

Why We Need An Independent Consumer Financial Protection Agency Now

For a century, government regulation of finance was the public structure responsible for protecting consumers, preventing and containing crises, and ensuring a dynamic, competitive financial sector. Thirty years ago, however, these essential structures began to be dismantled. Finance interests pressed the theory that fewer government rules would benefit everyone—from the most sophisticated investors and banking conglomerates to the individual checking account holder. But the result of this failed experiment in deregulation has been a crisis costing Americans \$11 trillion in family wealth, \$14 trillion in taxpayer bailouts and over 8 million jobs. The subprime mortgage crisis began in the early 1990s when unregulated predatory lenders targeted working-class communities. It spread in the 2000s as lenders discovered the profitability of pushing complex mortgages across the market. The crisis went global when regulatory changes allowed the same financial giants that were funding risky home loans to flood the market with hundreds of trillions of dollars in derivatives—essentially, bets on risk. A weakening of our public regulatory structure allowed for each of these developments.

It has also contributed to a small-scale crisis in family finances. The typical American household has become more indebted and less secure, unable to weather financial shocks without risking bankruptcy or foreclosure. With financial regulatory reform pending, Congress has the opportunity to rebuild the structures that will prevent another crisis and ensure broad-based economic growth. For American families and small businesses, the most critical structure Congress can create is a Consumer Financial Protection Agency (CFPA).

Seventy-five percent of Americans¹—and 67 percent of small business owners²—support the creation of a strong, independent new Consumer Financial Protection Agency. The following briefing paper makes the case for a strong, independent CFPA. It outlines the importance of consumer products to the household economy, the need to modernize regulation to create a level playing field, and the impact of poorly-regulated consumer products on family finances. It also answers some of the frequently asked questions about the CFPA.

The Broken Regulatory System

The dismal current state of consumer financial protection can be attributed to the success of a thirty-year anti-regulatory agenda. This success has led to sharp increases in financial sector profits (the sector overtook manufacturing as America's largest sector by profits in the mid-1990s³) as companies were freed to charge higher fees and rates to a broader segment of the population. An increasingly strapped middle class became the ideal customer for banks: highly reliant on loans for paying for the basics of family life, savings easily depleted by emergency events such as an illness or home repair, a paycheck-to-paycheck budget easily leading to overdraft fees and payday loans. Consumers were less and less able to avoid any one lender's high fees, penalties and interest rates because of government's newfound willingness to approve financial industry mergers.

Handcuffed State Laws. Finance interests first systematically attacked existing consumer laws, particularly through preemption of state authority. For example, in 1978 the U.S. Supreme Court effectively pre-empted state usury, or interest rate, limits on national banks⁴—and Congress declined to respond. As a result, a race to the bottom ensued, as states relaxed or completely removed their usury laws in the hopes of attracting the banks, with South Dakota and Delaware winning the race. Today, financial institutions headquartered in these states and others with lax or no limits export unregulated interest rates to customers nationwide. Today, only credit unions are subject to any limit whatsoever on the interest rates they can charge customers—and major credit card companies are charging customers rates as high as 31 percent APR. In 1996, the Supreme Court extended the same logic to state limits on fees, and the average card penalty fee has more than doubled since then.⁵

In the 1980s, Congress preempted state laws protecting consumers from what would become the toxic subprime mortgages of the crisis, through the Depository Institution Deregulation and Monetary Control Act and the Alternative Mortgage Transaction Parity Acts. Federal intrusion into state consumer protection rights reached a high-point in 2004, when a federal regulator—the Officer of the Comptroller of the Currency (OCC)—declared that national banks could ignore *all* consumer protection laws in the states in which

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Blocked Federal Action. In addition to rendering state laws ineffective, federal officials have also resisted modernizing federal protections to maintain effective consumer protection in today's credit-driven economy. As a result, huge portions of today's financial market are un- or under-regulated. Some of the most dangerous high-cost mortgage loans at the root of the financial crisis were not supervised by any federal regulator. The influence of lobbying and finance industry campaign donations must be considered when examining the continued move to relax consumer

protections. Federal campaign donations from finance and credit companies increased eight-fold from 1998 to 2008.⁷ A recent IMF study found that the banks with the largest lobbying expenditures against regulation had the highest-risk loans and poorest stock performance.⁸

Regulatory agencies should be a safe harbor from special interest influence, avoiding the campaign donations and lobbying that gridlocks Congress. However, the nominally independent regulators empowered to oversee consumer issues have their own structural impediment to action. Current finance regulators are designed to view banks, not customers, as their clients. The two major bank regulators, the OCC and the Office of Thrift Supervision, rely on bank fees for funding—a dependency that banks routinely exploit by “charter-hopping” to the regulator with the least regulation. The OCC has not only declined to regulate consumer abuses by its members, but also actively blocked state investigations and prosecutions of predatory lenders.⁹ The Federal Reserve Board also has built-in conflicts of interest, with banks responsible for nominating two-thirds of their regional boards of governors.¹⁰

Whose “Safety & Soundness”? Overall, the mission of these “prudential” regulators is to ensure the safety and soundness of the banks. This translates into maximizing revenues for banks—a mission fundamentally at

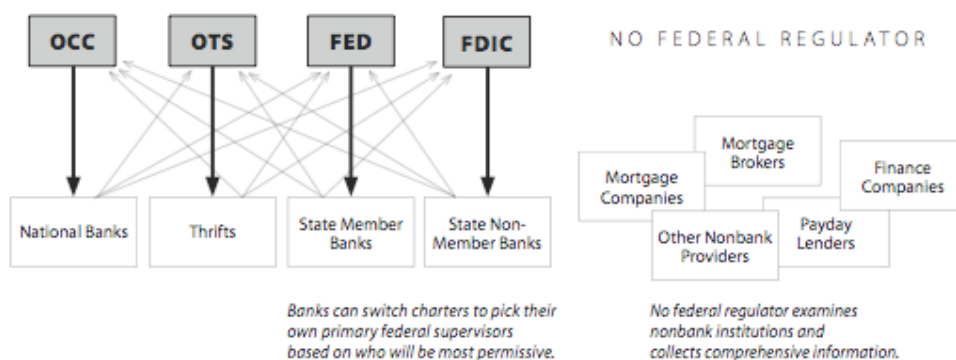
odds, at least in the short-term, with ensuring affordability or fairness for the customers who are banks' revenue base. Frederic Mishkin, former Fed Board governor, has acknowledged the mismatch, stating: "The skills and mindset required to operate as a consumer protection regulator is fundamentally different from those required by a systemic regulator."¹¹

Nevertheless, it should be noted that federal regulators' short-sighted neglect of consumer protection ill-served the banks' safety and soundness mission, as well. Deceptive loans seemed profitable for banks in the short-term because banks quickly securitized high volumes of loans and sold them to investors, but as they became unaffordable for consumers, they became unsustainable for the companies, as well. As of Sept. 30, 2008, the rate of one to four family residential loans from OCC national banks that were past due or in "nonaccrual status" was twice that of state banks; OTS federal thrifts' rate was more than four times that of state thrifts.¹²

In summary, the current patchwork system of regulators overseeing consumer financial products are ill-equipped, and even ill-designed to do the job of protecting consumers or ensuring a sustainable consumer finance system. Seven different agencies (the OCC, OTS, Federal Reserve Board, FDIC, NCUA, FTC, and HUD) administer multiple consumer protection statutes in inconsistent and often ineffective ways. The CFPA will streamline and simplify federal oversight and ensure that the same rules apply and are consistently enforced for all entities providing financial products to consumers.

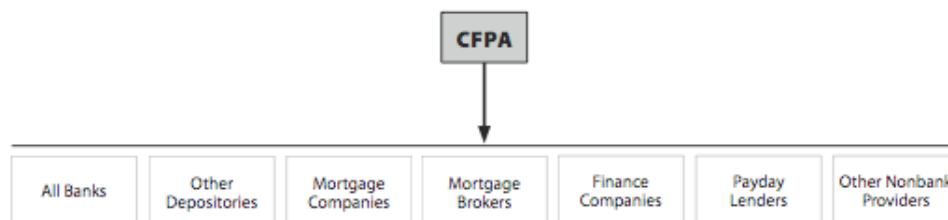
The CFPA will streamline and simplify federal oversight.

Status Quo



Consumer Financial Protection Agency

one agency, one mission, market-wide coverage



Source: U.S. Department of Treasury.

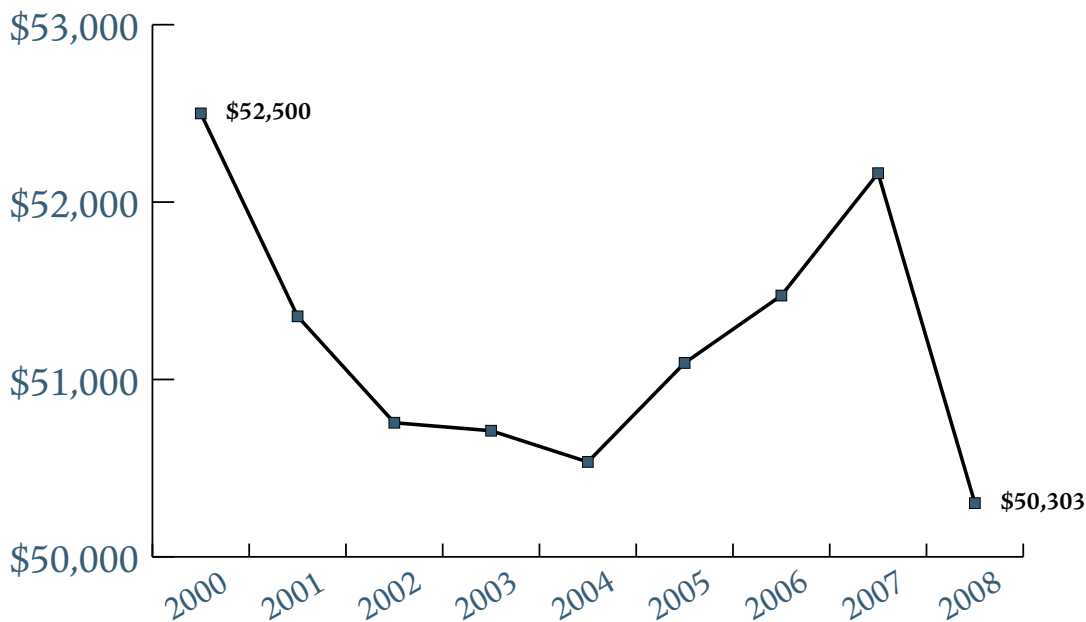
What's At Stake: Our Economy and Household Financial Security

For better or worse, consumer financial products—mortgages, bank accounts and debit cards, credit cards, payday loans and other loans—are at the center of today's economy. The number of credit cardholders in the United States grew from 159 million in 2000 to 181 million in 2010.¹³ In the last decade, credit card purchases have gone from \$1.2 trillion to \$2.1 trillion.¹⁴ By 2008, the average low- to middle-income family with credit card debt carried a balance of \$9,827 at a 15 percent interest rate.¹⁵ As median household income declined in the 2000s,¹⁶ households accumulated \$900 billion in credit card debt and cashed out \$1.5 trillion in home equity.¹⁷ The payday loan industry enjoyed twelvefold growth from 1996 to 2007, with a current annual estimated loan volume of \$48 billion.¹⁸ By the end of the decade, total consumer debt ballooned to \$2.5 trillion, up from just \$795 billion in 1989.¹⁹

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Why have consumer financial products become so important to the household economy? American families are facing stubbornly slow income growth despite increased work hours, even as costs increase. Put simply, the American people are borrowing to make ends meet. More than one-third of all income growth since 1989 has gone to the highest-paid one-tenth of one percent—.001—of workers.²⁰ More recently, since 2000 the typical American family has lost economic ground, earning over \$2,000 less than at the beginning of the decade.²¹

Inflation-Adjusted Median Family Income

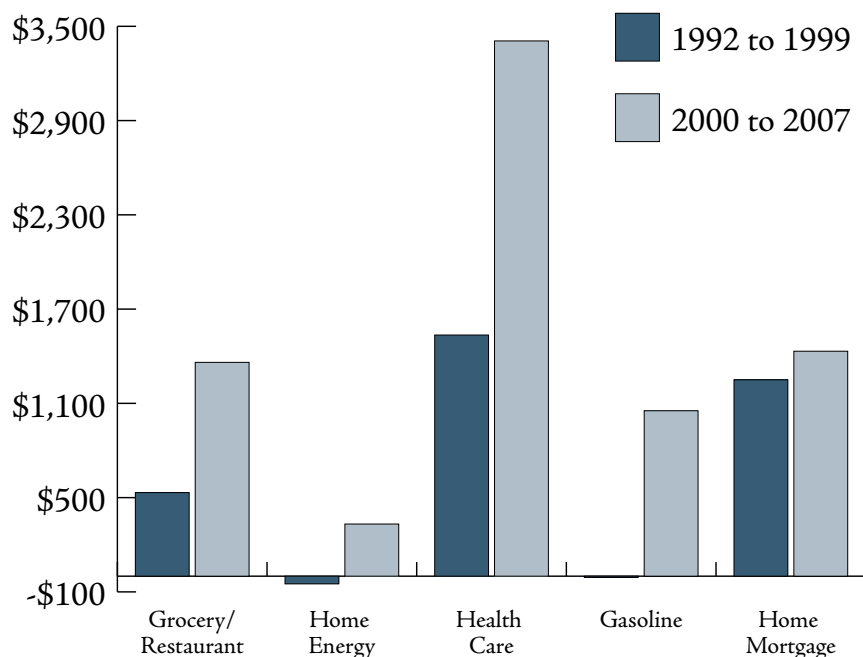


Source: U.S. Census Bureau

Over the same time period, costs for the basics—groceries, energy, health care and housing—increased significantly.

Not surprisingly, Dēmos' household survey of low- to middle-income households with credit card debt found that more than one out of three (37 percent) reported relying on credit cards to cover basic living expenses during, on average, five out of the last 12 months.

Change in Average Annual Household Spending for Living Expenses (2007 Dollars)



Source: JEC Majority Staff Calculations of U.S. Department of Commerce Data

Unchecked Abuses in an Era of High-Cost, Deregulated Credit

The government has a role in ensuring the fairness, transparency and affordability of consumer financial products. Unfortunately, at the same time that Americans' became more reliant on a borrowed safety net, the financial regulatory system has been dismantled. As a result of this deregulatory revolution, high rates and fees have proliferated throughout the lending industry. Last year, banks charged their customers \$39 billion in overdraft fees that averaged \$34 each for debits that averaged only \$17.²² Credit card companies collected \$104.6 billion in fees and interest.²³ Dēmos' survey found that one-third of cardholders with balances are being charged interest rates higher than 20 percent—a trend absorbed disproportionately by African American, Latino and lower-income cardholders.²⁴

Low-income taxpayers spend \$1.6 billion a year on aggressively-marketed refund anticipation loans.²⁵ Payday loans charging over 400 percent effective annual interest for a two-week loan are so onerous for borrowers that 76 percent of them must take out an additional loan to repay the original.²⁶ Between \$164 billion and \$213 billion of wealth was stripped from communities of color over the past eight years by subprime lenders who targeted them with toxic financial products.²⁷ Lenders have created and marketed each of these highly profitable financial products to exploit the current vacuum in consumer protection.

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Throughout this period, pleas by civil rights, community and consumer groups to address predatory lending and consumer abuses went unanswered. As described earlier, the Fed's conflict of interest assured that it adopted a hands-off approach to the consumer loans that were a profit base for its regulated entities. For fourteen years, the Fed refused to exercise its power to stop unfair and deceptive practices by its lenders. The trillions lost to deceptive subprime mortgages could have been avoided had there been an independent source of consumer protection subject neither to special interest influence in Congress or a regulator dominated by bank interests.

Congress must pass a strong Consumer Financial Protection Agency (CFPA) to ensure a more balanced approach to consumer protection that will help rebuild the foundation of the American economy. Millions more Americans will be able to save and invest in productive ways as billions of money is no longer extracted through deceptive and purposefully abusive lending products.

What a Consumer Financial Protection Agency Will—and Won't—Do.

The Consumer Financial Protection Agency will for the first time provide Americans a single, accountable and responsive source for consumer protection. The following section answers some common questions about the agency.

Q: How would a new “independent” agency work?

A: The Consumer Financial Protection Agency must be independent and fully empowered with the structure and authority needed to create and enforce fair rules of the road for consumer financial products. The Agency would have independent rulemaking authority applying to all financial products, regardless of the charter of the institution offering it. Likewise, it would have examination and enforcement authority over banks and non-banks, with examination and enforcement staff on its own payroll. The CFPA will be responsible for enforcing a range of consumer protection laws as well as addressing any unfair and deceptive practices. In order to avoid budget pressures or rider provisions, the Agency's budget must be funded by assessments, or some other independent source other than appropriations.

It is equally important that the Agency head be independently appointed by the president for a specified term and not subject to supervision by another regulator, person or board. Indeed, the CFPA's rulemaking, examination and enforcement authority, as well as all management and budget decisions, must not be subject to veto or approval by any prudential regulator or other person or board. [The Agency must have a clear, uncompromised and independent focus on protecting consumers.](#) This is the only way we will succeed in cracking down on abuses, strengthening our financial system, and preventing another financial crisis.

Q: Doesn't the CFPA add to the regulatory burden facing banks?

A: Today, regulated banks already face two separate examinations from their prudential regulator (for example, the OCC)—one from the safety and soundness examiner, and one from the consumer protection examiner. [Despite claims to the contrary, CFPA examinations will result in no additional examinations;](#) the CFPA examiner will simply take the place of the existing consumer protection examiner. However, issuers of consumer financial products that currently lack regulatory oversight—such as payday lenders, mortgage finance companies and brokers—will be subject to greater accountability. This lack of accountability led to widespread consumer abuses and was at the root of the financial crisis.

Q: Doesn't the CFPA create a new bureaucracy in an already crowded financial oversight field?

A: As part of comprehensive financial regulatory reform, the CFPA will actually streamline federal regulation. The Office of Thrift Supervision and the Office of the Comptroller of the Currency will be eliminated and replaced with a unified national bank supervisor. Today, rulemaking, supervision and examination are spread across multiple agencies—the CFPA will consolidate these activities and eliminate redundancies.

Q: Shouldn't the CFPA's rules preempt state consumer protection laws?

A: No. To end to the era of loosely-regulated, unsustainable credit products, the CFPA must be a floor, not a ceiling, for state laws. Broad preemption of state consumer laws is a recent development (with key steps in 1978, 1996, and 2004) that can be directly linked to both the credit crisis and the rise in foreclosures and personal bankruptcies. State officials are more easily held accountable to the consumers in their state than are regulators in Washington. That is why federal preemption has historically resulted in weaker protections for consumers—and that is why the industry continues to fight for it.

Fundamentally, preemption is not about efficiency; it is about the substance of consumer protection. The bank lobby's claim that national firms will be crippled by a "patchwork of state laws" is disingenuous. Not only have national banks easily complied with state laws for most of the 150 years they have existed, but states can and do enact uniform laws for widespread problems, such as the successful 49-state adoption of Uniform Mortgage Broker Licensing laws in 2008. Even with a Consumer Financial Protection Agency, Americans will continue to demand faster action to counter new industry abuses than a single federal regulator can accomplish.

Q: Won't the CFPA stifle innovation and consumer choice?

A: The CFPA will increase consumer choice by ensuring that lenders offer customers not just the riskiest product that will reap the highest fees, but the most affordable product for the customer. Offering customers higher-priced loans than they qualified for through steering, broker kickbacks and dealer markups was a hallmark of the recent deregulated era. As a result, toxic, unsustainable loans crowded out better alternatives, and the uneven regulatory playing field ensured a race to the bottom. For example, at the height of the subprime mortgage boom in 2006, risky loans had become so profitable to lenders that 61 percent of borrowers were steered into them even though they qualified for better loans.²⁸ Americans will benefit from truly informed customer choice with a CFPA.

Finally, the industry should recognize that its customers no longer trust lenders to be fair and transparent. Like an outbreak of contaminated food, the deceptive practices that have flourished in recent years have a long-lasting reputation cost for lenders. A product safety agency can benefit the industry, helping restore America's confidence in the banking system.

Q: Shouldn't the CFPA be an office within a bank regulator or a council of existing regulators?

A: No. Making the CFPA an office within a prudential regulator would be worse than the status quo. Any solution that gives a bank regulator veto power over the CFPA – an agency charged with protecting the public – would be like giving the Small Business Association a veto over workplace safety rules. Likewise, if the CFPA becomes an office within Treasury, it must have statutorily-guaranteed autonomy in rulemaking and enforcement, like the OCC does.

In the House, Walter Minnick (D-IA) sponsored an amendment to the Wall Street Reform and Consumer Financial Protection Act (H.R. 4126) to replace the CFPA with a council of existing regulators. However, the Minnick amendment failed because of broad recognition that consumer finance is too important—and the existing regulators too compromised—for a solution that would essentially perpetuate the status quo. Nevertheless, industry lobbyists have designed various less-effective alternatives to the CFPA and continue to find Congressional sponsors for their ideas. The 34 members of the U.S. House of Representatives that offered amendments to weaken consumer protections in the House financial reform package received \$3.8 million in campaign contributions from the financial sector in 2009.²⁹

Conclusion

The time has come for a Consumer Financial Protection Agency. For thirty years, Washington has been captive to a governing philosophy that eschewed regulation in almost any form, arguing that the hand of government was best kept behind its back. But the era of deregulated finance has shown that without public structures to ensure accountability and fairness, the system can not sustain itself.

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