., Views and Estimates on Matters To Be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2005, at 16 (Comm. Print 2004). "In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."

[88] Testimony of Illinois Attorney General Lisa Madigan Before the Committee on Financial Services, Hearing on Federal and State Enforcement of Financial Consumer and Investor Protection Laws, 20 March 2009, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/il_-_madigan.pdf (last visited 22 June 2009).

This month, General Madigan and seven colleagues sent President Obama a letter supporting a Consumer Financial Protection Agency preserving state enforcement authority:

> *[W]e believe that any reform must (1) preserve State enforcement authority, (2) place federal consumer protection powers with an agency that is focused primarily on consumer protection, and (3) place primary oversight with government agencies and not depend on industry self regulation.*[89]

F.2 Why Federal Law Should Always Be a Floor

Consumers need state laws to prevent and solve consumer problems. State legislators generally have smaller districts than members of Congress do. State legislators are closer to the needs of their constituents than members of Congress. States often act sooner than Congress on new consumer problems. Unlike Congress, a state legislature may act before a harmful practice becomes entrenched nationwide. In a September 22, 2003 speech to the American Bankers Association in Hawaii, Comptroller John D. Hawke admitted that consumer protection activities "are virtually always responsive to real abuses." He continued by pointing out that Congress moves slowly. Comptroller Hawke said, "It is generally quite unusual for Congress to move quickly on regulatory legislation – the Gramm-Leach-Bliley privacy provisions being a major exception. Most often they respond only when there is evidence of some persistent abuse in the marketplace over a long period of time." U.S. consumers should not have to wait for a persistent, nationwide abuse by banks before a remedy or a preventative law can be passed and enforced by a state to protect them.

States can and do act more quickly than Congress, and states can and do respond to emerging practices that can harm consumers while those practices are still regional, before they spread nationwide. These examples extend far beyond the financial services marketplace.

States and even local jurisdictions have long been the laboratories for innovative public policy, particularly in the realm of environmental and consumer protection. The federal Clean Air Act grew out of a growing state and municipal movement to enact air pollution control measures. The national organic labeling law, enacted in October 2002, was passed only after several states, including Oregon, Washington, Texas, Idaho, California, and Colorado, passed their own laws. In 1982, Arizona enacted the first "Motor Voter" law to allow citizens to register to vote when applying for or renewing drivers' licenses; Colorado placed the issue on the ballot, passing its Motor Voter law in 1984. National legislation followed suit in 1993. Cities and counties have long led the smoke-free indoor air movement, prompting states to begin acting, while Congress, until this month, proved itself virtually incapable of adequately regulating the tobacco industry. A recent and highly successful FTC program—the National Do Not Call Registry to which fifty-eight million consumers have added their names in one year—had already been enacted in forty states.

But in the area of financial services, where state preemption has arguably been the harshest and most sweeping, examples of innovative state activity are still numerous. In the past five years,

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[89] Letter of 15 June 2009 from the chief legal enforcement officers of eight states (California, Connecticut, Illinois, Iowa, Maryland, Massachusetts, North Carolina and Ohio) to President Obama, on file with the authors.

since the OCC's preemption regulations have blocked most state consumer protections from application to national banks, one area illustrating the power of state innovation has been in identity theft, where the states have developed important new consumer protections that are not directed primarily at banking. In the area of identity theft, states are taking actions based on a non-preemptive section of the Fair Credit Reporting Act, where they still have the authority to act against other actors than national banks or their subsidiaries.

There are seven to ten million victims of identity theft in the U.S. every year, yet Congress did not enact modest protections such as a security alert and a consumer block on credit report information generated by a thief until passage of the Fair and Accurate Credit Transactions Act (FACT Act or FACTA) in 2003. That law adopted just some of the identity theft protections that had already been enacted in states such as California, Connecticut, Louisiana, Texas, and Virginia.[90]

Additionally FACTA's centerpiece protection against both inaccuracies and identity theft, access to a free credit report annually on request, had already been adopted by seven states: Colorado, Georgia, Maine, Maryland, Massachusetts, New Jersey and Vermont. Further, California in 2000, following a joint campaign by consumer groups and realtors, became the first state to prohibit contractual restrictions on realtors showing consumers their credit scores, ending a decade of stalling by Congress and the FTC.[91] The FACT act extended this provision nationwide.

Yet, despite these provisions, advocates knew that the 2003 federal FACTA law would not solve all identity theft problems. Following strenuous opposition by consumer advocates to the blanket preemption routinely sought by industry as a condition of all remedial federal financial legislation, the final 2003 FACT Act continued to allow states to take additional actions to prevent identity theft. The results have been significant.

Since its passage, fully 47 states and the District of Columbia have granted consumers the right to prevent access to their credit reports by identity thieves through a security freeze. Indeed, even the credit bureaus, longtime opponents of the freeze, then adopted the freeze nationwide.[92]

A key principle of federalism is the role of the states as laboratories for the development of law.[93] State and federal consumer protection laws can develop in tandem. After one or a few states legislate in an area, the record and the solutions developed in those states provide important information for Congress to use in deciding whether to adopt a national law, how to craft such a law, and whether or not any new national law should displace state law.

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[90] See California Civil Code §§ 1785.11.1, 1785.11.2, 1785,16.1; Conn. SB 688 §9(d), (e), Conn. Gen. Stats. § 36a-699; IL Re. Stat. Ch. 505 § 2MM; LA Rev. Stat. §§ 9:3568B.1, 9:3568C, 9:3568D, 9:3571.1 (H)-(L); Tex. Bus. & Comm. Code §§ 20.01(7), 20.031, 20.034-039, 20.04; VA Code §§ 18.2-186.31:E.

[91] See 2000 Cal. Legis. Serv. 978 (West). This session law was authored by State Senator Liz Figueroa. "An act to amend Sections 1785.10, 1785.15, and 1785.16 of, and to add Sections 1785.15.1, 1785.15.2, and 1785.20.2 to the Civil Code, relating to consumer credit."

[92] Consumers Union, U.S. PIRG and AARP cooperated on a model state security freeze proposal that helped ensure that the state laws were not balkanized, but converged toward a common standard. More information on the state security freeze laws is available at http://www.consumersunion.org/campaigns/learn_more/003484indiv.html (last visited 21 June 2009).

[93] *New State Ice Co. v. Leibman*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

A few more examples from California illustrate the important role of the states as a laboratory and a catalyst for federal consumer protections for bank customers. In 1986, California required that specific information be included in credit card solicitations with enactment of the then-titled Areias-Robbins Credit Card Full Disclosure Act of 1986. That statute required every credit card solicitation to contain a chart showing the interest rate, grace period, and annual fee.[94] Two years later, Congress chose to adopt the same concept in the Federal Fair Credit and Charge Card Disclosure Act (FCCCDA), setting standards for credit card solicitations, applications and renewals.[95] The 1989 federal disclosure box[96] (know as the "Schumer Box") is strikingly similar to the disclosure form required under the 1986 California law.

States also led the way in protecting financial services consumers from long holds on deposited checks. California enacted restrictions on the length of time a bank could hold funds deposited by a consumer in 1983; Congress followed in 1986. California's 1983 funds availability statute required the California Superintendent of Banks, Savings and Loan Commissioner, and Commissioner of Corporations to issue regulations to define a reasonable time after which a consumer must be able to withdraw funds from an item deposited in the consumer's account.[97] Similar laws were passed in Massachusetts, New York, New Jersey and other states. Congress followed a few years later with the federal Expedited Funds Availability Act of 1986.[98] California led the way on security breach notice legislation. Its law and those of other states have functioned as a de facto national security breach law, while Congress has failed to act.[99]

It is certainly not the case that states always provide effective consumer protection. The states have also been the scene of some notable regulatory breakdowns in recent years, such as the failure of some states to properly regulate mortgage brokers and non-bank lenders operating in the sub-prime lending market, and the inability or unwillingness of many states to rein in lenders that offer extraordinarily high-cost, short term loans and trap consumers in an unsustainable cycle of debt, such as payday lenders and auto title loan companies. Conversely, federal lawmakers have had some notable successes in providing a high level of financial services consumer protections in the last decade, such as the Credit Repair Organizations Act and the recently enacted Military Lending Act.[100] This is why it is necessary for this new federal agency to ensure that a minimum level of consumer protection is established in all states.

Nonetheless, as these examples show, state law is an important source of ideas for future federal consumer protections. As Justice Brandeis said in his dissent in New State Ice Co., "Denial of the right [of states] to experiment may be fraught with serious consequences to the Nation" (285 U.S. at 311). A state law will not serve this purpose if states cannot apply their laws to national banks, who are big players in the marketplace for credit and banking services. State lawmakers

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[94] 1986 Cal. Stats., Ch. 1397, codified at California Civil Code § 1748.11.
[95] P. L. 100-583, 102 Stat. 2960 (Nov. 1, 1988), codified in part at 15 U.S.C. §§ 1637(c) and 1610(e).
[96] 54 Fed. Reg. 13855 (April 6, 1989 Appendix G, form G-10(B)).
[97] 1983 Cal. Stat. Ch. 1011, § 2, codified at Cal. Fin. Code § 866.5.
[98] P. L. 100-86, Aug. 10, 1987, 101 Stat. 552, 635, codified at 12 U.S.C. § 4001.
[99] More information on state security breach notice laws is available at http://www.consumersunion.org/campaigns//financialprivacynow/002215indiv.html (last visited 21 June 2009).
[100] Military Lending Act, 10 U.S.C. § 987. Credit Repair Organizations Act, 15 U.S.C. § 1679h (giving state Attorneys General and FTC concurrent enforcement authority).

simply won't pass new consumer protection laws that do not apply to the largest players in the banking marketplace.

Efficient federal public policy is one that is balanced at the point where even though the states have the authority to act, they feel no need to do so. Since we cannot guarantee that we are ever at that optimum, setting federal law as a floor of protection as the default—without also preempting the states—allows us to retain the safety net of state-federal competition to guarantee the best public policy.[101]

CONCLUSION

As detailed above, a strong federal commitment to robust consumer protection is central to restoring and maintaining a sound economy. The nation's financial crisis grew out of the proliferation of inappropriate and unsustainable lending practices that could have and should have been prevented. That failure harmed millions of American families, undermined the safety and soundness of the lending institutions themselves, and imperiled the economy as a whole. In Congress, a climate of deregulation and undue deference to industry blocked essential reforms. In the agencies, the regulators' failure to act, despite abundant evidence of the need, highlights the inadequacies of the current regulatory regime, in which none of the many financial regulators regard consumer protection as a priority.

As outlined in the testimony above, establishment of a single Consumer Financial Protection Agency is a critical part of financial reform. As detailed above, its funding must be robust, independent and stable. Its board and governance must be structured to ensure strong and effective consumer input, and a Consumer Advocate should be appointed to report semi-annually to Congress on agency effectiveness.

Our organizations, along with many other consumer, community, civil rights, labor and progressive financial institutions, believe that restoring consumer protection should be a cornerstone of financial reform. It will reduce risk and make the system more accountable to American families. We recognize, however, that other reforms are needed to restore confidence to the financial system. Our coalition ideas on these and other matters can be found at the website of Americans For Financial Reform, available at ourfinancialsecurity.org.

Thank you for the opportunity to testify. Our organizations look forward to working with you to move the strongest possible Consumer Financial Protection Agency through the House of Representatives and into law.

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[101] For further discussion, see Edmund Mierzwinski, "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," Government, Law and Policy Journal of the New York State Bar Association Spring 2004 (Vol. 6, No. 1, pgs. 6-12).

Attachments:

Appendix 1: Abusive Lending Practices by Smaller Banks and Thrifts

Appendix 2: Private Student Loan Regulatory Failures and Reform Recommendations

Appendix 3: Rent-A-Bank Payday Lending

Appendix 4: Information on Income (primarily user and transaction fees depending on agency) of Major Financial Regulatory Agencies

Appendix 1: Abusive Lending Practices by Smaller Banks and Thrifts

Members of Congress, the media and consumer organizations have properly focused on the role of large, national banks and thrifts in using unsustainable, unfair and deceptive mortgage and credit card lending practices. In contrast, smaller banks and thrifts have justifiably been praised for their more responsible lending practices in theses areas. However, when considering the need for and responsibilities of a federal Consumer Financial Protection Agency, it is also important to note that some smaller banks and thrifts have, unfortunately, been on the cutting edge of a number of other abusive lending practices that are harmful to consumers and that must be addressed by a CFPA.

High Cost Refund Anticipation Loans

The high cost refund anticipation loans (RALs) sold by tax preparers to the working poor are made by some of the largest banks, JPMorgan Chase and HSBC, but also by much smaller Santa Barbara Bank & Trust and Republic Bank & Trust. In fact, refund anticipation loans offered by the two smaller banks are much more expensive than those now sold by Chase and HSBC. For the 2009 tax season, a typical $3,000 refund anticipation loan cost $62.14 at H&R Block through HSBC and $62 through independent preparers who used JPMorgan Chase to make RALs. In contrast, Republic Bank & Trust charged $110.45 and Santa Barbara Bank & Trust charged $104.95 for the same $3,000 RAL. Furthermore, Santa Barbara permits the independent tax preparers with whom it partners to charge an additional $40 (we do not have information on the amount of additional fees for Republic Bank & Trust). With all fees included the annual percentage rate for RALs at the small banks ranged from 134 percent up to 187 percent for a $3,000 loan repaid by direct deposit of the taxpayers tax refund and/or Earned Income Tax Credits.[102]

Rent-A-Bank Payday Lending

Payday lenders partnered with small banks based in states with deregulated interest rates in order to make loans in states that retained usury laws, small loan rate caps, or had slightly restrictive payday loan laws. Through enforcement action, the Comptroller of the Currency stopped four small national banks from renting their charters to payday lenders. The Federal Reserve put regulatory pressure on the only state-chartered member bank involved in rent-a-charter lending and the bank withdrew from payday lending. The Office of Thrift Supervision prevailed on a small thrift in Ohio to stop.

For years, about a dozen very small state banks "rented" their charters to enable payday lenders to evade state usury and small loan protections. These banks ended this abusive practice only after state regulators and consumer attorneys initiated litigation, the National Association of Attorneys General sent a stern letter, consumer groups launched a multi-year advocacy campaign by across the country, key Congressional leaders sent letters, and new leaders at the FDIC used

[102] Chi Chi Wu and Jean Ann Fox, "Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Workers at Risk," National Consumer Law Center and Consumer Federation of America, February 2009, page 10.

all the enforcement tools at their disposal.[103] By the time bank regulators deprived payday lenders of willing bank partners, state consumer protections had been undermined.

Bank Overdraft Loans

Small banks also extend extremely expensive unauthorized credit through overdraft loans, charging consumers steep fees for covering transactions on accounts with insufficient funds. Instead of denying point-of-purchase debit card purchases or cash withdrawals from ATMs, banks large and small cover those overdrafts and charge high fees. The FDIC issued a ground-breaking report in late 2008 based on a survey of 462 FDIC-supervised state banks drawn from a sample of 1,172 banks which included banks scheduled for examination from May through December 2007, as well as FDIC-supervised banks with at least $5 billion in assets. The FDIC found that 75.1 percent of the mostly small banks surveyed automatically enrolled customers in automated overdraft programs with some of them denying consumers the ability to even opt out of having overdrafts paid for a fee. The fees charged by FDIC banks ranged from $10 to $38 with the median fee $27. About a fourth of these state banks added sustained overdraft fees when consumers did not repay the overdraft in just days. A quarter of all banks surveyed and over half of the largest surveyed banks batch processed overdraft transactions largest to smallest, which the FDIC noted can increase the number of overdrafts. Small banks turn their overdraft programs over to third-party vendors to manage and pay them a percentage of the fees generated, typically 10 to 20 percent of additional fees.

Overdraft and insufficient funds fees are a major source of revenue for banks, including the smaller state banks supervised by the FDIC. These fees in 2006 represented three-quarters of the $2.66 billion in service charges on deposit accounts reported by the surveyed banks in their Call Reports. Banks that permit overdrafts at cash registers with debit cards and at ATMs collected more in fees than banks that deny those transactions at no cost to consumers. Banks that process withdrawals largest first also rake in more revenue than banks that do not.[104]

Third-Party Direct Deposit Arrangements with Check Cashers and Loan Companies

Last year, CFA surveyed third-party direct deposit account arrangements by which federal exempt funds are delivered to unbanked recipients through check cashers, loan companies, and other outlets that partner with a handful of banks. The *Wall Street Journal* published a front page story, titled "Social Insecurity: High Interest Lenders Tap Elderly, Disabled[105]," which described the high cost and unfair terms of financial arrangements that target low-income recipients of taxpayer-supported federal benefits. Readers were shocked to learn that the Social Security Administration would direct deposit Social Security and SSI benefits into a bank

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[103] Jean Ann Fox, Consumer Federation of America and Edmund Mierzwinski, USPIRG, "Rent A Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," November 2001. See, also, Jean Ann Fox, Consumer Federation of America, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," March 2004, and Testimony, Jean Ann Fox, House Oversight and Domestic Reform Subcommittee on Domestic Policy Regarding Foreclosures, Predatory Lending and Payday Lending in America's Cities, March 21, 2007.
[104] FDIC, "FDIC Study of Bank Overdraft Programs," November 2008, pages ii-v.
[105] Ellen Schultz and Theo Francis, "Social Insecurity: High Interest Lenders Tap Elderly, Disabled," *Wall Street Journal*, February 12, 2008, A1.

account controlled by a loan company, not by the recipient. The Social Security Administration and Treasury Department permit delivery of exempt benefits through Master/Sub account arrangements that can include a bank, an intermediary, and the outlet where consumers go to pick up their "checks." Unbanked recipients are targeted by these "third-party direct deposit providers" as a means of getting faster access to their checks that is safer than receiving paper checks in the mailbox. Loan companies also use the direct deposit arrangements to secure repayment of loans before recipients gain access to their funds.

Banks set up a master account to receive exempt funds in the name of the recipient. The beneficiary goes to the check cashing outlet and pays to receive and then cash the "check" printed to deliver their funds or to have funds loaded onto a prepaid debit card. Fees are charged to set up the account, to deliver each payment, and to cash each check. The direct deposit accounts offered by check-cashers simply convert the electronic payment of benefits back into a paper check. When the benefits are delivered by debit card, recipients are provided a stored value card, which appears to be not covered by Federal Reserve Regulation E protections that provide limits on liability for unauthorized transfers, procedures to resolve disputes, disclosures, and other substantive protections.

Recipients who are enrolled in these third-party direct deposit accounts have no direct control over their funds. The bank deducts its fees and those paid to the check casher or other entity that delivers the "check" or provides the debit card. Contracts include fine print that permits the bank to channel exempt funds to make loan payments on behalf of the recipient before handing over the rest of that month's check. Recipients get what is left over.

CFA presented testimony to both the Social Security Administration and to the House Ways and Means Subcommittee on Social Security last June that detailed the bank/third-party arrangements in effect at that time. Banks included in the survey were Republic Bank & Trust, based in Louisville, Kentucky; River City Bank, based in Kentucky; Bank of Agriculture and Commerce in California; and First Citizens Bank/FirstNet/Cornerstone Community Bank based in Radcliff, Kentucky and Chattanooga, TN.[106] Following the hearing, the FDIC investigated and took regulatory action against the banks they supervise.[107]

Third-Party Subprime "Fee-Harvester" Credit Card and Loan Arrangements

Smaller banks also issue high fee, low limit credit cards to consumers with impaired credit. These "fee-harvester" cards are marketed to the most vulnerable consumers, and come with loaded high fees that use up most of the card's capacity, leaving consumers with minimal credit at an exorbitant price. While some large banks engaged in the fee-harvester sector, a report by the National Consumer Law Center identified several small banks that partnered with card issuers, including Columbus Bank and Trust and several other small banks that partnered with

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[106] Testimony of Jean Ann Fox, Consumer Federation of America, Before the Subcommittee on Social Security, Committee on Ways and Means, "Hearing on Protecting Social Security Beneficiaries from Predatory Lending and Other Harmful Financial Institution Practices," June 24, 2008.

[107] "Bank Ordered to Cease and Desist 'unsound' Banking Practices," Central Valley Business Times, March 28, 2009. See also, Social Security Administration Policy Instruction: EM-09039, "FDIC Investigation of the Bank of Agriculture & Commerce One-Time-Only Instructions, effective date May 15, 2009.

CompuCredit Corporation in Atlanta, Georgia; South Dakota based First Premier bank; First National of Pierre (SD); First Bank of Delaware, and Applied Bank, formerly known as Cross Country Bank. A MasterCard issued by CorTrust exemplifies the abuses of fee-harvester cards, as it featured a $250 credit limit that was quickly consumed by a $119 Acceptance Fee, a $50 annual fee, and a $6 per month Participation Fee, leaving users just $75 in total usable credit. A First Bank of Delaware card issued by Continental Finance in 2007 started with a $300 credit limit but provided only $53 in usable credit after charging a $99 account set-up fee, an $89 Participation Fee, a $49 Annual Fee, and $10 per month in Account Maintenance fees.[108]

Last year the Federal Trade Commission and the FDIC brought charges against CompuCredit and its small bank partners, accused of using unfair practices in marketing fee-harvester cards. The small banks subject to the FDIC's enforcement actions included $118 million-asset First Bank of Delaware in Wilmington, Delaware and $794 million-asset First Bank & Trust in Brookings, South Dakota.[109] In addition, $6 billion-asset Columbus Bank and Trust, Columbus, Georgia, settled the FDIC's charges related to CompuCredit by agreeing to a Cease and Desist Order and paying $2.4 million in a civil money penalty.[110] First Bank of Delaware agreed to a cease and desist order which required the bank to terminate its relationship, not only to CompuCredit, but with seventeen third-party lending programs and providers in total. These third party entities included payday lender Check 'n Go Online, CashCall, Inc., ThinkCash (TC Loan Service LLC), Fortris Financial, LLC, and several prepaid card providers.[111] First Bank & Trust was ordered by the Office of Comptroller of the Currency in 2003 to stop partnering with payday lenders and to set aside $6 million to reimburse credit card customers impacted by deceptive lending practices.[112]

Bank Payday Loans

As described at length in a separate appendix on Rent-A-Bank payday lending, starting in the 1990s and early 2000s, many smaller banks partnered with payday lenders to pass on their preemptive powers to avoid state payday loan laws. Though those rent-a-bank partnerships have ended, preemptive bank payday lending has not.

MetaBank, a federally chartered savings association headquartered in South Dakota, offers the iAdvance line of credit on prepaid cards, including payroll cards. The loan operates exactly like a payday loan. The loans are small, short term credit with a flat fee ($25 per $200); require that the borrower have a regular paycheck (direct deposit of wages or government benefits onto the prepaid card); and lead to frequent rollovers and a triple digit APR. The disclosed APR is 150%, but that assumes that the loan is outstanding for 30 days. That is highly unlikely, as the loans are most likely taken out toward the end of the pay cycle. The APR is 650% if the loan is taken out a week before payday.

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[108] Rick Jurgens and Chi Chi Wu, National Consumer Law Center, "Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers," November 2007, Pages 1, 6.
[109] Cheyenne Hopkins, "Will Third-Party Crackdown Set Stage for Showdown?" American Banker, June 11, 2008.
[110] Press Release, "FDIC Seeks in Excess of $200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing," June 10, 2008, http://www.fdic.gov/news/news/press/2008/pr08047.html.
[111] FDIC Stipulation and Consent to the Issuance of An Order to Cease and Desist, Order for Restitution, and Order to Pay, First Bank of Delaware, FDIC-07-256b. FDIC-07-257k, Exhibit A, October 3, 2008.
[112] Steve Young, "S.D. Bank Denies Credit Card Deception," Argus Leader, June 12, 2008.

But in several respects the loans are worse than payday loans. First, the bank is able to preempt state usury, small loan, and payday loan laws.

Second, unlike a payday lender, which must cash a check that can be stopped (at least in theory), the bank has immediate access to offset the loan against the next payment of the consumer's wages or benefits, even benefits that are exempt from garnishment.

Third, the cost can be much higher because the loan is not even necessarily outstanding the full two weeks that a typical payday loan is. It might only be a few days.

Some larger banks also have payday-loan products. Wells Fargo, Fifth Third Bank, and U.S. Bank have direct deposit account advances, which operate just like Meta Bank's iAdvance loans except that they offset a bank account not a prepaid card account.

Appendix 2: Private Student Loan Regulatory Failures and Reform Recommendations

During the height of the most recent wave of abusive mortgage loans, federal regulators took almost no public action. There was a similar lack of regulatory activity in the student loan area. There were problems in the federal student loan industry as well. However, at least for these products, there is a comprehensive set of borrower protections in the Higher Education Act (HEA) and a clear regulatory authority, the U.S. Department of Education. We recommend that jurisdiction over federal student assistance remain in the HEA and Department of Education.

In contrast, many different types of lenders originate, service, and collect private student loans and as a result, there is a wide range of regulatory agencies. These products are similar to other private unsecured credit products, such as credit cards.

In recent years, a subprime private student loan industry began to prey on vulnerable borrowers seeking to better their lives through education. Key problems included:

1. Pressuring Borrowers into High Cost Private Loans.
Many schools and lenders pressured borrowers into high cost private loans even in cases where borrowers had not yet exhausted the more affordable federal loans (and even grants in some cases). New York Attorney General Andrew Cuomo and others recently exposed many of the improper financial arrangements and collusions between schools and lenders.

2. Private Loans and Scam Schools.
As the private student loan industry developed, a particularly unholy alliance developed between unlicensed and unaccredited schools and mainstream banks and lenders. The creditors didn't just provide high-interest private loans to students to attend unscrupulous schools; they actually sought out the schools and partnered with them, helping to lure students into scam operations. Regulatory agencies for the most part ignored their responsibility to stop unfair lending practices.

A key regulatory check, the FTC Holder Rule, could be more efficiently enforced by a single agency with clear jurisdiction over all financial players. If banks are routinely being referred loans by schools and the schools are not arranging for the banks to put the notice in the notes as they are required to do, then the banks are using notes that violate federal law and should be liable for unfair practices.

Banking regulators must coordinate to enforce the FTC holder rule. The trade commission, state attorney generals, state licensing and accreditation agencies must review loan documents provided to students by schools and sue schools that violate federal law by not including the holder notice. Meanwhile, government agencies supervising lenders must monitor school notes and sue lenders that violate federal law by contradicting or otherwise trying to evade the holder requirement.

The FTC rule must also be amended so that lenders in addition to schools are obligated to include the notice. Other federal agencies must also adopt the FTC rule so that there is absolutely

no doubt that loan providers outside of the FTC's jurisdiction, including all national banks, can be held liable. A single agency should be able to more efficiently enact these reforms.

3. Unchecked Rates and Fees.
As in the subprime mortgage and credit card industries, very high cost loans were made to borrowers without evaluation of reasonable ability to repay. In a March 2008 report, NCLC surveyed a number of private student loan products and found that all of the loans in our survey had variable rates. The lowest initial rate in our sample was around 5% and the highest close to 19%. The average initial disclosed annual percentage rate (APR) for the loans in our survey was 11.5%.[113]

Some of the margins were shockingly high. Multiple loans in our survey had margins of close to 10%. None of the loans we examined contained a rate ceiling. A few set floors. These floors are particularly unfair for borrowers in an environment of declining interest rates.

There are no limits on origination and other fees for private student loans. According to the loan disclosure statements we reviewed, there were origination charges in all but about 15% of the loans. For those with origination fees, the range was from a low of 2.8% up to a high of 9.9%. The average in our survey was 4.5%. Most of the lenders in the private student notes we surveyed reserved the right to charge additional fees for other services.

4. Denying Access to Justice, including Mandatory Arbitration Clauses.
Sixty-one percent of the loan notes in the March 2008 NCLC report contained mandatory arbitration clauses. These clauses are just one example of lenders' systematic strategy to limit a borrower's ability to challenge problems with the loans or with the schools they attend.

5. Arbitrary and Unfair Default Triggers.
Borrowers are in default on federal loans if they fail to make payments for a relatively long period of time, usually nine months. They might also be in default if they fail to meet other terms of the promissory note. There are no similar standardized criteria for private loan defaults.

A few of the default "triggers" in the loans we reviewed in the March 2008 report were particularly troubling. For example, the typical loan we reviewed stated that borrowers could be declared in default if "in the lender's judgment, they experience a significant lessening of ability to repay the loan" or "are in default on any other loan they already have with this lender, or any loan they might have in the future."

Another troubling trigger is the lender's discretion to declare a default if the lender believes that the borrower is experiencing a significant lessening of her ability to repay the loan. If interpreted broadly, a borrower could be placed in default if she requests a temporary postponement of loan payments due to job loss or some other factor.

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[113] National Consumer Law Center, "Paying the Price: The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at:
http://www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

6. Disclosures.
The Higher Education Opportunity Act (HEOA) amended TILA to significantly improve disclosures for private student loans. A coalition of consumer advocacy organization filed comments on these proposed regulations in May 2009.[114] There is significant overlap between the new private student loan disclosure requirements and disclosure requirements for other types of credit. Enforcement should be enhanced if jurisdiction is clearly within one oversight agency.

7. Lack of Loss Mitigation Relief.
A key barrier to improved assistance programs is that lenders have not been *required* to provide redress for their irresponsible actions. Voluntary efforts have been few and far between. Similar trends occurred in the mortgage industry where most creditors failed to act on their own to stem the foreclosure tide.

Meaningful assistance should include loan restructuring and flexible repayment. Servicers should have the authority to modify loan terms, change interest rates, forbear or forgive principal, extend maturity dates, offer forbearances, repayment plans for arrearages, flexible repayment and deferments. Congress and the Administration should also act to ensure that borrowers receiving relief through these programs do not face tax consequences.

8. False and Misleading Advertising.
Private student loans are increasingly sold directly to consumers. We recommend schools be required to certify these loans before funds are disbursed.

9. Data Collection.
It is very difficult to understand private loan trends, including such important data as default rates. There is no comprehensive data base for private loans as there is for federal loans. The new regulatory agency should develop a data base of easily accessible data. The lack of this type of information in the private student loan context is a major impediment to understanding the scope of the problem and helping borrowers.

10. Private Enforcement.
Victims of abusive lending practices have very little recourse because the industry often uses its market power to limit borrowers' access to justice. To be effective, consumer protection laws must: (1) give borrowers a private right of action, the right to pursue class actions, and the right to raise school-related claims and defenses against lenders in cases where the school and lender have a referral relationship or other close affiliation; (2) contain strong remedies and penalties for abusive acts; (3) provide effective assignee liability so that borrowers can pursue legitimate claims even when the originator has sold their loan; and (4) prohibit mandatory arbitration clauses that weaken victims' legal rights and deny them access to seeking justice in a court of law. Without these fundamental procedural protections, other consumer protection rules are unenforceable.

[114] See http://www.studentloanborrowerassistance.org/uploads/File/policy_briefs/PrivateLoanCommentsJune09.pdf.

Appendix 3: Rent-A-Bank Payday Lending

Federal regulators also fueled the explosive growth of payday lending during the late 1990s and early 2000s by allowing banks to partner with loan companies to evade state protections. Payday lenders solicit consumers to write unfunded checks for immediate cash loans that are due in full on the borrower's next payday, in order to keep the check from bouncing. By claiming the right to "export" weak regulations from the states where their bank partners were based, payday lenders charged interest rates of 400 percent and higher in states with stronger laws.

The payday loan industry used its "National Bank Model" as a two-edged sword in state legislative debates, urging state legislators to legalize payday loans to "keep out" the out-of-state banks and provide "competition" for banks that brokered payday loans. Then, when industry-friendly laws were enacted, some payday lenders continued to partner with out-of-state banks to by-pass the limits in the new payday loan law. For example, ACE Cash Express was a leader in enacting the Colorado payday loan law but dropped its state license, claiming that its loans were made by a national bank. It is widely believed that payday loan authorizing legislation was enacted in Virginia because rent-a-bank payday lenders had entered the state and a state law was the only way legislators thought they could impact the market.

Payday lenders also used bank partners to stay in business when the North Carolina legislature permitted the payday loan law to sunset in 2001. Instead of closing up shop, payday lenders with about five hundred branches affiliated with national banks to continue making loans. By late 2001, the North Carolina Banking Commissioner reported that seven banks were partnering with payday lenders, including Peoples National Bank of Paris, Texas; First National Bank, Brookings, SD; First Bank of Delaware; Brickyard Bank, Illinois; County Bank of Rehoboth Beach, DE; Eagle National Bank, PA; and Goleta National Bank, CA. Eventually, the North Carolina Attorney General settled cases against the remaining "rent-a-bank" lenders to exit the state. Class action litigation against the same lenders continued.

To combat the explosion of triple-digit interest lenders in states with usury or small loan caps, state regulators and Attorneys General brought enforcement actions, filed litigation, and sought legislation to close loopholes being exploited. For example, the Massachusetts Banking regulators shut down a retail outlet that partnered with County Bank of Rehoboth Beach, DE for violating the Massachusetts usury and small loan act.[115] Other state regulators that went to court to stop rent-a-bank payday lending include Colorado, Georgia, North Carolina, New York, Oklahoma, and Ohio.

By partnering with banks located in states with no usury cap, payday lenders were able to charge consumers much higher rates than state laws permitted and use other loan features that trapped borrowers in debt. For example, a 2001 CFA/USPIRG survey found that ACE Cash Express (Goleta National Bank) and Advance America (BankWest, SD) charged Virginia consumers 442 percent APR for payday loans despite Virginia's 36 percent small loan rate cap. The same survey noted that Money Mart (Eagle National Bank) charged 455 percent APR and loan servicers for County Bank of Rehoboth Beach, DE charged 780 percent APR for two-week loans

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[115] Press Release, Commonwealth of Massachusetts Consumer Affairs and Business Regulation, "High Rate Payday Loan Operation Shut Down by Consumer Affairs Agency," April 20, 2000.

in Virginia.[116] Rent-a-bank lenders also made loans that exceeded the limits set by states that had authorized this product. ACE Cash Express partnered with Goleta National Bank and Dollar Financial Group partnered with Eagle National Bank to make loans up to $500 in California, a state that limited payday loans to $255 (if a lender charged the maximum fee). Colorado's payday loan law prohibited loan renewals but rent-a-bank lenders "rolled over" loans three or four times, charging borrowers the fee each payday without paying off the loan. While it is difficult to quantify the cost of rent-a-bank payday lending to consumers, the Center for Responsible Lending wrote to the FDIC Board of Directors in 2004 that 3,000 payday loan stores were at that time partnering with FDIC-supervised state banks. CRL estimated that over one million borrowers annually were trapped in a cycle of borrowing at a cost of about $750 million in fees per year that would otherwise be illegal under state law.[117]

Timeline of regulatory actions

The campaign to stop banks from renting their charters to enable payday lenders to evade state usury, small loan, and payday loan laws stretched over a decade. Below are noted key regulatory developments that eventually stopped this tactic. This list does not include numerous class action lawsuits, advocacy campaigns, and state law enforcement cases that were also instrumental in curbing usury by banks through payday lending outlets.

1999: National and state consumer groups wrote to Comptroller of the Currency John D. Hawke, in mid-1999, to urge regulatory action on Eagle National Bank, a small bank based in Pennsylvania, which partnered with payday loan outlets to make loans in states that prohibited such high interest rates.[118] The Comptroller replied on November 30, 1999 that "In the final analysis, there may, practically speaking, be little that bank regulators can do to eliminate abusive payday lending practices that comply with existing law."

September 2000: Office of Thrift Supervision lowered Crusader Bank's CRA rating because of its payday loan operations. The bank was later acquired and the program was discontinued.

November 2000. The Office of Comptroller of the Currency and the Office of Thrift Supervision issued advisory letters warning banks of the risks of partnering with payday lenders. "Title loans and payday loans are examples of types of products being developed by non-bank vendors who have targeted national banks and federal thrifts as delivery vehicles…We urge national banks and federal thrifts to think carefully about the risks involved in such relationships, which can pose not only safety and soundness threats, but also compliance and reputation risks." The OCC and OTS letter bluntly noted "Payday lenders entering into such arrangements with national

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[116] Jean Ann Fox and Edmund Mierzwinski, Consumer Federation of America and U. S. PIRG, "Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," November 2001, page 14.

[117] Mark Pearce and Eric Stein, Center for Responsible Lending, Letter to FDIC Board of Directors, Re: The Need for FDIC Action Regarding Payday Lending Rent-A-Bank Arrangements," August 26, 2004, page 15.

[118] California Reinvestment Committee, Consumer Federation of America, Consumers Union, Greenlining Institute, National Community Reinvestment Coalition, National Consumer Law Center, U.S. Public Interest Research Group, Woodstock Institute, Letter Re: Eagle National Bank and "Payday Loans," Address to The Honorable John D. Hawke, Jr., Comptroller of the Currency, July 27, 1999.

banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them."[119]

April 2001: National Credit Union Administration issued a directive, reminding federal credit unions of their 18 percent annual interest rate cap and urging credit union members to serve the legitimate short term credit needs of their members.[120]

September 2001. The Comptroller of the Currency filed an amicus brief in the Colorado Attorney General's case against ACE Cash Express for failing to get a license to make payday loans after partnering with Goleta National Bank. In a dramatic break with OCC preemption policy, the Comptroller stated that "ACE is the only defendant in this case and ACE is not a national bank."[121]

January 2002: Comptroller of the Currency ordered Eagle National Bank to cease its payday loan program, noting that "the bank essentially rented out its national bank charter to a payday lender to facilitate that nonbank entity's evasion of the requirements of state law that would otherwise be applicable to it."[122]

September 2002: The Illinois banking regulator and the Federal Deposit Insurance Corporation set high enough capitalization requirements for Brickyard Bank that the bank withdrew from its payday lending arrangement with Check 'n Go in Texas and North Carolina.

October 2002: Comptroller of the Currency ordered Goleta National Bank to cease making payday loans. The bank had partnered with ACE Cash Express. This action also brought resolution to state litigation against Goleta in Ohio, Colorado, North Carolina and in class action lawsuits filed in Florida, Texas, Maryland, and Indiana.

January 2003: Comptroller of the Currency ordered Peoples National Bank to terminate its payday loan arrangements with Advance America due to safety and soundness concerns.[123]

January 2003: Comptroller of the Currency issued a cease and desist order to First National Bank in Brookings, SD to terminate its payday loan program.[124]

January 2003: The Office of Thrift Supervision directed First Place Bank in Warren, Ohio to terminate its payday loan arrangements in Texas with Check 'n Go.[125]

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[119] OCC Advisory Letter AL 2000-10, "Payday Lending," November 27, 2000, p. 1

[120] NCUA Letter to Credit Unions, Letter No. 01-FCU-03, April 2001.

[121] Amicus Curiae brief filed by Julie Williams, Chief Counsel, Comptroller of the Currency, State of Colorado v. ACE Cash Express, Inc., Civil Action No. 01-1576, United States District Court for the District of Colorado, September 26, 2001.

[122] Press Release, "OCC Orders Eagle to Cease Payday Lending Program," January 3, 2002, NR 2002-01.

[123] Office of Comptroller of the Currency, Notice of Charges for Issuance of an Order to Cease and Desist, In the Matter of Peoples National Bank, Paris, TX, AA-ED-02-03, May 17, 2002.

[124] Press Release, OCC, January 27, 2003.

[125] "Texas Payday Lending to End: First Place Lists Earnings," Tribune Chronicle, Warren, Ohio, Jan. 30, 2003.

July 2003: FDIC issued guidelines for bank payday loan programs that did not definitively prohibit rent-a-bank payday lending by banks.[126] State banks continued to partner with payday lenders.

October 2003: The FDIC permitted First Bank of Delaware to switch to its supervision after the Federal Reserve imposed stiff regulatory requirements on the bank's payday loan business.[127]

March 2005: The FDIC issued revised payday loan guidelines for banks which further tightened lending to repeat borrowers by limiting loans to no more than three months out of a twelve month period.[128]

February 2006: The FDIC reportedly sent letters to all the remaining rent-a-bank payday lenders, asking the banks to consider terminating their arrangements. Since this was not an enforcement action, the FDIC did not issue the letters publicly, but payday lenders and banks impacted filed notices with the SEC and issued press releases making it clear that the FDIC had lowered the final curtain on rent-a-bank payday lending. Rent-a-bank payday lending ceased by mid-2006.

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[126] FDIC, Guidelines for Payday Lending, issued July 2003.
[127] CFA Letter to FDIC Chairman Powell, October 8, 2003, www.consumerfed.org/fdicletter10-2003.pdf.
[128] Press Release, "FDIC Revises Payday Lending Guidance," March 2, 2005.

APPENDIX 4: Information on Income (primarily user and transaction fees depending on agency) of Major Financial Regulatory Agencies

OTS

User fee income 2008: $245.699 million (2009 estimated: $246.706)[3]
FY 2009 Budget: $246.706 million[3]
Consumer Affairs Budget: $4.4 million[4]
Consumer Affairs Budget percent of total budget: 1.78%
OTS receives no appropriations from Congress, budget funded by user fees.

OCC

User fee revenue: $ 707.5 million
Total Budget 2008: $749.1 million[2]
Consumer Affairs Budget: $12.1 million ($9.1 million in 2008)[2]
Consumer Affairs Budget percent of total budget: 1.21%
Total FY 2008 revenue: $736.1 million[2]
Revenue from investment income: $ 26.1 million
Other revenue: $2.5 million (Other sources of revenue include bank licensing fees, revenue received from the sale of publications, and other miscellaneous sources.)[2]
The OCC receives no appropriations from Congress.

FDIC

User fee revenue was $2.965 billion for fourth quarter 2008.[8]
FY 2009 Budget: $2,243,765,244 ($1,205,161,868 in 2008)[7]
FTE for Consumer Affairs: 28 (33 in 2008)[4]
Consumer Affairs Budget: $7.2 million ($4 million in 2008)[4]
Consumer Affairs Budget as % of total Budget in 2009: .32%

FTC

Funding:
FY 2008 HSR Filing Fees: $144.600 million [10]
Do-Not Call Fees: $19 million [10]
General Fund: $76.639 million [10]
FY 2008 Total Budget: $240.239 million[10]
FY 2008 Total FTE: 1,084 [10]
FY 2008 Consumer Protection Budget: $139.122 million [10]
FY 2008 Consumer Protection FTE: 581 [10]
% of total Budget spent on Consumer Affairs: 57.9%

FED

Total Revenue from services provided to depositary institutions: $773.4 million [1]
Income from Priced Services: $53.4 million [1]
Budgeted Cost of Consumer and Community Affairs: $38.2 million budgeted 2008-2009[11]
Total Board Operations: $706.3 million[11]
Percent of total Budget spent on Consumer Affairs: 5.04 %

SEC

FY 2009 Budget: $913 million[13]
SEC Source of Fees:
Registration of securities: Securities Act of 1933: $234 million (FY 2008 estimate)[13]
Securities transactions under the Securities Exchange Act of 1934: $892 million (FY 2008 estimate) [13]
Merger and Tender Fees under the Securities Exchange Act of 1934: $21 million (FY 2008 estimate) [13]
Collections amount total: $1,147 million (FY 2008 estimate) [13]
Investor Protection and Education Program: $124.449 million[13]
Investor Protection Budget is 14% of total Budget.[6]
Investor Protection, 524 FTE are 15% of all FTE.[6]
Congressional Appropriation FY 2008: $63 million[12]
Exchange Revenues:
Securities Transactions Fees $794.672 million[12]
Securities Registration, Tender Offer, and Merger Fees $161.377 million[12]
Total Exchange Revenues: $956.317 million. [12]

PCAOB

2008 accounting support fee of $134.5 million.[5]
Total Budget: $144.6 million for 2008.[5]
The PCAOB income is from registration fees, user fees and transaction fees as approved by the Commission.[5]

Sources:

[1] http://www.federalreserve.gov/boarddocs/rptcongress/annual08/pdf/fro.pdf
[2] http://www.occ.treas.gov/annrpt/1-2008AnnualReport.pdf
[3] http://files.ots.treas.gov/481151.pdf
[4] http://www.house.gov/apps/list/speech/financialsvcs_dem/viewsandestimates2009.pdf
[5] http://www.pcaobus.org/About_the_PCAOB/Budget_Presentations/2008.pdf
[6] http://www.sec.gov/about/secfy08congbudgjust.pdf
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