BANKING INDUSTRY PERSPECTIVES ON THE OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JULY 15, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–58

U.S. GOVERNMENT PRINTING OFFICE

53–238 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

Page

Hearing held on:
July 15, 2009 1
Appendix:
July 15, 2009 55

WITNESSES

WEDNESDAY, JULY 15, 2009

Bartlett, Hon. Steve, President and Chief Executive Officer, The Financial Services Roundtable 11
Courson, John A., President and Chief Executive Officer, Mortgage Bankers Association 14
Leonard, Denise M., Vice President, Government Affairs, National Association of Mortgage Brokers 20
Menzies, R. Michael S., Sr., President and Chief Executive Officer, Easton Bank and Trust Company, on behalf of the Independent Community Bankers of America (ICBA) 24
Stinebert, Chris, President and Chief Executive Officer, The American Financial Services Association 15
Yingling, Edward L., President and Chief Executive Officer, American Bankers Association 22
Zeisel, Steven I., Vice President and Senior Counsel, The Consumer Bankers Association 17
Zywicki, Professor Todd J., George Mason University Foundation Professor of Law and Mercatus Center Senior Scholar, George Mason University School of Law 18

APPENDIX

Prepared statements:
Bartlett, Hon. Steve 56
Courson, John A. 111
Leonard, Denise M. 145
Menzies, R. Michael S., Sr. 158
Stinebert, Chris 176
Yingling, Edward L. 187
Zeisel, Steven I. 206
Zywicki, Professor Todd J. 211

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Bachmann, Hon. Michele:
Editorial from The Wall Street Journal entitled, "A Tale of Two Bailouts" 246

BANKING INDUSTRY PERSPECTIVES ON THE OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS

Wednesday, July 15, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Watt, Sherman, Meeks, Moore of Kansas, Hinojosa, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Ellison, Klein, Wilson, Perlmutter, Donnelly, Foster, Carson, Speier, Minnick, Adler, Driehaus, Himes; Bachus, Royce, Lucas, Manzullo, Jones, Biggert, Miller of California, Hensarling, Garrett, Barrett, Neugebauer, McHenry, Putnam, Bachmann, Marchant, McCarthy of California, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order.

As people know, we are in a very, very serious examination of the financial regulations of the country. It is the intention of myself as Chair to—that is pretty pompous—it is my intention to begin marking up a couple of aspects of this.

Most of the complex, systemic ones will be coming in September. But we do have a very heavy schedule of hearings, and I want to invite anyone listening in the audience today or through any other means, please feel free to submit information. We have a serious set of issues here. They are interconnected. We really do welcome information.

The hearing today is to receive the views of people in the financial services industry on various regulatory proposals. And I invite people to talk about the full range. Obviously, there is a certain amount of concern about the proposal for a financial customer protection agency, but we also are going to be dealing with the questions of systemic risk for those institutions which are not banks, the question of the resolving authority and how we can extend that.

We did have a separate hearing on compensation, but that will be one of the topics.

We obviously will also be dealing with questions of derivatives and how much we are going to tighten regulation on that, and the answer is a significant amount.

And I do want to note that on this coming Monday, after the Chairman of the Federal Reserve testifies, we are going to have a hearing specifically on the question of "too-big-to-fail." That has become a very important issue that people are concerned about.

My own view is that the Administration's approach deals with that in a reasonable way, but it is important that we both be doing it right and be seen to be doing it right. And so on Monday, we are going to be having a hearing specifically to address how we can avoid the danger of a too-big-to-fail regime. How do we have a situation—obviously, the hope is you want to keep them from getting too big and, particularly, you hope to keep them from failing. But how do you deal with that if it happens?

So I do recommend to anyone—and I almost want to have an essay contest, except we are not allowed to give anybody anything except through an appropriations bill, and that has gotten tougher than it used to be. But anyone who has any proposal for what we should be doing to substantially diminish the likelihood of any institutions being treated as too-big-to-fail—I am serious—please feel free to let us have them, in writing in particular, because I think there is a general consensus that one of the things we want to come out of this with is a substantial diminution, at the very least, of that problem.

Now let me begin my statement.

Today's hearing is about the whole set of issues. Obviously, the financial consumer protection issue has attracted a lot of attention, and that is the one that I believe we will be able to mark-up before we go.

I just want to read a memo I got from my staff. It is a memo summarizing the large number of complaints we have received both directly from consumers and from Members on both sides of the aisle who have heard from their constituents objecting to practices that the credit card companies are engaging in now that we have passed the bill.

Essentially, the argument is that in anticipation of the legislation, a number of things are happening. Senator Dodd, in fact, sent a letter to the Chairman of the Federal Reserve talking about this.

As you know, in a compromise with people in the banking industry, we agreed to hold off the effective date. But we were concerned that the effective date being held off might lead people to kind of flood the zone before we could get there. We have had complaints about significant increases in the monthly minimum payment, for example, from 2 percent to 5 percent on existing balances.

Again, I want to make clear, in my own mind, there is a distinction between what you do with existing balances and what you do going forward. And I don't think an increase in the minimum monthly payment is a bad thing in every case; and maybe it discourages people from getting too deeply in over their heads. But to raise the monthly minimum on an existing balance is changing the rules after people have started playing. And people could rightly say, "Well, if I had known that, I would have altered my behavior at the outset."

One of my colleagues told me that he had people complain that JPMorgan Chase had told him that it was Federal law requiring such increases. That is, of course, not true; and I have no reason to disbelieve people saying that is what they were told by various bank employees.

We have other changes being made, some of which are within the law, some of which I think would be prevented by the law. But that, I must tell you, is what strengthens the case for this Agency. We cannot and should not try to pass a law every time there is a set of complaints. What we need is for there to be rules. And it is not our experience that the existing regulators have used statutory authority given to them very vigorously.

But this, this flood of complaints—and I must tell you the complaints about the credit card issuance, the credit card-issuing banks—has become a very significant one.

There are a couple other points I will make with regard to financial customer protection. I know there will be people who won't want it in any case. I certainly agree that it should not be a situation in which any bank could ever be given contradictory orders. We can guarantee that this law will be written, if it becomes law, to prevent that.

I previously expressed my view that the Administration made a mistake in including the Community Reinvestment Act here. I think that is a different order of activity.

One other concern that came because, as the Administration sent it, they, of necessity, talked about their plans to abolish—well, to merge the OTS and the OCC and to—I know there are people who think merging the OCC and the OTS is kind of like merging Latvia with the Soviet Union, but we do really see this as a merger because we think there is a very important thrift function that has to be preserved.

And in that conjunction, I do not think this committee is going to abolish the thrift charter. I think it is important that we preserve the thrift charter. The problem with the thrift charter is that it is both a charter to engage in thrift activity and, to some extent, a hunting license to go and do other things with less regulation. I believe we are capable of rewriting that so that it is a thrift charter and a thrift charter only and will not get into that.

And while I am on thrifts, I just want to have one—we are often criticized, and good things happen and people don't notice, I was pleased to read in the report of the Federal Home Loan Banks, not that they had lost money; they lost money, as we expect for people in the housing business, but they made a point of noting that their losses were significantly less than they would have been had it not been for the alterations that had been made in the mark-to-market rules; that their ability to distinguish between instruments held for trading and instruments that they plan to hold until maturity, which are fully paying, minimize their losses.

When you minimize the losses of the Federal Home Loan Banks, you increase their ability to make home loans at a time when we need them. So I do want to take credit, because this committee had a major role in an advocacy capacity on both sides in urging that change in mark-to-market. And we have just had some evidence that it was the right thing to do.

The gentleman from Alabama is recognized for how much time?

Mr. BACHUS. Actually, Mr. Chairman, I don't have an opening statement.

I do want to respond to something in your pre-opening statement.

The CHAIRMAN. Sure.

Mr. BACHUS. The chairman invited you to submit essays. And I would simply say that they need to be plain vanilla essays. And if they are not, you need to get Elizabeth Warren's okay before you submit them.

The CHAIRMAN. That sounded like an opening statement to me, but all right.

The gentleman from Texas, Mr. Neugebauer, is recognized for 2 minutes. And then I will go right to the gentleman from California for 2 minutes. We split that up.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

As we continue to assess the Administration's and the chairman's proposal for regulatory restructuring, we need to take more time to understand the impacts. And I think we just heard the chairman say, there are consequences when we pass legislation. And we heard some of that today.

How will these proposals affect the cost of credit for those whom we represent? What are the impacts on the community lender and the constituents and small businesses in our hometowns who count on that credit?

At a time when our economy has slowed, and lenders are hesitant to lend, a new regulator would further limit the available credit. New fees to fund this agency mean added costs for consumers at a time when they can least afford it.

What do consumers get for this new tax? They get a massive Federal agency to substitute the government's judgment for theirs about what financial products and services best fit their needs. Taxpayers I represent are getting tired of the Federal Government dictating what kind of energy they are going to use, who is going to provide their health care, what kind of credit card they can have, what kind of a mortgage is appropriate for them, even what kind of car they can buy.

Our Republican plan is better for consumers. We keep safety and soundness regulation and consumer protection regulation under the same roof, because this structure holds regulators accountable. Our plan requires better disclosure and antifraud enforcement. When the American people receive good information about their financial products and services available and know that the fraudulent behavior will be stopped and punished, we think they are smart enough to make decisions about what products are best for them to use.

The problem I have had with this whole process is that we had a lot of legislation on the books. We had regulators in place who were supposed to be doing their job. The problem is that regulators, in many cases, didn't do their job. And so now our answer, rather than going back and holding those people accountable for their action, is to throw a whole new blanket of regulation over the markets to somehow give some indication that is going to fix the problem.

What we don't need is more regulation. We need better regulation, we need smarter regulation, and we need regulators doing their job. And I hope to hear from our witnesses today on some commonsense approaches to this so that we can continue to provide credit and not limit the choices of the American people. I don't think the American people are going to be overly excited about their choices being limited.

So I thank you, Mr. Chairman, for holding this hearing.

The CHAIRMAN. The gentleman from California for 2 minutes.

Mr. ROYCE. Thank you, Mr. Chairman. A major component of the Administration's regulatory reform proposal is the creation of a Consumer Financial Protection Agency, which would separate safety and soundness regulation from consumer protections.

This idea of separating the two has been around for some time. In fact, we saw that very structure over the GSEs. A weak safety and soundness regulator, OFHEO, was competing with HUD, who subjected Fannie Mae and Freddie Mac to ever-increasing affordable housing goals. And we know how that ended. The affordable housing goals of Fannie and Freddie, enforced by HUD, were the main reason behind the GSEs loading up on junk bonds, which ended up accounting for roughly 85 percent of their losses. Clearly, the goals were at odds with the long-term viability of these firms, and ultimately led to their demise.

We are now looking at applying that regulatory framework to the entire financial services sector. As the GSEs have shown, there is an inherent conflict in separating these two responsibilities. And there is also a reason why regulators like James Lockhart, who heads up the FHFA, and Sheila Bair, head of the FDIC, have expressed concern over such a proposal.

I think, long term, this Agency will do more harm than good, and based on the GSE history and political interference at the expense of safety and soundness, it should be avoided at all costs.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Kansas is recognized for 2 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman, and I thank you for your work to introduce H.R. 3126 to create the Consumer Financial Protection Agency.

I look forward to working with you and members of this committee to ensure that we have oversight of any new agency and the regulatory structures. I will be working to add an independent Office of Inspector General to the CFPA, as well as increasing the coordination between all financial IGs to ensure regulatory gaps are identified and addressed.

The financial meltdown last year made it very clear that our financial regulatory structure has problems that need to be fixed. We need to make sure that we have a system that protects consumers, investors, and taxpayers.

I thank the witnesses for their views on the Administration's proposal. We need to act thoughtfully and carefully, but quickly, to repair the gaps identified in our regulatory system. We also need to make sure that community banks that did not create this crisis are fairly treated under the new system.

Thank you, Mr. Chairman, and I yield back.

The CHAIRMAN. The gentlewoman from Illinois, Mrs. Biggert, for 2 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman.

It is no secret that one of the reasons our country got into this financial mess in the first place is because there simply were too many regulators who weren't doing their job and not talking to one another. Thus, I am very skeptical that for consumers the answer is making government bigger by creating a new Federal agency that is paid for by taxpayers, that tells consumers what financial products they can and cannot have, and tells financial institutions what products they can and cannot offer.

There is no question that our financial services regulatory structure is broken; and for both consumers and the health of our financial services industry and the economy, we need to clean it up. However, I fear that we are moving in the wrong direction when we strip from the banking regulators their mission to protect consumers. Instead, we place that responsibility with a new government bureaucracy, an agency that I think should really be called the Credit Rationing and Pricing Agency.

Why do I say this? Well, because this new agency, charged with deciding what is an affordable and appropriate product for each consumer, can only result in one or more of three things:

First, many consumers who enjoy access to credit today will be denied credit in the future;

Second, riskier consumers will have access to affordable products, but who will pay for that risk? It is the less risky consumer whose cost of credit will increase; and

Third, financial institutions will be told to offer certain products at a low cost to risky consumers, which will jeopardize the safety and soundness of that financial institution.

Secretary Geithner last week couldn't really answer the question, would the safety and soundness banking regulator trump a new consumer regulator if the consumer regulator's policy would put the bank in unsafe territory?

We must first do no harm. We must find a balanced approach to financial regulation. I think our Republican plan that puts all the banking regulators and consumer protection functions under one roof is a better answer for the consumer and really gets to the heart of preventing another financial meltdown.

I look forward to today's hearing and I yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Green, for 2 minutes.

Mr. GREEN. Thank you, Mr. Chairman. And I thank you for the introduction of H.R. 3126.

I am eager to hear commentary on H.R. 3126. I believe that we can have consumer protection as well as safety and soundness; I don't think these things are mutually exclusive of each other. I don't think that legislation is perfect, but I do think that we can do things to perfect it. And I am interested in being a part of the perfection process to make sure we have safety and soundness as well as consumer protection.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman from California, Mr. Miller, for 2 minutes.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman. I want to thank you for holding this hearing today.

And I believe that everyone in this room would agree that our current regulatory system failed to adequately protect not only the markets, but investors, and it does need to be restructured. However, I believe we need to proceed with caution to ensure that legislation does not overregulate our markets, stifle innovation or take choices away from consumers.

I want to thank the chairman for bringing up the issue of mark-to-market. I believe it was in February of last year that I introduced an amendment on a bill, the housing bill, that required the Federal Reserve and the SEC to look at mark-to-market, perhaps take part of it and revisit it and restructure it, and perhaps even avoid implementing portions of it at that point in time.

It is sad to say, I think I did that 3 or 4 times, and the Senate removed it from every bill we sent over there. I think, had we moved more aggressively in that direction, perhaps some of the problems we face today might have been avoided.

There has been much debate about Freddie and Fannie. I know in 2002–2003, we also passed legislation providing a strong regulator and providing oversight for Freddie and Fannie that perhaps might have avoided some of the circumstances they are facing today. But the concept of not having a Freddie or Fannie there today, when they are providing about 73 percent of all the loans out there and the guarantees in the marketplace, is bothersome to me. And if you include FHA in that, between Freddie, Fannie, and FHA, over 90 percent of the loans made today are taken by those or guaranteed by those companies.

The fact is that with liquidity as it is, the banks just don't have the liquidity on hand to make fixed-rate 30-year loans and hold those loans in many cases.

I think one thing we didn't do was open Freddie and Fannie up to the high-cost areas. We did that much later, in fact in this last year, but I think had we done that early on there would have been more liquidity in the overall marketplace, and I believe that certain portions of this country wouldn't have been discriminated against because they weren't having the option to participate in the program.

I really hope that the comments by this group of distinguished individuals today will be honest, above board, and really tell us your concerns. I am concerned that we overregulate you. We need to allow the market to take its course. We need to allow innovation within the marketplace, and especially within your industry, we need to allow for innovation.

I think sometimes we are not timely in implementing programs like mark-to-market. And I think sometimes we react overaggressively after the fact when things have occurred, and I am hoping we don't do that in many cases.

I hope we are thoughtful in what we are doing here, we discuss the pros and cons as it applies to your industry, and we come up with something that is reasonable.

Mr. Chairman, I thank you and I yield back the balance of my time.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you, Mr. Chairman, and thank you for this hearing. This is an important hearing. As I have often said, the banking industry is the heart of our financial system, and through it, everything flows.

We have so much on our plate as we deal with the President's regulatory reforms: the new financial oversight agency, the Consumer Financial Protection Agency; the Federal Reserve and its role as systemic regulator; the creation of a council of regulators; the FDIC's role; the merger of the Office of Thrift Supervision into the OCC; title rules on banks that package and sell securities backed by mortgages and other debt; proposals that companies issuing their mortgages retain at least 5 percent on their books; and the requirement that hedge funds and private equity funds register with the SEC and open their books to regulation. We have a lot on our plate to deal with in this regulatory reform.

And on top of that, how do we make this work with our State, our Federal, and international regulators, all in our efforts to ensure the stability of the financial services sector and protection of the financial consumer? What a challenge we have. It is the banking community that is at the heart of it, and this is why this hearing is so vital and so important.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling, for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

Under the national energy tax, House Democrats want to help decide what cars we can drive. Yesterday, House Democrats announced a plan to help decide what doctors we can see and when we can see them. And now under CFPA, House Democrats want to decide whether or not we qualify for credit cards, mortgages, or practically any other consumer financial product.

Yes, there is a troubling trend. The CFPA represents one of the greatest assaults on economic liberty in my lifetime. It says to the American people, you are simply too ignorant or too dumb to be trusted with economic freedom. Therefore, five unelected bureaucrats, none of whom know anything about you or your family, will make these decisions for you. But never fear, surely several of them will have Ph.D. by their names, and they will engage in vigorous discussions about consumer credit issues at very exclusive cocktail parties in Georgetown.

This is the commission that will now have sweeping powers to decide under the subjective phrase "unfair," what mortgages, credit cards, and checking accounts you may qualify for. Sleep soundly at night.

To take from consumers their freedom of choice, to restrict their credit opportunities in the midst of a financial recession, all in the name of consumer protection is positively Orwellian.

Let's protect consumers from force and fraud. Let's empower them with effective and factual disclosure. Let's give them opportunities to enjoy the benefits of product innovations like ATM machines and online banking. And let's not constrict their credit opportunities.

A consumer product Politburo does not equate into consumer protection.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from Texas, Mr. Green, for 2 minutes.

I am sorry, the gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

I am pleased we have an opportunity this morning to interact with the banking industry. I am particularly pleased that many of our witnesses have indicated they support more regulation for the shadow banking industry, a collection of unregulated lenders who operate outside of State and Federal oversight due to their nonbank status.

It was, yes, many of these lenders who preyed on customers with products such as no-doc loans, and helped erode the lending markets which compromised the foundation of our economy.

However, I am still concerned with the consumer-related activities of regulated banks. Large banks, in particular, have substantial interactions with the public, be it as a mortgage servicer, as a place for consumers and small businesses to access necessary credit.

I would agree with you that additional regulation would be unnecessary were our financial system functioning properly. However, data from the Federal Reserve on the availability of credit shows this is not the case.

Likewise, neither do the calls I receive from my constituents, the ones who are facing foreclosure, yet cannot reach their servicer to modify their loan. After all that we have gone through in trying to make loan modifications available to deserving people, we still have people who cannot reach their servicers. And even when they do, the servicers are not working out credible loan modification arrangements.

Clearly, the mechanisms we have to protect consumers and ensure their access to credit are inadequate. I believe that a Consumer Financial Protection Agency is vital to the proper functioning of our economy.

Our current crisis began when collateralized debt obligations and mortgage-backed securities began to be packed with exotic products such as no-doc and liar loans. It was exacerbated as consumers were continually squeezed with excessive penalties and fees from bank products, reducing purchasing power and leading families everywhere to make tough decisions. A strong regulator, one which focuses solely on consumer safety and champions simpler disclosure and products would have prevented all of this.

Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. The gentleman from New Jersey, Mr. Garrett, for 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman. Let me just make two points. The first one—I don't want to single out any single member of this committee, because what I want to say is a reflection on the process and not just the individual, because he is certainly not alone.

But this last Monday, in the American Banker magazine, this member of the committee was asked this question: "How will a dis-

pute be settled between the safety and soundness regulators and the newly formed CFPA?" And he responded, "Unfortunately, I can't give you an answer to that." He went on to say, "Your question is a good one, because you have to think about what you haven't thought about, and I haven't even thought about how a dispute between the agencies would be resolved, so I had better figure that out."

Now this comment, mind you, comes from one of the bill's sponsors, who just a couple of days ago had not thought about a process that is basically fundamental to the issue that is in this bill.

As I stated before, I am not singling out a single member, because I think other people have the same questions. They haven't had the time to think this all through, nor has the Administration thought about the unintended consequences of their proposal—this, despite the fact we rush long into the April break—I mean the August break—with the goal of getting this rammed through Congress without having thought it through.

Secondly, you know, there was an op-ed by Peter Wallison recently which points out that traditionally in this country for consumer protection we talk about disclosure, adequate disclosure. And it is always assumed if you have adequate disclosure, that regardless of the level of sophistication of the consumer, the consumer would make a rational decision as to what he was doing.

If the Administration's proposal is put through, however, the consumer will be told that regardless of the level of his sophistication, his education, or perhaps his intelligence, he is not going to be able to understand what is being offered to him. You know, this Administration has made a fairly dramatic move to make more and more decisions in place of the decisions that have been traditionally been made in the place of the consumer, whether it is in the area health care that you talked about, the bankruptcy process or the like.

Quite honestly, I don't think Americans want government bureaucrats deciding if they are smart enough or sophisticated enough to take out a line of credit at the local retailer, or policing whether the credit card that they choose offers reward points or not. When you come down to it, having choices is part of being an American.

With that, I yield back.

The CHAIRMAN. The gentlewoman from Kansas for 2 minutes.

Ms. JENKINS. Thank you, Mr. Chairman.

For months now, this body has been attempting to relieve the pain felt by our constituents because of today's economic turmoil. However, politicians should not use the current financial crisis as a convenient excuse for a massive overreach of government intervention into our free markets.

Smart and lean regulation can be effective, allow free markets to innovate, and balance consumer protection. Innovation is the base of American economic strength. Killing innovation, whether through overregulating or by allowing only plain vanilla products, could hinder access by individuals and businesses to sound, yet creative, financial products.

Plus, many of the proposals before us may not address the real faults in the system. The regulatory compliance costs alone may se-

verely impact smaller financial institutions at a time when many of these institutions in Kansas are already struggling.

I am eager to hear this week about how we can best reform our system, protect consumers, and allow for vibrant growth.

Regulatory restructuring is not to be taken lightly. I urge my colleagues to proceed with caution, taking into account unintended consequences these reforms may have on the financial industry and the consumer.

Thank you, Mr. Chairman. I yield back the remainder of my time.

The CHAIRMAN. We will now hear from Mr. Watt, then we will be able to hear one of the statements, and then we will break.

Mr. Watt is recognized for 1 minute.

Mr. WATT. Thank you, Mr. Chairman. I really had planned not to give an opening statement, but Mr. Garrett and his comments provoked me; and I did want to be clear that in answering the question that the gentleman asked, I don't think an appropriate response or answer is—just as if you have a safety and soundness regulator, you wouldn't have the consumer regulator overrule the final decision on safety and soundness, I don't think the appropriate response is to have a safety and soundness regulator overrule and be the final word on consumer issues.

The CHAIRMAN. Would the gentleman yield me his last—

Mr. WATT. I am happy to.

The CHAIRMAN. First of all, if we have the answers before the hearing, people are upset. And if we have the hearing before the answers, people are upset. If people want to be upset, there is nothing I can do to stop it.

I will say this: I can guarantee that any legislation that comes out of here will make it clear that no bank will be faced with any conflicting demands and that there will be, very clearly, a final resolution matter, and no one will be subjected to that double standard.

And now we are going to take one witness. And the members may know that in seniority, two people elected at the same time, if there is a member who had prior service that was interrupted, that member gets seniority. So following that principle, the former member of this committee, the gentleman from Texas, as he then was, Mr. Bartlett, will be our lead witness representing the Financial Services Roundtable.

STATEMENT OF THE HONORABLE STEVE BARTLETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you Mr. Chairman, Ranking Member Bachus, and members of the committee.

The focus of this hearing is on the future, as it should be, but I want to begin with an apology about the past—I said this at other times, in other forums, and in other places for perhaps a year; John Dalton, representing the Roundtable and Housing Policy Council, said this the last time he was before the committee—and that is, our sincere—my personal, sincere apologies and those of our organizations for the role that we played and I played in failing to see the crisis in time to help to avert it.

So I accept my responsibilities. And we are here to set out some responsibilities to seek reform to avert the next crisis.

It is the Roundtable's view and my view that this reform should be comprehensive, should be systemic, and should be quite large in terms of its scope of averting the next crisis. The fact is, there is a lot of blame to go around, a lot of sources of the problem; but the number one problem, it seems to me, that brought us here was the regulatory system that is in chaos in terms of its structure. The current system is characterized much more by silos of regulation than coherent regulation, and that introduces hundreds of different agencies who regulate the same companies with the same activities in totally different ways based on different statutes, different standards, different systems, different goals, with a total lack, or virtually total lack, of common principles and common goals.

So I am here today to start with this committee to urge comprehensive reform. The Roundtable supports bold reform, comprehensive reform that will strengthen the ability of our financial systems to serve the needs of consumers and to ensure the stability and integrity and safety and soundness of the financial system.

To be clear, the status quo is unacceptable.

I am going to comment orally on several components of the legislation or the proposal that has been proposed by the Administration. I have about 15 in total in my written testimony. I will offer four or five.

The CHAIRMAN. And without objection, all submissions by any of the witnesses on any material will be accepted into the record.

Mr. BARTLETT. I will comment on four or five of those in my oral testimony.

One is the Consumer Financial Protection Agency, no doubt the subject of the largest amount of heat and attention by this committee, as it should be. The Roundtable believes that strengthened consumer protection is an essential component of broader regulatory reform. To that end, we endorse the spirit to ensure sound protections and better disclosures for consumers, but we strongly, strongly oppose the creation of a separate, free-standing Consumer Financial Protection Agency.

Rather than create a new agency and bifurcate consumer protection from safety and soundness, we recommend that the Congress enact strong national consumer protection standards for all consumers.

We are not here to advocate the status quo; we are here to advocate stronger regulation. In short, we support consumers, we support financial regulatory reform, we support protection, and we oppose the agency.

Second, systemic risk regulator and the so-called Tier 1 financial holding companies: An essential part of regulatory reform legislation is the creation of a systemic risk regulator. Today, no single agency has the specific mandate or surveillance purview or the accountability to detect and mitigate the risks of financial stress in future financial crises.

We strongly support the designation of the Federal Reserve Board as a systemic risk oversight authority. However, the Board should not be added as an additional super-regulator. Rather, it

should work with and through the powers of prudential supervisors in nonemergency situations to achieve their goals.

We support a national resolution authority. The recent financial crisis demonstrated the urgent need for that authority.

The Roundtable supports and has advocated for the establishment of a resolution regime for insolvent nonbank financial institutions. We recommend that the Treasury Department have the authority to appoint the appropriate prudential regulator for an institution upon determination that authority is necessary. However, we strongly believe that the FDIC and other agencies that are set up for those sectors should be segregated and held off just for the sectors that those funds have been designated for.

Insurance: The Administration's proposal recognizes "our current insurance regulatory system remains highly fragmented, inconsistent and inefficient," and "has led to a lack of uniformity and reduced competition across State and international boundaries, resulting in inefficiency." Well, you get the picture. That is from the Administration's statement.

So at the Roundtable, we think a logical extension of that should strongly support the adoption of a Federal insurance charter as part of this regulatory reform for national insurers, reinsurers, and producers under the supervision of a single national regulator.

We urge the committee to consider H.R. 1880, the National Insurance Consumer Protection Act offered by Congresswoman Bean and Congressman Royce as part of this regulatory structure.

Mr. Chairman, the Roundtable supports comprehensive reform now. We recommend a number of practical and important improvements to this legislation to achieve that reform.

I yield back.

[The prepared statement of Mr. Bartlett can be found on page 56 of the appendix.]

The CHAIRMAN. We will now recess. We will vote.

It looks like there is one adjournment vote. So we will be able to come back fairly quickly, and we will get to the rest of the witnesses.

The committee is in recess.

[recess]

The CHAIRMAN. The hearing will reconvene. I have been told by the staff that the timer is broken, so I will be looking at the clock and going by the clock. That doesn't mean you won't get much time.

I will try to give people—I will try. That is not hard, except I may forget. That will mean you have a minute to go, so people will have a chance to wind up what they are saying or, to use the terminology of the industry, they will have a chance to resolve their statements; which means put you out of business, as we know. That is a nice way to say that.

So we will now go to John Courson, who is president and chief executive officer of the Mortgage Bankers Association, and my very able colleague here has a timer of 5 minutes, very good.

So we have a 5-minute timer from Mr. Neugebauer. Thank you.

Mr. Courson, please go ahead.

STATEMENT OF JOHN A. COURSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION

Mr. COURSON. Thank you, Mr. Chairman. Let me say from the outset that MBA supports regulatory modernization and strengthening our consumer protections. Our country's economic crisis gives us a once-in-a-generation opportunity to really improve the regulation of our mortgage markets. These improvements to the financial regulatory structure will have a profound effect on the availability and affordability of mortgage financing.

We believe they must be judiciously considered so reform is done right. Today's financial regulatory system is a patchwork of State and Federal laws. While MBA strongly supports the Congress' and the Administration's efforts to improve this system, having reviewed these proposals through the prism of our regulatory modernization principles, we do have some concerns.

MBA's principles include that all parts of financial services regulation must be addressed comprehensively and regulatory changes should focus on substance, not form. Uniformity and oversight and interpretation of standards should also be promoted whenever possible. Collaboration among regulators and transparency should be required. Appropriate borrower protections must be balanced with the opportunities for the industry to compete and to innovate.

Finally, attention must be given to ensure the continued availability and affordability of sustainable mortgage options.

With these points to guide our analysis, MBA has the following concerns about the creation of a consumer financial protection agency. Establishing a new consumer protection regulator, while also maintaining the authority at existing regulators, may actually weaken consumer protections by disbursing regulatory power and removing consumer protection from the mainstream of the regulators' focus.

In addition, CFPA may result in a worse patchwork of Federal and State laws as well as uneven protection and increased costs for consumers. To truly protect consumers, we need greater uniformity.

Additionally, while the proposal suggests that HUD and the Federal Reserve work together to achieve a single combined RESPA/TILA of disclosure or have it become the responsibility of CFPA, the bill does not require such collaboration as this committee directed in the mortgage reform bill, which passed this House in May. And borrower protections offered in H.R. 3126 could stem competition and innovation.

If saddled with responsibilities across the spectrum of financial products, CFPA could fail to give proper attention to the biggest asset most families purchase: a home. Because the new regulator would not be solely focused on mortgage regulation, there is a danger that mortgage products may not receive sufficient priority.

To respond to these issues, MBA believes there are better alternatives for improving consumer protections. With our expertise in the mortgage markets, MBA has developed a groundbreaking proposal to protect consumers and improve the system that regulates mortgage finance. We call it the Mortgage Improvement and Regulation Act.

It would provide uniform standards, consistent regulation for all mortgage lending. MIRA would improve the regulatory process to

include more rigorous standards for lenders and investors and equally clear protections for consumers. Instead of adding duplicative regulation at the Federal level, it would fill gaps in regulation of nondepository lenders and mortgage brokers, providing them with a Federal regulator, streamline regulation, and would enhance enforcement.

MIRA could easily be part of a more comprehensive regulatory modernization effort. More importantly, it would ensure that consumers are provided mortgage financing and protection from abuse.

We hope the committee will consider our MIRA proposal as part of its regulatory modernization efforts.

Mr. Chairman, MBA looks forward to working with the committee on new consumer protection and regulatory modernization legislation as these proposals develop. These are extremely complex and important issues, and we hope the committee will take all of the time it needs to do the right thing.

Thank you for this opportunity to testify.

[The prepared statement of Mr. Courson can be found on page 111 of the appendix.]

The CHAIRMAN. Thank you, Mr. Courson.

Next, we will hear from Chris Stinebert, president and chief executive officer of the American Financial Services Association.

STATEMENT OF CHRIS STINEBERT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. STINEBERT. Thank you, Mr. Chairman, and thank you for your assurances about no contradictory orders out there. That is very helpful. And, also, I heard from everyone in their opening statements about the desire of everyone to move cautiously and carefully as we move forward, and that is appreciated as well.

Today I am going to focus most of my remarks on the new formation of the Consumer Financial Protection Agency. Let me say from the outset that AFSA fully supports strong consumer protection.

What is troubling, however, is the notion that improved consumer protection depends entirely on the creation of a new Federal agency empowered to make product choices for consumers.

We believe the country does not need a vast new bureaucracy, and that the goals of the Administration and Congress can be achieved through other means that are quicker, more efficient, and certainly less costly.

If signed into law today, the CFPA's earliest action could be taken perhaps 2 to 3 years from now. Why then would Congress rush to launch a new agency before taking the time to carefully evaluate the potential consequences on the availability of credit and certainly the overall economy? We believe that a thorough assessment is needed to determine if the benefits will outweigh the risk and certainly the costs.

In essence, the proposal would impose a new tax on consumers at a time when they are least able to afford it. Congress should think carefully about setting up a new government agency that would cost taxpayers more money at a time when they are already struggling to stay afloat financially.

Given the vast scope of the new agency, it is certainly acceptable that these costs could be staggering. Any assessment or fees charged to lenders undoubtedly will be passed on to consumers. The result will be an increase in costs and hurt the availability of credit.

AFSA believes consumers will be better served by a regulatory structure where the prudential and consumer production oversight is housed within a single regulator. Congress tried to separate these two functions with the GSEs. Director James Lockhart recently cited this separation of functions was one of the primary reasons for failure at Fannie Mae and Freddie Mac.

We urge Congress to support a regulatory structure that continues to have that balance, that necessary balance between safety and soundness and the viability of the companies that offer them.

We also believe that the proposed agency has the potential to roll back the clock 30 years, back to when consumers only had a choice of standard and plain vanilla products.

In the last 30 years, in adjusted inflation dollars, consumer credit has increased from $882 billion to $2.6 trillion; household mortgages, from $2 trillion to $10.4 trillion.

For the last 30 years, financial innovation has been the fuel of this economy. We are not here today to claim that financial innovation did not play some role in the subprime mortgage crisis, but regressing to a bygone era is not progress. Financial services reform should take us forward, not back to plain vanilla.

Most AFSA members are regulated primarily at the State level subject to a patchwork of inconsistent requirements. Under this new proposal, you could wind up with 50 different State requirements as far as trying to meet those regulations in different forms and different disclosures, and certainly that is not a formula for simplification.

We have six different suggestions:

Allow time to evaluate the effects of other government initiatives, such as the Cardholders' Bill of Rights recently signed into law and the new changes to HOEPA.

Make current and future consumer protection rules apply to all financial service providers.

Pursue a regulatory structure that does not separate financial services and products from the viability of the companies that offer them.

Leave enforcement of rules of existing regulators, but give backup authority to the Fed for these areas, and step up enforcement. Step up enforcement, make stronger enforcement of existing consumer protection laws, and make sure that the necessary resources are provided.

Last but not least, I would like to mention, preserve the industrial bank charter. The Administration's proposal calls for eliminating the industrial bank charter. Industrial banks provide a safe, sound, and appropriate means for delivering financial services to many in the public. These institutions have not been part of the problem. As a matter of fact, there have been no instances of any problem within the ILC structure, and we think they should be part of the solution moving forward.

I am happy to answer any questions that you might have.

[The prepared statement of Mr. Stinebert can be found on page 176 of the appendix.]

The CHAIRMAN. Next, we have Mr. Steven Zeisel who is vice president and senior counsel of the Consumer Bankers Association.

STATEMENT OF STEVEN I. ZEISEL, VICE PRESIDENT AND SENIOR COUNSEL, THE CONSUMER BANKERS ASSOCIATION

Mr. ZEISEL. Good morning, Mr. Chairman, members of the committee. My name is Steve Zeisel, and I am senior counsel at the Consumers Bankers Association. I am very pleased to be given this opportunity to present the views of CBA to the committee.

CBA is a trade association focusing on retail banking issues, and we are therefore limiting our testimony today to the proposed Consumer Financial Protection Agency. CBA supports strengthening consumer protections as part of the regulatory reform initiative, and we support several of the goals outlined in the CFPA proposal, including improving transparency, simplicity, fairness, accountability, and access for consumers.

Our concern is with the approach being proposed. We believe these objectives can best be achieved within the existing regulatory framework rather than dismantling the current system and creating a separate new regulatory agency. Safety and soundness and consumer protection are intimately related, and cannot be separated without doing harm to both.

Furthermore, putting consumer protection in a separate agency will create a host of problems, including how the agencies will coordinate their activities—as the chairman mentioned—who will resolve inevitable disputes, and many more, none of which are necessary to achieve improved consumer protection. We also believe there needs to be stronger supervision of nonbank lenders so they receive a consistent and comparable level of oversight and enforcement as experienced by banks.

Although we have many other issues, many other concerns, there are two issues I particularly want to highlight today.

First, we are concerned that the proposal would subject retail banks to the consumer laws of 50 States. I ask you to consider the practical impact of such a policy. It could result in dozens, perhaps scores of differing requirements pertaining to minimum payments, fee limits, underwriting prescriptions and the like, making nationwide lending into a complex and costly undertaking.

Not only will this limit the range of products available, but some banks may have to make the unwelcome decision not to do business in States they otherwise would, due to the complexity and cost associated with the compliance burdens. That could mean fewer and more expensive choices for consumers as a result of the decreasing competition.

Further, due to the elimination of uniform consumer laws for federally chartered institutions, even a simple uniform disclosure, which is one of the goals of this initiative, would have to be supplemented by State disclosure requirements in every State in which the bank does business.

The best intentions of the bank or the CFPA to provide simple disclosures would be frustrated, as a uniform loan agreement would become a voluminous document cluttered with State-specific

information. We believe the better approach is to maintain a uniform national standard as it relates to retail banking.

Second, under the proposal, the CFPA will require retail banks and other financial service providers to offer products that are designed entirely by the Federal Government. This so-called plain vanilla requirement will remove product development from banks and transfer it to the new agency. Banks will offer vanilla products, but it is less clear whether they will be able to offer the variety of products they offer today or may develop tomorrow.

This is because the proposal strongly discourages the offering of other products consumers may find useful by creating regulatory uncertainty regarding how these nonvanilla products must be described, how they can be advertised, and the disclosures that must accompany them.

It is also unclear whether an institution would be required to make available the same plain vanilla products and features to everyone, regardless of whether they quality. It is unclear what hurdles a consumer would have to jump to obtain any other products, and it is unclear what risks the institution would be taking when it allows a consumer to have any other products.

The list of questions is long. In the final analysis, we believe retail banks are in a better position than the government to know which products serve their clients' needs.

In conclusion, we believe the proposed changes, though well intentioned, may stifle innovation, raise costs to consumers, reduce access to credit, and result in more confusion rather than less.

Thank you for the opportunity. I will be happy to answer any questions you may have.

[The prepared statement of Mr. Zeisel can be found on page 206 of the appendix.]

The CHAIRMAN. Next is Professor Todd Zywicki, from George Mason University.

STATEMENT OF PROFESSOR TODD J. ZYWICKI, GEORGE MASON UNIVERSITY FOUNDATION PROFESSOR OF LAW AND MERCATUS CENTER SENIOR SCHOLAR, GEORGE MASON UNIVERSITY SCHOOL OF LAW

Mr. ZYWICKI. Thank you, and let me make clear that even though this hearing estopped banking industry perspectives, I appear only as myself. My affiliation with the banking industry is as a consumer.

I am going to address the Consumer Financial Protection Agency today, and I think there are three fatal problems with the CFPA that I think are irremediable and really can't be overcome or approved.

The first is that it is based on misguided paternalism. The second is that because it misdiagnoses the underlying problems, it will create unintended consequences that will probably exacerbate rather than improve the situation we have seen in the past few years.

And, third, it creates a new apparatus of bureaucratic planning that is simply unfeasible and, at a minimum, unworkable.

First, it is based on an idea of misguided paternalism. The causes of the foreclosure crisis, if we focus on that particular issue, really have very little to do with consumer protection. What the

causes of foreclosure crises erode from were a set of misaligned incentives that consumers rationally responded to. When consumers rationally respond to incentives, that is not a consumer protection problem.

Take an example. Say there is a fellow in California who got a no-doc nothing-down loan. California has an antideficiency law that means that if you walk away from your house, the bank is limited in taking back the house and they can't sue you for any deficiency.

Say the guy was going to buy the house, live in it for a couple of years, and then flip it for a profit. Instead, the house goes down in value. He crunches the numbers and says well, it is worth it for me to walk away from the house and give it back to the bank. The bank can't sue me for any deficiency. There is no consumer protection issue in that hypothetical. There is a very, very, very serious safety and soundness issue. That was a very foolish loan by the bank, and it really created a lot of problems for safety and soundness. But that is not a consumer protection issue. And if we consider it a consumer protection issue, rather than consumers rationally responding to incentives, we are going to have problems.

Similarly, the other factor that caused a lot of foreclosures was adjustable rate mortgages. Adjustable rate mortgages are not inherently dangerous. There have been many times in the past, over the past 30 years, where adjustable rate mortgages have been 50 or 60 or 70 percent of the new mortgages that were written. Adjustable rate mortgages are a problem when the Federal Reserve engages in the kind of crazy monetary policy it engaged in from 2001 to 2004. When the Federal Reserve engages in crazy monetary policy, that is not a consumer protection issue. And I don't think there is anything in the CFPA that will make the Federal Reserve engage in better monetary policy in the future. So that basing it on the misguided idea that the crisis was spawned by hapless consumers being victimized by ruthless lenders is not going to be a basis for good policy.

Second, that leads to a second problem which is a problem of unintended consequences. Consider two issues identified in the Obama Administration's White Paper, prepayment penalties and mortgage brokers and yield spread premiums. Prepayment penalties are an especially good example. They talk about how they are going to get rid of prepayment penalties in subprime mortgages.

Well, what we know about prepayment penalties from all the empirical evidence is that there is no empirical evidence that prepayment penalties increase foreclosures. Why is that? Because consumers pay a premium in order to have the right to prepay their mortgage, because that shifts the risk of interest rate fluctuations to the bank.

Consumers pay about 20 to 50 basis points more for a mortgage that has a right to prepay, and that is even higher for subprime borrowers for reasons we can talk about. The effect is that by allowing borrowers to pay less for a mortgage, they are less likely to get into financial trouble and less likely to end up in foreclosure. So getting rid of prepayment penalties would increase the price of mortgages and have no discernible impact on foreclosures.

In fact, it could end up having the unintended consequence of worsening things. Why? Because the United States is virtually unique in the Western world in having the right generally to prepay your mortgage, which is basically to refinance when your interest rates go down.

What a lot of Americans did was when equity ramped up in their house, they exercised that right to prepay and refinance their mortgage and sucked out all the equity in their house. As a result, when their house went down in value, they decided to walk away from the house.

In Europe, they have had very big property value decreases as well, but Europe has not had a foreclosure crisis. And one reason is because in Europe nobody can prepay their mortgage. You have a 10- or 15-year mortgage with a balloon payment and an adjustable rate mortgage and no right to prepay. No right to prepay means you can't suck out the mortgage when your house goes up in value. When you can't suck out the mortgage, then you have a better equity if the house goes down in value. So that banning prepayment penalties would likely have the impact of increasing foreclosures by giving more people an opportunity to suck out equity in their homes going forward.

With respect to mortgage brokers, the evidence is clear that competition is what matters. If we reduce the number of mortgage brokers, people are going to pay more for mortgages.

Finally, let me say the third point, which is the problem of bureaucrat central planning. The CFPA essentially requires an impossibility. It requires identifying certain terms and mortgages as being unsafe.

What we know is there are no individual terms and mortgages that are unsafe. Terms in combination may be unsafe. Terms designed with State antideficiency laws may be unsafe. But the idea you can identify certain terms as unsafe is just folly and will stifle innovation and create other problems.

Thank you.

[The prepared statement of Professor Zywicki can be found on page 211 of the appendix.]

The CHAIRMAN. Next is Denise Leonard who is vice president for government affairs at the National Association of Mortgage Bankers.

STATEMENT OF DENISE M. LEONARD, VICE PRESIDENT, GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Ms. LEONARD. Good morning, Chairman Frank, distinguished members of the committee. I am Denise Leonard, vice president of government affairs for the National Association of Mortgage Brokers.

In addition to being vice president, I am also a mortgage broker in Massachusetts and have been for the past 19-plus years. I would like to thank you for the opportunity to testify before you here today.

We applaud this committee's response to the current problems in our financial markets and we share a resolute commitment to a simpler, clearer, more uniform and valid approach relative to finan-

cial products, most specifically with regard to obtaining mortgages and to protecting consumers throughout the process.

As such, NAMB is generally supportive of the tenet behind the plan and conceptually agrees with the establishment of an independent agency that focuses on consumer financial products protection, but believes some changes are necessary.

Before I address some specific areas of concern, I must first extinguish the false allegations targeted at mortgage brokers for years. We do not put consumers into loan products. We provide mortgage options to consumers and work with them throughout the process. We don't create loan products. We don't assess the risk on those products or approve the borrower. We don't fund the loan, and we are regulated.

Our testimony will focus on the Consumer Financial Protection Agency and how it affects us, as well as H.R. 3126.

In order for the CFPA to be effective, the structure must adequately protect consumers and account for the complexity of the modern mortgage market, and it must be in disparate treatment of any market participants. Any agency, whether new or existing, must act prudently when promulgating and enforcing rules to ensure real protections are afforded to consumers, and not provide merely the illusion of protection that comes from incomplete or unequal regulation of similar products, services, or providers.

To the extent that the CFPA will enhance uniformity in the application of those rules, regulations, disclosures, and laws that provide for consumer protection, NAMB supports such an objective, although we do believe that there should be added limitations on the CFPA's powers. Whereas the purpose of the agency is to promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products and to ensure the markets operate fairly and efficiently, it is imperative that the creation of new disclosures or the revision of antiquated disclosures be achieved through an effective and even-handed approach and consumer testing.

It is not the "who" but the "what" that must be addressed in order to ensure true consumer protection and success with this type of initiative. To ensure that all consumers are protected under the CFPA, there should be no exemption from its regulatory purview or limited exemptions that pick winners and losers in the industry.

We are very supportive of H.R. 3126's requirement that the CFPA propose a single integrated model disclosure for mortgage transactions that combine those currently under TILA and RESPA. Consumers would greatly benefit from a uniform disclosure that clearly and simply explains critical loan terms and costs.

Therefore, NAMB strongly encourages this committee to consider imposing a moratorium on the implementation of any new regulations or disclosures issued by HUD and the Federal Reserve Board for at least a year after the designated transfer date. This would help to avoid consumer confusion and minimize the increased costs and unnecessary burden borne by industry participants to manage and administer multiple significant changes to mandatory disclosures over a very short period of time.

We strongly support empowering the CFPA to take a comprehensive review of new and existing regulations, including the new Home Valuation Code of Conduct. Too often, in the wake of our current financial crisis, we have seen new rules promulgated through the use of existing regulations that run afoul of the purpose and objectives of the Administration that do not reflect measured, balanced, and effective solutions to the problems facing our markets and consumers.

The HVCC provides the most notable recent example of that flawed method and, as such, should be revealed during the CFPA's review of existing rules. We also believe that the SAFE Act should be amended to ensure that the CFPA possesses complete and exclusive authority to implement it in its entirety.

In addition, we support a Federal standard of care based on good faith and fair dealing for all originators as defined under the SAFE Act. We believe such a standard would greatly enhance consumer protections.

Finally, with regard to the board makeup as it is proposed, the committee would be anything but independent, and we recommend that its makeup be expanded and consistent with other agencies such as the FTC with regard to political affiliation. There should be no more than three members of the same party as the President who appoints them.

We appreciate this opportunity to appear before you, and we look forward to continuing to work with you, and I am available for any questions.

[The prepared statement of Ms. Leonard can be found on page 145 of the appendix.]

The CHAIRMAN. Next, Mr. Edward Yingling, president and chief executive officer of the American Bankers Association.

STATEMENT OF EDWARD L. YINGLING, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN BANKERS ASSOCIATION

Mr. YINGLING. Thank you, Mr. Chairman.

ABA believes there are three areas that should be the primary focus of reform: the creation of a systemic regulator; the creation of a mechanism for resolving institutions; and filling the gaps in regulation of the shadow-banking industry.

The reforms need to be grounded in a real understanding of what caused the crisis. For that reason, my written testimony discusses continuing misunderstandings of the place of traditional banking in this mess. ABA appreciates the fact that the bipartisan leadership of this committee has often commented that the crisis in large part developed outside the traditional banking industry. The Treasury's plan noted that 94 percent of high-cost mortgages were made outside traditional banking.

The ABA strongly supports the creation of an agency to oversee systemic risk. The role of the systemic risk oversight regulator should be one of identifying potential systemic problems and then putting forth solutions. This process is not about regulating specific institutions, which should be left primarily to the prudential regulators.

It is about looking at information on trends in the economy and different sectors within the economy. Such problematic trends from

the recent past would have included the rapid appreciation of home prices, proliferation of mortgages that ignored the long-term ability to repay, excess leverage in some Wall Street firms, the rapid growth and complexity of mortgage-backed securities and how they were rated, and the rapid growth of the credit default swap market.

This agency should be focused and nimble. In fact, involving it in a day-to-day regulation would be a distraction. While much of the early focus was on giving this authority directly to the Fed, now most of the focus is on creating a separate council of some type.

This would make sense, but it should not be a committee. The council should have its own dedicated staff, but it should not be a large bureaucracy.

The council should primarily use information gathered from institutions through their primary regulators. However, the systemic agency should have some carefully calibrated backup authority when systemic issues are not being addressed. There is currently a debate about the governance of such council. A board consisting of the primary regulators, plus Treasury, would seem logical.

As to the Chair of the agency, there would seem to be three choices: Treasury; the Fed; or an independent person appointed by the President.

A systemic regulator could not possibly do its job if it cannot have oversight authority over accounting rulemaking. A recent hearing before your Capital Markets Subcommittee clearly demonstrated the disastrous procyclical impact of recent accounting policies, and I appreciate the chairman's reference to that at the beginning of this hearing.

Thus a new system for oversight of accounting rules needs to be created in recognition of the critical importance of accounting rules to systemic risk. H.R. 1349, introduced by Representatives Perlmutter and Lucas, would be in a position to accomplish this. ABA has strongly supported this legislation in previous testimony.

As the systemic oversight agency is developed, Congress could consider making that agency the appropriate body to which the FASB reports under the approach of H.R. 1349.

Let me turn to the resolution issue. We have a successful mechanism for resolving banks. Of course, there is no mechanism for resolution of systemically important nonbank firms. Our regulatory bodies should never again be in the position of making up a solution on the fly to a Bear Stearns or an AIG or not being able to resolve a Lehman Brothers.

A critical issue in this regard is "too-big-to-fail," and again I appreciate the chairman's reference to a separate hearing on that critical issue. Whatever is done on the resolution system will set the parameters for too-big-to-fail.

We are concerned that the too-big-to-fail concept is not adequately addressed in the Administration's proposal. The goal should be to eliminate, as much as possible, moral hazard and unfairness.

When an institution goes into the resolution process, its top management, board, and major stakeholders should be subject to clear-

ly set out rules of accountability, change, and financial loss. No one should want to be considered too-big-to-fail.

Finally, the ABA strongly supports maintaining the Federal thrift charter.

Mr. Chairman, ABA appreciates your public statements in support of maintaining the thrift charter. There are 800-plus thrift institutions and another 125 mutual holding companies. Forcing these institutions to change their charter and business plan would be disruptive, costly, and wholly unnecessary.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Yingling can be found on page 187 of the appendix.]

The CHAIRMAN. Finally, Michael Menzies, who is the president and chief executive officer of the Easton Bank and Trust Company, and he is here on behalf of the Independent Community Bankers of America.

STATEMENT OF R. MICHAEL S. MENZIES, SR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, EASTON BANK AND TRUST COMPANY, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. MENZIES. Thank you, Mr. Chairman, and members of the committee. As you mentioned, I am president and CEO of Easton Bank and Trust, just 42 miles east of here. We are a $150 million community bank, and I am honored to be the volunteer chairman of the Independent Community Bankers of America, who represent 5,000 community-bank-only members at this important hearing.

Less than a year ago, due to the failure of our Nation's largest institutions to adequately manage their highly risky activities, key elements of the Nation's financial system nearly collapsed. Even though our system of locally owned and controlled community banks were not in similar danger, the resulting recession and credit crunch has now impacted the cornerstone of our local economies: community banks.

This was, as you know, a crisis driven by a few unmanageable financial entities that nearly destroyed our equity markets, our real estate markets, our consumer loan markets and the global finance markets, and cost American consumers over $7 trillion in net worth. ICBA commends you and President Obama for taking the next step to reduce the chances that taking risky and irresponsible behavior by large or unregulated institutions will ever again lead us into economic calamity.

ICBA supports identifying specific institutions that may pose systemic risk and systemic danger and subjecting them to stronger supervision, capital, and liquidity requirements. Our economy needs more than just an early warning system. It needs a real cop on the beat.

The President's plan could be enhanced by assessing fees on systemically dangerous holding companies for their supervisory costs and to fund, in advance, not after the fact, a new systemic risk fund.

ICBA also strongly supports H.R. 2897, introduced by Representative Gutierrez. This bill would impose an additional fee on banks affiliated with systemically dangerous holding companies and bet-

ter account for the risk these banks pose, while strengthening the deposit insurance fund.

These strong measures are not meant to punish those institutions for being large, but to guard against the risk they do create. These large institutions would be held accountable and discouraged from becoming too-big-to-fail.

But to truly prevent the kind of financial meltdown we faced last fall and to truly protect consumers, the plan must go further. It should direct systemic-risk authorities to develop procedures to downsize the too-big-to-fail institutions in an orderly way. This will enhance the diversity and flexibility of our Nation's financial system, which has proven extremely valuable in the current crisis.

In that regard, ICBA is pleased the Administration plan maintains the State bank system and believes that any bill should retain the thrift charter. Both charters enable community banks to follow business plans that are best adapted to their local markets and pose no systemic risk.

Unregulated individuals and companies perpetrated serious abuses on millions of American consumers. Community banks already do their utmost to serve consumers and comply with consumer protections. Consumers should be protected. Any new legislation must ensure that unregulated or unsupervised people in institutions are subject to examinations just like community banks.

My written testimony outlines serious challenges with the proposed Consumer Protection Agency, which we oppose in its current form. For example, we strongly believe that rural writing and supervision for community banks should remain with agencies that also must take safety and soundness into account. Clearly a financial institution that does not adhere to consumer protection rules also has safety and soundness problems. And we, too, are grateful, Mr. Chairman, with your statement that you are committed to preventing conflict between safety and soundness and consumer protection.

If we truly want to protect consumers, Congress must enact legislation that effectively ends the too-big-to-fail system, because these institutions are too-big-to-manage and too-big-to-supervise. And we are grateful for your hearings on Monday, Mr. Chairman.

ICBA urges Congress to add an Assistant Secretary for Community Financial Institutions at the Treasury Department to provide an internal voice for Main Street concerns. H.R. 2676, introduced by Representative Dennis Cardoza, will provide that important balance between Wall Street and Main Street within the Treasury.

Mr. Chairman, community banks are the very fabric of our Nation. We fund growth, we drive new business. Over half of all the small business loans under $100,000 in America are made by community banks. We help families buy homes and finance educations. We, too, are victims of the current financial situation, but we are committed to help the people and businesses of our communities, and we will be a significant force in the economic recovery.

Thank you, sir.

[The prepared statement of Mr. Menzies can be found on page 158 of the appendix.]

The CHAIRMAN. We have another hearing at 2 o'clock, so we will go as long as we can stay, until about 1:45.

I have to correct myself. That hearing on "too-big-to-fail" will be Tuesday. We will have the Chairman of the Federal Reserve in the morning, and we will have the too-big-to-fail hearing in the afternoon. It is a serious pace, but we need to deal with this.

My question has to do with a question many of you raised, and that is your objection to the extent where we would recognize State authority in this area. Now, I understand that the Comptroller of the Currency a few years ago did preempt, very substantially, State banking laws.

There was a good deal of concern about that. It was actually right at about the time a Republican Member of the House, our colleague Sue Kelly from New York, who was Chair of the Oversight Committee, she was particularly troubled by that, and I want to focus on that.

I gather it is a position of many of you here that we should continue to preempt any State consumer laws regarding national financial institutions. Tell me that, Mr. Bartlett.

Mr. BARTLETT. We support uniform national standards. As an essential ingredient to get to that, you have to preempt State laws. The goal is strong, high uniform national standards.

The CHAIRMAN. Well, I understand that. But the goal is also a Federal system, which people in various parties at various times seem to find convenient depending on the issue at hand.

Are there any others who would agree that all consumer State protection laws should be preempted here? Let me go down the list. Mr. Courson?

Mr. COURSON. Mr. Chairman, I can—obviously the Mortgage Bankers Association can only speak about mortgages, but we have certainly been consistent in asking for a uniform national standard. But I would also say that in working with the State regulators, we think they still play a very important role. We are not going to get—

The CHAIRMAN. All right. But I need to have you tell me, would you have us—should the law at the end of this process preempt all State laws on mortgages?

Mr. COURSON. Yes, that would be our position.

The CHAIRMAN. Okay. Next, Mr. Stinebert.

Mr. STINEBERT. Mr. Chairman, what we believe is that the way the proposal is currently structured right now in the area of consumer protection, you would have basically a meet-or-exceed standard that would be created by the new agency. But you would give the authorities to the States to—

The CHAIRMAN. All right. Well, what would you propose?

Mr. STINEBERT. So I think if you had a national Federal standard that was developed for—or standards that were developed for consumer protection, that should apply to all 50 States equally.

The CHAIRMAN. So you would preempt. I mean, I know sometimes people don't like to say it, but sometimes you would have to.

Mr. STINEBERT. Yes, we would preempt.

The CHAIRMAN. You are preempting for all State consumer protection areas in the areas that—

Mr. STINEBERT. Yes, promote consistency across the CFPA.

The CHAIRMAN. All right. Let me ask Mr. Zeisel.

Mr. ZIESEL. Yes. The CBA's position is that uniformity is important, that it is a consumer protection and that strong uniform Federal laws ought to be a ceiling, not a floor.

The CHAIRMAN. But you think the consumers are better off if we preempt all State consumer laws?

Mr. ZIESEL. If they are all strong, good, clear Federal laws, yes.

The CHAIRMAN. Well, we will get to that in a minute. Professor Zywicki.

Mr. ZYWICKI. Yes, you should preempt them for the same reasons that you can anticipate the possible conflict between a consumer protection regulator and a safety and soundness regulator, and you can anticipate consumer protection State law conflicting with safety and soundness regulators and Federal State ways preempt—

The CHAIRMAN. Wait, we do have the supremacy clause of the Federal Constitution. It does not arbitrate between the FDIC and this, but it does arbitrate between States and Federal. So there is no competition. Federal Government wins. Supremacy clause.

Ms. Leonard.

Ms. LEONARD. No, because we are currently regulated under those State laws.

The CHAIRMAN. So you are not for preempting them.

Ms. LEONARD. No.

The CHAIRMAN. You find this impossible. Are you torn in 50 different directions? Are you besieged by conflicting and inconsistent standards?

Ms. LEONARD. No.

The CHAIRMAN. Good. Mr. Yingling?

Mr. YINGLING. We would generally be in favor of preemption. However, we would urge that the kind of conversations that you had been urging for the last couple years between the Comptroller and the States continue and that there be some mechanism for coordination.

The CHAIRMAN. But you would preempt the laws. It would be at the grace of the Comptroller?

Mr. YINGLING. Well, I don't know that it has to be at the grace of the Comptroller. I think you could work in some mechanism that encourages this kind of coordination.

The CHAIRMAN. But as we all know, you can encourage; but having the law say it is qualitative in its difference.

Mr. YINGLING. Maybe you could do a little more than encourage.

The CHAIRMAN. Mr. Menzies.

Mr. MENZIES. Well, basically a States' rights organization, if preemption means that we neuter CSBS, then we probably would be opposed to it. But we do like the notion of uniformity, and we think CSBS has done a great job and isn't the reason we have the financial problems for that.

The CHAIRMAN. You are talking about the Conference of State Banking Supervisors?

Mr. MENZIES. Yes, sir. The State regulators.

The CHAIRMAN. The question is whether nationally chartered institutions would be exempt from any State law and covered only by Federal law. That is the issue.

Mr. MENZIES. Well, if you put national chartered institutions in a position where they are exempt and State institutions are not, as

we are subject to our State regulations, then you create exactly what you don't want to create.

The CHAIRMAN. An unfair or uneven competition.

Mr. MENZIES. Yes, sir.

The CHAIRMAN. All right. I am appreciative of that mix. I have to say that the description of chaos that comes if you have the State laws does not seem to be an accurate portrayal of what the situation was before the Comptroller did all that preemption. But my time has expired.

The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. One of the things that I heard, a common theme was coordination, innovation, and the fact that with two different regulators there could be conflicts.

And one of the things that I think about from my lending days is many times when people came in to borrow money, sometimes we had to tailor financial products to meet the consumer's need. And I think this hearing today is about the consumers to a great degree. And everybody here, I believe, believes that they ought to be treated fairly and appropriately and with integrity.

But what I am concerned about under the proposal that the Administration and the chairman have laid out is that this is really not a consumer protection bill but a products regulation bill.

And there is a difference between product regulation and consumer protection.

And I think I would just kind of like to go down the line there and get your perspective of—you know, one is about a behavior, and when people try to defraud or misrepresent something to someone, that is a behavioral issue and not a product issue—but get your reflections on the implications of the Federal Government being very prescriptive about the products that you would be providing and how that might impact the people that we are talking about here, and that is the consumer.

Mr. Bartlett?

Mr. BARTLETT. Congressman, you have hit the nail on the head. These agencies should regulate for safety and soundness and for consumer protection, but not to determine products. The products themselves, leave them in the competitive marketplace, but then protect the consumers by disclosure by anti-fraud protection, by unfair and deceptive acts, by coordinating the decentralized complaint systems and, otherwise, by sales practices, but don't set the products. As for the products, consumers are far better off with choice and with innovation.

Mr. COURSON. I certainly agree. And I think the key is—and there been those also who say that this might not even be prescriptive. You have a plain vanilla, and you can still then, once you have your plain vanilla, offer other products. But I think if you have a regulator out there that has the ability to call a product down the line out of bounds, that you clearly are going to move—lenders are going to move very reluctantly and with great trepidation of innovating products that may later be deemed to be "out of bounds."

And the other piece of that is, if the secondary market authority exists, consumers are going to pay more because the market is going to demand a premium for a product that they may buy, put

on their balance sheet or secure, as it may not exist going down in the future.

Mr. NEUGEBAUER. Mr. Stinebert.

Mr. STINEBERT. I think the flexibility moving forward is very important. As long as you look at specific products, I think it was mentioned on the panel earlier about adjustable rate mortgages, or ARM products—for many, many years and in other parts of the world are considered very good products. We talked about some types of balloon payments.

Everything should be customized to fitting what the consumer needs in that specific circumstance, that best meets what they need.

If you try a plain vanilla, if everything is just standard, you eliminate all innovation and you are really making choices of those people who don't necessarily need money, can get options, can have products that are available to them. Others that might have a more blemished credit record, might be lower income, would have less options, less choice.

And I think that it is best left to the industry and the lenders to make those decisions of what products are available to them—to their customers.

Mr. NEUGEBAUER. Mr. Zeisel.

Mr. ZEISEL. Yes, I think that the financial institutions deal every day with their customers, and they know what their customers' needs are and they understand those needs in a way that a Federal Government agency is not going to. And as a government agency defines what is an acceptable product, they are also defining what is not an acceptable product. And when they take a product off the shelf, it is one less option available for the consumer.

The product may or may not be acceptable for some consumers and not others. That is the determination that has to be made; not whether the product itself is always acceptable or always not acceptable, for the most part.

Mr. NEUGEBAUER. Mr. Zywicki.

Mr. ZYWICKI. A plain vanilla loan would be perfect for a plain vanilla consumer. I have never met that person, unfortunately. Every consumer seems to be completely different to me. And every consumer seems to have different needs and wants and different sorts of things. To think about plain vanilla products is being like credit cards 30 years ago. They were very simple.

They were plain vanilla, and they were really lousy products. They had a $40 annual fee, a high fixed-interest rate, no benefits, nothing else that came along with it.

Competition has intervened and credit cards have certainly gotten much more complex, but they have gotten much, much better for consumers. And if you think about the way in which consumers use credit cards to cash advances, to travel, to small businesses, all those sorts of things, there is no plain vanilla consumer. There is a plain vanilla loan.

The CHAIRMAN. Time has expired. I don't mean to imply that—Mr. Zywicki was certainly not the one who began this. I would say for this committee in particular, we would like the basic option to be either plain vanilla or basic black. We are not an entirely plain vanilla committee even in our legislative approach.

The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you, Mr. Chairman. I am not sure, in my decision to come to this hearing, I am not more confused leaving the hearing after hearing all of your statements than before I got here.

If you could help me think this through, were any of the eight witnesses here consistent in their beliefs as to what we should do?

Mr. STINEBERT. I think everybody certainly recommended a cautious, careful approach to addressing this issue.

Mr. KANJORSKI. And I understand that. You know, I really want to get to a more fundamental problem of why I worry about where we are going and how we are going to get there.

Did anybody who is on the panel, the eight witnesses, did you see this coming, and what actions did you take in terms to warn us of this eventuality? I remember very distinctly Alan Greenspan testifying here, a direct question as early as 2005, I think. I asked him a question: "Is there any foreseeable problem in the real estate bubble?" And he clearly said, "No, we have it all under control. There is nothing to worry about."

Now, you all do not handle all real estate, although the mortgage people sort of cover the unbanked portion of it. Who did see it and did not take action—or of you who did not see it? And is that not what we want to get to, what is the next calamity and how is it going to be handled? And God knows, there is going to be another calamity.

All we are arguing is whether we are going to get a rather comprehensive regulatory reform that will last 75 years, as the last set of regulations lasted, or whether we are going to get a financial crisis every 25 years as the history of the Republic reflected for its first 200 years or first 150 years of existence.

But if you could give me that fundamental question, because I am hearing from that side of the aisle that this all occurred from CRAs. How many of you believe that? Was that a major contributor to our problem?

How many of you believe that, except for Fannie Mae or Freddie Mac, this disaster would not have occurred?

Well, there go your two propositions, Randy.

Ms. LEONARD. One of the things that we saw was the fact that there was a need for licensing, there was a need for increased professional standards, and we advocated for that and with the SAFE Act that has now come into play. That is one of the things that we believe will help long term with some of the problems that did exist.

Mr. COURSON. Congressman, may I? I would respond differently. We didn't see it coming.

But I think it points up, and someone had asked me, what could have prevented this? And I think if we would have had a strong, uniform national standard and a consistent strong regulation, particularly in our industry, we have—we are examples of being subject to 50 different State regulators, very uneven regulation. Some States, granted, are very good, some States are not. That is why we are asking ourselves for a strong Federal regulator for nondepository mortgage brokers and lenders.

Mr. BARTLETT. Mr. Chairman, as I said in my opening statement, we saw it coming, beginning—and I did and my officers, in about the summer of 2006 as it began to—and as we began to unravel the pieces and try to figure it out, we spent 6 months trying to avoid it, setting up new standards, advocating some new regulations, advocating some new legislation. By January of 2007, we were pretty much—we were full on board by that—by that time the horses were out of the barn and running around in the pastures about 10 miles away.

It is one of the regrets of my professional life that I didn't see it earlier. But I don't think anyone did, and we saw it beginning in the summer of 2006.

Mr. YINGLING. Congressman, I would just say that I think what your question points out is the need for some kind of systemic oversight body. Did anybody see it coming? Some did. Should we have seen? Absolutely. It is a terrible failure of ours. It is a terrible failure of our regulatory system.

We had a previous discussion in a previous hearing. I had a previous discussion with the Chairman, that the Fed had the numbers; and we really should have done something about it, and that is true. But the weakness in our regulatory structure is there is really nobody at this point who is charged with looking for these kinds of disasters coming down the pike, ringing the alarm bell, and making sure something is done about it. And I think it points out the need for some type of oversight regulator that doesn't regulate, but says there is a disaster coming.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Well, yes, as a matter of fact we did have the Fed telling us there was a disaster coming. They said it was a systemic risk to the entire financial system unless there was deleveraging, some kind of regulation for safety and soundness over Fannie and Freddie. Not to get off the point, but I remember those lectures ad nauseam out of the Fed. And as a matter of fact, the Treasury chimed in as well.

But on the issue of bifurcating consumer protection and prudential regulation, Sheila Bair, the head of the FDIC, had this to say, and I am going to ask Mr. Courson to respond to this, if you would. She said, "I have always felt that consumer protection and safe and sound lending are two sides of the same coin. And if you have an abusive product that doesn't serve your customers' long-term interest it will come back to bite you."

Now as I mentioned in my opening statement, this idea of separating the two has been around for some time. In fact, we saw that very structure over the GSEs, a weak prudential regulator, in this case OFHEA, was competing with HUD, and HUD strong-armed OFHEA and Fannie and Freddie into ratcheting up the affordable housing goals. We know how this ended.

As Ms. Bair alluded to, the affordable housing goals of Fannie and Freddie enforced by HUD were at odds with the long-term viability of the regulated entities, in this case Fannie and Freddie, and ultimately led to their demise.

And I was going to ask you, do you see the potential for future conflicts between a Consumer Financial Products Agency and their prudential regulator in this case?

Mr. COURSON. Well, clearly—I mean obviously there is opportunity for the conflict. Not to be simplistic, but for 12 years we have been trying to get the Fed and HUD to work together on one simple upfront disclosure, and we can't get this done. In addition, to the fact that what we have said, and, in our case with a Federal regulator, we want a combined prudential, safety and soundness and mission consumer protection, all under one umbrella for mortgage banking.

Mr. ROYCE. Well, certainly the housing goals were created and enforced with an altruistic belief. It was misguided, but it was an altruistic belief that the highest possible stretch for homeownership was to the benefit of consumers. And I think it would be very difficult to create a separate regulatory entity, charge it with consumer protection oversight, and then not expect it to come up, you know, with a similar politically driven mandate further down the road.

It seems to me logical that would be the course of action here. In large part, these politically driven mandates caused the financial collapse, and allowing for a similar structure will likely encourage similar mandates down the road.

So I would like you to comment on the likelihood that a CFPA will be used for politically driven mandates in the future.

Mr. COURSON. Well, Congressman, obviously that is a concern in any regulatory venue, particularly when you are creating a new one.

The issue is in this respect, there is trepidation that we are trying something, sort of a laboratory experiment, to try something with the consumers; and, frankly, safety and soundness being at risk. So I think there are those concerns.

Mr. ROYCE. Yes. I just don't see how it is not something that we have already tried with pretty clear results.

But I will ask Mr. Zywicki for any observations he has on this front.

Mr. ZYWICKI. Sure. I think you point out more generally the fundamental problem here is that there are all kinds of tradeoffs. There are tradeoffs between the particular terms and the price of loans, between—as I talked about—prepayment penalties. Consumers pay an extra 100 to 150 basis points to get a fixed-rate mortgage. All these sorts of tradeoffs to think about price versus terms, accessibility versus risk, all the different sorts of things you are talking about are invariably and inevitably going to turn into political questions where there is no obvious answer.

And it is precisely these sorts of tradeoffs between risk and price, for instance, why we have eschewed government central planning and dictating of credit terms in the past, because there is no right answer to these questions and they run the risk of being politicized.

Mr. ROYCE. Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from California, Ms. Waters. And we will break after this.

I must say, it is not entirely clear if we will be able to reconvene this panel. We have five votes, I am informed, leading with a 15-minute vote. I am told that Members are advised that additional

Republican procedural votes are possible during this next series of votes.

So if we have not been able to conclude by about 1:30—if we are not back by 1:30, goodbye.

Ms. WATERS. Mr. Chairman and members, I almost hesitate to ask you any questions. I am just dumbfounded that we have before us representatives of the overall industry here today who do not appear to understand we have a crisis.

We have rising foreclosures. There is no end. And the tale keeps going on and on and on. And you come here today and say, don't try to stop us from having any kind of product we can come up with that we can put on the market, no matter what you say about some kind of standard product. We have products for any and everybody, whatever you can think of.

Someone just said to me, maybe I should design my own product for you.

Well, let me just say that, in addition to no support, no real support for a consumer finance agency to protect consumers from these exotic products that worry us so much, we are confronted with our constituents who are trying to get loan modifications. You can't even do that right. You can't set up systems where you can train enough people, that you can have telephone responses, that you can work out modifications and we can do something about keeping people in their homes.

You don't come here with any real instructions, advice, or plans that you can share with us to deal with the crisis that we are having. All you can do is come here and talk about preemption, knowing full well that you will work your magic with your influence in the Congress of the United States to keep any real strong legislation from coming out of here; and you want to prevent the States from coming up with anything that would cause you any kind of concerns at all.

What do I have to ask you? I don't know what I have to ask you. Would somebody answer me whether or not you think there is a crisis? Anybody? Is there a crisis?

Mr. BARTLETT. Congresswoman, there is a crisis, the crisis of delinquencies. There are some 3 million mortgage delinquencies today. We—as an industry, we are providing modifications for about 250,000 a month. That is woefully inadequate. We are doing everything we can to increase that number by as much as double, and we are seeking to do that. I believe we will do that. There are real barriers to keep us from it, but that is no excuse. We are going to increase those modifications because it has to be done for the economy to recover. There is a crisis.

Ms. WATERS. You are right. You have done a terrible job of modifications.

How many of you own or are connected with service agencies in addition to your banking interests? Financial Services Roundtable?

Mr. BARTLETT. You mean lenders?

Ms. WATERS. Yes, servicers. You own servicing, also. You do servicing, also. Is that right?

Mr. BARTLETT. Our members do. And we are one of the sponsors—

Ms. WATERS. That is what I mean. Your members, yes.

Mr. BARTLETT. Yes.

Ms. WATERS. Why can't you get it right? Why can't we get the modifications right?

Mr. BARTLETT. Congresswoman, we are doing 250,000 a month. That is not enough.

Let me stay that when we started this in July of 2007, we didn't measure the number, but we think that, historically, that mortgage modifications were in the range of 1,000 to 2,500 a month, and now we have moved it up to 250,000.

Is that enough? No, it is not enough. But we increase it every month, and we increase it every day. The new Obama mods, as they are called, are beginning to take hold and are beginning to get some real numbers. They are not there yet, but it is a big improvement.

I met with the Secretary yesterday—Under Secretary yesterday to seek—and we have a checklist of 10 additional steps that we can take to improve those numbers. We are painfully aware we have to improve the number of modifications, and we set about to do it every day.

Ms. WATERS. Mr. Bartlett, you have publicly said that the new agency would end up increasing the cost of financial products. Do you really mean that?

Mr. BARTLETT. I believe it will increase the cost of financial products. But, worse than that, it will increase the cost of credit, deny credit to consumers, and it will decrease safety and soundness, and it will deny consumers with financial products that they want and need and deserve.

Ms. WATERS. As I understand, the President's plan is to transfer existing staff and use a portion of those existing fees that you pay for enforcement of existing laws. Why would your members have to increase the cost of financial products? The President's plan proposes no additional costs to your members, yet you are here claiming that consumers will have to pay more. Why do you say that?

Mr. BARTLETT. Consumers will have to pay more under the plan as is before us with a separate agency than there would be separate regulation of products.

Product regulation is not the answer. The answer is—

The CHAIRMAN. We will have to get the rest in writing.

And, before closing, the gentleman from Oklahoma, Mr. Lucas, whom I should note is also the ranking Republican on the Agriculture Committee, with which we are working closely in our approach to the regulation of derivatives. The gentleman from Oklahoma.

Mr. LUCAS. That is very true, Mr. Chairman. I recently met with a group of bankers from small community banks and financial institutions in my district, and they have serious concerns, as do I, about the impact of the proposed Consumer Financial Protection Agency and what it will do to them.

Our community banks are small financial institutions that have had little to do with the cause of the current financial crisis and continue to serve their communities as safe and reliable sources of credit. Their very success depends on the success of their communities. However, under this new regulatory agency, they could, I

fear, be disproportionately burdened with additional regulations and fees.

In addition, there has been a lot of discussion here today in regard to the threat that too-big-to-fail institutions pose to the stability of our financial institutions as a whole, and how best to address this threat.

When considering how best to approach reform, we must not sacrifice the health of our small institutions that did not cause this situation.

Now, I address my question in particular to Mr. Yingling and Mr. Menzies. I do not represent a capital-intensive district. I do not have any money market facilities, institutions in my district. I have consumers of products, and I have small businesses.

Your two organizations represent the backbone of the financial institutions in my district. Expand for a moment what the effect of this piece of legislation, as now drafted, will be on those institutions. Because, after all, we all know rules have many effects. And they can limit opportunities and they can kill, too. That is the nature of the Federal process. Explain to me what this bill will do to your folks in my district.

Mr. YINGLING. Congressman, first, I want to thank you for your leadership on the accounting issue. And I do think that since you introduced your bill the report of the G–20 and the Group of 30 and others have shown that your approach was correct.

The concept that is in the Administration proposal that we are particularly concerned about is that products should be designed. And, as was pointed out earlier, particularly in community banks, loans to your constituents are not cookie-cutter. They are individually designed.

And lest people think we are being paranoid here, I would like to read from the paper that the Administration handed out in the White House when they announced this; and it says, the CFPA should be authorized to define standards for products and require firms to offer them.

So let's suppose it is a loan, a cookie-cutter loan that is a standard loan; and it says to your banks, you must offer these. Then they deviate from it. So they want to deviate one off like they do all the time and say, all right, I will let your father guarantee it. Or I will change this one provision. Or I will change the repayment terms so you can qualify for this loan.

Here is what the President's proposal says: "The CFPA could impose a strong warning label on all alternative products, require providers to have applicants fill out an experience questionnaire, require providers to obtain the applicant's written opt in to such products." "Originators of alternative products"—that is your bank—"should be subject to significantly higher penalties for violations."

You are not going to make that loan. You are not going to make those one-off deals. And I am reading from the Administration because I have to take what they say seriously.

Mr. LUCAS. Mr. Menzies.

Mr. MENZIES. Congressman, the $7 trillion of loss to this Nation was not the product of community banks. It was the product of mega banks and Wall Street creating shadow corporations and

SIVs that stuffed toxic assets based on products that they created into those entities, and community banks are truly the victim of the product regulation that is contemplated today because of that activity.

Don't take away my right to take care of a widow whom I loaned a year ago, who had 25 percent borrowed against her house, interest only for a year, at a market rate, no payments required, while she could care for her husband, who was dying, understanding that after he died she could go back and get a job and then we could amortize that loan.

That is a nonconforming product in every possible manner, but it provides me with the flexibility to be creative and take care of the needs of our customers. That is essential to retain the role that community banks do for this Nation.

Mr. LUCAS. Thank you for those real-world insights.

Thank you, Mr. Chairman, for your tolerance on the time.

The CHAIRMAN. The hearing is recessed. And, as I said, we may not be back in time. If we can be back here by 1:30, we will have a couple more rounds of questions, but it may not be possible. I apologize, but that is the way it is.

[recess]

The CHAIRMAN. The hearing will reconvene.

The gentleman from North Carolina is recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I was hoping Mr. Bartlett would be here, but I can deal with the ones who are here.

I perhaps have deluded myself into thinking that I am one of the members who deals with members of this panel on a regular basis and tries to understand and listen to what they really have to say about these issues. I guess I am a little bit perplexed about some of the things I am hearing today.

I think Mr. Garrett raised a valid question in his opening comments today. If you put part of the authority for consumer protection with the regulators and part of it with a new regulatory agency, there is the conflict potential because people are working on the same turf and you are going to have that conflict.

I am not sure that I see quite the conflict between consumer protection, which is one responsibility, and safety and soundness, which is another responsibility. I acknowledge that there are occasionally circumstances where the two overlap.

So I did hear Mr. Courson say that to the extent you leave part of the responsibilities one place and put part of them in the new agency that there is that potential. I am actually of a mind to agree with that and think that more of the responsibilities, most of the responsibilities for consumer protection, if not all of the responsibilities for consumer protection, ought be given to the new agency, taking the people, some of the people who are doing it in the existing agencies and putting them over there into the new agency, using the experience that they already have and building a new entity.

So I am troubled by this notion that somehow keeping consumer protection and safety and soundness in the same entity is an imperative, and if you don't do that there is going to be some kind of conflict. There are multiple agencies doing safety and soundness

now. And when—I guess the systemic regulator will be the ultimate authority on that, ultimately, but I don't hear anybody suggesting that there are irreconcilable conflicts now between the various agencies that are doing safety and soundness.

So my question is, is this real or is it—I understand that there is a resistance to change, but this didn't work in the old framework. And it seems to me to be more of an excuse for saying we want consumer protection subordinate to the other objective, rather than we think that there is the potential for conflict.

So that is one question that I hope you all will address for me, and I won't ask you to do it in this context.

The other thing I have trouble with, Mr. Bartlett in particular, is your position that we should set up a brand new Federal agency to deal with insurance. The cost I suppose would be fairly high, yet we should not spend the money to set up an agency that deals with consumer protection so that the people who come to work every day have as their primary, sole responsibility looking at consumer protection. I am having trouble reconciling those two positions. So if you can reconcile them for me, I would love to have you maybe address that little piece of—

The CHAIRMAN. In light of the unusual circumstances, we will do an extra couple of minutes—I don't think there would be objection—so that we can get a response to that.

Mr. BARTLETT. Mr. Chairman, I can understand how you could reach that conclusion.

Let me say it forcefully. We are not advocating the status quo. Consumer protections are not adequately provided in current Federal law for the safety and soundness regulators. That is the primary reason why they didn't get the job done. The unfair, deceptive trade practices does not apply to the OCC, just as one example. TILA and RESPA are with two different agencies that are mandated to cooperate, but they are not cooperating, and they have not done their job. So in issue after issue, these consumer protection practices are not in the hands of the safety and soundness regulators, and they should be.

I think you heard unanimously that it would be an unmitigated disaster to separate safety and soundness from consumer protection because—

Mr. WATT. I heard it. I just don't understand it. I really do not understand that, and I will talk to you separately on that.

Mr. BARTLETT. We will submit for the record if you like, also.

Mr. WATT. I really don't care to hear from Mr. Zywicki on this. I don't even know how you got on this panel, to be honest.

Excuse me. I yield back.

The CHAIRMAN. He was, as is the practice, as the gentleman knows, the witness suggested by the Republicans, which is I think an important part of our trying to get through this all.

Next is Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

I wanted to follow up a little on Mr. Kanjorski's question. We have 50 States, 50 State regulators, plus the territories, and then we have the OCC, the OTS, the NCUA, the FDIC, and the Fed, and now we have a new bill that creates the credit rationing and pricing agency, to add another layer. And I understand that the

Administration says it is interested in consistent regulation of similar products. Yet its proposal would gut the doctrine of preemption under which the national banks and thrifts have long operated.

How would the Federal standard work which allows the States to pile on on top? How would the Federal standard then promote consistent regulation of similar products?

I will start with whomever wants to answer.

Mr. COURSON. Congresswoman, being president of an association that is subject to 50-State regulation, we can tell you; and I would say that we think that is one of the things that, had we had a uniform national standard, we could have avoided. Some of this could have been avoided. It is really a disservice to consumers in the different States.

I will tell you we deal in all of the States; and some States, as I have said before, have very good regulations, very solid laws on the books. And, frankly, there are others that don't. And we have a map that we put in the back of our testimony that shows this patchwork.

We have to have a uniform national standard. State regulation, particularly if this is—if the national standard is a floor, just merely adds more complexity, additional disclosures, which we are trying to go the other way with our HUD and Fed initiative, and really doesn't well serve, assuming that the uniform national standard has to be strong and at the proper ceiling.

Mrs. BIGGERT. Do you think that the new agency weakens the regulations or the standard even further?

Mr. COURSON. Well, it just puts a floor in to continue on with this patchwork of State laws we have. And, in some respects, I must say that every time we see a Federal law it is almost a stimulant for the States to go in and do something else.

Mr. STINEBERT. We also have a good example of where that has happened with the implementation of the SAFE Act. You have basically a mandate on the States that they have a certain period of time in order to implement conforming laws, and we are finding in all 50 States we have basically no uniformity. We are going to have 50 different laws.

Mrs. BIGGERT. Okay. Thank you.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

I think that part of what—some of what we are looking at is credibility issues, etc. I would have liked to have heard—and what I think a lot of the members have heard, at least on this side, is that if people are diametrically opposed to a CFPA, I would have liked to have heard and would like to hear in the future how we can make it work, what we can do to make sure that it works. Because, obviously, consumers do need protection.

Someone—I don't know whether it was the professor or not, but somebody talked about how there are no foreclosures in Europe. And I don't think you really want to go where they are. Because if you look at Europe in particular, there are generally huge consumer protection programs, and banks primarily offer only vanilla products. And, you know, I am not so sure that I want to go all

the way there, because I think that there is some good utilization of some diversity in products.

But there has to be a buy in, some kind of way that we need to talk. And I, for one, want to again sit down, as I have with many of you, to talk and to try to figure out so that we can get this thing right. Because I am hoping that we will put a piece of legislation in place that is going to survive the test of time and try to minimize any unintended consequences but make sure that individuals who are in my district, for example, number one in New York City, which is small compared to some of my colleagues in other States, in home foreclosures, and how we can figure out how to make them. Because that is what—people are coming to me. They are saying, how do we fix this thing?

I am going to change the area that I am going to, because the question that I really wanted to ask to get your opinion has to deal with the subcommittee of which I am the Chair, and that is dealing with international monetary policy. And I know that many industry organizations and individual financial firms, and from what I am hearing here, agree that we must have some kind of a change and a resolution authority so that there would be a systemic risk manager.

The FDIC has typically put forward a successful example of how we can bring this kind of stability to the industry. But several of the key bank failures that brought the global financial system to the brink of collapse were international bank holding companies, with operations in multiple sovereign jurisdictions; and I was wondering if you had any thoughts on whether and how an FDIC-type model could work to manage these type of global banks so that, you know, people get out here, go to another jurisdiction and cause a systemic risk in Europe or other places where we don't have the direct jurisdiction. I was wondering if there were any thoughts on how we could manage that.

Mr. BARTLETT. Mr. Chairman, yes, we have some. And we have prepared some work—we actually would be preparing some suggestions for the record for the committee on global harmonization. We think that the President's draft said the right words as the goal for global harmonization. We would put our emphasis on the G–20, by the way; and we are going to offer some suggestions for how to beef that up to actually create an institutional framework for global harmonization through the G–20. We think that is essential to happen.

The markets are porous across international borders, and to just leave it to the sense of goodwill on an informal basis that the nations will try we think is expecting too much. So we will offer your subcommittee as well as this full committee some suggestions on how to structure global harmonization.

I don't see it in the context of the FDIC, by the way, but we will take your request and suggestion and think that through for you.

Mr. MEEKS. Thank you.

One other question I want to ask really quickly. I was wondering, you know, because I am concerned about like the failure of Lehman Brothers. Many individuals in the United States have some—they thought they were investing in Lehman United States. They now found out they were investing in Lehman U.K. Their

money is caught up in a bankruptcy proceeding in the U.K. They can't get it out, foundations, universities, etc.

I was wondering if any of your banks or institutions fell into that problem, where you are stuck with the U.K. And how you think we need to deal with bankruptcy proceedings in a foreign land or how do you think we can resolve those issues to protect those United States investors, citizen investors who invested here thinking they were investing safely in the United States, but actually the money was in the U.K. proceedings.

Mr. BARTLETT. We think that the new systemic regulator will look at that. So far, we haven't seen the adverse effects, but we may well. We think it is still an open question.

That is a real problem. Obviously—and you are not implying this—you don't want to solve that problem by denying Americans the right to invest across markets. So we think it is a problem, but as of this point it hasn't led to a crisis. It hasn't added to the crisis. But we think it ought to be something that ought to be looked at, and we will get you some thoughts on that on the record.

Mr. MEEKS. Thank you. I look forward to working with you.

The CHAIRMAN. The gentleman from California.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

I want to thank all of you for your testimony today. I appreciate you being candid. And, Professor Zywicki, I enjoyed your presentation.

I am trying to look at this not as a Republican or a Democrat. I am trying to look at the economy which I think is in far worse condition than I think some of us will acknowledge, and I think we need to look how do we get it back where it should be. And even with some of my good friends on the Republican side, we disagree on some things.

I heard some comments that some believe that the GSEs, Freddie and Fannie, should be phased out. I don't agree with that concept. I think they need a very strong regulator, and I think in recent years they were encouraged to forego basic underwriting standards that they should have implemented. And I think they should be strongly regulated, but I think there is a very sound place for them in the economy and especially in the housing industry.

So even on my side we can disagree, but we can disagree with a smile. But I think we have very tough times ahead of us; and I think you all need to be very honest, regardless who on this committee, my side or the other side, gets offended, because we are dealing with the future.

And I saw some grain of similarity throughout this testimony. You are concerned about winners and losers. More government could be more confusion, perhaps. You want uniformity. You are concerned about the board makeup. You want it to be more independent. Systemic risk and oversight was a big concern. But the national standard was talked about a lot.

But standard enforcement seemed to be something that I heard ring throughout your testimony. You are concerned with that, and I think that is something that didn't occur in recent years, and that things weren't enforced.

But there are many Federal banking statutes out there that already exist. And if the bank regulators had enforced those, do they have the authority basically with everything on the books now to pretty much do what we are talking about doing today, in your opinion?

Mr. ZEISEL. Congressman, there are a lot of tools out there that are available, Federal and State certainly, to address a lot of these problems. In addition, there are now regulations, such as HOEPA, that deal with a lot of the mortgage products that may have been behind a lot of the problems we have experienced.

Mr. MILLER OF CALIFORNIA. And regulators could enforce that?

Mr. ZEISEL. Regulators can enforce that, and the FTC can enforce that, and the States can enforce that as well.

Mr. MILLER OF CALIFORNIA. The trouble I have with the SEC testimony—and I asked specifically a question—is she is modifying mark-to-market, the Board is, to some degree. And yet I said, are you really working closely with regulators on enforcement? Because you are going to have quite a change from the history. They have always mandated on banks and regulators and what mark-to-market modifications might be. And the response was, we have talked to a few regulators.

But I think there is going to be more than talking to a few. You are going to have to get two organizations together to understand things have to be modified, and we have to also deal with each other on that modification.

The adoption of CFPA would result, some said, in serious reductions in credit to consumers; and, Professor Zywicki, you had talked about that. Could you kind of expand on your opinion on that?

Mr. ZYWICKI. Sure. There is a variety of different ways in which that would happen. Obviously, the idea of an exalted plain vanilla product that might fit some consumers but wouldn't fit a huge number won't add much. But it will make it much more difficult to tailor-make products for other consumers, because they will have to get permission in order to do this and all those sorts of things.

It will—they are contemplating outright bans on certain useful terms like prepayment penalties. They are contemplating a crackdown on mortgage brokers, which the empirical evidence is pretty clear that mortgage brokers—if there is competition, that mortgage brokers generate lower prices for consumers.

And so the final point is that, you know, I worked at the Federal Trade Commission. I know about the antitrust policy and that sort of thing. And the plain vanilla notion here is a very dangerous notion from a competition perspective, which is that we know, for instance, by studying usury ceilings on consumer credit is they tend over time to turn into collusive focal points and tend to dampen competition.

So the idea that everybody would be offering the same product has a lot of antitrust and anti sort of competition concerns embedded in it, because it makes it easier for parties to collude, more difficult for them to compete on different sorts of terms. That, too, would certainly not lead to lower prices and could lead to higher prices.

Mr. MILLER OF CALIFORNIA. We talked about something similar with GSEs. We talked about the programs that a GSE might adopt

and within that program various products they would come up with daily that modified what was the demand in the marketplace. And my concern was we overly restricted them in some fashion, or we could have, to not allow them to do the function based upon market needs and market demands and market trends.

And I thank you all for your testimony. I appreciate it.

The CHAIRMAN. The gentleman from Colorado—the gentleman from Kansas. I am sorry.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

How should this committee consider and balance the costs of creating the Consumer Financial Protection Agency? I think we need tougher consumer protection enforcement to prevent another costly financial meltdown in the future. So some additional resources may be needed up front so we don't have to spend more money later in rescuing the financial system or the economy in the event of another meltdown. But, Mr. Bartlett or anybody else on the panel, do you have any thoughts about what this committee should consider as we think about new costs?

Mr. BARTLETT. Mr. Chairman, I think there will be some additional costs with additional consumer protections, whether it is by the safety and soundness or a new agency. But the cost of a new agency itself would be a factor of tenfold of what it would cost to embed it into existing agencies.

I do think the existing agencies have the advantage of being able to see the whole of the organization, of the bank or the company that they are regulating and tie it all together and then relate it back to consumer protections.

In response to that as well as an earlier question, I will say that the laws granting consumer protection to the existing agencies are woefully inadequate. I think this committee and this Congress and we didn't realize how inadequate they were. But they are spotty. Some have UDAP, some have HOEPA, some have other things, but they are spotty and inconsistent across agencies. And the agencies, as a result, without a statutory mandate, had not acted very much at all on consumer protections.

We think it is the job of this Congress and this committee to provide those additional mandates and those additional consumer protections, but do it with an agency that can do something about it by coordinating with safety and soundness. That is not only less costly; it is also far more effective for consumer protection.

Mr. MOORE OF KANSAS. Thank you, Mr. Bartlett.

Yes, sir.

Mr. STINEBERT. One of the areas that I think there was agreement among all the panel here was the additional resources that are needed among the current agencies so they can step up their consumer protections.

Mr. MOORE OF KANSAS. Very good.

Any other comments?

Mr. COURSON. I would just—I am sorry, go ahead.

Mr. YINGLING. I would comment about the budget of this new agency. Nobody has any idea what it is. And I think the conundrum is if it is not large enough to do what it says it is going to do, it is going to end up having regulations, examining banks, but it is not as it says it is going to do—examine and enforce these

rules on the thousands of nonbanks. And that is where the great majority of the problem has been. But, to do that, it is going to take a significant budget. And so, in a weird way, we kind of want the budget to be bigger. It sounds unusual. But then the question is, how are you going to pay for it? And if it is done on the cheap, it cannot do what it says it is going to do, because it will end up discriminating in enforcement against banks.

Mr. MOORE OF KANSAS. Did somebody else have a comment?

Mr. COURSON. Congressman, in following up on that, as I have said, the mortgage bankers, we are one, ironically, that are here asking for Federal regulation, safety and soundness, prudential regulations, which we have not had from a Federal level. And in our proposal, this MIRA proposal that we have talked about, we envision that, as in the other agencies, those that are regulated would have to share in the cost of that regulation. We know there is going to be another cost, whether it is tucked inside an existing regulator or someplace else; and we are prepared, our members are prepared to pay their share of that cost.

Mr. MOORE OF KANSAS. Thank you.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

I have a number of concerns about this legislation and particularly the aspect of it that would regulate products, since I view it as abrogating consumer rights. I am concerned about the safety and soundness issues.

I am sorry that the gentleman from North Carolina is no longer here. When I think about the separation of essentially product supervision and safety and soundness, Fannie and Freddie come to mind. That was a model that we had up until roughly a year ago, and so I see parallels here.

I don't know if anybody else on the panel does, and would care to comment. I see a few heads nodding in the vertical. Mr. Bartlett?

Mr. BARTLETT. Congressman, I think that is one of several examples from the past of the bad things that happen when you separate consumer protection with safety and soundness. HUD had the approval over activities. So far as I know, so far as I know, HUD never disapproved an activity so far as I know. And that is a—zero is a very small number.

At the same time, OFHEO had their safety and soundness regulations disapproved, rejected, turned down, put on hold for decades and in part because it was separated and in part because they were not an independent authority. So we think that is an example that proves that that is not the right model.

Mr. HENSARLING. Let me change subjects here, if I could. And this is a fairly long bill, I say, by congressional standards, weighing in at 200-some odd pages. Maybe it isn't all that long. I am not sure I found the language where it expressly says there will be product pre-approval. But as I read various sections of the underlying Act that was introduced by the chairman, subtitle C, section 131, it talks about the rulemaking authority of this new agency:

"The agency may prescribe regulations identifying as unlawful unfair acts, abusive acts or practices in connection with any trans-

action with a consumer financial product. Regulations prescribed under this section may include requirements for the purpose of preventing such acts and practices."

So if we give the agency the ability to declare unlawful unfair practices—I assume each of your associations or organizations has legal counsel who has probably, hopefully, had a chance to review this. Have your organizations concluded whether a prepayment penalty in a 30-year fixed mortgage is fair under this statute? Mr. Yingling?

Mr. YINGLING. Congressman, one, if you are looking for where they are authorized to have standard products, it is section 1036, right in plain language.

Mr. HENSARLING. Thank you. I hadn't quite memorized it all.

Mr. YINGLING. You are raising an important issue, and that is this legislation changes everything. There is no law on the books that this Congress has authorized in the consumer area, no regulation that isn't trumped by this.

You read a very broad statute where they have changed the definition under UDAP. So we don't know what it means.

But let me just very briefly read you another section which trumps everything:

"The agency shall prescribe rules imposing duties on a covered person"—that is anybody engaged in consumer financial services—"as the agency deems appropriate or necessary to ensure fair dealing with consumers."

I am a banking lawyer of 35 years. I have no idea what that means, other than they can do anything they want. It is the broadest standard I think any of us could imagine, which means—and it gets back to the preemption argument—we are not going to know what the rules are for years.

Mr. HENSARLING. Is it your interpretation then that functionally Congress will cede to this five-person unelected body essentially the right of pre-approval of all consumer financial service products? Has anybody come to a different conclusion?

Mr. YINGLING. They could do that.

Mr. HENSARLING. With the exception, I believe, I don't believe they can impose usury limits.

Mr. YINGLING. They can't do that. They also can limit compensation in any way they want, except they can't limit total compensation. So they can regulate compensation, but not in total.

Mr. HENSARLING. I see my time is running out. I am going to try to slip this in quickly.

I know the statute appears to be aimed at consumer products, but, according to the Federal Reserve, 77 percent of all small businesses use credit cards. I am led to believe a number of those are under an individual name. Might this have a deleterious impact on small businesses and job creation?

Mr. STINEBERT. Absolutely.

Mr. ZEISEL. Yes, Congressman, small businesses often use consumer products and services, mom and pop shops and other small operations, and certainly would be affected by this.

Mr. HENSARLING. Thank you.

The CHAIRMAN. The gentleman from Colorado.

Mr. PERLMUTTER. Thanks, Mr. Chairman.

And, Professor, I would just say that ordinarily I don't agree very often with George Mason because my economic philosophy is a little different than yours. But I do agree with you I think with respect to the subprime piece and whether it was really a consumer protection issue or whether it was just a deregulation or refusal to do appropriate underwriting that affected financial institutions and people who invested in financial institutions and people who bought big portfolios. That I agree with.

I think you are off base on the credit card piece. That really is a consumer issue. And all the bells and whistles that come along with credit cards are probably one of the top five things discussed if you were to go door-to-door, walk in a precinct or having a town hall. People didn't expect "X," "Y," or "Z" with respect to their credit cards.

So—which brings me to sort of the general question of who is best, who best can assist consumers with a credit card that has, you know, this fee and that fee and, you know, this surcharge and that penalty charge? Is it a new agency? Is it the FTC? Is it the FDIC? The OCC? The Federal Reserve?

And so my question, if we don't go with what has been proposed and create a new agency, how do we—do we set up ombudsmen or new departments in every one of the regulators? If anybody has an answer to that, I would like to hear it. Or do we just beef up the FTC?

Mr. ZEISEL. Congressman, every one of the bank regulatory agencies has consumer departments. They do the examination of the consumer issues. Some of them have merged them with the safety and soundness teams. Some of them have separate ones. Each one probably has advantages. But if the consumer portion of their oversight doesn't get the amount of attention it deserves at the agency, that can probably be addressed through that agency and the agency charter and the agency structure more easily than stripping it out of each of the agencies and creating a new agency to do the same basic function.

Mr. ZYWICKI. I would just add I think the FTC could probably do a lot of this. A lot of it is simply unworkable for anybody, I think. But the FTC could do a lot of it.

And I think it is also worth exploring the proposal that I think the Republicans have suggested of creating a new agency that sort of takes the safety and soundness functions away from the Fed and combine—you sort of have a stand-alone safety and soundness/consumer protection agency separate from the Fed.

But I think keeping those two together really is an important issue, and I think the Federal Trade Commission does have this sort of expertise and experience and understanding of consumer decision-making and that sort of thing—that it could also be more authority at the FTC would probably be—could be a useful thing as well.

Mr. PERLMUTTER. Okay. Thank you. And just for me and listening to the bankers, Mr. Yingling and the gentleman from Easton Bank—I am sorry. I forgot your name.

Mr. MENZIES. That is all right.

Mr. PERLMUTTER. You know, for me, having been on this committee and what we went through in September and all of last

year, you know, it really is a too-big-to-fail. I mean, for me that is the big issue here, and I have sort of become radicalized on the whole issue. That and derivatives, you know, regulating derivatives, the hedge funds and credit rating agencies. I mean, those are where I think I would like to see—and I know a lot of our attention is focused on that. I do think that some consumer practices caused some issues. But really the focus I would like the reform to be really on, the too-big-to-fail. And anybody can comment on that if they like.

Mr. MENZIES. Congressman, I am itching to make a point. And this hearing, this legislation needs to focus on those who created the train wreck, not those who didn't, not those who played by the rules and did not abuse the consumer. And the small finance, small banking players in this arena had skin in the game, and they played by the rules. And it is as simple as that.

It is so important to make certain that it is recognized that community banks are really not in the product business. We are in the solutions business. And we create solutions with an array of products, some of which are on the shelf and some of which we need to create. And if our right to create solutions for individuals and small businesses are packaged into a bunch of pre-approved products, it will destroy our capacity to participate in this recovery.

Mr. PERLMUTTER. Thank you, and I yield back.

The CHAIRMAN. The gentlewoman from Minnesota.

Mrs. BACHMANN. Mr. Chairman, thank you very much, and I would like to ask unanimous consent to insert into the record—

The CHAIRMAN. We have general leave for anybody to insert anything into the record. We got that already today.

Mrs. BACHMANN. Okay. I would like to insert into the record today the editorial from the Wall Street Journal, "A Tale of Two Bailouts."

I had read this editorial this morning as I was preparing for this hearing today, and the question that I would ask of the panel is, is the discipline of the marketplace now a thing of the past? I am really wondering, as I look at what has transpired just since last fall and the actions that Congress is taking.

You take a look at risk, and risk in the American system has been a really good thing. We saw risk hurt a lot of people, but the question is, did risk hurt people because the Federal Government provided the backstop through a GSE like Freddie and Fannie? Was that the problem?

It was no longer really risky, because what happened is we spread—losses occurred. The only thing is the shareholders didn't have to bear the brunt of the losses. The net was spread wider so that now all of the American taxpayers are on the hook for those losses.

So it isn't that the losses went away. It is who is responsible for the losses. There were private contracts made between individuals who contracted for money and those who were lending money. But those people who were part of a private contract aren't the ones that are on the hook for risk.

Now people who had no part of that contract, the American taxpayer, they are all made involuntarily a part of that contract. They

have to subsume a risk they never wanted, they never asked for, and now it is their problem.

And so that is what I am asking you, a very simple question: Is the discipline of the marketplace now a thing of the past?

Professor Zywicki, and then I think Mr. Yingling, also would like to respond.

Mr. ZYWICKI. I agree with you completely.

Mrs. BACHMANN. Thank you. That doesn't happen very often. Really.

Mr. ZYWICKI. Like I said, I am on this panel, but I don't speak for the banking industry, and so I am not sure I would get uniform agreement with this, but I think that is a very, very serious problem. I think that, you know, risk and the risk of failure, if you get to keep the profits and socialize the losses, you are going to have a train wreck. If we continue to do that going forward, it is going to be an even bigger train wreck.

And I think that coming up with some way of making sure that those who fail feel the pain of their failure and they actually fail is an important part of capitalism and risk. And it applies even to consumers as well that, you know, that consumers have to have the opportunity to be able to take chances, and we can't put a safety net under every consumer as well for every decision that they make.

Mrs. BACHMANN. And I wonder as well about growth in our economy. How will we have continued growth in our economy without risk? We need to have a certain element of risk taking, risking capital on the gamble that somehow you are going to profit down the road. If we have just plain vanilla products, it seems to me we are going to be limiting consumer choices, especially for those at the bottom echelon of the economic lifestyle.

And just like we saw in the article this morning in the Wall Street Journal, they termed it, is Goldman Sachs GoldiMac? Because now they are too-big-to-fail. The American taxpayer is always going to be bailing out Goldman. I have nothing against Goldman. It is a great American company. But if you take a look at CIT and look at the fact that we did give them bailout money, now it looks like we might be predisposed to giving them bailout money again, is this really systemic risk? You know, supposedly this panic has passed now. It is like the article says, we vitiated the definition of systemic risk.

Mr. Yingling.

Mr. YINGLING. Well, you are raising excellent points, and it really comes down to too-big-to-fail. And I think Mr. Perlmutter was raising the same question. You left out accounting from your list, Congressman Perlmutter.

Mr. PERLMUTTER. I know. Yes, and accounting.

Mr. YINGLING. And that is why this issue of the systemic risk resolution is so important. Because that is the mechanism through which you all will determine too-big-to-fail in the future.

And I think the Administration's proposal was, frankly, too weak and too vague in this area. The systemic risk process will look—the marketplace will look to that and it will say, what will happen to an institution when it goes through systemic risk? And when it goes through that process, say a future Lehman Brothers or a fu-

ture AIG, it should pay very, very heavy penalties so that you don't want to be there, so that the stakeholders you are talking about, the people who take risks through it, are basically wiped out. And that is why that part of this proposal is so critical and should be getting I think more attention than the Administration gave to it.

The CHAIRMAN. The gentleman from Connecticut.

Mr. HIMES. Thank you, Mr. Chairman.

I would like to direct a couple of questions to Professor Zywicki.

Professor Zywicki, I appreciate your testimony and some of the facts here, but I would like you to defend some of the things that I have read and heard in your testimony. Stories have power. And you tell a story that you call not unrealistic here about a California borrower in northern California who can pay his mortgage but chooses not to and consults with his lawyers, your conclusion is that this does not present a consumer protection issue.

I have never been to this part of northern California. I represent Connecticut, which includes Bridgeport, which is the densest concentration of foreclosures in Connecticut. We have seen over a thousand. And while you call this not unrealistic, what I see when I go to Bridgeport is often minority families out of their house, on the curb, with crying children, surrounded by their belongings. They didn't consult their lawyer, because they don't have a lawyer. They didn't have a choice.

And I don't ordinarily deviate from the sort of rationale here, but your story just sort of strikes me as a cartoon of where the American people find themselves today, and the conclusion is what really concerns me. Foreclosure is certainly, in my district, a terrible consumer protection issue. It is a community protection issue. Because, as you know, as an economist, when you have a neighborhood with foreclosures, you see a decline in property values with all that that implies.

So I guess I would like to know whether you really believe—and this is a question being asked by somebody who worked for 12 years in the financial services industry who sometimes has trouble understanding his own mortgage and credit card contracts. Do you really believe that the foreclosure situation was really more about incentives and that in fact all of our individual actors here were rational economic actors who had that fundamental quality that capitalism requires, which is information and knowledge of what they got into?

Mr. ZYWICKI. Thanks. That is an excellent question. So let me clarify my thoughts, which is, first, yes, there are serious problems in a lot of inner cities where people got in bad mortgages and ended up in foreclosures. I don't doubt that. That is definitely a problem. Those are—things should be done about that. What I am focusing on—

Mr. HIMES. My question is really very narrow, which is do you believe that we have done an adequate job as regulators, as government, as private industry to creating that fundamental unit of capitalism, which is a fully informed, smart consumer?

Mr. ZYWICKI. Right. With respect to the story that I told, I get one or two e-mails a week from borrowers in California and Arizona who say, "Professor Zywicki, I bought a house 2 years ago. I

am $100,000 underwater. I saw an article that said I can walk away from my mortgage. Should I do it?"

Right. People are out there. So it is not a cartoon. People are making that decision.

Do people understand their mortgages? No, nobody does. I mean, that is one of the problems with this, is it sets up this aspirational standard where every person can understand every mortgage. And according to a study done by the Federal Trade Commission 2 years ago, what they found was that nobody understands their mortgages, whether they are prime or subprime borrowers. It is not a subprime versus prime sort of issue.

What they also recommended, which I think—to go to what else we should do—is they went through and they gave very clear instructions on how we could construct better disclosures so that people could shop in a better sort of way. That would solve a lot of the problems if we solved the disclosure problem. The disclosures are not good.

Mr. HIMES. The reason I am going down this path is, look, this is a complicated topic, and we have to get it right. There is merit on both sides and many different sides, and we have to get it right. But to me it is a no-brainer, and as people with some economic training here, it is a no-brainer that you need a fully informed consumer.

And you repeat here there is no evidence that the financial crisis was spawned by a systematic lack of understanding. No evidence that consumer ignorance was a substantial cause.

Nobody is saying that it was spawned by consumer ignorance. Was not a substantial contributing factor to this crisis the lack of education, the lack of knowledge, the lack of information that consumers had?

Mr. ZYWICKI. No.

Mr. HIMES. It was not a contributing factor?

Mr. ZYWICKI. Not a substantial contributing factor. I have not seen that it is a minor contributing factor, but—

Mr. HIMES. But you did just say that we agree that there was substantial misunderstanding and misinformation out there. So you are saying that exists, despite no evidence that it was causal, you are saying that it didn't cause it.

Mr. ZYWICKI. Sure. That has been around for 10, 20, 30—that has been around forever, those sorts of problems. But the problems that were caused here were caused, as you read my testimony, as you see, I think caused by incentives. It was interest rates, Federal Reserve monetary policy, and incentives when house prices fell. That is what caused the problem. There were other things that exacerbated it that were around the margins.

Mr. HIMES. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Florida, I think, was next.

Mr. PUTNAM. Thank you, Mr. Chairman.

I apologize for being late. So if we are going over previously plowed ground, my apologies.

The CHAIRMAN. Well, given the next job the gentleman looks for, that is probably a good practice.

Mr. PUTNAM. I appreciate the chairman's faith and optimism.

If you accept that the credit, liquidity, economic contraction crisis is substantially behind us, is it far enough behind us for us to make the type of sweeping regulatory reforms that are being contemplated with the immediate aftermath being such recent history? Do we understand enough about the events of last summer and fall to accomplish the type of sweeping reforms that are being discussed here today?

It is a simple question, so let's start at one end and work down to the other. Mr. Menzies?

Mr. MENZIES. I guess your question presumes that we have some knowledge on whether this is all behind us or not; and that depends upon whether you are from Florida, California, Arizona, Nevada, Ohio, Michigan, or Atlanta, or when you are from the Eastern Shore of Maryland. You can bet I don't know the answer to that question.

It also presumes that there is a need to create some regulation to deal with the problem, to deal with the collapse, if you will. And again I would repeat that it is so important to focus on what caused the problem. What caused the $7 trillion of economic loss to the American consumer?

We can have all the product legislation in the world and do everything possible to protect the consumer, but the greatest damage to the consumer was the failure of a system because of concentrations and excesses across the board, of a Wall Street vehicle that gathered together substandard, subprime, weird mortgages that community banks didn't make, created a warehouse to slice and dice those entities, make huge profits selling off those items, and have very little skin in the game, very little capital at risk, and to be leveraged, leveraged in some cases, according to the Harvard Business Review this week, 70 to 1. That deserves attention. The too-big-to-fail, systemic-risk, too-big-to-manage, too-big-to-regulate issue must be dealt with. And from the perspective of the community banks, that is the crisis of the day. That is what has destroyed the free market system.

Mr. PUTNAM. Mr. Yingling, do we know enough?

Mr. YINGLING. I think we need to be extremely careful, because what the Congress does with this legislation will not just determine the regulatory structure, it will determine the financial structure for decades to come. It will change all the incentives. So I think we need to be very careful.

And I would just add another point that I touched on earlier. There is great uncertainty already in the markets, and it is affecting the markets. It is affecting the cost of credit. And I do worry, particularly in terms of this consumer agency, as I mentioned earlier, that all the rules will be changed, and we won't know what the rules are for years to come.

So I think an additional point to the one you are raising and related is, is there going to be so much uncertainty in the market that people will not know what the rules of the road are? And that can affect economic recovery.

Ms. LEONARD. I think we, too, need to be extremely cautious, because the market has changed. The market has adjusted based on going so far in the opposite direction in terms of being risk tolerant that there could be extreme unintended consequences for future

credit if we don't really take the time to know where the problems took place all the way down the line and how to stop them from happening again.

Mr. ZYWICKI. This proposal made credit more costly and less available to consumers. That would be bad in itself.

Secondly, it will probably push consumers to even less attractive forms of credit such as pawn shops, payday lenders, a lot of these sorts of organizations, because it will make regular credit less available. That is a bad idea anytime. It seems like an especially bad idea at this time.

The CHAIRMAN. The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

The gentlelady from Minnesota mentioned Goldman. The one issue that I need to bring up is we own warrants in Goldman. They are worth between a quarter and a half billion dollars. And there are negotiations now in process that I fear will lead to us cashing in those warrants for far less than they are worth.

We took a huge risk. Goldman is doing well. We are going to have to profit on this deal, because I know we are going to lose money on a bunch of the other deals.

As to consumer ignorance being the cause of all this, I would say to my way of thinking it is investor ignorance. They treated Alt-A as triple A. They loaned $500,000 to people to buy a three-bedroom bungalow in my district, and then we counted that as increase in our worth. It increased property values, didn't exactly increase the value of that home.

And I don't think the borrowers were all that dumb, even if they signed a loan that they ultimately couldn't pay. Because if they sold in 2006, they made more money on their home than they ever made working, or at least for many years of working.

The people who took ridiculous risks were the investors, the lenders. They thought they were creating wealth. All they were doing is creating a bubble.

The three issues that I think are going to be most contentious on regulatory reform are: first, the enhanced powers of the Fed. We are going to have to deal with Fed governance. It is absolutely absurd to put huge governmental powers in an entity that is selected, whose leadership is selected—not always one man, one vote—they will have to appoint Fed board members. But in some cases, the regional side and various other entities, the governance of the Fed is one bank, one vote; one big bank, one big vote. And last I checked the Constitution, governmental powers should be in the hands of those who are elected one man, one vote; one woman, one vote.

Also a big discussion on whether the Fed should be audited like every other government agency. The more governmental power you give it, the more reason there is to audit.

And, finally, the chairman has discussed Section 13.3 of the Federal Reserve Act.

Mr. Bernanke was here and I facetiously questioned him about whether he would accept a $12 trillion limit on the power of the Fed to go lend money to whomever he thought ought to get it. He thought a $12 trillion limit on that power would be acceptable. The

power of the purse is supposed to be in Article 1 of the Constitution, not Article 2.

And the proposal of the Administration is to say, well, you need two entities in Article 2 of the Constitution, both the Fed and the Treasury Department, to go out and take—and to risk trillions of dollars. I would think that we would want a dollar limit imposed by Congress.

Derivatives are often a casino. We are told that they are used as hedges, and that is the justification for them. But for every $10 billion that an airline hedges on the future fuel of costs, there seems to be $10 trillion in casino gambling. Which would be more or less fine, except, unlike Las Vegas, we have the Secretary of the Treasury, when he came before us a couple of days ago, making it plain that he reserves the right to use whatever governmental powers he might have to bail out the counterparties on derivatives being written today.

So we do have an interest in minimizing the over-the-counter derivatives and minimizing what could be a risk that ultimately falls on the taxpayer.

I would think at a minimum, we would limit over-the-counter derivatives to those cases where somebody has a genuine insurable risk and is unable to hedge it in the exchange-traded derivatives.

For us to say we are going to have a taxpayer-insured casino involving trillions of dollars a day, just so that one or two airlines could hedge fuel costs, fails to recognize the size of this, of the casino part of the over-the-counter market.

Finally, Professor, I will be introducing a bill that would deprive the issuer of a debt security from selecting the credit-rating agency. To me, that is like having the umpire selected by the home team. Which is fine if it is a beer league; not so fine if you are in the major leagues.

And instead, we would select at random from a panel of SEC-qualified credit-rating agencies. Another way to go would be to make the credit-rating agencies liable for negligence. I don't know if I am allowed a response.

The CHAIRMAN. No, you can't get—

Mr. SHERMAN. I will ask you to respond for the record.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Illinois.

Mr. MANZULLO. Mr. Chairman, you know it is amazing, if I had asked each of you guys—that of course includes the gentlelady—what caused everything, the answer is pretty simple: too easy credit. The Federal Reserve had the authority to stop the 2/28 and the 3/27 mortgages, and the Federal Reserve also had the authority to require, goodness gracious, written proof of a person's income before that person was eligible to get the mortgage.

You know something? No one starts with the problem. The problem is not in the derivatives, the problem is in the stinky piece of financial garbage that was generated because of the bad subprime loans.

So if we already have a government agency that had the powers to stop this, and didn't do so for any number of reasons, why create another agency given the authority to come in and mess up?

I mean, I don't know if you guys have taken a look at this Consumer Financial Protection Agency Act of 2009, the proposal on it. You know what that does? That says that this new organization gets to work with HUD, and perhaps FHSA, on a Truth-in-Lending and RESPA financial disclosure form. And how long did we fight those people at HUD on RESPA?

When I chaired the Small Business Committee, that went on for 6 years. They finally came up with something they thought would work.

And now FHA says well, we are going to take care of the appraisers. It allows banks to own an appraisal management company so that the appraisal management company can be wholly owned by the bank. But if you separate the men's bathroom from the women's bathroom, they can go out there and do an independent appraisal.

And if a person gets an appraisal that he doesn't like—you know, we were told by the head of the FHFA what his resolution is: to contact them or the CC. You know, the more power and the more agencies we set up, it just screws everything up.

I mean, Mr. Menzies, you know, you are a community banker. In your opinion—I like to pick on you—this is the third time since you have been here.

In your opinion, if we did not have those exotic mortgages, if they were not allowed, and people had to show proof of their income, don't you agree that this crisis probably never would have occurred?

Mr. MENZIES. You do pick on me all the time.

Mr. MANZULLO. Yes, that is because I like your answers.

Mr. MENZIES. Thank you, sir. You know, as a community banker, knowing that my personal capital is at risk, knowing that I have personal skin in the game, introduces a great deal of morality in the business decision-making; because we own, individually and personally, the consequences of our own loan decisions, whether we put it in the secondary market through Fannie and Freddie, whether we keep it, we own the consequences of those decisions personally.

So my perspective would be that the lack of capital, the lack of ownership, the extraordinary leverage, the lack of skin in the game, created an environment that allowed those who were feeding off of the system to create products that they would not have created if their personal skin were in the game, if their personal capital were at risk, if they were truly at risk of owning their own decisions.

Mr. MANZULLO. Now, Ms. Leonard, do you agree with my assessment that had the Fed had some reasonable—I mean, the Fed finally has put these into effect, will take effect in October of this year— wouldn't that have stopped a lot of the subprime?

Ms. LEONARD. Yes. If the lenders were not allowed to create those products, those, you know, riskier guidelines, yes.

Mr. MANZULLO. Well, then isn't that the answer? You know, I just can't see setting up a whole new—I mean, this consumer financial protection—

The CHAIRMAN. The gentleman's time has expired. I am going to give myself 10 seconds.

Mr. Menzies, I take what you have said, if I am correct, as a strong argument in favor of some requirement of risk retention throughout the system.

Mr. MENZIES. Yes, sir. We believe that risk retention is an important part of the whole system. And at the same time, we hope those transactions that are clearly underwriting, like a conforming mortgage loan, don't get buried or weighted down in that process. But we think risk retention is an important part of the whole system.

The CHAIRMAN. Right. And it seems to me it takes the place of some other restrictions that may come.

I thank the panel very much, and it is dismissed.

[Whereupon, at 2:07 p.m., the hearing was adjourned.]

A P P E N D I X

July 15, 2009

TESTIMONY

OF THE HONORABLE STEVE BARTLETT

PRESIDENT AND CHIEF EXECUTIVE OFFICER

OF

THE FINANCIAL SERVICES ROUNDTABLE

ON

BANKING INDUSTRY PERSPECTIVES ON THE

OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

JULY 15, 2009

Executive Summary

- The Financial Services Roundtable ("Roundtable") supports bold, comprehensive financial regulatory reform to strengthen the ability of our financial markets to serve consumers and support the economy.
- The Obama Administration's New Foundation is a thoughtful starting point for discussion; we agree with many aspects and believe there are ways to improve upon other parts of it in the legislative process.
- Any reform legislation should include clear objectives and guiding principles for our financial markets and their direct linkage to serving consumers and supporting the economy.
- Specifically, the Roundtable:
    - *Consumer protection* – supports strong and improved consumer protection and comprehensive, uniform national standards for consumer protection to be achieved through enhanced and explicit regulation for the prudential regulators; we strongly oppose the creation of a new agency to achieve better outcomes for consumers
    - *Financial literacy* – supports increased efforts to promote greater financial literacy in a nationwide educational program
    - *Executive compensation* – supports linking executive compensation to long-term performance by adhering to Roundtable supporting principles
    - *OTC derivatives* - supports a regulatory framework for standardized and customized over-the-counter ("OTC") derivatives that maintains these products' usefulness and protects consumers
    - *Systemic risk* – supports the designation of the Federal Reserve as a market stability oversight authority, but opposes drawing a "bright line" around systemically important financial institutions and defining them publicly as Tier 1 FHCs and making the Federal Reserve an "uber-regulator"
    - *National resolution authority* – supports the creation of a new regime for the orderly resolution of failing nonbank financial institutions that may pose systemic risk but recommends such authority be designated to the prudential regulator and that current funding systems for each sector be preserved
    - *Insurance* – supports the creation of the Office of National Insurance within Treasury, but also supports H.R. 1880 to create a national insurance charter with its own national insurance supervisor
    - *National Bank Supervisor* – supports the creation of the NBS but also include federal oversight of state member and non-member banks
    - *Financial Services Coordinating Council* – supports the legislative creation of a new Council with some additional amendments
    - *Accounting* – supports improving accounting for financial institutions and international harmonization of accounting standards, while specifically requiring the FASB to become subject to the Administrative Procedures Act ("APA") under the Securities and Exchange Commission ("SEC")
    - *Retirement security* - supports a comprehensive set of policies to improve American retirement readiness, including the Roundtable's own proposals to enhance retirement security
    - *Payments* - supports regulatory improvements that ensure the integrity, security and availability of these payments systems but opposes any action that inhibits the ability of the private sector to sponsor and operate various payments systems
    - *Housing* - supports simplified, uniform, coordinated mortgage disclosures for consumers; supports the Administration's proposal to assign appropriate levels of risk retention by mortgage originators on loans, provided regulators retain sufficient discretion in establishing risk retention; and supports the prohibition of yield spread premiums for mortgage loans.
    - *Global harmonization* - supports the U.S. playing a more visible leadership role in the new G20 forum and Financial Stability Board while ensuring that these new structures develop new international standards that are enforced consistently, recognize the benefits of globally competitive markets, and do not put U.S. financial firms at a competitive disadvantage.
    - *Credit Rating Agencies* – supports the maintaining the independence of the credit rating process, enhancing transparency within this process, and addressing conflicts of interest through enhanced supervision by the SEC

Chairman Frank, Ranking Member Baucus, and Members of the Committee, my name is Steve Bartlett, and I am President and CEO of the Financial Services Roundtable (the "Roundtable"). I appreciate the opportunity to testify on our perspective of the Obama Administration's Financial Regulatory Reform Proposals and most importantly, on the need for comprehensive financial regulatory reform.

The Roundtable is a national trade association composed of the nation's largest diversified banking, securities, and insurance companies. Our members provide the full range of financial products and services to every kind of consumer and business. Roundtable member companies provide fuel for America's economic engine, accounting directly for $85.5 trillion in managed assets, $965 billion in revenue, and 2.3 million jobs.

I. The Roundtable Supports Bold and Comprehensive Regulatory Reform

The Roundtable supports bold and comprehensive regulatory reform that will strengthen the ability of our financial system to serve the needs of consumers and ensure the stability and integrity of our financial system. Although there is specific legislation that has been introduced on the Consumer Financial Protection Agency (which I will address in a minute), it is important to emphasize that this is just one important component of regulatory reform that should move forward as part of the comprehensive regulatory reform package and not in lieu of such reform.

We need to be mindful of lessons learned from the financial crisis. Yet, we also need to be forward-looking and rebuild our financial regulation system to ensure that U.S. financial markets and firms remain competitive and innovative. Financial services firms must be well positioned to meet the needs of their customers, support sustained economic recovery and steady growth, and provide a robust foundation to create jobs.

Today, I will provide the Roundtable's views on the Administration's comprehensive financial regulatory reform proposals, as set forth in the recently released paper entitled "Financial Regulatory Reform: A New Foundation." There are many features of the proposal that we favor. There are also some features that we do not support as proposed, and we would hope to work with this Committee to modify those features. Throughout this discussion, I will highlight aspects of the Roundtable's proposed financial regulatory architecture that are consistent with the Administration's proposal and at times, bolder than the Administration's proposal[1] and outline three basic reforms that we believe should be part of any financial regulatory reform package. These reforms are (1) the enactment of common principles to guide all financial regulators; (2) the enactment of a coordinating council for financial regulators; and (3) the enactment of incentives for financial regulators to employ a prudential approach to supervision.

II. The Administration's New Foundation for Financial Regulation

The Administration has proposed a thoughtful plan for financial regulatory reform. There are many elements of the plan that the Roundtable supports. There are also parts that we respectfully disagree with, and should be modified. Let me turn now to the Roundtable's position on various elements of the Administration's plan or on the subsequent legislation. For each element, I will provide our analysis and, where appropriate, offer specific recommendations.

A. Consumer Financial Protection Agency

Consumer protection should be significantly strengthened. It is fundamental to our financial system. The status quo – with its regulatory gaps and lack of uniform, national standards to ensure equal protection under U.S. law – is unacceptable. Consumers must have confidence in the firms they deal

[1] Starting in early 2008, the Roundtable developed our own proposed "Financial Regulatory Architecture" to address the flaws in our current system and meet the needs of consumers and our globally linked economy in the 21st century. This architecture can be found on our website at: www.fsround.org.

with, and the financial firms must treat consumers fairly. Therefore, we endorse the spirit of the Chairman's legislation, HR 3126, the Consumer Financial Protection Agency Act of 2009, to ensure sound protections and better disclosures for consumers. However, **we strongly oppose the creation of a separate, free-standing Consumer Financial Protection Agency, but we support elevating the importance of consumer protection within prudential regulators and requiring them to promulgate rules to greatly strengthen consumer protections while considering the implications for safety and soundness.**

The Roundtable is not advocating for the status quo. Rather, we recommend that stronger, more explicit consumer protections be provided to regulators to close the regulatory gaps and provide for uniform national standards. **We are concerned that, in its current form, the legislation will have some negative consequences for consumers, for sound financial institutions, and for our financial system.**

1. Consumer Protection and Safety and Soundness Should Not Be Separated

We are most concerned about the separation of consumer protection and safety and soundness regulation. Consumer protection and safety and soundness regulation go hand in hand. Standards that ensure that only qualified borrowers obtain a loan help ensure that a lender gets repaid and remains solvent to serve other consumers in the future. Likewise, consumer protection is at the core of safety and soundness regulation. Consumers are protected when they deal with a firm that is in a stable strong position to provide competitive products and services. Sound mortgage underwriting standards, for example, protect both the interests of consumers and the solvency of lenders. These functions should not be separated.

We recognize that many members of this Committee and many consumer groups believe that consumers have not been adequately protected under the current system. Clearly, consumers have been

harmed by the recent financial crisis. However, the harm was primarily due to gaps and lapses in regulation, including a lack of regulation of certain types of mortgage originators; inappropriate underwriting standards for mortgage lenders; insufficient capital standards; and insufficient liquidity requirements.

One of the key flaws revealed in this current crisis was there were no uniform standards of consumer protection and there was inadequate supervision over certain players in the financial markets. Many of the firms and individuals involved in the origination of mortgage were not subject to supervision or regulation by any prudential regulator. No single regulator was held accountable for identifying and recommending corrective actions across the activity known as mortgage lending to consumers. Many mortgage bankers and brokers were organized under state law, and operated outside of the regulated banking industry. Their incentives were linked to volume, not the quality of the product or the best interests of consumers. They had no contractual or fiduciary obligations to brokers who referred loans to them. Likewise, many brokers were not subject to any licensing qualifications and had no continuing obligations to individual borrowers. Most were not supervised in a prudential manner like depository institutions engaged in the same business line.

The solution to these problems is to close the gaps and to put consumer protection on par with safety and soundness regulations, not to add another layer of regulation to our already fragmented system of financial regulation. In fact, improved regulation of mortgage brokers and stronger underwriting standards for all mortgage lenders has already begun through regulation and legislation, much of it initiated by this Committee. This experience also demonstrates the nexus between consumer protection and safety and soundness regulation. We believe Congress must go further and mandate that prudential regulators treat consumer protection as a fundamental obligation equal to their responsibility to ensure safety and soundness.

The legislation itself illustrates the difficulty in separating consumer protection and safety and soundness. It provides for each of the federal banking agencies to transfer consumer financial protection functions to the new agency. Such functions are defined to mean "research, rulemaking, issuance of orders or guidance, supervision, examination, and enforcement activities, powers, and duties relating to the provision of consumer financial products or services."[2] This appears to apply to underwriting standards, loan limits, and even anti-money laundering requirements. Clearly, such requirements should protect both consumers and safety and soundness

2. All Consumers Deserve to Be Treated the Same

One of the central goals of HR 3126 is the establishment of more consistent regulation of similar products and services. In its report on financial regulatory reform, the Administration notes that this new agency would "reduce gaps in federal supervision and enforcement; improve coordination with the states; set higher standards for financial intermediaries; and promote *consistent* regulation of similar products."[3] Yet, as drafted, the Consumer Financial Protection Agency Act of 2009 would frustrate the goal of consistent consumer protection standards.

In a section of the legislation that is entitled, "Preservation of State Law," every state is permitted to enact its own set of consumer protection regulations that would be in addition to the regulations developed by the new agency. In other words, a financial services company would have to comply with different state rules, and compliance with the national regulations will not be sufficient. This is like saying that different truck safety features can be mandated by each state, and the trucking company must change its equipment at state borders to travel across state lines. Such a system would not be good for American commerce, and the imposition of different state requirements on identical or similar financial products would likewise have a negative impact on consumers.

---

[2] Section 161 of HR 3126.

[3] "Financial Regulatory Reform: A New Foundation, (http://www.financialstability.gov/docs/regs/FinalReport_web.pdf), page 55 (emphasis added).

It also is important to note that in writing consumer protection regulations, the states would not be subject to the same principles as the new agency. The legislation directs the new agency to take a balanced approach in its regulatory efforts: weigh the potential benefits and costs to consumers and providers, consider the potential reduction of consumer access to financial products and services, and consult with the prudential regulators to assess the consistency of a proposed regulation with the safety and soundness of financial services providers, market impacts, and systemic risks.[4] The creation of a stand-alone Agency that merely "consults with" prudential regulators does not create a system of consistent standards.

The states are not required to consider any of these factors. They would be free to take actions that are not balanced. So long as a state action is not in conflict with the regulations of the new agency the action will apply, even if it may have a detrimental impact on safety and soundness, systemic risk, or the efficient functioning of our financial markets in a globally linked economy.

The provision preserving state law in the legislation is patterned after provisions in several existing federal consumer protection laws, such as the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Equal Credit Opportunity Act, and the privacy provisions in the Gramm-Leach-Bliley Act. However, the authority for state action in these laws is relatively narrow. In this case, the proposal would authorize the states to regulate all aspects of a consumer financial transaction.

Under the proposed legislation, a state could adopt rules prohibiting "unfair, deceptive, or abusive" acts or practices in connection with any transaction with a consumer for a financial product or service. States could impose different disclosure requirements and communication standards between financial services firms and consumers, as well as new fiduciary duties, including the duty of fair dealing. Such requirements may result in actually confusing consumers to the extent they are

[4] Section 122(b)(2) of HR 3126.

overwhelmed with new information, using non-standard terminology. The costs of complying with all of these rules, multiplied by the number of states adopting different requirements, will eventually be passed on to consumers and to the economy. Additionally, the creation of new fiduciary or suitability requirements, over and above the standards adopted by the new agency, will expose financial services companies to litigation costs and risks that will also be passed on to consumers. Further, to the extent that the states supplement the new agency's requirements to provide a standard or "plain vanilla" product, financial services firms will be required to offer several of these "plain vanilla" options, negating the concept that consumers would have one product to use as a base when considering alternatives. In sum, the authority for states to adopt "stronger" standards in all of these areas could result in a multiplicity of different standards that frustrate the goal of consistent consumer protection.

Multiple and different state consumer protection standards also would impact product opportunities for consumers. Today, many financial products and services are national in scope. However, if states exercise the authority granted in this proposal, financial services firms will be required to develop different products for consumers in different states. For example, an adjustable rate mortgage permissible in one state may not be deemed acceptable in another state. Likewise, a credit card that meets the standards set by the new agency may not be offered in a state that imposes different standards. This will create inconveniences for consumers, especially as they move from state to state, and adds to regulatory costs that may not be beneficial to consumers.

Administration officials and some consumer advocates suggested that if the new agency sets high minimum consumer protection standards, the states may not feel compelled to adopt different standards. Nonetheless, the Administration argues that the authority of the states to set different standards is necessary to ensure optimal protection for consumers. The Roundtable disagrees; creating such a system would only encourage even less coordination amongst the regulators. Rather, we believe

consumer protection rules that are clear and applied equally regardless of where a consumer resides should be the rule.

3. The Dual Banking System Should Be Preserved

The current legislation also would significantly alter the regulation of national banks and federal thrifts. It would do so by permitting individual states to regulate the lending, deposit-taking and other basic banking activities of national banks and federal thrifts. While this proposal is intended to benefit consumers, it will have just the opposite effect.

Currently, national banks and federal thrifts must comply with a variety of state laws, including state contract, criminal, debt collection, real property, tax, tort and zoning laws. However, under a long-standing policy, national banks and federal thrifts have not been required to comply with state laws that impact their lending, deposit-taking, and other authorized activities. This legal structure is the foundation of the dual banking system. It has permitted the development of two parallel systems of banking in the United States: a system of national banks that may engage in banking activities under a single set of rules on a national basis, and a separate system of state banks, which operate under state law. This structure has been in place since 1863. The political and intellectual force behind the system was President Lincoln, who saw a need for a system of national banks to finance the development of the nation. Congress subsequently extended this same legal structure to federal thrifts and to federally chartered credit unions.

The proposed Consumer Financial Protection Agency Act of 2009 would alter this legal structure by expanding the category of state laws that apply to national banks and federal thrifts to include "state consumer protection laws." The Act defines such state laws broadly to include any state law that "accords rights to or protects the rights of its citizens in *financial transactions* concerning the

negotiation, sale, solicitation, disclosure, terms and conditions, advice and remedies..." (emphasis added).[5] The Act does not define "financial transactions", but presumably this term would include the deposit-taking, lending, and other basic banking activities of national banks and federal thrifts.

While intended to benefit consumers, this legislation will actually limit product opportunities for consumers and increase the cost of banking products and services for consumers. For example, national banks and federal thrifts will no longer be able to design and offer the same mortgage or credit card products to all consumers, regardless of where the consumers may live. Separate products will need to be designed to conform to standards set by individual states. This will increase the cost of products, and create confusion for consumers especially when they move from one state to another.

4. The U.S. is Unique

Some may argue that we should create a separate consumer protection agency because other G20 countries – Canada or Australia, for example – have them. While that is true, we should not forget the differences between the U.S. and those countries. Canada and Australia only have two basic financial regulators – prudential and consumer - not the hundreds that we have across financial services at both the national and state levels, so these really are not fair comparisons or good examples. We must remember that one of the lessons we have learned from the financial crisis is that we have numerous regulatory gaps among too many regulators. There is a strong consensus that we need fewer regulators and regulatory consolidation, not an expansion of regulators, more diffuse authority, and more open questions about which regulator is ultimately accountable for the kind of regulatory outcomes we all desire – treating consumers fairly.

5. The Better Answer is Uniform, National Consumer Protection Standards

A better approach to protecting consumers, and one more in line with the Administration's stated goal of consistent regulation, would be to establish federal standards that apply to all consumers,

[5] See sections 143 and 146 of the Act.

regardless of where they live or what type of institution provides the particular financial product or service. If these standards are sufficiently robust, there is no need to reserve any additional power to the states and impose the costs and confusion on consumers that will result from multiple, and different consumer protection standards.

Rather than create a new agency and bifurcate consumer protection from safety and soundness regulation, we recommend that the Congress enact strong, national consumer protection standards for all consumers. This would ensure that all Americans are accorded the same consumer protections regardless of where they live or what institution provides the product or service.

6. Financial Literacy

Financial literacy is a key component of consumer protection. Therefore, we also support the need to strengthen financial education for consumers. We do not, however, believe that the creation of a separate consumer protection agency is the solution.

The financial preparedness of our nation is essential to not only consumers' well-being but of vital importance to our economic future. Consumers make better decisions if they are better informed and, in essence, the whole economy benefits. Roundtable member companies offer financial literacy opportunities to consumers in a variety of ways, including online curriculums, workshops and seminars, and free-of-charge tips and advice booklets.

The Roundtable recommends the creation of a specific K-12 and post-secondary level financial literacy curriculum for the nation's school system so all children learn to manage their financial affairs as they grow up and become responsible adults.

B. Compensation

The topic of compensation in the context of promoting better corporate governance has been the subject of much public scrutiny and debate. This is not just a U.S. debate; the Group of Twenty (G20) has addressed this issue as well. Consequently, any actions we take must be consistent internationally, otherwise we risk unintended competitive effects as talent and skills seek the best opportunities either outside U.S. financial markets or outside the United State entirely.

Should the Committee include compensation in the larger Regulatory Restructuring package, we believe the Committee should focus on the following Roundtable principles: 1) the Board of Directors should oversee the executive compensation system's design and practices; 2) the Board of Directors or Board Committee should consult with the firm's risk management personnel and/or outside experts regarding the risk components of the firm's executive compensation programs; 3) executive incentive compensation should be based on performance and aligned with shareholder interests and long-term, sustainable, firm-wide success; 4) executive compensation mix and payout schedules should be sensitive to the time horizon of risks; and 5) termination of benefits provided to executives, including severance, should be consistent with good corporate governance. We would be happy to work with you and your staff to provide more details on these principles.

C. OTC Derivatives

The use of over-the-counter ("OTC") derivatives has been a central part of the debate about the causes of the crisis. Issues ranging from transparency to risk management of the broader securitization process to the necessary capital cushions are rightly being debated. Restoration of the securitization process, albeit at a different level than the recent past and under new supervisory norms, is essential to

U.S. economic growth in the future. Properly regulated and supervised derivatives markets need to play an integral part of our nation's return to economic growth.

The Roundtable supports a regulatory framework for standardized and customized OTC derivatives that maintains these products' usefulness and protects consumers. OTC derivatives are a key tool for American corporations to manage their risks and finances. It is important to strike an appropriate balance between effective oversight of OTC derivatives trading and their risk-managing benefits. The Roundtable supports a strong regulatory framework for OTC derivatives that promotes the stability and transparency of the financial markets and meets the other goals laid out by the Administration, including the prevention of market manipulation and fraud, and ensuring that derivatives are not marketed inappropriately.

The Roundtable recommends that standardized derivatives are cleared through a regulated clearinghouse to provide more transparency and to reduce systemic risk within the industry. However, clearing sophisticated, customized derivatives should not be required because they allow flexibility for institutions to meet their customers' needs. Additionally, we support recordkeeping and reporting requirements of end-of day pricing of these instruments to a central reporting entity for dealers of OTC derivatives, regardless of whether or not the derivatives are standardized or customized.

D. Systemic Risk Regulator and Tier 1 FHCs

The creation of a systemic risk authority is an essential part of regulatory reform legislation. Today, no single agency has the specific mandate, the necessary surveillance purview, or the accountability to detect and mitigate the risks of financial stress and future financial crises. Realistically, we cannot expect any single agency to prevent each and every financial panic or crisis;

like it or not, financial bubbles are part of a competitive market economy. Yet, we can do a better job of anticipating trouble spots, issuing the necessary public warnings about brewing hot spots, and then taking prompt corrective action when needed in a timely manner.

We express our strong support for the designation of the Federal Reserve Board ("the Board") as a systemic risk oversight authority that can collect data on the financial services industry and identify potential systemic risks. The Roundtable actually recommended the Federal Reserve Board in this role in our own proposed architecture. We must emphasize, however, that the Board should not be an additional super-regulator. Rather, it should work with the prudential regulator in non-emergencies to address potential systemic risks. Moreover, the Board also should not publicly identify systemically significant institutions ("Tier 1 FHCs"), as proposed by the Administration; it should focus its priorities and focus on activities and practices across the entire financial system, not individual institutions. In retrospect, the activities of relatively small, state-licensed mortgage brokers created significant systemic risk, but they would not fall into the Administration's Tier 1 FHC category. Institutions designated as Tier 1 FHCs could be viewed as "too-big-to-fail." This designation also could have the unintended consequence of encouraging such institutions to take excessive risk (i.e., create even more of a moral hazard) and/or create a competitive imbalance in the market as customers choose to do business with "too-big-to-fail" institutions.

Further, requiring each Tier 1 FHC to comply with the nonfinancial activity restrictions of the Bank Holding Company Act does not address a cause of the current credit crisis or threat to the safety and soundness of the financial system. Commercial ownership of financial services has been a source of strength and capital to the nation's economy, and restricting it would reduce the total amount of credit available to consumers and businesses. Forcing unnecessary divestitures, when there

are no safety and soundness issues, does not make any sense and can impede our much needed economic recovery and dampen economic growth in the future.

Since the Roundtable submitted a statement for the record on this topic just last week to the Domestic Monetary Policy and Technology Subcommittee, I will not repeat the need for a new market stability oversight authority and better regulatory coordination here. I have attached our as an appendix to my testimony (See Attachment A).

E. National Resolution Authority

The recent financial crisis demonstrated the urgent need for an explicit and definitive resolution regime for nonbank financial institutions, especially those that had the potential to increase or exacerbate systemic risk. As such, **the Roundtable supports and has advocated for the establishment of a resolution regime for insolvent nonbank financial institutions that pose a systemic risk to U.S. financial markets and the economy during financial emergencies.** From our perspective, such a regime should achieve several clear objectives: (1) respect the rule of law and contracts; (2) be objective and fact-based; (3) be transparent; (4) impose resolution costs on the segment of the industry most affected by a resolution; and (5) never impose an obligation on the FDIC to act as a receiver or conservator for nonbank financial institutions or jeopardize the integrity of the federal deposit insurance fund.

While we support the general concept of an orderly failure resolution regime for systemically significant nonbank financial institutions during financial emergencies, we have significant reservations with the Administration's draft proposal and will reserve final judgment until we see the final legislation that is introduced and considered by Congress. The Administration's legislative draft, for example, relies too heavily upon the FDIC to act as a receiver or conservator for such institutions, and thereby

runs the risk of jeopardizing the integrity of the deposit insurance fund. **We would recommend that the Treasury Department have the authority to appoint the appropriate prudential regulator for an institution upon a determination that such authority is necessary. We also oppose funding such an authority with assessments of all systemically significant institutions. Furthermore, the FDIC's Deposit Insurance Fund, the Securities Investor Protection Corporation, and the state insurance guarantee funds should be retained and protected for their original intended uses. Additionally, in normal times, the Roundtable supports the use of current bankruptcy proceedings to resolve these failing firms.**

We are currently discussing bankruptcy reforms with our members as an additional tool to resolve troubled firms. We would be happy to provide our solutions for such reforms with you and your staff at a later date.

F. Insurance

The Roundtable strongly supports the adoption of a federal insurance charter for national insurers, reinsurers, and producers under the supervision of a national regulator. It is essential that this piece be included in the larger regulatory reform legislation. In our financial architecture, the Roundtable recommends that such authority be housed in a single prudential regulator, which I will discuss in a minute.

Insurance is a national and international business, and we need to recognize it as such, at least for those insurance companies that choose to serve their customers' needs with a nationwide or global strategy. We are the only member country of the G20 that does not have a national insurance regulator, and we have been singled out as running counter to international best practices in numerous official reports (e.g., the most recent Group of Thirty Report) for our deficiencies and inconsistencies at the

international level. We need to modernize our statutes and provide the ability for companies to serve their customers under a national charter, with uniform national principles and rules, and under the supervision of a single, accountable national supervisor.

In addition to a new national insurance charter and regulator, the Roundtable also supports the establishment of an Office of National Insurance ("ONI"), as outlined in the Administration's proposal, and the proposal's six principles for insurance regulation: (1) effective systemic risk regulation; (2) strong capital standards; (3) meaningful and consistent consumer protection; (4) comprehensive and consolidated regulation of insurance companies and affiliates; (5) international coordination; and (6) increased national uniformity.

However, history has proven that these principles can only be accomplished by giving the ONI the authority to charter and exclusively regulate national insurers and reinsurers. The Administration proposal recognizes that "our current insurance regulatory system remains highly fragmented, inconsistent, and inefficient" and "has led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers."[6] Strong, uniform federal regulation and supervision of insurance companies, producers, and holding companies would reduce risks to consumers and the economy. Consequently, **we strongly support enactment of H.R. 1880, the National Insurance Consumer Protection Act, sponsored by Congresswoman Melissa Bean and Congressman Ed Royce and urge that the Committee consider this bill as part of the comprehensive regulatory restructuring legislation.**

G. National Bank Supervisor

Correcting clear regulatory failures and closing equally clear regulatory gaps is one of the most urgent priorities for Congress and the Administration to address. We need comprehensive reform, a

[6] Financial Regulatory Reform: A New Foundation, page 40.

simple, more rational regulatory architecture, and fewer regulatory agencies that have overlapping missions. Rationalizing our financial regulatory architecture will also help to increase regulatory accountability and more uniform treatment of financial activities, practices, and products as we move away from having different supervisors for different legal entities.

The Roundtable supports the merger of the Office of the Comptroller of the Currency and the Office of Thrift Supervision to create the new National Bank Supervisor ("NBS"). Creating a single bank supervisor will enhance the prudential regulation between such a supervisor and the entities under its authority. To further enhance prudential supervision, the Roundtable also recommends that the state bank regulation and supervision responsibilities of the Federal Reserve and the FDIC move into the NBS.

The Roundtable's proposed financial architecture goes a bit further than the Administration's proposal and proposes the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator ("NFIR"). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities.

Regardless of how many agencies are consolidated into this single regulator, the Roundtable does not view the various financial charters that exist today as a "gap" in regulation. Institutions have been free to choose the charter that best serves their competitive strategy to serve their customers and are fully regulated at the state and national level. The choice of a national or state bank charter will still be possible even if the Administration's plan is adopted as proposed. Therefore, **the Roundtable supports grandfathering existing charters (such as ILCs and thrift charters).** Placing even greater restrictions on affiliations between commercial and financial firms would force unnecessary separations

of finance companies from their parent institutions, often a source of strength for the finance company, and in some cases, would cause their outright divestiture. ILCs and nonbank finance companies have been a vital source of affordable credit for consumers and small businesses at a time when many other sources of credit have all but dried up. **The Roundtable supports increased regulatory oversight of the financial affiliates of commercial companies to assure that such finance companies continue to provide this much needed credit in a safe and sound manner, but cautions against proposals that eliminate or severely restrict the activities of such institutions.**

H. Financial Services Oversight Council

As part of the Roundtable's 2007 *Blueprint for U.S. Financial Competitiveness*, we fully endorsed better regulatory coordination and cooperation as an imperative for any financial reform. At that time, we recommended formally expanding and enhancing the authority of the President's Working Group on Financial Markets ("PWG") and enacting it into statute instead of just relying on an Executive Order that only covered some of the financial regulators but not all of them. We also thought it should have a more forward-looking agenda, not one exclusively focused on the last financial crisis. Therefore, **the Roundtable supports the creation of a new Financial Services Oversight Council ("Council") described in the Administration's proposal, but with additional suggestions.**

1. Additional Seats on the Council

Consistent with our views on the need for a national insurance regulator and a national charter, the national insurance regulator should also have a seat on the new Coordinating Council.

2. Develop a set of Guiding Principles

As part of a more forward-looking mandate, **the Council should monitor the adherence to basic principles that Congress legislates to guide future financial regulation and preferred regulatory outcomes for regulators and regulated firms.** Today, our federal financial regulators have different and sometimes conflicting missions. The enactment of a set of principles to guide all financial regulators and financial firms would help to ensure a more uniform and consistent approach to financial regulation. The enactment of a set of principles also would help to eliminate any existing confusion over regulatory missions, including the relationship between safety and soundness and consumer protection.

The Roundtable has its own set of six "Guiding Principles." We recognize that these may not be the only or the best principles. However, we believe that a common set of principles to guide financial regulators and financial firms would promote more consistent and better regulation. We urge this Committee to include this concept in its package of financial regulatory reforms.

Our proposed Guiding Principles are intended to ensure that the regulation of financial services and markets is more balanced, consistent, and predictable for consumers and firms. They would guide the supervisory and regulatory policies and practices of all financial regulators, as well as the policies and practices of financial services firms. They are not intended as a complete substitute for rules, but should guide both the development of new rules and the review of existing rules.

Our six Guiding Principles are as follows:

1. Fair treatment for consumers (customers, investors, and issuers). Consumers should be treated fairly and, at a minimum, should have access to competitive pricing; fair, full, and easily understood disclosure of key terms and conditions; privacy; secure and efficient delivery of products and services; timely resolution of disputes; and appropriate guidance.

2. Competitive and innovative financial markets. Financial regulation should promote open, competitive, and innovative financial markets domestically and internationally. Financial regulation also must support the integrity, stability, and security of financial markets.

3. Proportionate, risk-based regulation. The costs and burdens of financial regulation, which ultimately are borne by consumers, should be proportionate to the benefits to consumers. Financial regulation also should be risk-based, aimed primarily at the material risks for firms and consumers.
4. Prudential supervision and enforcement. Prudential guidance, examination, supervision, and enforcement should be based upon a constructive and cooperative dialogue between regulators and the management of financial services firms that promotes the establishment of best practices that benefit all consumers.
5. Options for serving consumers. Providers of financial services should have a wide choice of charters and organizational options for serving consumers, including the option to select a single national charter and a single national regulator. Uniform national standards should apply to each charter.
6. Management responsibilities. Management should have policies and effective practices in place to enable a financial services firm to operate successfully and maintain the trust of consumers. These responsibilities include adequate financial resources, skilled personnel, ethical conduct, effective risk management, adequate infrastructure, complete and cooperative supervisory compliance as well as respect for basic tenets of safety, soundness, and financial stability, and appropriate conflict of interest management.

3. Require Comprehensive Regulatory Action Plans from each Regulatory Agency

The Roundtable proposes that each regulatory agency at the table should develop comprehensive regulatory action plans to review the costs and benefits of each regulation under an agency's purview on a continuous basis. These action plans would be regularly presented and reviewed by the Council to ensure regulations are effective and efficient in serving their intended purpose while adapting to changes in consumer needs and competitive market conditions.

The proposed Regulatory Action Plans are intended to ensure that each financial regulator adheres to the principles enacted by Congress. Each financial regulator would be required to develop its own Regulatory Action Plan to implement the principles. We propose that all financial regulatory agencies at the table design a multi-year plan to review of all regulations that affect the ability of financial services firms to serve consumers' financial needs and compete in the marketplace. Our goal is that this review process will lead to regulations that are consistent with the principles, agency policy objectives, and desired regulatory outcomes.

The Council would serve as the U.S. Government's review panel to monitor and measure the progress of each agency in implementing these principles. It would rely upon a system of public reporting and transparency to ensure the implementation of the principles. The Council would be required to submit the results of its evaluation of the Regulatory Action Plans in its annual or interim reports to the Congress and the President. Those evaluations could be performed by Treasury Department personnel in cooperation with relevant agency personnel. The reports would identify regulations deemed to be inconsistent with the principles and recommend actions that should be taken to bring regulations into compliance with the principles by the regulators and Congress.

It is not our desire to have the Council intrude on the statutory mission of individual regulators or become an impediment to other needed regulatory reforms. To the contrary, because we do not have one single financial regulator, we expect the Council to provide greater focus, accountability, and transparency to regulatory issues across the financial services industry that affect broader national policy concerns.

4. Prudential Supervision

The Roundtable also recommends the adoption of a "prudential" approach to supervision by all financial regulators. Prudential supervision is a form of supervision in which regulators and regulated entities maintain a constructive engagement to ensure an effective level of compliance with applicable laws and regulations. Prudential supervision relies upon regular and open communications between firms and regulators to discuss and address issues of mutual concern as soon as possible. Prudential supervision encourages regulated entities to bring matters of concern to the attention of regulators early and voluntarily. Prudential supervision promotes and acknowledges self-identification and self-correction of control weaknesses, thereby reinforcing continued focus and attention on sound

internal controls. We recommend that financial reform include incentives for financial regulators to adhere to a prudential approach to supervision.

At the end of my statement, I have included a draft bill to implement a set of common principles, expand and empower the Council, and encourage all regulators to adhere to prudential supervision (Appendix B). I urge you to incorporate these three concepts into the larger, financial reform legislation you are developing. We believe these three basic reforms should be part of any financial regulatory reform package.

I. Accounting Standards

The Roundtable has been a consistent advocate of improving the quality of financial reporting information. **We support accounting standards that provide transparent information, but not ones that drive economic activity.** While we believe that Congress should not legislate accounting standards, **we propose that Congress subject the Financial Accounting Standards Board ("FASB") to the Administrative Procedures Act ("APA") by placing FASB under the jurisdiction of the Securities and Exchange Commission ("SEC"). Let me be clear — making FASB subject to the APA should in no way allow Congress to legislate accounting standards; rather, it will provide a new and fair standard of due process for public comment to current FASB accounting standard setting procedures. The Roundtable supports efforts to review current accounting standards to improve and streamline financial reporting, with an emphasis on accelerating convergence and harmonization internationally. The Roundtable supports modifications of procyclical accounting standards, including loan loss reserves, fair value accounting, and purchase accounting.**

J. Retirement Security

The Administration appropriately included essential items on retirement security in their proposal – enacting voluntary automatic IRAs administered by the private sector and strengthening the Saver's credit to give low-income households greater incentives to save. **The Roundtable strongly supports these proposals.** The time is now that retirement security needs to be address. This economic crisis has significantly affected the retirement security of all Americans.

The Roundtable believes that the list of reforms to address retirement security can also be expanded to include: **1) creating incentives for lifetime income options in defined contribution ("DC") plans; 2) developing clear and meaningful disclosure for plan participants and plan sponsors; 3) creating mechanisms to reduce leakage from DC and defined benefits ("DB") systems by increasing the cash-out distribution balance for auto rollovers to IRAs to $10,000; 4) temporarily doubling the cap on annual dollar deferral contributions to retirement accounts for the next five years to allow for the recent market downturn; and 5) eliminating the current 10% auto escalation cap and providing employers the option to apply an initial default rate between 3% and 6%, with a maximum escalation to 15%.**

K. Payment Systems

Payment systems are an integral part of our nation's financial system. They are the conduit for funds to flow between and among domestic and international businesses, consumers and government agencies.

The Roundtable supports regulatory improvements that ensure the integrity, security and availability of these payments systems. The Roundtable believes that the Congress and regulators should not inhibit the ability of the private sector to sponsor and operate various payments systems. The

Roundtable encourages the U.S. financial regulatory agencies to engage other federal agencies with oversight of telecommunications providers and consumer protection responsibilities to address safety and soundness and consumer protection concerns with emerging mobile financial services products.

L. Housing

The Roundtable supports simplified, uniform, coordinated mortgage disclosures for consumers. A single prudential regulator could be given authority and direction to ensure development of uniform and understandable disclosures for mortgages for consumers under RESPA and TILA. This is best done by providing enhanced authority to an existing prudential regulator rather than by creating a new separate agency. We are supportive of the Administration's proposal to assign appropriate levels of risk retention by mortgage originators on loans, provided regulators retain sufficient discretion in establishing risk retention. **The Roundtable supports the prohibition of yield spread premiums for mortgage loans and for providing simpler, more understandable disclosures for mortgage products. However, mandating the offering of some type of "plain vanilla" mortgage product would have the impact of reducing consumer choice and increasing costs for consumers. A better approach would be to continue to improve and clarify the current effort to ensure strong underwriting by ensuring the ability to repay a loan by prospective consumers. Strengthening underwriting is a more effective approach than attempting to proscribe specific products for consumers.**

M. Global Harmonization

The recent G20 Leaders Summit stressed the need for new and harmonized international regulatory standards and supervisory procedures. The G20 leaders also reaffirmed their support for

open and competitive global markets that are well regulated and supervised as a precondition for sustained, stable economic growth. They also endorsed better coordination and cooperation at the international level, and opposed regulatory fragmentation among individual countries. Significant differences in regulatory regimes can undermine the safety and soundness of the financial system and produce competitive disparities across countries that will impede international trade, finance, and investment.

From the Roundtable's perspective, it is essential that the Administration play a more visible leadership role in the G20 and the new Financial Stability Board ("FSB"). Specifically, the U.S. Government needs to ensure that the proper structures and frameworks are implemented to achieve internationally consistent standards as well as the consistent enforcement of those standards. Moreover, the Treasury Department needs to ensure that U.S. firms are not disadvantaged when competing globally under any new international regulatory structures or standards. New international regulatory standards for supervision, capital, liquidity, and risk management should not only be balanced, effective, and risk-based, but also recognize the benefits of globally competitive financial markets. Any change in U.S. financial laws and regulations must be consistent with these evolving new international norms, and regulatory fragmentation among nations should be opposed as a matter of U.S. Government policy.

N. Credit Rating Agencies

Credit ratings are an integral part of the financial system. As such, ratings should be independent, reliable, clear, and unbiased. The credit ratings process should be made more transparent so investors can make a more informed analysis of the relevance of specific ratings. Toward that end, **the SEC should publish, on a regular basis, audits of credit rating agencies that include the following**

information: (i) an analysis of the credit rating agency's compliance with its own internal policies and procedures; (ii) a comparison of the agency's ratings for individual securities with the actual experience of the rated securities, and (iii) the time periods used by the agency in estimating probability of default. Credit rating agencies should address conflicts of interest within their published processes and policies that include the separation of the fee discussion from the ratings process. The SEC should continue to permit the issuer-paid model with adequate disclosure and firewalls. Moreover, the SEC should examine how to manage inherit conflicts of interest in general and then issue a report to Congress in 6 months on its findings and recommendations.

O. Merger of the SEC and CFTC

One issue that was not included within the Administration's proposal was the merger of the SEC and the Commodities Futures Trading Commission ("CFTC"). **To focus greater attention on the stability and integrity of financial markets, the Roundtable proposes in its financial architecture the creation of a National Capital Markets Agency (NCMA) through the merger of the SEC and the CFTC, preserving the best features of each agency.** The NCMA would regulate and supervise capital markets and exchanges. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

The Administration prefers to maintain two separate agencies to oversee our capital markets, making the U.S. the odd man out with all other developed countries, which have a single securities regulator with the exception of Canada, which regulates securities at the provincial level.

P. Federal Housing Finance Agency

To supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy. This was another issue that was not discussed in the Administration's proposal but we expect that this will be a priority issue for the industry and policymakers in 2010.

IV. Conclusion

The Roundtable favors comprehensive reform now, but recommends a number of practical and important improvements to the Administration's initial proposal and Chairman Frank's legislation on consumer protection to achieve a common objective: a strong and resilient financial system that not only complements full economic recovery in the short-run, but also sustained and stable economic growth in the future. Broader regulatory reform – starting from some clearly articulated common objectives and guiding principles - is important not only to ensure that financial institutions continue to meet the needs of all consumers but to restart economic growth and much needed job creation.

The Roundtable believes that the reforms to our financial regulatory system we have proposed and highlighted above would substantially improve the protection of consumers by reducing existing gaps in regulation, enhancing coordination and cooperation among regulators, ensuring greater regulatory accountability for commonly desired regulatory outcomes, and identifying systemic risks.

Financial reform and ending the recession soon are inextricably linked – we need both. We need a financial system that provides market stability and integrity, yet encourages innovation and competition to serve consumers and meet the needs of a vibrant and growing economy. We need better,

more effective regulation and a modern financial regulatory system that is unrivaled anywhere in the world. We deserve no less. The Roundtable stands ready to work closely with the Congress and the Administration to achieve our common goals to help all consumers of financial services and provide a stronger financial market foundation for our economy.

APPENDIX A

STATEMENT OF
THE FINANCIAL SERVICES ROUNDTABLE
On
REGULATORY RESTRUCTURING: BALANCING THE INDEPENDENCE OF THE FEDERAL RESERVE IN MONETARY POLICY WITH SYSTEMIC RISK REGULATION
Before the
SUBCOMMITTEE ON DOMESTIC MONETARY POLICY AND TECHNOLOGY
FINANCIAL SERVICES COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
JULY 9, 2009

Chairman Watt, Ranking Member Paul, and Members of the Subcommittee on Domestic Monetary Policy and Technology, the Financial Services Roundtable appreciates this opportunity to submit this statement for the record. The Roundtable is a national trade association composed of the nation's largest diversified banking, securities, and insurance companies. Our members provide the full range of financial products and services to every kind of consumer and business.

The Roundtable supports the urgent need for bold and comprehensive regulatory reform of financial services. We need to be mindful of lessons learned from the worst financial crisis in our lifetime, but we also need to be forward-looking and rebuild our financial regulation and regulatory architecture to ensure in the longer term that U.S. financial markets and firms are the most competitive and innovative in the world consistent with high standards for risk management and good governance. Financial services firms must be well positioned to meet the needs of their customers, support sustained economic recovery and growth, and provide a foundation to create new jobs. Any reforms enacted by Congress and signed by the President must be mindful of this simple economic imperative.

The Obama Administration has put forward a thoughtful proposal for regulatory reform, its New Foundation. The Treasury Department's white paper released on June 17, 2007, is a positive contribution to the current public policy debate. Specifically, we support the creation of a new Financial Services Coordinating Council (Council) and designating the Federal Reserve as what we prefer to call a market stability oversight authority (authority); in both cases, we recommend several changes to strengthen the Administration's proposal.

The Roundtable has testified numerous times in 2008 and 2009 on both the market and regulatory failures exposed by the financial crisis; this statement, therefore, will dispense with reciting that testimony again today. Instead, this statement will focus on three points that are directly relevant to your inquiry: 1) the Roundtable's detailed position on the need for better oversight and surveillance of systemic risk by the U.S. Government as one important part of regulatory reform; 2) the need for clear objectives and principles for our financial system to support our economy as a starting point for regulatory reform; and 3) the need for a new regulatory architecture for our financial system that fully supports stable economic growth and serves consumers. Since we only have analyzed the Treasury's white paper, we reserve the right to provide additional testimony when the detailed draft legislation on systemic risk is sent to Congress.

1. THE NEED TO LIMIT AND MITIGATE SYSTEMIC RISK

As a practical matter, we believe that "systemic risk" should be defined as an activity or practice that crosses financial markets or financial services firms, and which, if left unaddressed, would have a significant, material adverse effect on financial services firms, financial markets, or the U.S. economy. Risk is inherent in all competitive financial markets – banking, insurance, and securities. It is part of the intermediation process between providers and users of all financial services. It needs to be managed first at the institution level as well as at the systemic level to the extent possible, recognizing that no Government will be able to fully protect open and competitive markets from all financial stress and even occasional panic in the future.

After a brief review of why the Roundtable believes a market stability oversight authority is necessary, we analyze two important parts of the Administration's New Foundation: the creation of a permanent Financial Services Coordinating Council and the designation of the Federal Reserve as the market stability oversight authority.

Why do we need a systemic risk regulator?

The activities and practices of U.S. financial markets are interconnected, nationally and internationally. Banks, broker-dealers, insurance companies, finance companies, hedge funds, and other regulated and unregulated financial services firms are continuously and mutually engaged in a variety of lending, investment, trading, and other financial transactions. Yet, under our existing financial regulatory structure, no single agency has the authority to look across all sectors of the financial services industry and all markets to evaluate risks posed by these interconnections.

While often it is assumed that some combination of the U.S. Treasury Department (Treasury) and the Federal Reserve Board (Federal Reserve) are responsible for broad financial market stability, neither the Treasury nor the Federal Reserve has the explicit mandate and the full arsenal of supervisory authorities to promote market stability and prevent systemic risk across different company charters and products. Different regulators are responsible for the different silos they oversee; no single agency looks at the entire financial system serving consumers and our economy.

Prior to 2008, the only authority the Secretary of the Treasury (Secretary) had to look at the financial markets as a whole was the authority delegated to the Secretary by the President (through an Executive Order) in 1988 to chair and convene the President's Working Group on Financial Markets (PWG). The PWG could only ask regulators to cooperate on key issues and issue occasional reports. In 1991, the Congress gave the Secretary a pivotal role in the implementation of the systemic risk exception to the FDIC's least-cost resolution process. Under that process, the Secretary, in consultation with the President, must agree that paying uninsured depositors or creditors "would have serious adverse effects on economic conditions or financial stability" and as such, the FDIC would have the power to intervene in the market to address systemic risk. Yet, the FDIC Improvement Act did not give the Secretary any additional responsibilities, either to determine what constitutes systemic risk, to more closely monitor systemically relevant institutions, or to make any detailed reports about its analysis when this exemption is invoked.

The Federal Reserve plays multiple roles in financial markets, but also does not have an explicit market stability mandate or clearly defined role to identify and prevent systemic risk to U.S. financial markets. As the nation's central bank, it has broad monetary policy tools to promote price stability and full employment in the U.S. economy. It oversees part of the U.S. payments system, but not all. It regulates and supervised state-member banks at the national level, but not national banks, which are regulated by the OCC or state nonmember banks, which are regulated by the FDIC. It regulates and supervises all bank and financial holding companies, but not thrift holding companies, which are regulated and supervised by the OTS, or investment bank holding companies, which are supervised by the SEC. It lends to financial institutions through normal discount window operations. Starting in 2008 during the current crisis, the Federal Reserve greatly expanded its emergency lending to financial institutions and others using its authority to lending in Section 13(3) during "unusual and exigent circumstances." But even in these roles, the Federal Reserve's market stability activities are confined mainly to *reactive* actions and financing vehicles under its unique lending powers.

The missing link is a single federal authority with the mandate, responsibility, and expertise to oversee the nation's entire financial system, not just its individual parts, and to promote market stability while preventing systemic risk for firms that operate in this global marketplace. This would resolve the regulatory redundancy that currently creates the gaps in oversight.

Why the Federal Reserve as a market stability oversight authority?

From the Roundtable's perspective, the U.S. financial system does not need another layer of regulation and a new bureaucracy on top of the current structure. What we do need, however, is better surveillance of interconnected activities and practices among all providers of financial services across the financial system, not another super-regulator of individual institutions. As such, we support and prefer the nuanced designation of a new Market Stability Oversight Authority that is the Federal Reserve, without making the Federal Reserve a super-regulator and without drawing a "bright line" around a set of providers publically designated as "systemically important". This nuance is explained in greater detail below.

Designating the Federal Reserve is a natural complement to the Board's existing role as the nation's central bank and lender of last resort. However, we recognize that this new role would require the Board to expand its staff to include experts in all types of financial activities, practices, and markets. Also, if the Board is given this new authority, it would need to establish a clear and transparent governance structure internally to minimize any potential conflicts with its existing responsibilities. Rigorous Congressional oversight of this new role will be critical.

Furthermore, we would recommend that the Board establish an Advisory Council on Market Stability to review activities and practices that may pose a systemic risk, balanced against the need for continuing market innovation and competitiveness. The Advisory Council should include representatives of domestic and international financial services firms doing business in the United States as well as representatives of consumers of financial services.

What is the role of a market stability oversight authority?

The purpose of a market stability oversight authority should be to promote the long-term stability and integrity of the nation's financial markets and financial services firms by identifying and addressing significant risks to the financial system as a whole.

This new authority should be authorized to oversee all types of all financial markets and all financial services firms, whether regulated or unregulated. However, a market stability authority should **not** focus on financial services firms based upon size. The designation of "systemically significant financial services firms" would have unintended competitive consequences and increase moral hazard as these firms would be deemed too big to fail.

The authority should **not** be just another layer of regulation added to the existing system; it should **not** be a "super-regulator". Absent an immediate, systemic threat, it should be required to work with and through other financial regulators, including a national insurance regulator. Also, a national insurance regulator is needed to give the federal government a better understanding and role in the supervision of this key part of our nation's financial services sector.

Congress, by statute, should require this new authority to balance the identification of activities or practices that pose a systemic risk against the need for continuing market innovation and competitiveness. This new responsibility should not stifle innovation, or preclude isolated failures. Failures in a market-based economic system are a fact of life and should be resolved in an orderly manner across all financial services. Innovation is a key to economic growth and new job creation.

Congress also should direct this new authority to focus attention on factors that present the greatest potential for systemic risk, such as excessive concentrations of assets or liabilities, rapid growth in assets or liabilities, high leverage, a mismatch between long-term assets and short-term liabilities, currency mismatch, and regulatory gaps. This authority should **not** focus attention on products or practices that pose little or no systemic risk.

How would this new authority function?

The authority should identify, prevent, and mitigate systemic risk by –

- Collecting and analyzing data from other financial regulators and individual financial services firms to understand potential or existing systemic risks in the financial system. Data on individual firms should be treated as confidential supervisory information;
- Establishing a surveillance system for activities and practices to detect early crisis warning signs and vulnerabilities, conduct scenario planning, and develop contingency planning with other prudential financial regulators across all financial markets;
- Examining individual financial services firms when a systemic risk is apparent. If a firm is engaged in activities and practices that are a threat to market stability and regulated by another national or state financial regulator, such examinations should be limited and coordinated with such regulator. Examination results should be treated as confidential supervisory information;
- Issuing, as necessary, reports and public notices on activities or practices that may pose a systemic risk;

- Working closely with other international authorities to ensure a global perspective on financial markets and potential systemic risk; and
- Taking corrective actions to prevent or address systemic risk.

To help prevent this authority from becoming a "super-regulator", we would recommend that, absent an emergency situation, the market stability regulator should take actions through other primary regulators. In other words, in non-emergency times, the market stability authority should be authorized to make recommendations to other regulators, the new Coordinating Council, and/or Congress to address activities and practices that could pose a potential systemic risk, but do not pose an immediate systemic threat to markets or the economy.

Whenever this new authority identifies a practice or activity that could pose a systemic risk and such practice or activity is within the jurisdiction of another national or state financial regulator, then it should issue a finding and recommend appropriate preventive actions to the other regulator. It also should submit any such findings and recommendations to the Administration's new Council and/or to the Congress. If another regulator disagrees with the authority's finding and recommendation, then the regulator can submit its own findings and recommendations to the new Council or this Congress.

If the new authority identifies an activity or practice that could pose a systemic risk, and such activity or practice is not subject to regulation or supervision by another regulator – a clear regulatory gap – then it should make a recommendation to Congress on how best to regulate and supervise such activity or practice in the future to close the regulatory gap.

The authority should be granted the ability to take unilateral actions only in the most limited situations to address significant activities or practices and only when the authority determines that they pose an immediate, systemic risk, which could not be addressed in a timely fashion if the authority were to recommend actions by any other regulator. Such unilateral actions would include the power to issue orders or regulations affecting activities or practices of individual firms or categories of firms. Such unilateral actions should only be approved by a super-majority of the members of the Federal Reserve Board, and should be agreed to by the Secretary of the Treasury, who must consult with the President. Such unilateral actions also should be reported immediately to Congress. This authority would be in addition to the Board's existing authority under section 13(3) of the Federal Reserve Act to make extend credit to financial or non-financial institutions in "unusual and exigent" circumstances. The Board should retain that authority, with full and timely public disclosure every time this authority is used.

If market stability oversight authority had been in place before this crisis, how would it have impacted the crisis?

We should not expect a market stability oversight authority to identify all potential systemic risks and eliminate the potential for any crisis in a competitive, market-based, global economy. In fact, some level of risk is inherent in all financial systems by definition. As noted earlier, any new authority should be required explicitly by Congress to balance risk mitigation and innovation to serve all consumers better in the future and meet all the financing needs of the economy.

That said, there are a couple of activities or practices that this new authority could have flagged, and, if such activities and practices had been adjusted, the current crisis should have been identified earlier and

as a result could have been less severe. First, it is now clear that one of the practices that contributed to the current crisis was excessive leverage by large financial services firms, especially investment banks. This new authority as the Roundtable envisions could have identified this leverage as a potential warning sign sooner and urged the SEC to take corrective actions. Has the SEC not acted, the authority could have taken its case to the new Coordinating Council for a full inter-agency review and debate.

Another practice that contributed to the current crisis was growth in non-traditional mortgage instruments. A new oversight authority might have seen this and recognized the value of these innovations for certain consumers, as well as the risk to other consumers who were at risk from no documentation, no money down, adjustable rate loans. This new authority then could have recommended new uniform, national standards for such products long before the banking agencies acted on their own joint guidance.

Managing systemic risk better in the future

There are two major and inter-related components in the Administrations proposal that will help to prevent and mitigate systemic risk in the future, recognizing that no architectural design is a guarantee against all future financial crises. The first is the Administration's proposal to create a new Financial Services Oversight Council, which is modeled on the Roundtable's 2007 proposal. The second is making the Federal Reserve responsible for the promotion of market stability and the prevention of systemic risk. We support both of these improvements to the U.S, financial regulatory architecture with some further refinements to strengthen what has been proposed by the Administration. We reserve the right to recommend additional changes once the Administration sends Congress draft legislation.

Financial Services Oversight Council. The Roundtable has been a consistent advocate of better regulatory coordination and cooperation since our 2007 Blueprint on Financial Modernization. We called for the codification of an enhanced and expanded President's Working Group on Financial Markets (PWG) with all regulators having a seat at the table, including representatives of state regulated industries (banking, insurance, securities).

Therefore, we generally support the creation of a new Financial Services Oversight Council along the lines described in the Treasury's report, with four additional suggestions: 1) a new National Insurance Supervisor for all insurance companies opting or mandated by Congress to have a national insurance charter to serve their customers nationally or internationally should also have a seat on the new Council; a new national insurance regulator is needed to give the federal government a better understanding and role in the systemic supervision of a key part of our nation's financial services sector; 2) representatives of state banking, insurance, and securities regulators also should be included; 3) as part of a more forward looking mandate, the Council should also monitor the adherence to whatever principles Congress legislates to guide financial regulation and preferred regulatory outcomes in the future; and 4) each regulatory agency should develop comprehensive regulatory action plans to review the costs and benefits of each regulation under an agency's purview; in turn, these regulatory action plans would be presented and reviewed by the Council on an ongoing basis to ensure regulations are as effective and efficient as possible in serving their intended purpose.

Market Stability Oversight Authority. There clearly is a need for a market stability or systemic risk oversight authority to look across all financial markets and try to identify and then mitigate potential

threats of systemic risk from activities and practices before they undermine market stability. The Roundtable supports the Administration's position that the Federal Reserve should play this role of greater market surveillance, leading the effort to set new standards for capital, liquidity, and risk management, and then working with other regulators to prevent a systemic collapse or another financial panic in the future. In this capacity, the Federal Reserve should focus primarily on the activities and practices by firms that may pose a risk to the economy across markets, while leaving the regulation and supervision of individual firms to their primary regulator under the new system. We also support the addition of a private-sector Advisory Council on Market Stability as noted above.

From our perspective, there is no need to create an artificial distinction of a Tier 1 Financial Holding Company (FHC), as proposed by the Administration, if the new standards we are setting for all financial institutions – capital, liquidity, risk management, and governance – are risk-based and focused on the desired regulatory behaviors and outcomes mandated by these reforms. Therefore, the Roundtable opposes drawing any bright line around an artificially determined class of institutions because of their size or business lines – which will vary constantly over time - especially since doing so will only increase moral hazard, have a destabilizing effect on competition and the pricing of products, services, and funding, and ultimately work to the disadvantage of the long-term competiveness of U.S. financial services firms and markets.

Consequently, the Roundtable also opposes any forced or unnecessary divestitures of ongoing businesses, especially during an anemic economic recovery. We support stronger capital and liquidity requirements as well as better risk management and supervision – including better consolidated supervision at the parent company level - based on underlying risk fundamentals, but we oppose the artificial and public designation of institutions as systemically important (Tier 1 FHCs) and therefore assumed by the public, potentially, as still "too big to fail," for the reasons noted above. No financial institution should be too big to fail, and, as an aside, the Roundtable fully supports a new orderly resolution process for nonbank financial institutions during times of economic emergencies. In other normal times, bankruptcy should be the preferred option for orderly resolution of failing nonbank financial firms, and it should be harmonized across the financial services industry over time.

2. THE NEED FOR CLEAR OBJECTIVES AND GUIDING PRINCIPLES

The starting for any regulatory reform effort should be common agreement on a few clear objectives for our financial system's role on the real economy – what we want to achieve – and then a companion set of some basic principles for both regulators and regulated firms - to guide how they achieve those objectives. The Administration has outlined five objectives for financial regulatory reform, which at their highest level are hard to oppose and in fact the Roundtable supports as well. We also would encourage the Congress to write into law a set of even higher objectives for our financial markets and their connection to serving consumers and the broader U.S. economy. The Roundtable's three simple objectives, to serve as a discussion starter in this evolving debate, are:

1. Enhance the competitiveness of financial services firms to meet the financial and related needs of all consumers;
2. Promote financial market stability and security; and

3. Support sustained economic growth and new job creation in a globally integrated economy.

If we can agree on some basic objectives about "what" we want our financial system to achieve for the benefit of society, then we need to agree on a set of principles that everyone can understand – regulators, regulated firms, and consumers – about "how" we will achieve those objectives. Guiding principles don't replace the need for more detailed rules especially at the retail level – it's not an either-or discussion - but they do inform desired behavior and outcomes, and they can act as a much needed compass for every stakeholder in our financial markets. Again, the Roundtable believes that Congress should develop a clear set of guiding principles in any reform legislation. To begin this aspect of the debate, our regulatory reform principles for Congress' consideration are:

1. New Architecture. *Our financial regulatory system should be better aligned with modern market conditions and developing global standards.*
2. Consumer and Investor Protection Standards. *Financial services firms engaged in offering comparable products and services should be subject to comparable prudential, consumer, and investor protection standards. In the event of multiple oversight authorities, uniform standards should apply nationwide. Consumer protection should be part of prudential supervision.*
3. Balanced and Effective Regulation. *Financial regulation should be focused on outcomes, not inputs, and should seek a balance between the stability and integrity of financial services firms and markets, consumer protection, innovation, and global competitiveness.*
4. International Cooperation and National Treatment. *U.S. financial regulators should coordinate and harmonize regulatory and supervisory policies with international financial regulatory authorities, and should continue to treat financial services firms doing business in the United States as they treat U.S. financial services firms. The United States should continue to play a leadership role in the current G-20 process to develop new international norms for financial regulation across markets.*
5. Failure Resolution. *Financial regulation should provide for the orderly resolution of failing financial services firms to minimize systemic risk.*
6. Accounting Standards. *U.S. financial regulators should adjust current accounting standards to account for the pro-cyclical effects of the use of fair value accounting in an illiquid market. Additionally, U.S. and International financial regulators should coordinate and harmonize regulatory policies to develop accounting standards that achieve the goals of transparency, understandability and comparability.*

3. THE NEED FOR BOLD, COMPREHENSIVE REGULATORY REFORM

The latest financial crisis has shown us that the time is now for bold, comprehensive regulatory reform. The Roundtable has developed a proposed "Financial Regulatory Architecture" to address the flaws in our current system. Our proposed architecture is designed to:

- Create a better, more rational financial regulatory architecture to support the U.S. economy and meet all consumer financial needs;
- Limit and mitigate systemic risk;
- Reduce regulatory overlap and close critical gaps in regulation;
- Provide for greater coordination among all financial regulators;

- Promote uniform regulation and supervision; and
- Preserve state financial regulation.

Our proposed regulatory architecture can be found on our website at www.fsround.org.

Briefly, the six components of this proposed architecture are as follows. First, to enhance coordination and cooperation among the many and various financial regulatory agencies, we propose to expand membership of the President's Working Group on Financial Markets (PWG) and rename it as the Financial Markets Coordinating Council (FMCC). This Council should be established by law, in contrast to the existing PWG, which has operated under a Presidential Executive Order dating back to 1988. This would permit Congress to oversee its Council's activities. The Council should include representatives from all major federal financial agencies, as well as individuals who can represent state banking, insurance and securities regulation. The Council should serve as a forum for national and state financial regulators to meet and discuss regulatory and supervisory policies, share information, and develop early warning detections. The Council should not have independent regulatory or supervisory powers. However, it might be appropriate for the Council to have some ability to review the goals and objectives of the regulations and policies of federal and state financial agencies, and thereby ensure that they are consistent.

Second, to address systemic risk, we propose that the Federal Reserve Board (Board) should be authorized to act as a market stability oversight authority. If granted this new authority, the Board should be responsible for looking across the entire financial services sector to identify activities, practices, and interconnections that could pose a material systemic risk to the U.S. economy. The interaction of these two points is addressed in the last section of this statement.

Third, to reduce gaps in regulation, we propose the consolidation of several existing federal agencies into a single, National Financial Institutions Regulator (NFIR). This new agency would be a consolidated prudential and consumer protection agency for banking, securities and insurance. The NFIR would reduce regulatory gaps by establishing comparable prudential standards for all of these of nationally chartered or licensed entities. For example, national banks, federal thrifts and federally licensed brokers/dealers that are engaged in comparable activities should be subject to comparable capital and liquidity standards. Similarly, all federally chartered insurers would be subject to the same prudential and market conduct standards.

In the area of mortgage origination, the NFIR's prudential and consumer protection standards should apply to both national and state lenders. Mortgage lenders, regardless of how they are organized, should be required to retain some of the risk for the loans they originate. Likewise, mortgage borrowers, regardless of where they live or who their lender is, should be protected by the same safety and soundness and consumer standards.

Fourth, to focus greater attention on the stability and integrity of financial markets, we propose the creation of a National Capital Markets Agency (NCMA) through the merger of the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), preserving the best features of each agency. The NCMA would regulate and supervise capital markets and exchanges. As noted above, the existing regulatory and supervisory authority of the SEC and CFTC over firms and individuals that serve as intermediaries between markets and customers, such as

broker/dealers, investment companies, investment advisors, and futures commission merchants, and other intermediaries would be transferred to the NFIR. The NCMA also should be responsible for establishing standards for accounting, corporate finance, and corporate governance for all public companies.

Fifth, to protect depositors, policyholders, and investors, we propose that the Federal Deposit Insurance Corporation (FDIC) would be renamed the National Insurance and Resolution Authority (NIRA), and that this agency act not only as an insurer of bank deposits, but also as the guarantor of retail insurance policies written by nationally chartered insurance companies, and a financial backstop for investors who have claims against broker/dealers. These three insurance systems would be legally and functionally separated. The failure of Lehman Brothers illustrated the need for such a better system to address the failure of large non-banking firms.

Finally, to supervise the Federal Home Loan Banks and to oversee the emergence and future restructuring of Fannie Mae and Freddie Mac from conservatorship we propose that the Federal Housing Finance Agency remain in place, pending a thorough review of the role and structure of the housing GSEs in our economy.

Conclusion

The Roundtable believes that the reforms to our financial regulatory system we have proposed would substantially improve the protection of consumers by reducing existing gaps in regulation, enhancing coordination and cooperation among regulators, ensuring greater regulatory accountability for commonly desired regulatory outcomes, and identifying systemic risks. Broader regulatory reform is important not only to ensure that financial institutions continue to meet the needs of all consumers but to restart economic growth and much needed job creation. We support the thrust of the Administration's proposals for a new Council and designating the Federal Reserve as a new market stability oversight authority with the caveats noted above.

Financial reform and ending the recession soon are inextricably linked – we need both. We need a financial system that provides market stability and integrity, yet encourages innovation and competition to serve consumers and meet the needs of a vibrant and growing economy. We need better, more effective regulation and a modern financial regulatory system that is unrivaled anywhere in the world. We deserve no less. The Roundtable stands ready to work closely with the Congress and the Administration to achieve our common goals to help all consumers of financial services and provide a stronger financial market foundation for our economy.

APPENDIX B

111th CONGRESS
2nd Session

H.R. XXXX

To protect consumers and promote economic growth through enhanced regulation and supervision of financial services firms and financial markets.

IN THE HOUSE OF REPRESENTATIVES

July ___, 2009

_____ introduced the following bill; which was referred to the Committee on Financial Services.

A BILL

To protect consumers promote economic growth through enhanced regulation and supervision of financial services firms and financial markets.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sec. 1. Short Title and Table of Contents.

(a) Short Title. – This Act may be cited as the "Financial Services Regulation Improvement Act of 2009."

(b) Table of Contents. – The table of contents for this Act is as follows:

Sec. 1. Short Title and Table of Contents.
Sec. 2. Findings and Purposes.
Sec. 3. Definitions.

TITLE I – REGULATORY COORDINATION

Sec. 101. Establishment and Composition of Working Group.
Sec. 102. Chairman and Meetings.
Sec. 103. Purpose, Consultation, and Information Sharing.
Sec. 104. Annual Report, Congressional Oversight, and Administrative Support.
Sec. 105. Authorization.

TITLE II – PRINCIPLES-BASED REGULATION

Sec. 201. Guiding Principles.
Sec. 202. Implementation of Guiding Principles.
Sec. 203. Regulatory Action Plan.

TITLE III – PRUDENTIAL SUPERVISION

Sec. 301. Prudential Supervision.
Sec. 302. Policy Statements on Prudential Supervision.
Sec. 303. Administrative Matters.
Sec. 304. Ombudsman for Prudential Supervision.

Sec. 2. Findings and Purposes.

(a) Congress finds that –

(1) Effective regulation of financial services firms and financial markets protects consumers and investors, and ensures the stability and integrity of financial services firms and financial markets;

(2) The existing system of financial regulation and supervision is fragmented, and different financial regulators often pursue different, and conflicting, missions;

(3) Given the dynamics of markets and consumer demands, financial regulators must have the flexibility to adjust policies to maintain consumer protection and the integrity of financial services firms and financial markets; and

(4) Early identification of practices that harm consumers or destabilize markets can help to better protect consumer and maintain the integrity of financial services firms and financial markets.

(b) Purposes. – The purposes of this Act are to –

(1) promote greater cooperation and coordination among all financial regulators by expanding the membership and mission of the President's Working Group on Financial Markets;

(2) enable financial regulators to adapt and respond more effectively to changes in markets and consumer protection through the adoption of a set of regulatory and supervisory objectives and principles; and

(3) encourage the early identification and resolution of potential supervisory risks by establishing a system of prudential supervision by financial regulators.

Sec. 3. Definitions.

In this Act, the following definitions shall apply –

(1) Financial regulator. – The term "financial regulator" means the Federal banking agencies (as defined in section 3(q) of the Federal Deposit Insurance Act), the National Credit Union Administration, the Financial Crimes Enforcement Network within the Treasury Department, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Financial Institutions Regulatory Authority, the Federal Housing Finance Board, the Office of Federal Housing Enterprise Oversight, and the Federal Trade Commission, with respect to its regulation and supervision of financial services firms.

(2) Financial services firm. – The term "financial services firm" means an individual or entity that engages primarily in one or more activities that are financial in nature, as that term is defined pursuant to section 4(k) of the Bank Holding Company Act of 1956, and is subject to the supervision or regulation of a financial regulator.

(3) Prudential supervision. – The term "prudential supervision" means a form of supervision that –

(a) is designed to ensure compliance by a financial services firm with applicable laws, regulations, and other supervisory requirements;

(b) is based upon an open and on-going engagement between a financial regulator and a financial services firm;

(c) encourages a financial services firm to establish and maintain sound internal controls;

(d) promotes and acknowledges self-identification and self-correction of compliance problems by a financial services firm;

(e) recognizes and distinguishes among financial services firms based upon their risk profile; and

(f) includes transparent regulatory incentives designed to promote compliance with laws, regulations, and other supervisory requirements by financial services firms.

TITLE I – REGULATORY COORDINATION

Sec. 101. Establishment and Composition of Working Group.

(a) Establishment. – There is established the Working Group on Financial Markets.

(b) Composition. – The Working Group shall be composed of –

(1) the Secretary of the Treasury;

(2) the Chairman of the Board of Governors of the Federal Reserve System;

(3) the Chairman of the Securities and Exchange Commission;

(4) the Chairman of the Commodities Futures Trading Commission;

(5) the Comptroller of the Currency;

(6) the Director of the Office of Thrift Supervision;

(7) the Chairman of the Federal Deposit Insurance Corporation;

(8) the Chairman of the National Credit Union Administration;

(9) the Director of the Office of Federal Housing Enterprise Oversight;

(10) the Chairman of the Federal Housing Finance Board;

(11) the Chairman of the Federal Trade Commission;

(12) the Chairman of the Financial Institutions Regulatory Authority;

(13) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of depository institutions and other State licensed lenders;

(14) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of the business of insurance;

(15) an individual, appointed by the President, by and with the advice and consent of the Senate, who is knowledgeable in State regulation of securities activities; and

(16) the Chairman of the Public Company Accounting Oversight Board.

(c) Conditions Applicable to Appointed Members of the Working Group. –

(1) Term and Vacancy. – Appointed members shall be appointed for a term of five years. If an appointed member resigns from the Working Group prior to the expiration of the member's term, or is otherwise unable to continue to serve as a member of the Working Group for any reason, another appointed member shall be selected in the manner established under subsection (b) and paragraph (1) of this subsection. The member appointed to fill the vacancy shall be appointed only for the remainder of the term of the preceding member.

(2) Compensation. –

(A) In General. – Appointed members shall receive compensation at the rate prescribed by law under section 5314 of title 5, United States Code, for positions at level III of the Executive Schedule.

(B) Technical Amendment. – Section 5312 of title 5, United States Code, is amended by inserting "Appointed Members of the Working Group on Financial Markets" as a new item after "Administrator, Pipeline and Hazardous Materials Safety Administration.".

(3) Prohibition on Financial Interests. – An appointed member may not have a direct financial interest in any financial services firm.

Sec. 102. Chairman and Meetings.

(a) Chairman. – The Secretary of the Treasury shall be the Chairman of the Working Group.

(b) Meetings. –

(1) In General. – The Working Group shall meet upon notice by the Chairman, but in no event shall the Working Group meet less frequently than once every 3 months.

(2) Special Meetings. – The Chairman may call a special meeting of all or some of the members of the Working Group.

(3) Designees. – Each member of the Working Group (other than the appointed members) may designate a senior policymaking official within the agency or an authority who may represent such member at a meeting of the Working Group, as necessary and appropriate.

Sec. 103. Purpose, Consultation, and Information Sharing.

(a) Purpose. – The Working Group shall –

(1) serve as a forum to identify and consider issues related to the regulation and supervision of financial services firms, including the stability and integrity of financial markets, investor and consumer protection, the efficiency and effectiveness of cross border regulation and

supervision, the implementation of Titles II and III of this Act, and other matters of mutual concern consistent with the purposes of this Act;

(2) recommend coordinated actions for financial regulators and financial services firms, especially in times of market stress or financial crisis;

(3) issue interpretations of the Guiding Principles established in section 202 of this Act, and guidelines for compliance with such Principles; and

(4) develop model supervisory policies on the matters specified in section 303 of this Act.

(b) Consultation. – The Working Group shall consult, as appropriate, with state regulators, major market participants, the various exchanges, clearinghouses, self-regulatory bodies, trade associations and others, and shall seek private sector solutions to issues whenever possible.

(c) Information Sharing. – The members of the Working Group shall, to the extent permitted by law, share information as may be necessary to meet the purposes and functions of the Working Group.

Sec. 104. Annual Report, Congressional Oversight, and Administrative Support.

(a) Annual Report. – Each year, no later than 3 months after the submission of the regulatory action plans, as required by section 206 of this Act, the Chairman of the Working Group shall –

(1) submit an annual report to the President, Congress and the governors and legislatures of each State that –

(A) describes –

(i) how the Working Group acted as a forum for the identification and discussion of regulatory and supervisory matters, during the preceding year, and

(ii) what coordinated actions, if any, the Group recommended to its members or financial services firms during the preceding year;

(B) summarizes the findings of the regulatory action plans submitted to the Working Group pursuant to section 206 of this Act;

(C) makes recommendations for changes in law to eliminate inconsistencies between existing regulatory and supervisory activities and the Guiding Principles established in section 201 of this Act; and

(D) addresses such other matters as the Working Group deems appropriate; and

(2) cause such annual report to be published in the Federal Register.

(b) Congressional Oversight. – Each year, following the submission of the annual report required by subsection (a), the Secretary of the Treasury, as Chairman of the Working Group, shall appear before the Committee on Financial Services of the U.S. House of Representatives and the Committee on Banking, Housing and Urban Affairs of the U.S. Senate regarding –

(1) the activities of the Working Group during the preceding year;

(2) the implementation of Titles II and III of this Act;

(3) any recommendations for changes in Federal or State law that would allow existing regulatory and supervisory activities to be made consistent with the Guiding Principles established in section 201 of this Act; and

(4) such other matters as the Secretary deems appropriate.

(c) Administrative Support. – The Secretary of the Treasury shall provide the Working Group with such administrative support services as may be necessary for the performance of its functions.

Sec. 105. Authorization. – There is authorized such funds as necessary to enable the Secretary of the Treasury to perform the duties required by this Title.

TITLE II – PRINCIPLES-BASED REGULATION.

Sec. 201. Guiding Principles.

(a) Financial Regulators. – The regulations, interpretations, guidelines, advisories, and other supervisory actions of a financial regulator shall be consistent with the Guiding Principles established in subsection (b).

(b) Guiding Principles. –

(1) Fair Treatment for Consumers. – Consumers shall receive fair treatment through uniform standards that ensure–

(A) protection from unfair or deceptive acts and practices;

(B) clearly written disclosure of key terms and conditions;

(C) protection of non-public personal information;

(D) secure and efficient delivery of financial products and services;

(E) timely and fair resolution of disputes;

(F) relevant guidance regarding financial products and services; and

(G) competitive pricing.

(2) Stability and Security. – Financial regulation and supervision shall support the integrity, stability, and security of U.S. financial markets and financial services firms.

(3) Competitive and Innovative Financial Markets. – Financial regulation and supervision shall support open, competitive and innovative financial markets, organizational options for financial services firms, including a single national charter and single national regulator.

(4) Proportionate, Risk-Based Regulation. – Financial regulation and supervision shall be proportionate to the benefits and risks of the product or service offered. Proportionate financial regulation and supervision shall be risk-based, aimed primarily at the material risks applicable to financial services firms and consumers, and shall take into consideration the cost of such regulation and supervision to consumers, financial services firms, the economy, and U.S. competitiveness;

(5) Prudential Supervision and Enforcement. – The examination, supervision, and enforcement policies and procedures of a financial regulator shall be informed by an open and on-going engagement with the managers of financial services firms and shall seek to encourage all segments of the financial services industry to utilize the best practices to ensure the safety and soundness of financial services firms, consumer protection, and compliance with these Guiding Principles;

(6) Management Responsibilities. – The managers of a financial services firm shall adopt and implement policies and procedures that enable the firm to operate successfully and maintain the trust of consumers. Such policies and procedures shall require –

(A) the maintenance of adequate financial and managerial resources and skilled personnel;

(B) ethical conduct at all levels of the firm;

(C) effective risk management and controls;

(D) infrastructure that is adequate to ensure compliance with these Guiding Principles and other business requirements;

(E) complete and cooperative compliance with all applicable regulatory and supervisory mandates;

(F) respect for, and compliance with, the basic tenets of safety, soundness and financial stability; and

(G) appropriate conflict of interest management.

Sec. 202. Implementation of Guiding Principles.

(a) Five-Year Phase-in Period. – A financial regulator shall make its regulations, interpretations, guidelines, advisories and other supervisory actions consistent with the Guiding Principles as soon as practicable, but not later than five (5) years after the date of enactment of this Act.

(b) Interpretations and Compliance Guidance. – A financial services firm may seek interpretations of the Guiding Principles and compliance guidance from the Working Group for Financial Markets under the terms of section 103(a)(5) of this Act.

Sec. 203. Regulatory Action Plan.

(a) Process for Reviewing Regulations and Supervisory Activities. – A financial regulator shall establish a continuing process for assessing the consistency of its regulatory and supervisory activities with the Guiding Principles. Such process shall provide for –

(1) a continuous review of the consistency of its regulations, interpretations, guidelines, advisories, and other supervisory actions with the Guiding Principles;

(2) an opportunity for public comment on the consistency of such regulations, interpretations, guidelines, advisories, and other supervisory actions during the review described in paragraph (1); and

(3) the preparation of an annual regulatory action plan, as described in subsection (b).

(b) Annual Regulatory Action Plans. – Beginning one year after the date of enactment of this Act, and continuing annually thereafter, a financial regulator shall issue a regulatory action plan that –

(1)

(A) identifies the regulations, interpretations, guidelines, advisories and other supervisory actions reviewed by the regulator during the preceding year pursuant to the process required by subsection (a),

(B) summarizes any public comments received as part of that review, and

(C) explains whether or not such public comment should be adopted;

(2)

(A) describes how its regulations, interpretations, guidelines, advisories and supervisory actions are consistent or inconsistent with the Guiding Principles, and

(B) explains how the financial regulator plans to resolve any inconsistencies;

(3) makes, to the extent necessary, recommendations for changes in Federal or State law needed to allow the financial regulator to eliminate any inconsistencies between its regulations,

interpretations, guidelines, advisories and other supervisory actions and the Guiding Principles; and

(4) outlines a schedule for reviewing other regulations, interpretations, guidelines, advisories and other supervisory actions in order to comply with the five-year cycle required by subsection (a).

(c) Submission of Plans. – A financial regulator shall submit the regulatory action plan described in subsection (b) to –

(1) the Chairman of the Working Group on Financial Markets, who shall –

(A) provide a copy to all other members of the Working Group; and

(B) cause such plan to be published in the Federal Register; and

(2) the Speaker of the U.S. House of Representatives and the President Pro Tempore of the U.S. Senate, if the financial regulator is a Federal agency or authority; or

(3) the Governor and the leaders of the legislature of the State that created the financial regulator, if such regulator is a State agency or authority.

TITLE III – PRUDENTIAL SUPERVISION.

Sec. 301. Prudential Supervision.

(a) Required. – No later than three years following the date of enactment of this Act, each financial regulator shall apply prudential supervision in the exercise of its responsibilities with respect to financial services firms.

(b) Determination. – The Secretary of the Treasury shall determine if a financial regulator has complied with the requirement in subsection (a). The Secretary shall find that a financial regulator has complied with such requirement if the regulator has –

(1) adopted and implemented the policy statement specified in section 302 of this Act,

(2) taken the administrative actions specified in section 303 of this Act, and

(3) appointed the ombudsman required by section 304 of this Act.

Sec. 302. Policy Statement on Prudential Supervision.

(a) Policy Statement on Prudential Supervision Required. – Each financial regulator shall develop and publish a policy statement on prudential supervision.

(b) Contents of Policy Statement. – The policy statement required by subsection (a) shall address the following matters. –

(1) Internal Controls. – The policy statement shall encourage financial services firms to establish and implement internal risk control practices and procedures that are designed to detect and prevent violations of laws, regulations, and other supervisory requirements.

(2) Open and On-Going Engagement. – The policy statement shall encourage an open and on-going engagement with the financial services firms for which the regulator has regulatory or supervisory responsibility, and shall include transparent regulatory incentives for compliance with applicable law and regulations by financial services, as well as penalties for non-compliance, that are based upon the risk posed by, and performance of, a financial services firm.

(3) Self-Reporting. – The policy statement shall encourage financial services firms to self-report violations of applicable laws, regulations, or other supervisory requirements, and shall include appropriate incentives for a financial services firm to self-report an apparent violation of law, regulation, or other supervisory requirement.

(4) Self-Correction. – The policy statement shall encourage financial services firms to self-correct violations of applicable laws, regulations, or other supervisory requirements, and subject to such limitations as a regulator deems necessary to protect the safety and soundness of a financial services firm and the interests of consumers, the policy statement shall provide for the regulator to give a financial services firm a notice of the violation and an opportunity to take corrective action before the regulator decides to bring an enforcement action.

(5) Continuum of Actions. – The policy statement shall identify the range of enforcement actions the regulator may bring in response to a violation of law, regulation, or other supervisory requirement, and subject to such limitations as a regulator deems necessary to protect the safety and soundness of a financial services firm and the interests of consumers, the policy statement shall provide that a regulator shall impose enforcement actions in a continuum that begins with the least severe sanction or penalty and gradually escalates to the most severe sanction or penalty.

(6) Mitigating Factors. – The policy statement shall identify the factors the regulator will consider in determining whether to bring an enforcement action and in determining the type of action to be brought, including

(A) a firm's good faith effort to self-identify the violation;

(B) a firm's good faith effort to take self-corrective action;

(C) the gravity of the violation, including its impact on consumers;

(D) the firm's history of previous violations; and

(E) such other matters as justice may require.

(7) Fair Notice. – The policy statement shall ensure that a financial services firm has sufficient prior notice of any law, regulation, or other supervisory requirement upon which an enforcement action may be based, and shall address the publication of applicable laws, regulations and other supervisory requirements by the regulator, or other State and Federal agencies and authorities, as appropriate.

(8) Investigations. – The policy statement shall specify the regulator's practices and procedures related to investigations, and shall require the regulator to notify a financial services firm within 10 days of completing an investigation, and to review the status of all open investigations on a semi-annual basis and determine if such matter should remain open or be closed.

(c) Public Comment. – A financial regulator shall seek public comment in developing the policy statement required by this section.

Sec. 303. Administrative Matters.

(a) Communications Between Divisions. – A financial regulator shall establish practices and procedures that encourage the enforcement and non-enforcement personnel of such regulator to communicate and coordinate actions so that financial services firms regulated or supervised by the regulator are encouraged to self-report violations of applicable laws, regulations, and other supervisory requirements and to self-correct those violations.

(b) Training and Incentives. – A financial regulator shall establish –

(1) a training program for enforcement and non-enforcement personnel that explains and promotes the application of prudential supervision by such personnel; and

(2) incentive programs for all personnel to apply prudential supervision in the exercise of their duties.

(c) Publication of Supervisory Policies and Procedures. –

(1) Requirement. – A financial regulator shall make its examination manual and other supervisory policies and procedures available to the public.

(2) Internet Access. – If a financial regulator maintains a web site on the Internet, the materials described in paragraph (1) shall be posted on such web site.

Sec. 304. Ombudsman for Prudential Supervision.

(a) Ombudsman. – A financial regulator shall appoint an Ombudsman for prudential supervision who shall report directly to the head or board of such regulator, as the case may be.

(b) Duties of Ombudsman. – The Ombudsman appointed under subsection (a) shall –

(1) ensure that the financial regulator has adopted practices and procedures that encourage financial firms supervised or regulated by such regulator to present compliance questions to the regulator and to self-identify and self-correct violations of laws, regulations or other supervisory requirements;

(2) advise and guide firms through the process of self-reporting violations of applicable laws, regulations or other supervisory requirements;

(3) act as a liaison between the financial regulator and a firm with respect to any problem the firm may have in dealing with the agency;

(4) ensure that financial services firms that engage in the self-reporting of violations of laws, regulations and other supervisory requirements are given due credit by non-enforcement and enforcement personnel;

(5) ensure that the regulator has adopted practices and procedures to train enforcement and non-enforcement personnel to apply prudential supervision in the exercise of their duties, and to provide incentives for doing so;

(6) ensure that the regulator has established practices and procedures that promote communications between the enforcement and non-enforcement personnel of the agency; and

(7) maintain the privilege of confidential communications between a financial services firm and the Ombudsman, unless such privilege is waived by the firm.

(c) Limitation. – In carrying out the duties under subsection (b), the Ombudsman shall utilize personnel of the financial regulator to the extent practicable, and nothing in this section is intended to replace, alter or diminish the activities of any other ombudsman or similar office that otherwise exists within a financial regulator.

(d) Report. – Each year, the Ombudsman for a financial regulator shall submit a report for inclusion in the annual report of such regulator. Such report shall –

(1) describe the activities of the Ombudsman during the preceding year; and

(2) include solicited comments and evaluations from financial services firms with respect to the effectiveness of the Ombudsman's activities.

Testimony of John Courson

President and Chief Executive Officer

Mortgage Bankers Association

Before the

Committee on Financial Services

United States House of Representatives

Hearing on

Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

July 15, 2009

Good Morning Chairman Frank, Ranking Member Bachus and members of the committee.

I am John Courson, President and Chief Executive Officer of the Mortgage Bankers Association.[1] I greatly appreciate the opportunity to testify before you today on proposals to reform regulation of the financial services industry including establishing a separate Consumer Financial Protection Agency (CFPA).

MBA shares your commitment to developing more effective protections for consumers and providing needed reforms to the housing finance system. Just as you have worked toward this objective, MBA has dedicated its own resources to developing what we regard as ground-breaking proposals for reform of our industry. As I will explain in my testimony, our proposals would establish new, rigorous national lending standards and new federal regulation of nondepository mortgage bankers and mortgage brokers that would fit well within an improved regulatory structure.

While we believe the introduction of the administration's proposals and H.R. 3126, the Consumer Financial Protection Agency Act of 2009, are important steps on the path to regulatory reform, we also believe that before this Committee takes action, much more work needs to be done. Changes to the financial regulatory structure can be expected to have profound effects on the availability and affordability of mortgage financing and other financial products and services for years to come. These proposals must not be rushed through. They must be judiciously considered so reform is done right.

Because the administration's proposals and H.R. 3126 were only recently introduced, we are now in the process of consulting with our members about the details of this legislation, and in the weeks ahead, MBA will have further comments. We very much look forward to working with this committee and the entire Congress to further develop these important reform initiatives.

An Unparalleled Time for Regulatory Reform and Improved Consumer Protection

As MBA has stated before, the nation faces a once-in-a-generation opportunity to improve the mortgage lending process. The dual federal-state regulatory framework has shown that it must be better designed to provide effective oversight of all aspects of the financial services industry to better serve consumers. The scope and powers of

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

financial services regulators have not kept pace with advances in the type, sophistication and delivery mechanisms of the financial products, services and providers they are tasked with regulating. This has resulted in broad supervisory gaps in some areas of the industry and costly redundancies in others.

We believe carefully crafted regulatory improvements would help restore investor and consumer confidence in the nation's lending and financial markets and assure the availability and affordability of sustainable mortgage credit for years to come. At the same time, if regulatory solutions are not well-conceived, they risk exacerbating a credit crisis that trillions of public dollars have still not fully resolved. In this regard, we must emphasize that consumer protection regulation must be carefully constructed to have its intended effects and best serve all consumers – those who have benefitted greatly from the mortgage market as well as those who have been confused or even harmed.

In our view, the Mortgage Improvement and Regulation Act (MIRA), attached to this statement (Attachment 1), which MBA developed and to which I alluded, is the right combination of improvements to serve consumers. It would establish rigorous, uniform standards to assure greater transparency regularize prudent lending practices and prohibit those that are harmful or even predatory. It would close existing regulatory gaps by requiring national regulation of nondepository lenders and mortgage brokers. And it would empower both federal and state officials to assure that the standards are comprehensive, up-to-date and vigorously enforced everywhere.

Proposals for Regulatory Reform

The administration's financial regulatory reform package is a thoughtful and comprehensive package of proposals. Of particular significance to MBA and its members are (1) establishment of a Financial Oversight Council; (2), empowering the Federal Reserve as a systemic regulator; (3), establishment of a new national bank supervisor to supervise all federally chartered institutions; (4) elimination of the federal thrift charter; (5) enhanced regulation of the securitization markets; (5) consultations within government on the future of Fannie Mae and Freddie Mac with a deadline of early next year for a position; and (6) finally, establishment of the CFPA.[2] However applying our principles for reform, particularly to the CFPA proposals, they raise several concerns which I will outline in my testimony. Nonetheless, so that this opportunity for reform is not missed, we have suggestions for further work to address these concerns.

Consumer Financial Protection Agency (CFPA)

The proposed CFPA would be charged with regulating an extraordinarily broad array of "financial activities" that would include "extending credit and servicing loans, deposit-taking activities, check guaranty services, collecting, analyzing, maintaining and providing consumer report information, consumer debt collection, providing real estate settlement services, leasing personal or real property, acting as a financial adviser,

[2] See as examples, S. 566 and H.R. 1705, both entitled Financial Product Safety Commission Act of 2009.

acting as an investment advisor, financial data processing, sale or issuance of stored value, acting as a money services business, acting as a custodian of money, and any other activity that the agency defines as a financial activity."

CFPA would be just as broadly empowered to:

- Ensure the appropriate and effective disclosure or communication to consumers of the costs;
- Restrict unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service;
- Prescribe rules and issue orders regarding the manner, settings and circumstances for the provision of any consumer products or financial services;
- Establish new duties of care for covered persons;
- Define standard or "plain vanilla" products and require offering them along with or prior to alternative products;
- Establish duties regarding compensation practices including yield spread premiums (YSPs);
- Ban mandatory arbitration;
- Establish operating requirements like bonding, recordkeeping, and the like;
- Enforce the law through orders and penalties; and
- Perform a variety of other functions including research.

Under H.R. 3126, CFPA also would be reassigned all of the consumer financial protection functions of the Board of Governors of the Federal Reserve (Board), the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the Federal Trade Commission (FTC). These regulators would have secondary, or back-up, enforcement authority.

A top concern for MBA is that CFPA's rules would serve as a "floor," not a "ceiling" for future state legislation. States would be encouraged to enact additional laws and rules – exacerbating the patchwork of laws that provide uneven protection and increased costs to consumers.

MBA's Mortgage Improvement and Regulation Act (MIRA)

To improve lending nationwide, MBA's MIRA proposal would establish uniform national mortgage standards that include a comprehensive set of substantive requirements and consumer protections. These uniform national standards would apply to all mortgage lenders and mortgage lending institutions, regardless of their size, charter type, or which regulator has responsibility for them.

In arriving at these standards, MIRA builds on the Federal Reserve Board's new rules under the Home Ownership and Equity Protection Act (HOEPA). These rules include greater protections for subprime borrowers, with new requirements for ability to repay determinations, documentation, escrows and prepayment penalties. The standards

also include requirements for all mortgage loans to stem appraiser coercion, servicing and advertising abuses.

Additionally, MIRA includes other standards that were developed by this committee as part of H.R. 3915, the Mortgage Reform and Anti-Predatory Lending Act of 2007, which was approved by the House of Representatives and not acted on by the Senate. It also includes new transparency provisions to conform Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA) disclosures (which the proposals on the table now embrace) and MBA's own initiatives, such as proposals for a duty of care for loan originators – all with an eye to assuring consumer protection and returning liquidity to the market.

MIRA's changes to the regulatory structure would include establishment of a new federal regulatory agency that could be nested within an existing regulator to implement the new lending standards and, for the first time, regulate independent nondepository mortgage bankers and mortgage brokers at the federal level. The new agency would also be charged with operation of the nation's mortgage counseling and financial literacy programs, resulting in greater focus on these important efforts. The proposal even requires that lenders and brokers pay the costs of their own regulation.
In contrast to the administration's proposals and H.R. 3126, MIRA's new standards would be truly uniform and preemptive of state lending laws. However, they also would be dynamic. To achieve this, MIRA would establish a council of state and federal regulators to revisit and update the standards regularly and to address any new abuses and concerns. Federal banking agencies would enforce the uniform standards against national banks. At the same time, state and federal regulators would be required to work together in reviewing and examining mortgage bankers and brokers and enforcing the new standards.

Overall, the proposal is both comprehensive and workable and would be complementary to other improvements to achieve comprehensive regulatory reform.

MBA's Principles for Consideration of Regulatory Reform

In order to evaluate proposed changes to the regulation of financial service companies, MBA has established the following principles to consider such proposals:

1. **All sectors of financial services industry regulation should be addressed comprehensively.** There are several components to this principle.

    a. Financial services regulators should be designed to work well together.
    b. Federal regulators should have appropriate oversight over all financial-related products, services and entities.
    c. Congress should establish and assign to federal agencies the development of uniform standards.
    d. Federal banking agencies should enforce uniform standards against national banks, and federal regulators should work in cooperation with

state agencies to enforce uniform standards for residential mortgage bankers and mortgage brokers.

e. Protocols should be established among agencies regarding the regulation of hybrid products, services or entities that may emerge in the future.

2. **Regulatory changes should not focus on form over substance.** One of the goals of regulatory reform should be to enhance the level of regulatory efficiency in order to create a strong, yet responsive, regulatory regime and minimize the burden of regulatory compliance. Care should be taken to avoid creating further stratifications in oversight and enforcement.

3. **Uniformity in oversight and interpretation of standards should be promoted**. When considering changes to the regulatory framework, preference should be given to a regime that truly promotes uniform, national standards that are ultimately interpreted by a single federal regulator to provide consistency in borrower protections and prevent regulatory arbitrage.

4. **Require regulatory collaboration and transparency.** With some exceptions, regulators should be required to operate collaboratively, and adopt measures to seek industry and other interested party input prior to issuing regulatory mandates.

5. **Balance the need for the appropriate borrower protections with opportunities to innovate.** Regulators should have the authority to establish robust measures to prevent providers of products and services from presenting undue risk to the financial markets and borrowers by ensuring greater transparency. The financial services regulatory framework should continue to permit innovations and advancements that capitalize on emerging developments or make improvements to existing products, services and delivery mechanisms while assuring sustainable mortgage credit.

6. **Give due attention to ensuring the continued availability and affordability of sustainable mortgage options**. Homeownership remains central to the American dream and the residential and commercial real estate finance sectors are key drivers of the nation's economy. While all aspects of financial market regulation deserve scrutiny to ensure efficient and effective regulation, particular care must be given to improve mortgage regulation to assure the continued availability and affordability of sustainable mortgage credit for borrowers.

Consideration of a Separate Consumer Protection Regulator Under These Principles

In light of the above principles, MBA has the following initial concerns about the establishment of a separate consumer protection regulator:

- **Establishment of the CFPA should occur in the context of a comprehensive effort to improve regulation, considering new and existing protections, and should be designed to work well within the regulatory scheme.** We are concerned about how effectively a new consumer protection regulator will operate with the prudential regulators. In order to ensure that the CFPA will work well with prudential regulators, regulatory changes and the issues involved in successful implementation should be considered comprehensively.

- **Establishment of a separate consumer protection regulator may paradoxically marginalize consumer protection concerns and remove them from the mainstream of other regulators' focus.** Separate bureaucracies in government, each assigned a narrow portion of regulatory responsibility, may result in less effective regulation. The split of programmatic and financial regulatory responsibilities for Fannie Mae and Freddie Mac, between the Department of Housing and Urban Development (HUD) and the Office of Federal Housing Enterprise Oversight (OFHEO), is a troubling example from the recent past. Consumers need smarter and more effective regulation of all aspects of the market and there is concern whether a separate new regulator will achieve that objective.

- **Establishment of a regulator along the lines proposed would worsen the patchwork of federal and state laws resulting in uneven protection and increased costs for consumers.** Not only does H.R. 3126 establish the rules of the CFPA as a "floor," the bill actually invites state regulators to promulgate additional rules, thus worsening the patchwork of laws and increasing disparities in regulation and costs to consumers. To illustrate this concern, with this testimony, MBA is submitting a map showing the patchwork of state anti-predatory lending laws that exist today (Attachment 2).[3] Costs to consumers increase exponentially as the patchwork increases and will also increase significantly from assessments to fund the CFPA, on top of the assessments for prudential regulators at the federal and state levels.

- **While the bill suggests that HUD and the Federal Reserve should work together to achieve a single combined RESPA/TILA disclosure, or have it become the responsibility of CFPA, the bill does not require such collaboration.** The result is that consumers will not be given the improved disclosure they deserve. In the meantime, HUD and the Board will proceed with piecemeal reform – despite the direction from the House embodied in H.R. 1728 that they work together – at considerable cost to consumers and the industry.

[3] Some states have highest cost loan laws that track federal law, some have their own highest cost loan laws, some have both their own highest cost and higher-cost laws and some do not have highest cost or higher-cost loans at all.

- **The borrower protections offered in H.R. 3126 could stem innovation.** The product restrictions mandated in H.R. 3126, although introduced with the goal of protecting consumers, would have the unintended consequence of effectively halting most innovation. By requiring the regulator to identify particular products as "plain vanilla" and further requiring that such products must be offered first, industry participants would face significant expense, as well as legal and regulatory compliance risks if they were to introduce any product innovations or improvements. The impact would be to limit the available product menu, which would undoubtedly reduce the ability of some borrowers to qualify for a loan. Clearly, not all mortgage product innovations have been successful, either for homeowners or lenders. However, there has been much useful innovation in the industry. It is worth remembering that the 30-year, fixed-rate, self-amortizing mortgage was a radical, nontraditional product when it was first introduced. Yet this product has since become the "plain vanilla" choice that has helped countless families realize the dream of sustainable homeownership.

- **The CFPA could fail to give due attention to mortgage products and unnecessarily delay or deprive borrowers of the availability of needed and sustainable mortgage credit options.** Homes are typically the single largest asset for most families and mortgages are typically their largest single liability. As such, mortgages deserve and require special regulatory consideration. Because the new regulator would not be solely focused on mortgage regulation and products, there is a very real danger that mortgage products may not receive sufficient priority and may be tied up in lengthy review, delaying and even depriving borrowers of sound credit options and innovations.

- **Separating consumer protection regulation from prudential financial supervision may fail to achieve an appropriate balance of the competing considerations of prudential financial supervision and consumer protection.** Financial regulators have a critical role, balancing different objectives such as supporting and maintaining the integrity of competitive markets, guarding against systemic risk, and protecting depositors, borrowers, and investors. While there are certainly instances where appropriate regulation meets all of these objectives, there are times when these objectives are clearly in conflict. We believe that a wise regulator, armed with appropriate statutory guidance, and seeking input from all interested parties, can achieve a balance among competing objectives. A regulator singularly focused on any one of these objectives risks being myopic to these other important concerns.

While MBA strongly supports regulatory reforms to improve consumer protection, in light of these concerns, we believe other avenues for improving consumer protection deserve consideration.

A mix of some of the administration's proposals and MBA's MIRA proposal may be just such a road. Rather than dispersing regulatory authority, MBA's proposal seeks to close existing regulatory gaps by centralizing responsibility for the establishment of

mortgage lending standards while assigning regulation of nondepository mortgage lenders and mortgage brokers to a new or existing regulator.

Empowering and assuring far greater attention to consumer protection by a federal prudential regulator, which would be responsible for all mortgage originators and which would implement uniform, national standards could prove to be a significant improvement on the current proposals. But such a standard must improve protection while truly ending the patchwork of inconsistent laws which unnecessarily add costs and confusion to the process. Such a paradigm would empower consumers and the regulators who protect them.

The new regulator would work in partnership with state officials to update and enforce the standards, protecting consumers in every state from abuse. The underlying law also would assure funding from regulated entities so both federal and state regulators would have the resources they need to carry out their important work. At the same time, restrictions must not stem innovation but must work to foster it in the context of financial safety and soundness and consumer protection. Just like the 30-year mortgage or the 7-year adjustable rate mortgage (ARM), the next innovation must be allowed to germinate and grow to serve America's home finance needs.

In sum, we are grateful for the administration and the Congress's important steps in this area. We look forward to working hard together in the months ahead to improve these proposals to provide consumers the protections they deserve and ensure the vitality of the nation's mortgage financing system for years to come.

Again, I appreciate the opportunity to testify and welcome your questions.

Attachments

Attachment 1 – MBA's Mortgage Improvement and Regulation Act

Attachment 2 – MBA's Map of the Patchwork of State Laws

Outline of Draft Proposed Legislation
"Mortgage Improvement and Regulation Act of 2009 (MIRA)"
As of March 19, 2009

Executive Summary

Overview: This legislation, entitled the "Mortgage Improvement and Regulation Act of 2009," or "MIRA" would establish a tough new, federal regulatory scheme for mortgage lending. Specifically, it would establish new uniform national standards and a new national regulator, assisted by state officials, to replace the current patchwork of state and federal mortgage lending laws. The key sections of MIRA are as follows:

I. **Purposes** – Describes MIRA's purposes as: establishing a new, comprehensive framework for national regulation of mortgage lending to protect borrowers nationwide; to ensure consistent regulation of independent mortgage bankers and mortgage brokers; to invigorate a fairer and more competitive primary mortgage market and increase transparency; to facilitate greater secondary market investment; and to otherwise foster a return to stability of the nation's financial system.

   MIRA achieves these purposes by: establishing a new federal regulator responsible for mortgage lending standards; requiring the regulator to implement rigorous uniform national mortgage lending standards enacted under MIRA, as well as servicing standards, that are to be supplemented as necessary by the Director in consultation with state and federal regulators; assigning the regulator responsibility for regulating independent mortgage bankers and mortgage brokers including establishing uniform licensing and registration standards with increased net worth and bonding requirements; assigning disclosure, counseling and financial literacy responsibilities to the new regulator; and preempting state and local lending laws, as necessary;

II. **Definitions** – Defines all necessary terms including the standards (or "triggers") for higher priced or subprime loans which are subject to special requirements under the Act;

III. **New Regulator** – Establishes a new Federal Mortgage Regulatory Agency (FMRA), within the Treasury Department, headed by a Director of Federal Mortgage Regulation (Director) to be responsible for regulating mortgage lending

including implementing and establishing Uniform National Mortgage Standards (UNMS) by regulation; regulating independent mortgage bankers and mortgage brokers in partnership with state financial regulators who also shall review for compliance with and examine and enforce the UNMS for such entities; consulting with federal and state financial regulators which shall examine, review and enforce the UNMS for federal and state depository institutions which they regulate respectively and operating national financial literacy, counseling and consumer information programs;

IV. **New Advisory Council** – Establishes a Council of State and Federal Regulators (CSFR) to consult at least quarterly with the Director and report to Congress annually on needed additions to UNMS to address abuses; to consult with the Director on regulations before they are publicly proposed; to advise on the regulation of independent mortgage bankers and brokers, including licensing standards and registration; and to consult on the development and operation of national financial literacy, counseling and consumer information;

V. **New Oversight Board** – Establishes a Mortgage Lending Oversight Board, comprised of the Secretaries of Treasury and Housing and Urban Development (HUD) and the Chairman of the Federal Reserve Board, to oversee operations of FMRA;

VI. **Uniform National Standards** – Establishes Uniform National Mortgage Standards (UNMS) which include substantive requirements and consumer protections. UNMS include all of the restrictions that the Federal Reserve recently promulgated by regulation under the Home Ownership and Equity Protection Act (HOEPA) for higher priced (nonprime) loans and for all closed-end loans and restrictions against unfair mortgage advertising. These include requirements that lenders determine a borrower's ability to repay, require documentation verifying income and/or assets, limit prepayment penalties, and establish escrow accounts for taxes and insurance. UNMS also includes key prohibitions from H.R. 3915 (passed by the House of Representatives in November 2007) including, but not limited to, additional provisions to improve mortgage servicing and the appraisal process to protect consumers as well as provisions developed by the Mortgage Bankers Association. For example, a revised duty of care would require that all loan originators including loan officers for mortgage lenders (lender loan officers) and loan officers for mortgage brokers (mortgage broker loan officers): (1) comply with all licensing and registration requirements; (2) present the consumer with a choice of loan products for which the consumer likely qualifies which is available from that lender, and which may be appropriate to the consumer's existing circumstances, based on information obtained by the originator; and (3) make full and timely disclosures to each consumer of (a) comparative costs and benefits of each loan product offered or discussed and (b) whether the originator is or is not acting as an agent for the consumer. The duty of care would also require that (4) the mortgage broker loan officer provide the borrower a disclosure of the mortgage broker's total

compensation including any amounts that the broker may receive from the lender based on a higher rate or the terms of the loan; and (*5*) a consumer must affirmatively, opt-in, in writing *prior to closing*, to a nontraditional mortgage product[1] after the lender's loan officer or mortgage broker discloses the costs and benefits of the loan to the borrower, also in writing;

VII. **Additions to Standards** – Requires the Director to meet at least quarterly in consultation with CSFR to supplement the UNMS as necessary, to promulgate such changes by regulation and to report to Congress annually on the need for additional changes and their disposition;

VIII. **Regulatory Responsibilities** – Requires the Director to implement the UNMS to regulate mortgage lending activities nationally; to supplement the UNMS as necessary in conjunction with the CSFR; to regulate activities of non-depository mortgage bankers and mortgage brokers including establishing uniform licensing and registry requirements for such entities in conjunction with the CSFR (including net worth and bonding requirements) with licensing and registration requirements to be applied by state officials; to work in partnership with state regulators to examine, review and enforce the UNMS for non-depository mortgage bankers and brokers; and to consult with federal and state financial regulators which shall examine, review and enforce the UNMS for federal and state depository institutions which they regulate respectively;

IX. **Penalties/Remedies** – Clarifies existing penalties for noncompliance such as the right of rescission, and also establishes alternative remedies for borrowers and a right to cure for lenders;

X. **Enforcement/Examination Authorities** – Authorizes the Director, federal agencies and state agencies to review, examine and enforce the UNMS concerning all mortgage lending operations and also confers rights on private parties to enforce provisions of MIRA;

XI. **Financial Literacy and Counseling** – Assigns the Director responsibility of operating a national financial literacy and counseling program including requiring mandatory counseling for reverse mortgages, HOEPA highest cost mortgages and interest-only mortgages for first-time homebuyers under certain conditions including the availability of sufficient counseling resources to avoid denying or unreasonably delaying the availability of mortgage credit;

XII. **Mortgage Fraud** – Provides increased resources for investigating and prosecuting mortgage fraud;

---

[1] A nontraditional mortgage product is a mortgage product that allows a borrower to defer principal or interest, such as a payment option ARM or an interest-only loan.

XIII. **Initial Funding** – Authorizes start-up funds for establishment of the FMRA and its first two years of operations including the costs of consumer testing, financial literacy, counseling and anti-fraud activities;

XIV. **Resources for Regulation Going Forward/Sharing Funds With States** – Beyond the start-up period, authorizes FMRA to charge a reasonable assessment of each entity regulated by the FMRA to defray the costs of regulation. States would receive licensure and registry fees and would share in assessments on regulated entities for examination and enforcement to extent appropriate to avoid duplicate charges on regulated entities;

XV. **Improving Transparency** – Requires HUD and the Federal Reserve to work in consultation with FMRA to develop simplified, uniform and national disclosure forms and consumer information. This would include combined and coordinated RESPA and TILA Good Faith Estimate (GFE) disclosures, HUD-1 and final TILA disclosures as well as accompanying consumer information. Also, MIRA requires these agencies to develop forms to facilitate borrower understanding of the mortgage process and lender, broker and their loan officers' duty of care for consumers: (1) to provide information regarding their circumstances, including the consumer's risk appetite, to assist the loan officer or mortgage broker in deciding which loan products should be presented to the consumer; (2) to affirmatively opt-in to a nontraditional mortgage product following a disclosure explaining the option, including the risks and benefits of an adjustable loan; and (3) to disclose the amount of a mortgage broker's compensation;

XVI. **Preemption** – Amends federal and state laws as necessary including preempting contrary state laws.

More Detailed Outline of MBA's MIRA Proposal

Specifically, MIRA:

I. **Purposes -** Describes its purposes as: establishing a new, comprehensive framework for national regulation of mortgage lending to protect borrowers nationwide; to ensure consistent regulation of independent mortgage bankers and mortgage brokers; to invigorate a fairer and more competitive primary mortgage market and increase transparency; to facilitate greater secondary market investment and to otherwise foster a return to stability of the nation's financial system. The short-term responses to the mortgage crisis have been national in scope and so too should be the long-term solutions.

The Act indicates that it seeks to achieve this purpose by:

A. Establishing a new federal regulator responsible for mortgage lending standards;

B. Requiring the regulator to implement rigorous uniform national mortgage lending standards enacted under MIRA, including substantive requirements for originations, servicing standards and means of making the market much more transparent, that are to be supplemented by the federal regulator in consultation with state and federal regulators, as necessary, with greater requirements applicable to subprime lending;

C. Assigning state and federal regulators concurrent responsibility for reviewing, examining and enforcing the uniform national standards while conferring new, more effective enforcement means;

D. Assigning the new regulator responsibility for regulating, and establishing uniform licensing and registration standards, with increased net worth and bonding requirements, for independent mortgage bankers and mortgage brokers;

E. Assigning disclosure, counseling and financial literacy responsibilities to the new regulator; and

F. Preempting state and local lending laws as necessary.

II. **Definitions -** Defines all necessary terms including:

A. "Council of State and Federal Regulators (CSFR)" means an advisory body of mortgage regulators representing each of the 50 states, the District of Columbia and United States territories as well as

representatives of the Federal Reserve, Comptroller of Currency, Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the National Credit Union Administration and the Federal Trade Commission;

B. "Federal Mortgage Regulatory Agency (FMRA)" means an independent office within the U.S. Treasury Department established under this Act;

C. "Federal Mortgage Regulatory Agency Oversight Board" or "Oversight Board" shall be composed of the Secretary of Treasury, Chairman of the Federal Reserve Board and the Secretary of HUD;

D. "Higher Priced Loans" for first lien residential mortgage loans are 1.5 percentage points above the average prime offer rate issued by Freddie Mac, and for second-lien loans are 3.5 percentage points over the same index. The Director may adjust these limits as necessary through rulemaking to more precisely define higher cost or subprime loans;

E. HOEPA Covered Loans are Highest Cost or Section 32 residential mortgage loans that meet the following tests:

1. For a first-lien loan, the annual percentage rate (APR) exceeds by more than eight percentage points the rates on Treasury securities of comparable maturity;
2. For a second-lien loan, the APR exceeds by more than 10 percentage points the rates on Treasury securities of comparable maturity; or
3. The total fees and points payable by the consumer at or before closing exceed the larger of $561 or eight percent of the total loan amount. (The $561 figure is for 2008. This amount is adjusted annually by the Federal Reserve Board, based on changes in the Consumer Price Index.) Credit insurance premiums for insurance written in connection with the credit transaction are counted as fees.

F. "Nontraditional mortgages" are residential mortgage loans that allow borrowers to defer principal or interest;

G. "Qualified mortgages" are residential mortgage loans that have APRs that are do not exceed the Federal Reserve higher cost triggers;

H. "Regulated entity" – Non-depository residential mortgage lenders and residential mortgage brokers;

I. "Residential mortgage loans" are any extensions of credit to purchase, finance construction, or refinance secured by a 1-4 unit dwelling;

J. "Uniform National Mortgage Standards (UNMS)" includes standards promulgated under this Act and amended by the FMRA in consultation with the CSFR.

III. **New Regulator -** Establishes a Federal Mortgage Regulatory Agency (FMRA) as an independent office within the federal government or within an agency of government:

A. Headed by a Director, confirmed by the Senate, for a five-year term responsible for implementing and establishing UNMS, regulating independent mortgage bankers and brokers and operating national financial literacy programs and establishing national mortgage transparency and disclosure requirements in consultation with the Council of State and Federal Regulators (CSFR);

B. Assigns powers to the FMRA and the Director on par with the general powers of the Federal Housing Finance Agency (FHFA) and its Director including, but not limited to, the power to appoint employees and examiners, to contract and to remain outside the appropriations process;

C. Also assigns sufficient powers to the FMRA and the Director to assure consumer protection and prudential operations by mortgage bankers and mortgage brokers to provide financing needs to consumers. Such regulation should be principles-based to the greatest extent feasible to assure market innovation and lower borrower costs while assuring much better consumer protection;

D. Stipulates that FMRA should have deputy directors, including:

1. Deputy Director for Mortgage Standards
2. Deputy Director for Regulation
3. Deputy Director for Financial Literacy and Information.

IV. **New Advisory Council -** Establish a Council of State and Federal Regulators (CSFR) that shall include representatives of all members of the Federal Financial Institutions Examination Council (FFIEC), and representatives of the District of Columbia and all 50 state's financial regulators. The CSFR shall:

1. Advise the FMRA on an ongoing basis of abuses occurring which are not addressed by the UNMS;
2. Make recommendations for additions to the UNMS;

3. Provide advice and guidance on regulating regulated entities, operation of the financial literacy counseling program and other matters at the request of the Director;
4. Be headed by an executive committee of nine members which shall be elected by the members and meet monthly with the Director, in person or by phone;
5. Meet quarterly with at least one annual in-person meeting; and
6. Report to the Congress annually on recommendations by the CSFR and their disposition.

V. **Oversight Board -** Establishes a Mortgage Lending Oversight Board.

The Oversight Board shall:

1. Meet regularly and oversee the operations of the FMRA;
2. Provide any necessary advice to the FMRA; and
3. Establish a strategic plan for the FMRA to carry out its mission.

VI. **Uniform Mortgage Standards -** Establish Uniform National Mortgage Standards (UNMS) that include standards for nontraditional and subprime loans and standards for all loans that include:

A. *Note - This section includes Federal Reserve HOEPA restrictions largely verbatim.* Enacting into legislation the requirements for higher cost or subprime loans (called "not qualified mortgages" pursuant to H.R. 3915) promulgated by the Federal Reserve in regulations under the Home Ownership and Equity Protection Act (HOEPA) that shall also apply to nontraditional loans and become effective October 1, 2009 that:

1. Prohibition Against Failing to Consider Borrower's Ability to Repay - Prohibit creditors from extending a higher-priced mortgage or a HOEPA-covered loan without considering borrowers' ability to repay the loan based on the consumer's income or assets. Establishes a presumption of compliance with requirement where a creditor satisfies three requirements: (1) verifies and documents repayment ability of borrower; (2) determines repayment ability using the fully indexed rate and fully amortizing payment, except in certain circumstances, and considering other mortgage-related obligations such as property taxes and homeowners insurance; and (3) assesses the consumer's repayment ability using either ratio of the consumer's total debt obligation to income (DTI) or income the consumer will have after paying debt obligations. Does not

prescribe particular thresholds for the DTI or the residual income ratio.

2. Prohibition Against Failing to Verify Income - Prohibits creditor from relying on amounts of income (except for expected income) or assets to assess repayment ability for higher-priced loan or HOEPA-covered loan secured by consumer's principal dwelling unless the creditor verifies the amounts. Authorizes creditor to rely on W-2 forms, tax returns, payroll receipts, financial records or any other document providing reasonably reliable evidence of income, except a statement only from the consumer.

3. Prohibition Against Certain Prepayment Penalties - Prohibits prepayment penalties for any higher-priced loan or HOEPA-covered loan where payments can change during the four-year period following loan consummation. For other higher-priced loans, where payments do not change for four years, prohibits prepayment penalties exceeding two years from loan consummation or applicable to refinancing by creditor or its affiliate.

4. Requirement for Escrow Accounts - Requires creditors to establish escrow account for property taxes and homeowners insurance for at least one year. Servicer maintains the authority to continue or discontinue escrowing after required time. MIRA also provides FMRA authority to eliminate the requirement on servicer in case of emergency, such as loss of credit lines to advance taxes and insurance (T&I) payments.

B. Enacting into legislation the requirements for <u>all</u> closed-end loans promulgated in regulation by the Federal Reserve under HOEPA, with additions from H.R. 3915, as well as the mortgage broker contract provisions that were proposed by the Federal Reserve Board but not finalized, as follows:

    1. Appraisals – In order to regularize and protect against misconduct in the appraisal process, MIRA shall contain the following:

        a. Prohibition Against Coercing or Otherwise Pressuring Appraisers – Prohibits creditors, mortgage brokers, real estate brokers, or anyone else interested in the transaction and their agents and affiliates from coercing, extorting, colluding, inducing, bribing, intimidating, pressuring, or otherwise encouraging an appraiser to misstate or misrepresent a dwelling's value, for all closed-end residential loans. MIRA also prohibits a

creditor from extending credit if the creditor knew of a violation, e.g., that an appraiser has been encouraged by creditor, mortgage broker or affiliate of either (including any of their employees) to misstate or misrepresent the principal dwelling's value, unless the creditor acts with reasonable diligence to determine that the appraisal was accurate or extends credit based on a separate appraisal untainted by coercion.

b. Prohibition Against Appraiser Misconduct – No appraiser conducting an appraisal may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal.

c. Require FMRA to prescribe regulations and guidelines to:

    i. Implement the foregoing prohibitions in "a." and "b." above, including detailing conduct which is permissible and impermissible under each section, combining the guidance in the Board's final HOEPA rule and H.R. 3915;

    ii. Prohibit other practices which are unfair or deceptive in the appraisal process, including establishing reasonable safeguards against flipping and to otherwise ensure adequate and independent appraisals; and

    iii. Permit mortgage lenders to establish procedures including appropriate organizational structures to allow them to order appraisals or to engage the services of in-house appraisal staff for the purpose of attaining an independent and accurate appraisal, provided adequate safeguards, to be set by the Appraisal Standards Board to ensure that the ordering and operations of the lender are consistent with and do not violate the prohibitions of this section.

d. Establish penalties for violations of appraisal requirements.

e. Establish an Appraisal Oversight Board of federal and state regulatory officials to monitor appraisal practices and abuses and advise FMRA on the development of rules and guidance.

2. Assigns the Government Accountability Office (GAO) responsibility to study the appraisal process and standards for appraisers in each of the states and the District of Columbia, to recommend whether uniform national standards and a national mortgage fraud database are warranted for appraisers similar to the standards for loan originators, and to report to the Congress and FMRA on this subject and other improvements to the appraisal process within one year.

3. Prohibitions Against Certain Servicing Practices – Prohibits certain practices by servicers of closed-end consumer credit transactions secured by consumer's principal dwelling, including: (i) failing to credit a consumer's full periodic payment as of the date received, but creditors are not required to credit partial payments, and whether a payment is a full or partial payment is governed by the loan agreement or promissory note; (ii) imposing a late fee or delinquency charge where the only basis is consumer's failure to include in a current payment delinquency charge imposed on earlier payments; and (iii) failing to provide an accurate payoff statement within reasonable time after request.

   In addition, MIRA includes several provisions to facilitate servicing which are to be implemented by FMRA, including:

   a. Amend RESPA to allow FMRA to establish standards for forced placed hazard and flood insurance including proper notice and refunds when duplicative insurance is in place; and

   b. Amend RESPA to decrease the time to respond to valid qualified written requests but also provide 30-day extension upon notification to the borrower that more time is needed to research the request.

4. MIRA includes a safe harbor to facilitate improved servicing, which is to be implemented by FMRA. The safe harbor would:

   a. Help servicers implement strong streamlined modification programs using either a FDIC-style program, their own variants or the standards issued by the government pursuant to the Making Home Affordable Plan;

b. Provide an official mechanism for a review of alternatives to or variations of the FDIC program, and allows them to be deemed within the safe harbor;

c. Standardize the net present value (NPV) test and allows servicers to modify a loan if the NPV of a loan modification is greater than the NPV of foreclosure (i.e., there is no requirement to maximize the investor return on each individual loan modification);

d. Provide a specific indemnification for losses to a securitization vehicle or investor regarding loan modifications authorized by this Section as long as the servicer acts in good faith in accordance with this Section;

e. Mitigate the risk of constitutional challenges by creating a right of recovery through the Troubled Assets Relief Program (TARP) for securitization vehicles and investors if they can show that a servicer's streamlined modification program has injured them and the safe harbor has resulted in a taking;

f. Set a workable standard of proof for the investor to prove that a streamlined modification program has damaged them; and

g. Allow removal of actions to federal court.

5. *The following provision, as indicated, was proposed but not finalized by Federal Reserve Board.* Prohibits YSPs Unless Written Agreement – Prohibits creditor from directly or indirectly paying the mortgage broker unless the broker enters into a written agreement with the consumer that includes a disclosure to the consumer of the broker's total compensation that the broker will receive and retain from all sources, that the consumer will pay the entire compensation even if all or part is paid directly by the creditor, and that a creditor's payment to a broker can influence the broker to offer loan terms or products that are not in the consumer's interest or are not the most favorable the consumer could obtain. Also, prohibits broker from exceeding the compensation in the agreement.

6. *Amends advertising rules for both open-end home equity plans and closed-end mortgages including applying "clear and*

conspicuous" standard as was provided under the Board's HOEPA rules. Requires:

a. Whenever rate or payment is included in advertisement for closed-end or open-end credit secured by dwelling, all rates or payments that will apply over term of loan must be disclosed with equal prominence and in close proximity to advertised rate or payment; and

b. For closed-end mortgages, no longer allows advertisement of any interest rate lower than rate at which interest is accruing on annual basis. Also, for closed-end mortgage loans, prohibits: (a) advertising fixed-rate or payments when rate or payments are fixed only for limited period of time rather than full loan term; (b) comparing an actual or hypothetical consumer's current rate or payment to advertised loan unless the advertisement states rate or payments over the full term of the advertised loan; (c) advertising loan products as "government" or "government-sponsored" or otherwise government endorsed loan programs when they are not; (d) prominently displaying the name of a consumer's current lender unless the advertisement also discloses that the advertising lender is not affiliated with current lender; (e) advertising claims of debt elimination if product advertised merely replaces one debt obligation with another; (f) advertising that creates false impression that mortgage broker or lender has fiduciary relationship with consumer; and (g) foreign language advertisements in which certain information such as teaser rate is provided in foreign language and other disclosures only in English.

7. Additional Standards from H.R. 3915 are to be included in the UNMS, with some revisions, as follows:

a. Duty of Care – Requires all loan originators including loan officers for mortgage lenders (lender loan officers) and loan officers for mortgage brokers (mortgage broker loan officers): (1) comply with all licensing and registration requirements; (2) present the consumer with a choice of loan products for which the consumer likely qualifies available from that lender, and which may be appropriate to the consumer's existing circumstances, based on information known by or obtained by the originator; and (3) make full and timely disclosures to

each consumer of (a) comparative costs and benefits of each loan product offered or discussed and (b) whether the originator is or is not acting as an agent for the consumer. The duty of care would also require that: (4) the mortgage broker loan officer provide the borrower a disclosure of the mortgage broker's total compensation including any amounts that the broker may receive from the lender based on a higher rate or the terms of the loan; and (*5*) a consumer must affirmatively, opt-in, in writing *prior to closing*, to a nontraditional mortgage product after the lender's loan officer or mortgage broker discloses the costs and benefits of the loan to the borrower, also in writing.

b. Anti-Steering – All mortgage brokers, for all transactions are prohibited from receiving any incentive compensation (including yield spread premiums or equivalent compensation) that is based on or varies with the terms other than the amount of principal of any loan unless they enter into an agreement with the consumer that they are receiving such compensation and the amount of such compensation in accordance with the provisions of this Act. This restriction does not limit or affect the ability of a mortgage originator to sell residential mortgage loans to subsequent purchasers.

c. Effect of Foreclosure on Preexisting Lease – A successor to a foreclosed property shall take the property subject to the rights of a bona fide tenant (not the mortgagor) under a lease entered into before the date of the notice of foreclosure for 30 days after the date of a foreclosure, as long as the tenant receives notice from the servicer at the time the foreclosure is instituted stating that the property has entered the foreclosure process and that the tenant must vacate the property no later than 30 days after the foreclosure is complete, unless the successor waives the requirement.

d. Negative Amortization – Prohibited unless the creditor provides a complete disclosure to the consumer.

8. HOEPA High Cost Mortgages – Note: *MIRA does not include a third trigger for High Cost Mortgages in H.R. 3915 of a prepayment penalty for more than 36 months. The Federal Reserve Board rules are more restrictive for higher priced loans limiting prepayment penalties to two years or prohibiting them*

entirely for some adjustable loans. Would amend HOEPA in several ways, including expanding its coverage to purchase loans.

9. Servicing – Requires the Director in consultation with CSFR to promulgate rules governing mortgage servicers that ensure that servicing companies are competent and qualified and that servicers institute training, procedures and standards to assure borrowers are treated fairly and competently, including the Board's servicing requirements at VI, b, 3 above and procedures for quick response and appropriate action when borrowers are delinquent and facing foreclosure. Also requires the Director to establish a new centralized servicing database, in lieu of existing inconsistent state and federal systems, which includes data on borrower requests for workouts and their disposition.

10. Miranda Warning – To improve mortgage servicing interactions with borrowers, amends the Fair Debt Collection Practices Act (FDCPA) which requires a debt collector to provide a debtor with a "Miranda" warning upon initial contact with debtor, and a shorter "mini-Miranda" in all subsequent contacts (written and oral) for the life of the loan.

    a. Unfortunately, mortgage servicers are considered "debt collectors" in the vast majority of cases and must state that they are attempting to collect a debt and that any information will be used for that purpose. This statement is misleading when applied to loss mitigation activity and serves to chill a borrower's willingness to work with the servicer to provide information required to execute loss mitigation.

    b. MIRA amends the FDCPA to exclude mortgage servicers of first lien residential mortgages from the Miranda notice requirement. All of the other consumer protection under FDCPA would continue to apply. Thus, a mortgage servicer who, whether by assignment, sale or transfer, becomes the person responsible for servicing mortgage loans secured by first liens, including loans that were in default at the time such person became responsible for the servicing, shall be exempt from the FDCPA Miranda requirements in connection with the collection of any debt arising from such a defaulted related mortgage loan.

VII. Additions to Standards - Requires the Director in consultation with CSFR to meet at least quarterly to supplement the UNMS as necessary,

to promulgate such changes by regulation and report to Congress on the state of mortgage lending, the need for additional changes and their disposition by the Director, annually.

VIII. **Regulatory Responsibilities -** Requires the Director to apply the UNMS to regulate the mortgage lending activities of all federally and state regulated lending institutions in cooperation with their regulators, to regulate all activities of independent lenders and mortgage brokers including establishing uniform licensing and registry requirements for such entities, in consultation with CSFR, consistent with the requirements of the S.A.F.E. Act; and to work in partnership with federal and state regulatory and enforcement officials to examine, review and enforce the UNMS. Specifically, the Act:

A. Establishes a new uniform federal regulatory structure for mortgage lending under which the FMRA would:

1. Regulate all mortgage lending activities of all state and federally regulated lenders through the UNMS; such regulators would retain responsibility to regulate all other activities of such institutions and examine, review and enforce the UNMS; and

2. Promulgate rules in consultation with CSFR governing mortgage servicers that ensure that servicing companies are competent and qualified and that servicers institute training, procedures and standards to assure borrowers are treated fairly and competently, including the Federal Reserve Board's servicing requirements at VI, b, 3 above and procedures for quick response and appropriate action when borrowers are delinquent and facing foreclosure.

B. Requires FMRA to directly regulate all non-depository mortgage lenders and mortgage brokers and mortgage bankers and work cooperatively with current federal and state regulators to review, examine and enforce the UNMS established under this Act for those entities.

1. In carrying out this function, FMRA is required, within one year of enactment, to establish uniform nationwide licensing and registry requirements to apply to all independent mortgage bankers and mortgage brokers which are not federally regulated. Such rules should provide rigorous requirements to ensure competent and qualified lenders and brokers and maximum competition across state lines to lower costs to consumers. *Note: The Act (below) would amend the S.A.F.E. Act which sets minimum requirements for licensing of mortgage originators and requires the states to enact laws specifying licensing and registry requirements for non-federally regulated originators within one year. The Act would*

transfer responsibility for establishing licensing and registry requirements from the states to the FMRA;

2. Also in carrying out this function, such rules should appropriately differentiate between the two types of entities where necessary considering their differing functions and the differing policy concerns which the respective industries present. The rules should require that bankers and brokers at the time of first licensure and on a continuing basis shall:

    a. Meet appropriate educational, testing and character requirements;

        1. Meet net worth and bonding requirements-

            i. For mortgage bankers – the corporate net worth requirement shall be at least $500,000, plus $50,000 for each branch office with a maximum limit of $1 million, as evaluated by audited statements and the bonding requirement shall be a suitable amount to protect borrowers; and

            ii. For mortgage brokers the corporate net worth requirements shall be at least $150,000, plus $25,000 for each branch office up to the requirement for a full eagle from FHA, and the bonding requirement shall be at least $75,000.

IX. Penalties/Remedies - Clarifies Penalties and Establishes New Penalties

A. Consumers who bring action against creditors for violations may seek:

1. Actual damages;

2. Statutory damages in an individual action of up to $2,000 or, in a class action, total statutory damages for the class of up to $500,000 or one percent of the creditor's net worth, whichever is less;

3. Special statutory damages equal to the sum of all finance charges and fees paid by the consumer; and court costs and attorney fees;

4. Refinance mortgages subject to the right of rescission. An action for rescission, costs and attorney's fees may be brought against a lender for violation of the Ability to Repay requirements for a higher priced mortgage;

5. In all cases where a claim for rescission and a claim for damages is made, a creditor has a right to cure non-compliance in lieu of rescission if no later than 90 days after receipt of notification of the consumer's claim, the creditor provides a cure at no cost to the consumer;

6. Definition of Cure – Cure for a violation of the ability to repay requirement means modification or refinancing of the loan at no cost to the consumer to provide terms that would have satisfied the ability to repay requirement.

B. Limited Assignee Liability – An action for rescission and costs may be brought against an assignee or securitizer. Assignees and securitizers are protected from liability if no later than 90 days after notice from a consumer the assignee or securitizer provides a cure or the assignee or securitizer satisfies the following conditions:

1. Has a policy against buying loans other than qualified mortgages or higher cost mortgages meeting the requirements of the Act;

2. Has a policy intended to verify assignor or seller compliance with representations and warranties that the seller is not selling any loan that is not a qualified mortgage or a higher cost mortgage meeting the requirements of the Act;

3. Satisfies 2 above, by exercising due diligence per regulations issued by the Securities and Exchange Commission and banking regulators including through adequate sampling procedures; and has a contract with the assignee which represents and warrants that the seller or assignor is not selling loans which are not higher cost loans meeting the requirements of this Act.

C. New penalties for disclosure violations. Amends Section 4 and 5, of RESPA, 12 USC 2603 and 12 USC 2604, to provide penalties for:

1. Failing to provide a consumer the disclosures under 4 and 5 as applicable;
2. Failing to disclose the costs that the borrower is estimated to receive or is charged at closing on the HUD-1;
3. Charging the consumer at closing an amount 10 percent greater than the total cost of lender, mortgage broker, title and other third party fees that was estimated at the time of application, provided the borrower qualifies for the loan in final underwriting and does not request a different loan;

4. Charging a consumer more than the maximum amount of mortgage broker compensation disclosed; and
5. Wrongfully advising the consumer of the broker's function in the transaction; i.e., that he will shop for a borrower when he is not in fact an agent of the borrower. This provision may include a criminal penalty.

D. MBA supports civil money penalties and private remedies instead of rescission or refund of finance charges for minor infractions and infractions that trigger from on-going or periodic servicing or lending responsibilities.

X. **Enforcement/Examination Authorities -** Authorizes FMRA, other federal agencies, state agencies and private parties to enforce the UNMS and to interact with federal and state banking regulators to review, examine and enforce UNMS concerning all mortgage lending operations.

XI. **Financial Literacy and Counseling -** Assigns the Director national responsibility of operating a national financial literacy and counseling program targeted at understanding credit and mortgages, including requiring mandatory counseling for certain mortgage products. The Director shall, with the advice of the CSFR and interested stakeholders:

1. Develop a curriculum for a national financial literacy program in conjunction with the CSFR for use by educational institutions at the elementary, middle school and secondary school levels;

2. Develop a comprehensive Web site to inform the public about the mortgage process and to compare the mortgage products available;

3. Establish and administer an assistance program to eligible recipients to develop counseling capacity;

4. Require, through rulemaking, mandatory counseling for mortgage products that present an increased risk of default, in the judgment of the Director. These products should include all reverse mortgages, and, as long as adequate counseling resources are available such that loan closings are not delayed, HOEPA highest priced and higher priced loans which could result in negative amortization made to first-time homebuyers.

XII. **Mortgage Fraud -** Authorizes $31,250,000 from 2009 through 2013 for new employees at the Department of Justice dedicated to combat mortgage fraud, and $750,000 for the same period for additional funding for a mortgage fraud interagency task force.

XIII. **Initial Funding -** Authorizes start-up funds of $____ for establishment of the FMRA and its first two years of operations including the costs of consumer testing, financial literacy, counseling and anti-fraud activities.

XIV. **Resources for Regulation/Sharing Funds With States** – Beyond start up period, authorizes FMRA to charge a reasonable assessment on each entity regulated by the FMRA to defray the costs of regulation. States would receive licensure and registry fees and would share in assessments on regulated entities for examination and enforcement to extent appropriate to avoid duplicate charges on regulated entities.

XV. **Improving Transparency** – Requires HUD and the Federal Reserve to work together in consultation with the Director and CSFR to develop a simplified, combined RESPA/TILA disclosure that shall be uniform and used nationally. HUD would be directed to withdraw the pending RESPA rule prescribing a new GFE and HUD-1 and coordinate its efforts with the TILA reform efforts of the Federal Reserve Board. These joint efforts of the Federal Reserve Board and HUD should be placed on an aggressive timetable established by Congress which would implement the new disclosures in a coordinated manner that would avoid confusion and reduce consumer costs. Specifically, MIRA requires:

A. Combined, coordinated and simplified RESPA and TILA Good Faith Estimate (GFE) disclosures, combined, coordinated and simplified HUD-1 and final TILA disclosures as well as accompanying consumer information meeting the requirements of TILA and RESPA that would require that disclosures be given at the same time and in accordance with the Mortgage Disclosure Improvement Act (enacted July 2008).

B. The combined RESPA and TILA GFE would include:

1. A uniform one-page, box-type summary of the estimated costs and terms of each individual mortgage loan offer that would include:

   i. the estimated loan amount; note rate and Annual Percentage Rate (APR); the total settlement costs;
   ii. whether the loan is adjustable and, if so, how frequently;
   iii. the note rate and APR for the loan;
   iv. the estimated mortgage payment of principal and interest and estimated amounts for taxes and insurance (Estimated PITI);
   v. whether the loan does or does not have a prepayment penalty with its duration and amount;
   vi. whether the loan has a balloon payment with its timing and amount;

vii. whether the lender automatically escrows taxes and insurance;
viii. whether private mortgage insurance or a second mortgage is needed with its cost(s); and
ix. which, if any, costs are or are not guaranteed to come within 10 percent of the final settlement costs subject to approval of the borrower and property securing the mortgage.

2. Group key settlement costs into major categories based on which service provider receives them, discloses the total cost for each category and then totals them as a total estimated cost. These categories would include: fees paid to the mortgage originator, lender or broker, fees paid for title insurance and closing services, fees paid to other third parties and government charges and not detail the sums for sub-costs within cost categories, except government charges, on the GFE or the HUD-1;

3. Include the maximum amount of compensation the mortgage broker will receive in the transaction;

4. Arrive at total estimated settlement costs: and monthly payment(s);

5. Advise the borrower of possible payment shock, balloon payments, prepayment penalties, the cost of a no-doc or low-doc loan and the borrower's responsibility for taxes and insurance and mandatory homeowners' association dues or condominium fees, where applicable; and such other information regarding the transaction as the Director deems necessary for borrowers.

C. A new standard, combined, brief plain language home purchase and mortgage financing handbook drawing from the current Special Information Booklet and the Consumer Handbook on Adjustable Rate Mortgages (CHARM) and other materials, to provide consumers generic information for both home purchase and mortgage refinance transactions that, among other things:

1. Clearly describes the key terms and costs of homeownership including the down payment, monthly payments, settlement costs, taxes and insurance and other monthly charges;

2. Advises consumers of the importance of credit history, down payment and adequate reserves in obtaining a lower cost mortgage and maintaining homeownership;

3. Advises consumers of the risks and benefits of various mortgage products including providing information on payment adjustments, balloon payments, prepayment penalties, the need to pay taxes and insurance and the costs of no-documentation and low-documentation loans;

4. Advises consumers of the roles and responsibilities of different players in the mortgage process including the differences between mortgage lenders and mortgage brokers, that only those mortgage brokers which identify themselves as such are borrowers' agents and the fact that all mortgage originators will receive additional income if a borrower agrees on a higher mortgage rate.

D. A standard agreement intended to replace disparate state disclosures, regarding the cost and function of the mortgage broker in the transaction that: notifies a consumer of the maximum amount the mortgage broker will receive in the transaction; whether a broker is or is not acting as an agent for the borrower; and whether the mortgage broker may increase its commission based on the borrower's agreement to an increased interest rate. This form will be provided by mortgage brokers in addition to the GFE disclosure.

E. A new combined HUD-1 and final TILA disclosure, for each mortgage loan covered by RESPA and TILA that easily corresponds to a new standardized GFE/TILA form so that a borrower can readily compare both documents including both the estimated and final settlement costs. Note: The current HUD-1, and even the one recently promulgated by HUD, is still not comparable to the GFE. The consumer, therefore, is not able to make an apples-to-apples comparison of the fees and terms at application and at settlement.

F. New forms to facilitate borrower understanding of the mortgage process and lender, broker and their loan officers' duty of care for consumers: (1) to provide information regarding their circumstances including the consumer's risk appetite to assist the loan officer or mortgage broker in deciding which loan products should be presented to the consumer; (2) to affirmatively opt-in to a nontraditional mortgage product following a disclosure explaining the option, including the risks and benefits of an adjustable loan; and (3) to disclose the amount of a mortgage broker's compensation.

G. New forms to provide reasonable notice to a borrower prior to reset of an adjustable rate mortgage

XVI. **Preemption and Revisions to Federal Laws -** Preempts contrary state laws and amends several federal laws as follows:

A. Amends the S.A.F.E. Act to transfer responsibilities for establishing uniform national mortgage licensing and registry standards for originators of regulated entities from the states to FMRA;

B. Amends TILA and RESPA to:

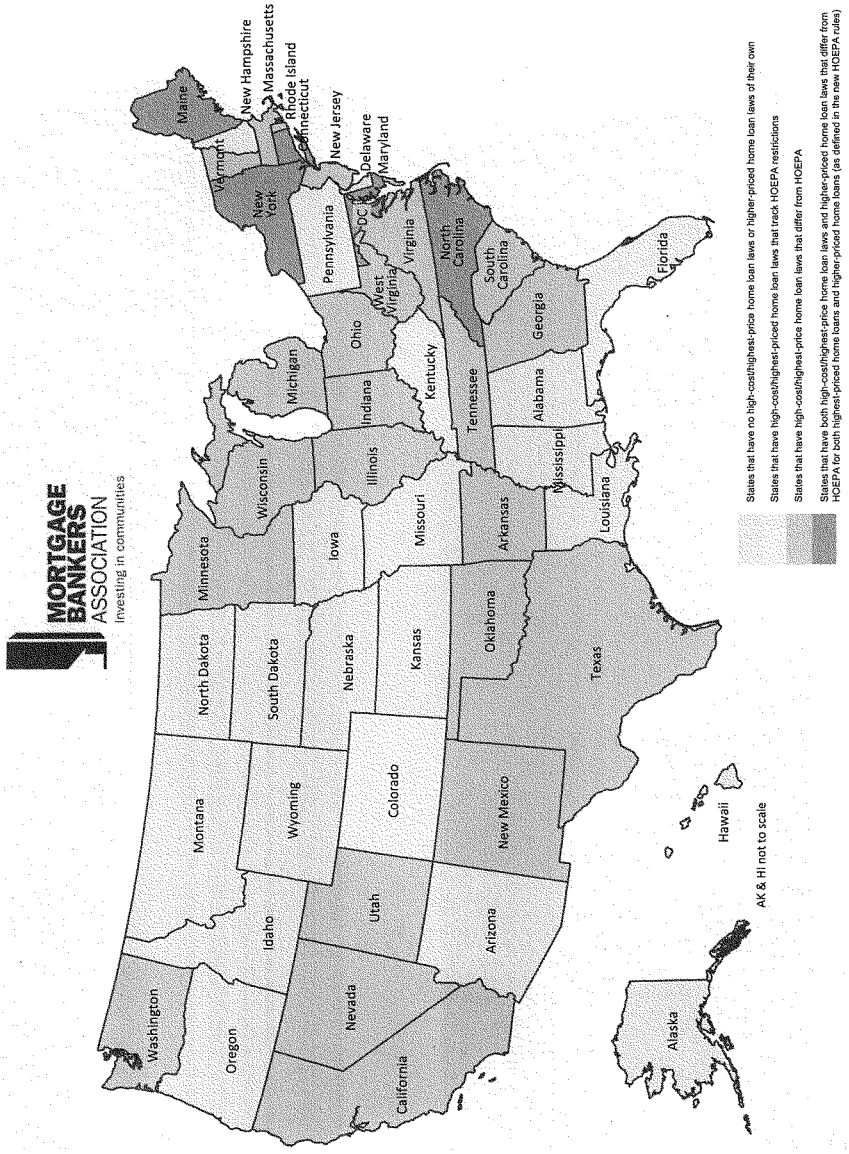
1. Require HUD and the Federal Reserve Board to work together on a single set of uniform disclosures and accompanying borrower information for all mortgage transactions nationwide and for HUD to withdraw its pending rule until such a single set of disclosures can be issued;

2. Make borrower remedies compatible without establishing a new right of rescission under RESPA; and

3. Preempt state disclosures of the same information covered by RESPA and TILA.

C. Amends TILA to provide that all settlement charges other than government charges must be included in the computation of the finance charge and the Annual Percentage Rate (APR) for the loan. The current APR is not a useful shopping tool since major settlement costs are not included in its calculation. An all-in APR would make the APR much more useful to borrowers for such purpose.

D. Maintains the current preemption for federally regulated financial institutions.


MORTGAGE BANKERS ASSOCIATION
Investing in communities
Maine
Vermont
New Hampshire
Massachusetts
Rhode Island
Connecticut
New York
New Jersey
Pennsylvania
Delaware
Maryland
DC
Virginia
West Virginia
North Carolina
South Carolina
Georgia
Florida
Ohio
Michigan
Indiana
Kentucky
Tennessee
Alabama
Mississippi
Louisiana
Wisconsin
Illinois
Missouri
Arkansas
Minnesota
Iowa
Oklahoma
Texas
North Dakota
South Dakota
Nebraska
Kansas
Montana
Wyoming
Colorado
New Mexico
Idaho
Utah
Arizona
Washington
Oregon
Nevada
California
Alaska
Hawaii
AK & HI not to scale
States that have no high-cost/highest-price home loan laws or higher-priced home loan laws of their own
States that have high-cost/highest-priced home loan laws that track HOEPA restrictions
States that have high-cost/highest-price home loan laws that differ from HOEPA
States that have both high-cost/highest-price home loan laws and higher-priced home loan laws that differ from HOEPA for both highest-priced home loans and higher-priced home loans (as defined in the new HOEPA rules)

Prepared Testimony of

Denise Leonard, Vice President
Government Affairs

National Association of Mortgage Brokers

on

"Banking Industry Perspectives on
the Obama Administration's Regulatory Reform Proposals"

Before the

Committee on Financial Services

United States House of Representatives

Wednesday, July 15th, 2009

Good morning Chairman Frank, Ranking Member Bachus, and members of the Committee. I am Denise Leonard, Vice President of Government Affairs for the National Association of Mortgage Brokers ("NAMB") and a mortgage broker from Massachusetts with 19 years of experience. Thank you for inviting me to testify today on "Banking Industry Perspectives on the Obama Administration's Regulatory Reform Proposals."

NAMB is the only national trade association that represents the mortgage broker industry. NAMB advocates on behalf of more than 70,000 mortgage broker professionals located in all 50 states and the District of Columbia. NAMB also represents the interests of homebuyers, and advocates for public policies that serve mortgage consumers by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to enhancing consumer protection and promoting the highest degree of professionalism and ethical standards for its members. NAMB requires that its members adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. NAMB provides its members with access to professional education opportunities and offers rigorous certification programs to recognize members with the highest levels of professional knowledge and education. NAMB also serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

Mortgage brokers work with consumers to help them through the complex mortgage origination process. Mortgage brokers add value to the process for both consumers and lenders by serving areas that are typically underserved by banks and other lending institutions. Mortgage brokers also add value by providing goods, facilities, and services with quantifiable value, including a customer base and goodwill.

I. Introduction

On June 17, 2009, the Obama Administration released a policy paper through the Department of Treasury entitled "A New Foundation: Rebuilding Financial Supervision and Regulation." In this paper, the Administration outlines a number of proposals aimed at overhauling the structure of our nation's system of financial regulatory oversight, with a special focus on protecting consumers in the market for financial products and services.

The policy paper specifically cites the failure of our current regulatory framework to adequately protect borrowers in mortgage transactions as a critical underlying cause of our financial crisis. The Administration contends that gaps and conflicts of interest have long-existed between state and federal regulators charged with enforcement of consumer protection statutes. The paper goes on to say that consistency and strength of regulation of consumer financial products and services are primary objectives of the Administration's Financial Regulatory Reform Plan ("Administration Plan").

The Administration Plan, as outlined in the Department of Treasury policy paper, focuses on a number of significant issues. Today, our testimony will specifically address issues raised by Section III of the paper which has generally been introduced as H.R. 3126, the "Consumer Financial Protection Agency Act of 2009."

NAMB is generally supportive of the concept behind the Administration's Plan outlined in the Department of Treasury policy paper. NAMB believes that protecting consumers is critically important to rebuilding faith and confidence in our mortgage and financial markets, which has eroded over the past several years. Nevertheless, NAMB feels that any overhaul of the financial regulatory structure must adequately account for the complexity of the modern mortgage market and must endeavor to treat similarly situated market participants equally.

II. Consumer Financial Protection Agency

The Administration's Plan calls for the establishment of a new independent federal regulatory agency called the Consumer Financial Protection Agency ("CFPA"), which is reflected in H.R. 3126. This new agency would become the primary federal regulator focused on consumer protection in the markets for financial products and services.

Under the legislation, the CFPA would be granted rule-making authority for consumer protection under existing statutes, and would possess enforcement and supervisory authority over all persons covered by

those statutes.[1] Additionally, the CFPA would be given specific authority to impose greater responsibilities on mortgage lenders, originators, and securitizers. These responsibilities would include: (1) ensuring all communications and disclosures made to consumers are reasonable; (2) offering consumers a "standard" or "plain vanilla" mortgage product option in addition to any other product options available; and (3) exercising a duty of care, possibly among other duties, when working with consumers.

NAMB believes the CFPA, or any other agency for that matter, must act prudently when promulgating and enforcing rules in order to ensure real protections are afforded to consumers, and not merely the illusion of protection that often comes from incomplete or unequal regulation of similar products, services, or providers. Although the CFPA would be given broad powers to regulate and enforce substantive standards for all "consumer financial products or services," today we will focus our testimony on its impact on the mortgage broker industry.

III. How the Mortgage Broker Industry is Currently Regulated

Before delving into the details of the CFPA, it is essential to discuss how mortgage brokers are currently regulated under our existing financial regulatory structure. Since the inception of the mortgage broker industry, brokers have been regulated at both the state and federal levels. Like bankers and other lenders, mortgage brokers comply with every federal fair lending and housing law and regulation affecting the mortgage loan origination industry. Additionally, mortgage brokers comply with a host of state laws and regulations affecting their businesses, from which bankers and lenders are largely exempt.

Mortgage brokers are just one participant in a larger network of loan originating entities – including mortgage bankers, mortgage lenders, credit unions, and depository institutions – all competing to deliver mortgage products to consumers. In today's market, there are actually very few substantive differences between these distribution channels when it comes to originating mortgages. The lines that once divided them have become increasingly blurred with the proliferation of the secondary mortgage market, and more often mortgage brokers and mortgage lenders perform essentially the same function – *i.e.*, they present an array of available loan products to the consumer and close the loan. The lenders, who underwrite and fund the loan, then almost instantaneously sell the loan to the secondary market.

Although mortgage brokers are typically held to higher standards in most states, and consumers often fail to distinguish one origination source from another, brokers stand singularly accused of operating on an unregulated basis. This accusation is plainly false. Mortgage brokers are regulated by more than ten federal laws, five federal enforcement agencies and at least forty-nine state regulation and licensing statutes. Moreover, mortgage brokers, who typically operate as small business owners, must also comply with a number of laws and regulations governing the conduct of commercial activity within the states.

a. Federal Regulation of Mortgage Brokers

Mortgage brokers are governed by a host of federal laws and regulations. For example, mortgage brokers must comply with: the Real Estate Settlement Procedures Act ("RESPA"), the Truth in Lending Act ("TILA"), the Home Ownership and Equity Protection Act ("HOEPA"), the Fair Credit Reporting Act ("FCRA"), the Equal Credit Opportunity Act ("ECOA"), the Gramm-Leach-Bliley Act ("GLBA"), and

[1] The statutes under which the CFPA would be granted authority include the Truth-in-Lending Act ("TILA"), Real Estate Settlement Procedures Act ("RESPA"), Home Ownership & Equity Protection Act ("HOEPA"), Equal Credit Opportunity Act ("ECOA"), Fair Debt Collection Practices Act ("FDCPA"), and Home Mortgage Disclosure Act ("HMDA").

the Federal Trade Commission Act ("FTC Act"), as well as state and federal fair lending and fair housing laws. Many of these statutes, coupled with their implementing regulations, provide substantive protection to borrowers who seek mortgage financing. These laws impose disclosure requirements on brokers, define high-cost loans, and contain anti-discrimination provisions.

Additionally, mortgage brokers are under the oversight of the Department of Housing and Urban Development (HUD) and the Federal Trade Commission (FTC); and to the extent their promulgated laws apply to mortgage brokers, the Federal Reserve Board, the Internal Revenue Service, and the Department of Labor. These agencies ensure that mortgage brokers comply with the aforementioned federal laws, as well as small business and work-place regulations such as wage, hour and overtime requirements, the do-not-call registry, and can-spam regulations, along with the disclosure and reporting requirements associated with advertising, marketing and compensation for services.

b. Mortgage Broker Regulation in the States

The regulation of mortgage brokers begins at the federal level, but it certainly does not end there. Mortgage brokers are licensed and registered and must comply with pre-licensure and continuing education requirements and criminal background checks in every state pursuant to the Secure & Fair Enforcement for Mortgage Licensing Act of 2008 ("SAFE Act") – a law for which NAMB advocated more than 6 years before its enactment.

The SAFE Act is designed to enhance consumer protection and reduce fraud by encouraging states to establish minimum standards for the licensing and registration of state-licensed mortgage loan originators and for the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) to establish and maintain a nationwide mortgage licensing system and registry for the residential mortgage. The SAFE Act requires all mortgage originators to adhere to such licensing and registration requirements, with the exception of loan officers at federally chartered institutions.

As small businessmen and women, mortgage brokers must also comply with numerous state anti-predatory lending and consumer protection laws, regulations and ordinances (*i.e.*, UDAP Regulations). Again, this is not true for a great number of depository banks, mortgage bankers, mortgage lenders and their loan officer employees, which remain exempt from such requirements under federal agency preemption. Many states also subject mortgage brokers to oversight, audit and/or investigation by mortgage regulators, the state's attorney general, or another state agency, and in some instances all three.

To the extent that the CFPA will enhance uniformity in the application of the regulations and laws stated herein that provide for consumer protection, NAMB supports such an objective.

IV. Jurisdiction of the CFPA

The Administration Plan would vest the CFPA with the responsibility of implementing the Truth-in-Lending Act ("TILA"), Home Ownership and Equity Protection Act ("HOEPA"), Real Estate Settlement Procedures Act ("RESPA"), Equal Credit Opportunity Act ("ECOA"); and the Home Mortgage Disclosure Act ("HMDA"), among other statutes. The agency would be granted broad consolidated authority over the functions of rule-writing, supervising and examining regulated entities, and administratively enforcing violations of the statutes it is charged with enforcing.

The CFPA would also be granted authority over all persons covered by the statutes the agency implements, including banks and bank affiliates, non-bank entities, and institutions currently regulated exclusively by one of the federal prudential regulators.

The CFPA's mission would be to help ensure that (1) consumers are provided the information they need to make responsible financial decisions; (2) consumers are protected from abuse, unfairness, deception and discrimination; (3) the markets for consumer financial services operate fairly and efficiently; and (4) traditionally underserved consumers and communities have access to financial products and services.

One fact lost in debates over mortgage policy is the fact that mortgage products are created by very few entities and that products are repackaged and re-branded by many "product" distribution channels. We do appreciate the CFPA's approach of the application of uniform legal standards to all originators so that consumers are free to shop and compare mortgage products and pricing among different distribution channels without fear or confusion. Because each distribution channel is competing for consumers' mortgage loan business, consumers are best served when every mortgage originator is held to the same professional standards under the law. For many years, stronger market competitors have used state and federal mortgage disclosure and other laws to create a competitive advantage over weaker competitors. These actions have only confused consumer understanding of mortgage products.

However, we also believe that there should be some standards in place to prohibit the CFPA from imposing overly prescriptive measures to the detriment of consumers. Ultimately, the CFPA may be regulating in areas that have not been addressed by Congress and therefore, not subject to hearings, oversight or certain checks and balances as provided through the legislative process.

V. Board Makeup

According to the Administration's Plan, "The Agency shall seek to promote transparency, simplicity, fairness, accountability and access in the market for consumer financial products or services." NAMB agrees with such objectives, and before we delve into the particular areas addressing the general powers of the CFPA, we think it is imperative to address the consistency of the CFPA board members.

The Board is established as an "independent" agency within the Executive Branch of the federal government to regulate consumer financial products, services, and service providers. The CFPA would be governed by a board composed of 5 members, one of which will be the director responsible for heading up the merged Office of the Comptroller of Currency (OCC) and the Office of Thrift Supervision (OTS). The other 4 members of the board will be appointed by the President and confirmed by the Senate for staggered terms. One of the Board members will be designated as the chief executive of the CFPA. Unlike other federal agencies which are delegated rulemaking and enforcement authority, such as the Federal Trade Commission and the Securities and Exchange Commission, the CFPA does not impose any requirement that a particular number of board members be from a political party different than the party of the President who appoints them. This raises serious concerns about whether the CFPA can truly function as an independent agency, or whether it could be used as a means for a President to circumvent Congress and legislate without any meaningful checks and balances.

Additionally, because the President may remove any appointed Board member for inefficiency, neglect of duty, or malfeasance in office (which are very subjective terms and undefined in the legislation) the Board's independence may again be called into question. Such criteria for removal would not be concerning if there were bipartisan representation on the board.

In addition to requiring that no more than 3 Board members be of the same political party, we recommend that the Board have proper industry representation and be comprised of individuals who possess business acumen and an understanding of the market for consumer financial products and services.

VI. Fees

The CFPA grants broad authority to impose fees and assessments on "covered persons." NAMB is concerned that those regulated on the state level, such as mortgage brokers, may be forced to pay more to do business, which will place such entities at a competitive disadvantage and will ultimately increase costs for consumers.

Additionally, there is absolutely no limitation on the fees charged and the legislation does not correlate the fees with a covered person's business size or transaction engagement.

VII. Exemptions

The purpose of the agency is to promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products or services, and to ensure the markets for consumer financial products and services operate "fairly and efficiently" with "ample room for growth and innovation." However, the bill specifically allows for exemptions for any covered person, product or service that meets specified criteria, which small business professionals are not likely to meet. If the CFPA's mission is to truly create uniformity of all products and services and protect consumers regardless of where they shop, providing for exemptions is contrary to such a goal. There should be no exemptions or a tiered form of exemptions, *i.e.*, very large covered persons, those covered persons that provide de minimis services and products.

VIII. Directive to Review Existing Regulations

As was clearly stated in the Administration's policy paper, the financial regulatory reform effort is not about more regulation. It is about better regulation. The Administration Plan would require the CFPA to complete comprehensive regulatory studies of every new regulation that is enacted, in order to assess the effectiveness of such regulation in meeting its stated purposes and goals. Additionally, the CFPA would be directed to review existing regulations for similar purposes.

NAMB strongly supports empowering the CFPA to undertake a comprehensive review of new and existing regulations. Too often, in the wake of our current financial crisis, we have seen new rules promulgated that do not reflect measured, balanced solutions to the problems facing consumers and our markets. The Home Valuation Code of Conduct ("HVCC") provides one such example.

The HVCC is the result of a joint agreement reached in March 2008 between Fannie Mae, Freddie Mac (together, the "GSEs"), the Federal Housing Finance Agency ("FHFA"), and New York Attorney General, Andrew Cuomo. The HVCC purports to enhance the independence and accuracy of the appraisal process. However, what the HVCC truly accomplishes is an increase in consumer costs, a decline in appraisal quality, the extension of closing deadlines, and the virtual extinction of local small business appraisers.

The HVCC is a substantive rule that affects consumers and regulates mortgage and appraisal professionals in all 50 states. Yet, the HVCC was promulgated by an agency – the FHFA – charged with

ensuring safety and soundness and promoting a stable and liquid mortgage market, which clearly falls outside of the HVCC's purpose and objective. Moreover, the HVCC was drafted, revised, and implemented by the FHFA outside of the federal rule-making procedures required under the Administrative Procedures Act ("APA").

NAMB believes it is important to strengthen the integrity and independence of the home appraisal process, as appraisal independence is essential to protecting consumers from fraud and from unscrupulous actors. However, NAMB does not believe the FHFA acted in the best interests of consumers when promulgating the HVCC and NAMB does not believe the FHFA should be instituting measures that would more properly fall under the authority of an agency like the CFPA.

NAMB respectfully urges this Committee to direct the FHFA to withdraw the HVCC immediately, and to empower the CFPA with the authority to undertake rule-writing that more appropriately regulates appraisal activities, ensures appraisal independence, and protects consumers.

Additionally, NAMB encourages this Committee to amend H.R. 3126 to specifically preempt any state statute from having any force or effect where the CFPA or a similar federal agency is vested with authority under any federal statute to provide similar protection to consumers that the state statute provides. The Consumer Product Safety Act[2] preempts any state from establishing or continuing any safety standard designed to deal with the same risk of injury as a federal standard, unless it is identical to the federal standard. H.R. 3126 should similarly restrict the potential establishment of 50 different consumer protection standards in addition to those promulgated by the CFPA.

The impetus behind the ill-conceived HVCC was the use of an extremely broad and controversial state statute to investigate possible financial fraud at a large lending institution in the state of New York. As this investigation unfolded, the New York Attorney General utilized his virtually boundless authority under the statute to expand his investigation into certain activities at the GSEs. Although the HVCC is a substantive rule, ultimately promulgated by a federal agency – the FHFA – it stems directly from the New York Attorney General's use of the highly controversial Martin Act[3], which vests unprecedented investigatory and prosecutorial powers with a single State Attorney General.

Specifically, New York's Martin Act grants the Attorney General the power to subpoena virtually any document from any individual or entity doing business in the state of New York. The Martin Act also permits the New York Attorney General to commence an investigation whenever he believes it is in the public interest that an investigation be made, or whenever it appears any person has engaged in fraudulent practices. Moreover, once an investigation has been initiated under this Act, the New York Attorney General is relieved of any obligation to demonstrate probable cause or to disclose the details of the investigation. Additionally, anyone brought in for questioning during a Martin Act investigation does not have a right to counsel or a right against self-incrimination, and the Attorney General may prevail in a case without proving there was any intent to defraud, that anyone was actually defrauded, or even that a transaction actually took place.

The Martin Act in New York is the paramount example of state regulation already in existence that runs afoul of the purposes and objectives behind establishing the CFPA. NAMB strongly believes H.R. 3126 should preempt the Martin Act, as well as any other current or subsequently enacted statutes having the same force and effect in other states.

---

[2] 5 U.S.C. 2051, et: seq.
[3] 1N.Y. GEN. BUS. LAW, Art. 23-A, § 352 et seq.

IX. Creation of an Outside Advisory Panel

NAMB supports the proposal in the Administration's Plan to create an outside advisory panel, akin to the Federal Reserve Board's Consumer Advisory Council, to encourage accountability on the part of the CFPA and allow for the useful sharing of information regarding emerging industry practices. NAMB believes such a panel must be comprised of enough members to fairly represent all segments of the industry, as well as consumers, and NAMB would welcome an opportunity to participate on such a panel. However, clarification is required as to the makeup of the Consumer Advisory Board, specifically with regard to how large it will be and what "a full time employee of the United States" actually means.

X. Administration of the S.A.F.E. Act

NAMB believes that the Secure & Fair Enforcement for Mortgage Licensing Act of 2008 ("SAFE Act") should be amended to ensure that the CFPA possesses complete and exclusive authority to implement the entire Act, including oversight of the operations of the registry created by the Act. Transferring total administrative authority over the SAFE Act to the CFPA will eliminate any potential gaps in coverage, where lesser standards and/or the exemption or insulation of a certain class or group of individuals who originate loans may persist. This will also eliminate the seemingly conflicting language in H.R. 3126 that encourages states to apply standards to non-depository and credit union covered persons, including background checks, education requirements, registration, etc.

NAMB strongly supports making the CFPA the sole federal agency responsible for administering the SAFE Act. Authority to administer the SAFE Act is currently divided among several federal agencies, and NAMB believes consumers would benefit greatly from having unified authority vested in a single federal regulator responsible for overseeing the implementation and administration of the SAFE Act.

To help illustrate this point, one need not look further than the recently published "proposed rules" to implement the SAFE Act, issued jointly by the federal banking agencies – the Office of the Comptroller of the Currency; Federal Reserve Board; Federal Deposit Insurance Corporation; Office of Thrift Supervision; and National Credit Union Administration. The failure of these agencies to properly emphasize and implement important consumer protection measures set forth in the SAFE Act highlights one of the fatal flaws in a fragmented approach to regulatory oversight of consumer protection measures, like the SAFE Act.

In these proposed rules, the five federal banking agencies seek to implement only the bare minimum requirements for consumer protection set forth in the SAFE Act with respect to agency-regulated institutions. Moreover, the agencies seek to delay any implementation of the SAFE Act's consumer protection requirements for agency-regulated institutions for at least 180 days from the time the agencies announce that the national registry is actively accepting initial registrations. Lastly, these agencies have proposed exemptions to SAFE Act requirements for some of their employees.

NAMB believes responsibility for implementing the SAFE Act should be vested exclusively with a single federal regulator focused on consumer protection, like the CFPA. Additionally, NAMB believes in keeping with the broad authority granted to the CFPA under the Administration's Plan, that the CFPA should undertake comprehensive rulemaking to extend and implement the most critical consumer protections included in the SAFE Act – namely, the education and testing requirements – so that all loan originators are held to the same high standards, including those who are employees of federally-regulated institutions.

While states are now required under the SAFE Act to increase standards for state-licensed mortgage originators, employees of federally-regulated institutions continue to escape requirements that they meet important benchmarks for training, continuing education, and proficiency testing. Today most consumers are unable to distinguish one mortgage originator from another (*i.e.*, a state-licensed mortgage originator vs. a loan officer employee of a federally-regulated institution), so why should some of our most important consumer protection regulations make such a distinction?

NAMB strongly believes that even more can and should be done to increase professional standards for all mortgage originators. Great strides were made with the passage of the SAFE Act in 2008. However, even in passing the SAFE Act, there remain cracks in our consumer protection regulatory framework where loan originators employed by certain entities or institutions must meet more rigorous standards than loan originators at other institutions.

Today NAMB is advocating for an extension of the consumer protection requirements set forth in the SAFE Act so that all mortgage originators, including employees of federally regulated banks and other institutions are required to satisfy the same education and testing requirements.

XI. Consumer Education & Financial Literacy

NAMB supports the CFPA playing a leading role in efforts to educate consumers about financial matters, improve consumers' ability to manage their own financial affairs, and make proper judgments about the subjective appropriateness of certain financial products.

NAMB believes that consumers are, and should remain, the ultimate decision-maker when it comes to the product, pricing, and service offered in connection with a financial transaction. Therefore, it is imperative that consumers possess the necessary financial knowledge to carefully evaluate the risks and rewards presented by different financial products and be able to determine the appropriateness of such products for their particular needs.

In the context of mortgage transactions, regardless of how knowledgeable a loan originator is or becomes, an educated consumer is always in a better position to make an informed decision when selecting a mortgage product to match his or her financial needs and goals.

NAMB has always been a strong advocate for consumer financial literacy efforts. It is our firm belief that an educated borrower is significantly less likely to fall victim to any abusive lending practices, and that is why we support the Administration's proposal to make consumer education and financial literacy a key component of the larger financial regulatory reform effort. We urge Congress to require the CFPA to utilize modern testing of forms and consumer choice science to formulate modern mortgage disclosure forms. We believe this is a cornerstone of financial literacy. Disclosures that confuse consumers lead to incorrect choices and open the door for unscrupulous actors to take advantage of the consumer.

XII. Specific Consumer Protection Reforms

The Administration's Plan calls for a series of legislative, regulatory and administrative actions to reform consumer protections, based upon the principles of transparency, simplicity, fairness, accountability and access.

NAMB has long advocated for consumer protection through transparency and simplification of the mortgage process. Granting the CFPA broad regulatory authority will level the playing field for loan originators and prevent certain entities and institutions from falling through the cracks that exist between the enforcement jurisdiction of various state and federal agencies.

Although NAMB welcomes transparency across the entire mortgage market, NAMB would caution the CFPA, or any such regulator, against potentially causing unintended harm to consumers in the process of revising disclosures and attempting to simplify what has become a very complex mortgage process. NAMB strongly believes that any effort to improve simplicity and fairness in mortgage transactions must respect the complexity of today's market and emphasize transparency at each stage in the lifecycle of a loan – from origination through sale or securitization.

No single aspect of a mortgage transaction should be examined in a vacuum. While transparency is critical at origination, if it exists there alone it is meaningless and confusing to consumers. There must also be transparency in the processes extending beyond origination but affecting the products and prices available to consumers.

To the extent the Administration's Plan and this Committee endeavor to improve transparency, simplicity, and fairness at origination and throughout the entire life cycle of a mortgage, NAMB is very supportive.

a. Transparency – Balanced, Clear, Concise & Consumer-Tested Disclosures

The Administration's Plan calls for mandatory disclosure forms that are simple, clear, concise and consumer-tested. NAMB generally supports greater transparency in consumer financial transactions, and is very supportive of efforts to simplify, clarify and effectively consumer-test all mandatory disclosure forms. Many current disclosures have failed to keep pace with market innovations and increasing transaction complexity. At the same time, recent efforts to revise antiquated disclosure forms, such as the Goof Faith Estimate, have failed to demonstrate their effectiveness through consumer testing.

NAMB is very supportive of the requirement in H.R. 3126 to require the CFPA to propose model disclosures that combine the disclosures required under TILA and RESPA into a single, integrated disclosure for mortgage loan transactions. Consumers will greatly benefit from a single, integrated and uniform federal mortgage disclosure form which clearly and simply discloses critical loan terms and costs.

Additionally, NAMB strongly encourages this Committee to consider imposing a moratorium on the implementation of any new regulations or disclosure forms issued by HUD and FED for at least 1 year after the designated transfer date. This will help avoid consumer confusion and minimize the increased costs and unnecessary administrative burden borne by industry participants if multiple significant changes are made to mandatory disclosure forms over a short period of time.

The Administration's Plan and H.R. 3126 seek to provide consumers with disclosures that help them to understand the consequences of their financial decisions. NAMB strongly supports this goal and has long-advocated for clear, consistent, and uniform communication with consumers from the shopping stage through closing, and afterwards throughout the life of the loan (*i.e.*, through monthly statements).

Regardless of the form that a consumer disclosure takes, there are certain essential elements that NAMB believes must be included in order for the form to effectively aid consumers in making appropriate financial decisions. First, an effective consumer disclosure must be even-handed. The disclosure must be uniform and equally applicable to all individuals and entities engaged in the activity being regulated through disclosure. Second, an effective consumer disclosure must be informative. Consumers must be provided clear statements of fact concerning the roles of the parties to the transaction, as well as a clear breakdown of estimated costs or other critical information associated with the transaction. Third, an effective disclosure must be proven effective. Disclosures must be consumer-tested in real-life situations

and objectively evaluated to determine whether they are in fact communicating the proper information to consumers and are doing so in a clear and concise manner.

Moreover, NAMB believes the CFPA should be required to consumer-test all current disclosure forms, as well as any new disclosure forms aimed at helping consumers understand financial products and services better. This testing should focus on the disclosure's effectiveness in communicating critical information to the consumer, as well as any potential negative affects that the disclosure could have on competition between market participants.

Finally, as the Administration's policy paper correctly points out, regulators are typically limited to testing disclosures in a "laboratory" environment, which can skew results and lead to the widespread implementation of an ineffective disclosure form. Field-testing can, and often does, produce more accurate results and more useful feedback. NAMB supports the provisions of the Administration's Plan that call for the CFPA to establish standards and procedures for effectively conducting field tests of consumer disclosures before they are implemented and required across the board.

b. Simplicity – "Plain Vanilla" Mortgage Products

The legislation mandates that rules requiring a covered person to offer a "standard consumer product or service" at the same time or before it offers an "alternative consumer product or service." It also authorizes the CFPA to adopt rules regarding the offer of standard and alternative consumer products and services including warnings about the heightened risks of alternative consumer products and services and rules requiring that consumers be provided a "meaningful" opportunity to decline to obtain the standard consumer financial product or service.

The term the Administration's Plan uses to describe these less risky, simpler products is "plain vanilla." In the context of mortgages, "plain vanilla" products would have either fixed or adjustable rates, predictable payments, mandatory escrows for taxes and insurance, and no prepayment penalties attached. The idea behind these "plain vanilla" products is that they could be compared and differentiated by a single, simple characteristic, *i.e.*, the interest rate.

NAMB is supportive of efforts to simplify the process of obtaining a mortgage. However NAMB is concerned that efforts to simplify and standardize mortgage products could have serious negative consequences for consumers looking to find the most appropriate and cost effective loan for their situation. Specifically, NAMB is worried about the unnecessary additional costs of developing new products, questionnaires, and opt-in disclosures that would likely be passed-on to consumers if institutions' product offerings are overregulated. Additionally, NAMB is concerned that consumers may fall into the trap of merely opting for the "plain vanilla" mortgage product, regardless of its appropriateness for their particular situation, simply because it appears to be preferred and may falsely be interpreted as a "government approved" product. NAMB would be opposed to placing "non-plain vanilla" products at a competitive disadvantage by imposing additional operational or disclosure burdens than the "plain vanilla" government approved product.

Rules governing such "plain vanilla" products should help to ensure that consumers have and understand affordable options for financing homeownership.

c. Fairness – Duties Owed to Consumers by Originators & Entities

H.R. 3126 imposes duties on covered persons and their agents and employees to ensure fair dealing with consumers in financial transactions. Such rules may establish duties regarding compensation practices, but specifically prohibit the CFPA from capping the amount of compensation paid to any person.

NAMB has some concerns about this broad power without any rules of construction to ensure that there is no disparate treatment among industry participants. NAMB is concerned about the CFPA's ability to remove consumer financing options and we believe that the CFPA should be provided with some specific rules of construction in interpreting this section.

NAMB does, however, appreciate the importance of ensuring that loan originators are not incentivized to steer consumers into particular loan products purely for personal gain, and NAMB is very supportive of efforts to eliminate any such incentives from the marketplace. Therefore, NAMB commends the Administration's Plan for recognizing and proposing affirmative steps be taken to require banks and lenders to disclose to consumers the payments made to their employees called "overages," as well as their "service release premiums."

NAMB supports those provisions in the Administration's Plan that call for all originators, including banks and non-depository lenders, to disclose all direct and indirect income generated in a mortgage transaction, as mortgage brokers have done since 1992. In fact, NAMB advocates for utilizing the mortgage broker model of complete financial disclosure to effectively reveal the heretofore hidden bank payments to loan officers and service release premiums.

Although not in the bill, included in the Administration's Plan is the CFPA's authority to require loan originator compensation to be tied to loan performance and paid-out over the life of a loan, as opposed to in one lump sum upon origination.

NAMB sees a number of specific practical flaws in the Administration's Plan to propose regulations linking loan originator compensation with the longer-term performance of a loan. Loan originators earn their compensation when they successfully match a loan product with a customer's individual needs and desires for home financing and are involved in that transaction through to closing. Additionally, lenders create mortgage products, determine the type of risk they are looking for and price that risk accordingly.

i. Standards of Care

The Administration's Plan also proposes granting the CFPA the authority to impose certain duties of care on the providers of financial products and services. In prescribing such regulations, the CFPA shall consider whether (1) the covered person is acting in the interest of the consumer with respect to any aspect of the transaction; (2) the covered person provides the consumer with advice; (3) the consumer's reliance on any advice from the covered person would be reasonable and justifiable under the circumstances; (4) the benefit to the consumers of imposing a duty would outweigh the costs; and (5) any other factors the CFPA deems appropriate.

Since 2002, NAMB has advocated for more stringent standards for all loan originators to protect consumers and curb abusive lending practices in the mortgage industry. However, NAMB cautions the CFPA, or any regulator attempting to implement a standard of care for mortgage originators, that there is a likelihood of unintended negative consequences for consumers if such a standard is overly restrictive or under-inclusive of essential market participants.

NAMB believes that a standard of care should apply whenever a person is acting as a loan originator under the definition in the SAFE Act, and should be broad and flexible enough to operate as a ceiling, not a floor, in establishing a loan originator's responsibilities when working with consumers. Also, because the acts of originating, funding, selling, servicing, and securitizing mortgage loans may all be conducted separately and independently, or may be engaged in collectively under one corporate structure or through affiliated business arrangements, it is important for consumer protections to relate to the function, as

opposed to the structure of entities. In the end, consumers deserve the same level of protection no matter where they choose to obtain a mortgage loan.

Specifically, NAMB believes that any person required to be licensed or registered as a loan originator under the SAFE Act should have a federal statutory duty to exercise good faith and fair dealing in all communications and transactions with consumers. All loan originators should be held to the same standard of conduct toward consumers so that all consumers are shielded from the potentially grave consequences that can occur when transacting business with under-qualified individuals, regardless of whether they are working with a federally-chartered bank, state-chartered lender, credit union, or mortgage broker. In addition, if the CFPA requires disclosure or duties on any particular mortgage provider, the CFPA should require disclosures to be symmetrical. Meaning, those with no duty to the consumer must disclose that fact to their customer.

ii. Consistent Regulation of Similar Products, Services & Providers

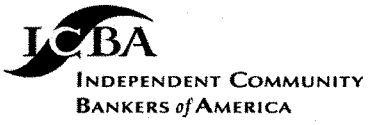
NAMB strongly supports the Administration's emphasis on fairness and the preservation of effective competition on our financial markets throughout its policy paper. We agree entirely with the Administration that similar disclosures for similar products, services, and providers enables consumers to make more informed choices based upon a full appreciation of the nature and risks involved in a given transaction.

We do not deny that differences exist between depository and non-depository institutions, both in terms of their business models and how they are currently regulated. However, when it comes to the contact with consumers in the context of mortgage loan origination, these entities are virtually indistinguishable, particularly in the eyes of consumers, and therefore should be regulated by a single federal agency and held to the same standards as their competitors.

XIII. Conclusion

NAMB greatly appreciates the opportunity to discuss the Obama Administration's Financial Regulatory Reform Plan and H.R. 3126 with this Committee. Although we generally support many of the consumer protection measures outlined in the Administration's Plan, we do have concerns over certain specific elements of the proposal, and we look forward to working closely with this Committee to alleviate those concerns moving forward.

Thank you again for inviting NAMB to appear before this Committee and discuss these very important issues affecting consumers and our industry as a whole.



Testimony of
R. Michael S. Menzies, Sr.
President and CEO, Easton Bank and Trust Company

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals"

July 15, 2009
Washington, DC

Chairman Frank, Ranking Member Bachus, Members of the Committee, my name is Michael Menzies, and I am the President and CEO of Easton Bank and Trust Company, Easton, MD, and the Chairman of the Independent Community Bankers of America. [1] Easton Bank is a state-chartered community bank with $150 million in assets. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on President Obama's proposals to restructure and reform the nation's financial regulatory system and address consumer abuses mainly perpetrated by unregulated institutions that contributed to the financial crisis.

Less than one year ago, due to the failure of our nation's largest institution's to adequately manage their highly risky activities, key elements of the nation's financial system nearly collapsed. Other parts – especially our system of locally owned and controlled community banks – were not in similar danger. But community banks, the cornerstone of our local economies, have suffered, both from the steps government had to take to deal with the crisis – especially steps taken to subsidize too-big-to-fail institutions – and from our severe recession.

This was, as you know, a crisis that community banks did not cause. A crisis driven by a few unmanageable financial entities that nearly destroyed our equity markets, our real estate markets, our consumer loan markets, the global finance markets and cost the American consumer over $7 trillion in net worth. A crisis that forced the federal government to inject almost $10 trillion in capital and loans and guarantees to large complex financial institutions whose balance sheets were over leveraged and lacked adequate liquidity to offset the risks they had taken. A crisis that has brought the world markets to a point where they even question if the U.S. dollar should be retained as the reserve currency of the world. A crisis driven by the ill conceived logic that some institutions should be allowed to exist even if they were too big to fail.

Congress has already passed legislation at great cost to the taxpayers intended to deal with that crisis and the recession. It is now this committee's job to craft a program that will reduce the chances that risky and irresponsible behavior by large or unregulated institutions will again lead us into economic crisis.

ICBA commends you and President Obama for tackling this important task. The President's plan takes strong steps toward addressing systemic risks posed by too-big-to-fail financial firms. We offer detailed recommendations to make them even stronger. It is critical to remember that taking measures to reduce systemic risk and eliminating

---

[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and more than $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

too-big-to-fail is the best way to protect consumers. Millions of Americans have suffered economic hardship, losing their jobs, their savings and their homes as a result of the crisis. ICBA believes other consumer protection aspects of the plan should be refocused to target those who perpetrated the abuses and improved so that it does not add unnecessary burdens those institutions that have always treated their customers with respect and fairness.

Addressing Systemic Risk

ICBA supports President Obama's plan to identify specific institutions that may pose systemic risk and to subject them to stronger supervision, capital, and liquidity requirements. Our economy needs more than an "early warning" about possible problems; it needs a real cop on the beat.

But, the President's plan could be enhanced to better protect the taxpayers and safeguard the financial system. ICBA believes that systemically risky holding companies should pay fees for their supervisory costs and to fund – in advance – a new systemic risk fund. The President's plan calls for funding only after an institution fails.

ICBA also strongly supports the "Bank Accountability and Risk Assessment Act of 2009" introduced by Rep. Luis Gutierrez (H.R. 2897) which would require the FDIC to impose an additional fee on any insured bank affiliated with a systemic risk institution. This would better account for the risks these institutions pose and strengthen the Deposit Insurance Fund.

These strong measures are not meant to punish those institutions for being large, but to guard against the risks they pose and to protect the taxpayers and the public. They would hold these large institutions accountable and discourage them from remaining or becoming "too big to fail." However, if these enhancements are not enough, the President's plan sensibly calls for a plan to resolve failing institutions. Our testimony details how Congress can further improve the plan.

But to truly prevent the kind of financial meltdown we faced last fall, and to truly protect consumers, the plan must go further. It should direct systemic risk authorities to develop procedures to downsize the too-big-to-fail institutions in an orderly way.

ICBA is pleased that the plan maintains the state banking system and believes that any final bill should also maintain the thrift charter. Both charters enable community bankers to follow business plans that are best adapted to their local markets and pose no systemic risk.

Protecting Consumers

Unregulated individuals and companies perpetrated serious abuses on millions of American consumers. This committee and the President are completely justified in your efforts to prevent these kinds of abuses in the future. Community banks already do their utmost to serve consumers and comply with consumer protections. Therefore, ICBA strongly recommends that new legislation ensure that otherwise unregulated or

unsupervised people and institutions are following existing law. We strongly believe that – in contrast to the Administration's proposals – rule writing and supervision for community banks should remain with agencies that also must take safety and soundness into account. Clearly a financial institution that does not adhere to consumer protection rules also has a safety and soundness problem.

Improving Policy Making

Since the onset of the thrift crisis in the late 1980s, the Treasury Department's role in policy making for financial institutions has grown substantially. Before that time, it was more focused on broad national and international financial markets; the executive branch generally left financial institutions policy making to the various supervisory agencies. ICBA urges Congress to update the Treasury's organizational structure to add an assistant secretary for community financial institutions to provide an internal voice for Main Street concerns. The "Administrative Support and Oversight for Community Financial Institutions Act of 2009" (H.R. 2676) introduced by Rep. Dennis Cardoza will provide that important balance between Wall Street and Main Street within the Treasury.

Summary of ICBA Key Recommendations

Designate the Federal Reserve as the primary systemic risk regulator.

Give the Financial Services Oversight Council clear policy setting and oversight authority over the Federal Reserve, including the power to establish capital, liquidity and other requirements for systemic risk firms, the power to over-rule Fed decisions by a majority vote of the Council, and the power to force the Fed to take actions.

Identify institutions that potentially pose systemic danger and make them subject to substantially higher capital and liquidity requirements, plus more rigorous supervision.

Give the Federal Reserve, in consultation with the Council, the authority to declare an institution insolvent when capital falls below an established level and the institution cannot raise new private capital.

Grant receivership, conservatorship and bridge bank authority to the FDIC to operate an insolvent institution and develop a restructuring, downsizing or dissolution plan.

Eliminate too-big-to-fail so the future failure of a systemic risk institution would not threaten the stability of our economic system.

Reduce and strengthen the 10% nationwide deposit concentration cap established by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

Downsize financial institutions that continue to pose a systemic danger below systemic danger limits within five years, or impose harsh monetary and management penalties.

Impose a systemic risk premium on all "Tier I" financial holding companies, broadly defined to include all large complex financial firms that have the potential of posing a systemic risk.

Require all FDIC-insured affiliates of large complex financial firms to pay a systemic risk premium to the FDIC in addition to their regular FDIC premiums to compensate the FDIC for the increased risk they pose.

Broaden the assessment base used by the FDIC to determine a bank's premium by including total assets minus tangible equity for the assessment base, rather than domestic deposits. A broader assessment base would result in a fairer assessment system.

Retain the system of federal and state bank chartering and do not create a single, monolithic federal regulator.

Maintain the federal thrift charter and if the Office of Thrift Supervision and Office of the Comptroller of the Currency are merged, then a separate division for thrift supervision should be established in the new National Bank Supervisor.

Focus new consumer protections on otherwise unregulated people and institutions, and avoid adding extra burdens to community bankers. We strongly oppose proposals that would strip rule writing and supervision for community banks from agencies that also must take safety and soundness into account.

Establish an Assistant Treasury Secretary for Community Financial Institutions.

Enhance Systemic Risk Regulation

The Administration's proposal expands the authority of the Federal Reserve to supervise all institutions that could pose a threat to financial stability, including non-banks, and creates a Financial Services Oversight Council to identify emerging systemic risks in firms and market activities and improve interagency cooperation. These proposals are a substantial improvement over the current system, but can be improved to truly protect consumers, local communities and our economy.

Make Federal Reserve the Primary Systemic Risk Regulator

Our nation needs a strong and robust regime of systemic risk regulation and oversight. It is clear that reckless lending and leveraging practices by too-big-to-fail institutions were the root of the current economic crisis. The only way to maintain a vibrant banking system where small and large institutions can fairly compete – and to protect taxpayers – is to aggressively regulate, assess and eventually downsize institutions that pose a risk to financial stability.

ICBA supports the President's proposal to designate the Federal Reserve as the primary systemic risk regulator. The Federal Reserve is the agency best equipped to take on this new role. However, we share the concerns expressed by some in Congress that without proper direction and oversight, the Fed may be slow or reluctant to act to address systemic risks. Some Members of Congress have justifiably criticized the Fed for its slow response to the congressional mandate to promulgate new rules to govern the unregulated segments of the mortgage industry or for its promotion of the Basel II capital agreement. Indeed, one of the weaknesses of the Administration's proposal is that the Federal Reserve is given too much new power with no accountability for enforcement.

Enhance Duties of Council

Therefore, the proposed Financial Services Oversight Council should have the power to set clear policy and have oversight authority over the Federal Reserve, including establishing capital, liquidity and other requirements for systemic risk firms, the power to over-rule Fed decisions by a majority vote of the Council, and the power to force the Fed to take actions. In addition, the Fed should be required to report to Congress on a regular and frequent basis, so that Congress can also exercise oversight to ensure that the Fed is properly and appropriately implementing its new authority.

The Council should be responsible for identifying gaps in regulation and recommending institutions that should come under consolidated supervision by the Federal Reserve. It is critical to extend supervision and oversight to those non-bank entities that contributed to the current financial crisis largely because they did not fall under any agency's regulatory umbrella.

Identify Systemic Risk Institutions

Generally speaking, systemic risk institutions are Large Complex Financial Institutions (LCFIs) that are sufficiently large that diversification no longer mitigates risk. Instead, their risk profiles increasingly come to resemble that of the financial market itself, leaving them vulnerable to any major shock to the financial markets.

When companies like Morgan Stanley and Goldman Sachs and Lehman Brothers are leveraged 25 to 34 to one, when they have less than 4 cents at risk for every dollar in assets, their success or failure determines the future of the markets. According to Bridgewater Financial Group (HBR August 2009)[2] in September of 2008 the Bank of America was leveraged 73 to 1 and if it were to capitalize all of its off balance sheet entities it would have been leveraged 134 to 1. That means less than 1 penny of capital at risk for every dollar of assets.

Congress and the Council must establish clear principles to identify systemic risk institutions. It is not difficult to identify the handful of mega-bank financial institutions which will form the core of the proposed Tier 1, but at the margins, defining systemically important institutions by asset size alone is insufficient. Institutions that are not

[2] Harvard Business Review, August 2009

systemically risky may become so through growth or complexity. Flexibility ensures that the systemic risk regulator can respond to changes in the market, but they should always operate under clearly articulated principles.

Some contend that Tier 1 institutions should not be publicly identified because that would give them an unfair advantage in the marketplace. We disagree. Institutions that potentially pose systemic risk must be identified. Supervision by specific regulators and the enforcement of any rules designed for systemic risk institutions might make this obvious anyway. Status as Tier 1 should not be a signal to markets that an institution will not be allowed to fail, but rather that its failure would raise systemic concerns.

The fundamental purpose would be to make clear that these institutions will be subject to substantially higher capital and liquidity requirements, plus more rigorous supervision in order to protect the financial system and the economy. This will help mitigate any "advantage" they might receive. In addition, more liquidity and better supervision will decrease the chance that an institution will fail in the first place. And, in the event of failure, higher capital will protect taxpayers.

Systemic Risk Guidelines

ICBA suggests as a guideline that a systemic risk financial institution is one that has more than $100 billion in assets, and has a risk profile that is susceptible to one or more risk factors. While not all institutions with more than $100 billion in assets are by definition systemically significant, all institutions in excess of $100 billion in assets should be examined closely to determine their systemic importance with special attention paid to the following factors:

- o Provision of systemically essential services within the economy.
- o Use of leverage – both traditional and embedded in derivatives.
- o Status as a major client and/or counterparty of LCFIs.
- o Overall level of participation/integration with capital markets, especially high risk activities such as proprietary trading activities.
- o Trade in derivative instruments which can potentially multiply risk exposures as well as mitigate, especially writing of derivatives contracts.
- o Dependence on short-term non-depository funding from capital markets such as commercial paper.
- o Off-balance sheet activities.
- o Rate of asset growth.
- o Deposit concentration.
- o Organizational complexity and capability of management.

Give FDIC Sole Resolution Authority

We must take measures to end too-big-to-fail by ensuring there is a mechanism in place to declare an institution in default and appoint a conservator or receiver that can unwind or sell off the institution's operations in an orderly manner. In order to maintain market discipline, as part of the process shareholders and management responsible for the institution's demise should not be protected. The Federal Reserve, in consultation with the Council, must have the authority to declare an institution insolvent when capital falls below an established level and the institution cannot raise new private capital. Agencies insulated from politics – not the Treasury as proposed by the Administration – should make these calls.

We strongly support the Administration's proposal to grant receivership, conservatorship and bridge bank authority to the FDIC to operate an insolvent institution, including its holding company and affiliates, and develop a restructuring, downsizing or dissolution plan. The FDIC, should have sole authority to determine how a systemically important institution should be resolved. The FDIC has extensive experience resolving banks and has the infrastructure in place to exercise conservatorship and receivership powers over financial companies.

The FDIC should have clearer guidelines than provided in the Administration's plan for resolving failing Tier 1 institutions leading to restructuring and downsizing through sales of assets. At a minimum, Tier 1 financial holding company shareholders should not be protected. Government must re-establish credibility that shareholders of financial institutions will bear the full loss in any insolvent financial institution. This core principle of capitalism has been repeatedly violated or in the often cited words of Allan H. Meltzer[3], "Capitalism without failure is like religion without sin – it doesn't work."

Clear seniority must be established among types of uninsured financial institution creditors. Uninsured creditors should not be supported like bank depositors – they receive market rates of return and should bear the risks of the marketplace. In the event of a failure, they should have their claims written down or become the new equity holders as they would in bankruptcy.

Congress should also modify the Administration's plan to give the FDIC resolution authority over all bank holding companies regardless of size in order to promote consistent and efficient resolution of all bank holding companies, not just Tier 1 FHCs. The current bifurcated resolution authority between the FDIC and the bankruptcy courts has added significant costs to many receiverships and resolutions.

Require Insolvency Contingency Plan

As the Lehman Brothers failure demonstrated, subverting market expectations, especially too-big-to-fail expectations, can be extremely destabilizing – therefore a clear, rules-based process must be followed. Tier 1 FHCs should have an insolvency

[3] University Professor of Political Economy at Carnegie Mellon University, and Visiting Scholar at the American Enterprise Institute, author of *A History of the Federal Reserve, Volume 1: 1913-1951*

contingency plan which the resolution authority can use in the event of failure. This plan should include close monitoring of their counterparty exposures for possible spillover effects. Regulators should ensure systemic risk institutions are organized so they can continue to perform systemically important functions during a resolution process.

End Too-Big-To-Fail

Ending too-big-to-fail is one of the most critical issues facing our nation. The only way to truly protect consumers, our financial system, and the economy is by finding a solution to rein in too-big-to-fail institutions. One of the weaknesses in the Administration's proposal is that it assumes special treatment for Tier 1 FHCs, which could result in the perpetuation of the too-big-to-fail doctrine. One of the goals of any regulatory restructuring plan should be to eliminate too-big-to-fail so the future failure of a systemic risk institution would not threaten the stability of our economic system.

Indeed, implicit in the FDIC's role in resolving insolvent institutions is the end of the too-big-to-fail doctrine, which has driven the creation of systemic risk institutions and given too-big-to-fail institutions an unfair competitive advantage.

In a recent speech Federal Reserve Chairman Ben S. Bernanke outlined the risks of the too-big-to-fail system:

> [T]he belief of market participants that a particular firm is considered too big to fail has many undesirable effects. For instance, it reduces market discipline and encourages excessive risk-taking by the firm. It also provides an artificial incentive for firms to grow, in order to be perceived as too big to fail. And it creates an unlevel playing field with smaller firms, which may not be regarded as having implicit government support. Moreover, government rescues of too-big-to-fail firms can be costly to taxpayers, as we have seen recently. Indeed, in the present crisis, the too-big-to-fail issue has emerged as an enormous problem.[4]

FDIC Chairman Sheila Bair, in remarks before the ICBA annual convention in March, 2009, said, "What we really need to do is end too-big-to-fail. We need to reduce systemic risk by limiting the size, complexity and concentration of our financial institutions." [5] The Group of 30 report on financial reform stated, "To guard against excessive concentration in national banking systems, with implications for effective official oversight, management control, and effective competition, nationwide limits on deposit concentration should be considered at a level appropriate to individual countries."[6]

Strengthen Deposit Concentration Cap

---

[4] Financial Reform to Address Systemic Risk, at the Council of Foreign Relations, March 10, 2009
[5] March 20, 2009
[6] "Financial Reform; A Framework for Financial Stability, January 15, 2009, p. 8.

The 10% nationwide deposit concentration cap established by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 must be immediately reduced and strengthened. The current cap is insufficient to control the growth of systemic risk institutions the failure of which will cost taxpayers dearly and destabilize our economy.

Unfortunately, government interventions necessitated by the too-big-to-fail policy have exacerbated rather than abated the long-term problems in our financial structure. Through Federal Reserve and Treasury orchestrated mergers, acquisitions and closures, the big have become bigger.

Downsize Systemic Risk Institutions

Congress should make clear that downsizing of systemic risk institutions is not only desirable, it is essential if we are to avoid future financial calamities. It is clearly not in the public interest to have so much power and concentrated wealth in the hands of so few, giving them the ability to destabilize our entire economy.

The Administration's plan includes valuable incentives to encourage downsizing. ICBA strongly supports the Administration's proposal to subject "Tier 1" FHCs to stricter and more conservative prudential standards than those that apply to other bank holding companies – including higher standards on capital, liquidity and risk management. Capital requirements should be graduated for institutions $100 billion in assets and larger to protect against losses, and act as a disincentive to growth that increases systemic risk. The imposition of systemic risk fees, which will be discussed later, also should serve as a disincentive to unbridled growth.

Financial institutions that continue to pose a systemic risk should be required to downsize to below systemic risk limits within five years, or face harsh monetary and management penalties. Any dissolution plan should include breaking up the institution and selling off pieces to other institutions, including community banks.

Research suggests that economies of scale and scope in banking are exhausted at much smaller sizes, but size does yield monopoly (market) power, 'synergies of conflict of interest' and an implicit subsidy provided by the taxpayer guaranteeing the bank against default and insolvency. [7] These abuses must end for a vibrant, competitive financial services marketplace to emerge from this crisis.

The Justice Department should have the authority to downsize systemic risk institutions through reinvigorated and reformed antitrust policy. Regulators should closely examine – and deny – new merger applications that would result in the creation of new too-big-to-fail institutions.

Impose Systemic Risk Premiums

Large complex financial institutions created the most severe economic crisis in the United States since the Great Depression through poor underwriting practices,

[7] Buiter, Too Big To Fail Is Too Big.

predatory credit practices and a system of financial interdependence that no one even in these companies understood. Since last October, Congress has invested $700 billion in the Troubled Asset Relief Program and $700 billion in stimulus to rescue the economy, and the Federal Reserve has also dedicated hundreds of billion dollars to aide the failing economy. Out of these funds, the Federal government has dedicated more than $150 billion in taxpayer and FDIC funds to shore up the nine largest banks and $ 70 billion in assistance and guarantees to AIG. Although some of these institutions have repaid the assistance, the current financial crisis illustrates the enormous risk that large complex financial institutions pose to taxpayers and the FDIC. As a result, ICBA urges Congress to impose two types of systemic risk fees against large complex financial institutions to compensate the taxpayers and the FDIC fund for this risk exposure.

Holding Company Premiums. First, Congress should impose a systemic risk premium on all Tier I financial holding companies, broadly defined to include all large complex financial firms that have the potential of posing a systemic risk. Part of this first premium would pay for improved regulation of systemic risk. Additionally, part should be made available to the FDIC to fund the administrative costs of systemic resolutions and other costs associated with an orderly unwinding of the affairs of a failed institution.

Bank Premiums. Second, Congress should require all FDIC-insured affiliates of large complex financial firms to pay a systemic risk premium to the FDIC in addition to their regular FDIC premiums to compensate the FDIC for the increased risk they pose. Because their depositors and creditors receive superior coverage to the coverage afforded depositors and creditors of community banks, the largest financial institutions should pay an additional premium. The FDIC's Deposit Insurance Fund is ultimately responsible for insuring the deposits in those institutions. Enhancing resources available to the FDIC through a systemic-risk premium would reduce the risk that taxpayers would be called on to resolve a systemic risk depository institution.

The Bank Accountability and Risk Assessment Act of 2009, H.R. 2897, by Financial Institutions Subcommittee Chairman Luis Gutierrez, would impose just such an annual systemic risk premium on all banks and thrifts that are part of systemically significant holding companies.

H.R. 2897 addresses other deposit insurance issues, which should be part of regulatory restructuring legislation. In addition to a systemic risk premium, the legislation would create a system for setting rates for all FDIC insured institutions that is more sensitive to risk than the current system. First, the legislation requires the FDIC to examine risks throughout a bank's holding company, when the FDIC establishes rates for a bank. Recent history has demonstrated that the risk to the FDIC and taxpayers cannot be determined solely by looking at a depository institution in isolation. Second, the bill requires the FDIC to consider the amount of assets and liabilities, not just the categories and concentrations of assets and liabilities.

Finally, H.R. 2897 would create an assessment base that is more closely linked to the risks in insured institutions and would create greater parity between large and small

banks. The bill would broaden the assessment base used by the FDIC to determine a bank's premium by including total assets minus tangible equity for the assessment base, rather than domestic deposits. A broader assessment base would result in a fairer assessment system with the larger banks paying a share of the assessments that is proportional to their size rather than their share of total deposits.

Under the current system that assesses only domestic deposits, banks with less than $10 billion in assets pay approximately 30% of total FDIC premiums although they hold approximately 20% of total bank assets. Furthermore, 85-95 percent of the funding for these community banks comes from domestic deposits, while for banks with $10 billion or more in assets, the figure is approximately 52 percent. Thus, while community banks pay assessments on nearly their entire balance sheets, large banks pay on only half. Under H.R. 2897, banks with less than $10 billion in assets would pay about 20% of FDIC premiums, which is in line with their share of bank assets.

Moreover, the proposed base in more closely linked to risks. The amount of assets that a bank holds is a more accurate gauge of an institution's risk to the DIF than the amount of a bank's deposits. Bad assets, not deposits, cause bank failures, and all forms of liabilities, not just deposits, fund a bank's assets. Most of the $18 billion in actual losses that the DIF incurred in 2008 came from the resolution of IndyMac Bank F.S.B., a bank with $32 billion in assets including many subprime loans and mortgage-backed securities but only $19 billion in deposits.

The proposed assessment base of assets minus tangible equity was used by the FDIC for the special assessment adopted this May. The bill would establish assets (minus tangible equity) as the assessment base for all regular and special FDIC assessments. The change would reduce the assessments of 98% of the banks with less than $10 billion in assets, keeping millions of dollars in community banks, which continue to lend to small businesses and consumer throughout America.

Improve Financial Markets

A risk-retention requirement for mortgage-backed securities could be a useful tool in regulating risk associated with the securitization process, if coupled with an exemption from the retention requirement for mortgages subject to comprehensive standard underwriting requirements, such as loans sold to the housing government sponsored enterprises or guaranteed by the Federal Housing Administration.

ICBA endorses stronger regulation of the over-the-counter derivatives because of the central role credit default swaps played in the current financial meltdown.

ICBA also supports further hedge fund regulation including requiring hedge funds to (1) register with the Securities and Exchange Commission (2) disclose appropriate information on an ongoing basis to allow supervisors to assess the systemic risk they pose individually or collectively.

Enhance Supervision of Systemically Important Payment, Clearing and Settlement Systems

ICBA supports the Administration's proposal to provide the Federal Reserve with new authority to identify and regulate systemically important payment, clearing and settlement systems. This expanded authority would allow the Federal Reserve, in conjunction with a system's primary federal regulator, to collect applicable information and to subject covered systems to regular, consistent, and rigorous on-site safety and soundness examinations to enforce compliance with applicable risk management standards.

The recent financial crisis highlighted the ineffectiveness of a patchwork regulatory structure for systems critical to the clearance and settlement of financial transactions and confidence in our financial markets. The Federal Reserve has a wealth of relevant expertise and resources that should be extended to all systems deemed systemically important. These systems should also have access to Reserve bank accounts, financial services, and the discount window for emergencies.

Additional Structural Issues

Maintain Dual Banking System and Federal Regulatory Structure

ICBA is pleased that the President's plan retains the system of federal and state bank chartering and does not recommend creating a single, monolithic federal regulator. The current system of bank supervision – though admittedly complicated on paper, has weathered the current crisis reasonably well. It provides substantial uniformity of capital and supervisory standards, but also different perspectives and essential checks and balances.

Some have complained that these advantages also give institutions the opportunity to engage in "regulatory arbitrage," playing one regulator against another. Let me be completely clear on this, no institution should be able to escape a regulatory action, such as a cease and desist or similar order, by changing charters. In fact, the Federal Financial Institutions Examination Council recently issued a statement that provides "that charter conversions or changes in primary federal regulator should only be conducted for legitimate business and strategic reasons." It goes on to say that, "Conversion requests submitted while serious or material enforcement actions are pending with the current chartering authority or primary federal regulator should not be entertained." [8]

Retain the Federal Thrift Charter; Subject Unitary Thrift Holding Companies to the BHCA; Close ICL Loophole

The federal thrift charter must be maintained. The U.S. financial system benefits from a charter dedicated to housing and consumer lending. Certain large banking institutions intent on engaging in risky, nontraditional banking activities used a thrift charter to do so, but this was not the fault of the charter but of the business plan of those institutions. Unlike Washington Mutual or Countrywide Financial, most thrift institutions are well run

[8] **FFIEC Statement on Regulatory Conversions;** FIL-40-2009, July 7, 2009

community institutions that are heavily engaged in making prime residential mortgage loans in their communities and were never engaged in subprime, interest-only or other types of alternative residential mortgage lending. Mr. Chairman, we appreciate your expressed support for the thrift charter.

The Office of Thrift Supervision should be retained since we need a regulator that has the expertise to supervise and regulate institutions like thrifts and mutual institutions that focus on housing lending. If the OTS is merged into the proposed National Bank Supervisor, at a minimum, existing federal thrift charters should be preserved or grandfathered, and a Division of Thrift Supervision should be established within the NBS to regulate institutions that want to maintain their federal thrift and mutual institution charters. For example, it would be a substantial hardship for existing mutual institutions organized as federal thrifts to convert to commercial bank charters. This could force some of them to convert to stockholder-based entities. No mutual institution should be pressured into converting or denied the option of mutuality.

We agree that unitary thrift holding companies should be regulated as bank holding companies, supervised and regulated by the Federal Reserve on a consolidated basis, and subject to prohibitions on commercial activities. Many commercial entities used the unitary thrift loophole to get into the banking business. Unfortunately, the Gramm-Leach-Bliley Act of 1999 grandfathered existing thrift holding companies that qualified as unitary thrifts. By escaping the Bank Holding Company Act, these unitary thrifts have been able to evade consolidated supervision by the Federal Reserve and the long-standing policy of separating banking from commerce. This loophole should be shut down and unitary thrifts should be given a definite period of time to divest their commercial activities once they become subject to the Bank Holding Company Act.

Of course, the same must be said about the industrial loan company loophole, which remains open. Under this loophole, commercial companies may acquire or establish banks in several states. Administrative action and economic conditions have discouraged this activity in recent months, but unless the Congress acts, commercial companies could soon begin seeking banking charters again. Just imagine if major commercial firms had been heavily involved in the banking business last fall. The Administration has proposed the safest course – close the loophole in connection with this legislation.

Protecting Consumers

Community bankers put their customers first. It's just the way we do business. ICBA strongly agrees that consumers must have comprehensible information that they need to make informed, responsible financial decisions and must be protected from abusive, unfair or deceptive practices.

Community bankers believe that the best way to protect consumers is to end the too-big-to-fail concentration risks that cost the consumer over $7 trillion in economic worth. No disclosure or product approval system could offset the damage done by a few behemoth financial entities that brought our economy to its knees.

Unregulated individuals and companies perpetrated serious abuses on millions of American consumers. Therefore, new legislation should focus on otherwise unregulated people and institutions, and avoid adding extra burdens to community bankers who treat their customers fairly and honestly and did not engage in the behavior that fed the financial crisis. In addition, we strongly oppose proposals that would strip rule writing and supervision for community banks from agencies that also must take safety and soundness into account.

Mr. Chairman, we appreciate that your recently introduced legislation establishing the Consumer Financial Protection Agency (CFPA), H.R. 3126, does not transfer enforcement authority over the Community Reinvestment Act (CRA) to the new agency. This is a common-sense step that allows current prudential regulators to maintain their authority over this law. CRA is intended to ensure that banks are providing services to all segements of the community. Similarly, other fair lending statutes, such as the Equal Credit Opportunity Act (ECOA) and Home Mortgage Disclosure Act, should also remain with the current financial regulatory agencies that will be conducting safety and soundness examinations. Of course, fair lending is good lending and good business. But regulators must consider safety and soundness considerations when they impose specific requirements to achieve these goals.

This applies more broadly. For community banks, safety and soundness and consumer protection are not mutually exclusive functions. Not only must these elements co-exist and be balanced in order maintain effective financial services regulation and enforcement, but also because the community banking model rests on the unique long-term relationships community bankers develop with their customers. Customers are attracted to do business with community banks because they are common sense, responsible lenders with local decision-making. Our common sense approach is also why community banks have not gotten into trouble through the use of exotic lending products that led other large firms into bankruptcy or partial government ownership. This relationship is symbiotic: Instilling confidence in our customers that they will be treated honestly means a community banker is not going to take excessive risks, and will certainly not engage in an abusive practice to drive customers away. It also explains why community bankers never relaxed their lending standards simply to compete with the megabanks and non-bank lenders.

The proposed CFPA regrettably splits the safety and soundness and consumer protection functions, going so far as to place this new agency as the ultimate arbiter of any dispute between a prudential regulator and itself. While community banks go above and beyond to protect their customers, allowing consumer protection to trump safety and soundness is a dangerous precedent. Bank regulators have expertise in balancing safe and sound operation with the need to provide consumers information they need to make informed financial decisions and protect them from unfair and harmful practices. Furthermore, if stripped of their consumer protection personnel and authorities, existing agencies would be deprived of the ability to properly determine CAMEL ratings. Regulators today give consideration to consumer protection and compliance when

evaluating a bank's Capital and Management during a safety and soundness exam, a critical task rendered impossible under this legislation.

The proposed agency will be responsible for regulating and enforcing actions against a universe of entities more diverse, complex, and numerous than any other existing agency is responsible for. Congress and taxpayers will need to determine how to pay for this agency's activities. It is particularly worrisome to community bankers that one of the recommended means of funding the CFPA is through a new series of fees levied on consumer products and individual transactions. It seems contradictory that an agency with a mission to protect consumers would fund itself by directly raising the cost of everyday consumer products.

Community bankers are particularly concerned that they and their customers could bear a considerable share of this added funding burden. Banks already pay significant fees for their regulation, and this proposal could well increase them.

This proposal highlights a long-standing challenge facing community banks, namely encouraging policymakers to distinguish between large and small financial institutions and not to assume that a one-size-fits-all approach is an appropriate way to legislate or regulate the financial sector. If the current economic crisis has proven anything, it is that there are significant disparities between the way large firms and smaller firms do business. Regulation for community banks should be proportional. Yet, in its current form, the CFPA is not required to make any distinction between large banks, non-bank financial firms, and community banks. In fact, only the proposed National Bank Supervisor – a regulator focused on the well-being of the largest banks in our country – is given a seat on the Agency's board.

In recent Congressional testimony, administration officials pointed out the disparity between the existing regulatory regimes for federally insured banks and those for non-bank financial firms. We agree that the lack of sufficient regulatory oversight of many unregulated firms, particularly those in the mortgage industry, contributed significantly to our financial crisis. However we disagree with a response that, instead of focusing on regulatory gaps and augmenting existing systems, places community banks into an entirely new regime with only vague limits and checks on its powers.

We also disagree with the notion that community banks would be better served under a new regulator that has no definitive mandate to consider the differences between the products offered by a large, national bank and a community bank operating exclusively in a small geographic area. For example, many community banks have for years offered short-term balloon loans to members of their communities. This was not done to be predatory, but rather because that type of product made most sense for the individual needs of a select group of bank customers in a defined geographic area. Such a product would likely fall outside the agency-approved definition of a "standard" financial product, and would be subject to stricter and costlier regulation. While community banks generally offer sensible, simple products, this one example highlights how our unique understanding of the needs of our community will often not coincide with the one-size-fits-all product parameters defined by the proposed CFPA in Washington.

Community bankers need the flexibility to offer the products and services best suited to the specific needs of their customers, and a regulator able to balance this need with safety and soundness. This proposed agency, by separating these two regulatory functions and enforcing product mandates and adding new costs to consumer products, will unquestionably reduce the ability of small community banks to operate effectively in their communities.

By divorcing safety and soundness regulation from consumer protection regulation and mandating specific products, this proposal sets the stage for the broadest, most substantial increase in regulatory burden on community banks our industry has ever experienced. The CFPA as proposed will dramatically reshape the operating and regulatory environment for community banks in a way that will inevitably make it difficult for community banks to continue to efficiently serve their local economies.

Congress has an historic opportunity to greatly enhance consumer financial protection but the current proposal does not do this. It could well make financial products more expensive – or even unavailable – for community bank customers.

Assistant Treasury Secretary for Community Financial Institutions

The current economic downturn has revealed just how critical community banks are to our country's financial system and why we need to give them appropriate consideration when devising national policies and programs. Recent reports by the FDIC indicate that even when the biggest banks have stopped lending, community banks have seen an increase in their loans. Despite the fact that they are a vital part of our nation's banking system, there is no Assistant Secretary at the Department of Treasury to coordinate federal policy for smaller financial institutions.

For more than two decades, Treasury has taken the lead in crafting the Federal government's response to crises in the banking sector and formulating regulatory reforms to prevent reoccurrences of the crises. Because Treasury plays a central role in Federal banking and economic policy, it is important that community banks have a voice inside Treasury advising the Secretary on how policies will impact community banks. Two actions by the Bush Treasury Department in response to the current financial crisis highlight the need for a community bank advocate inside Treasury.

First, Treasury created a money market mutual fund insurance program overnight with almost no statutory authority. The fees charged to the mutual fund industry for the guarantee were minimal compared to the price that banks have paid for deposit insurance. Treasury's action gave a community bank competitor a significant advantage. The original plan would have given unlimited coverage to money market funds, which would have devastated community bank liquidity with runs on deposits. Although Treasury eventually limited coverage to amounts already in the funds, thanks to intervention by the FDIC and the banking industry, these events illustrate how the Treasury can overlook the community banking sector.

Second, when Fannie Mae and Freddie Mac were put in conservatorship last year, Treasury drastically misjudged the impact of the conservatorship on community bank holders of GSE preferred shares. Prior to the conservatorship, regulators had encouraged community banks to purchase GSE preferred shares as a safe investment that supported housing. Treasury believed that the conservatorship would impact less than ten community banks, when, in fact, the actions wiped at large amounts of capital of hundreds of community banks. While we appreciate the limited tax relief Congress provided community bank preferred shareholders, many community banks are still burdened by the loss of capital caused by the devaluation of their GSE preferred shares.

H.R. 2676, the Oversight for Community Financial Institutions Act of 2009, introduced by Rep. Dennis Cardoza, would create an Assistant Treasury Secretary for Community Financial Institutions. H.R. 2676 would ensure that community banks – including minority-owned institutions – are given appropriate and balanced consideration in the Treasury policy-making process. This is absolutely vital to the continued health and strength of our nation's community banks and the communities they serve. ICBA urges that H.R. 2676 be included in the regulatory reform legislation.

Conclusion

ICBA appreciates this opportunity to testify on the President's plan to restructure and reform our nation's system of financial regulation. It is vital that Congress take action, but it is essential that you take the right actions so that when America emerges from this current crisis, our citizens continue to enjoy a vibrant economy and the ability to build a strong financial future. Your plan should strengthen President Obama's proposals to deal with systemic risk and properly focus the effort to protect consumers.

We must end too-big-to-fail and reduce systemic risk in order to protect consumers, local communities, our financial system and the economy from the destabilizing effects that occur when a giant institution runs into trouble. Community banks are the very fabric of our nation. We fund growth, drive new business development, help families buy homes, finance education. We are not responsible for the current state of our economy but are the victim of others' bad practices. Yet, we continue to help the people and businesses in our communities recover from this crisis and find a way back to prosperity. ICBA looks forward to supporting a plan that embodies our recommended improvements.

HOUSE COMMITTEE ON FINANCIAL SERVICES

Hearing on:

Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

Wednesday, July 15, 2009

WRITTEN TESTIMONY OF CHRIS STINEBERT

PRESIDENT AND CHIEF EXECUTIVE OFFICER

THE AMERICAN FINANCIAL SERVICES ASSOCIATION

HOUSE COMMITTEE ON FINANCIAL SERVICES

Hearing on:

Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

Wednesday, July 15, 2009

WRITTEN TESTIMONY OF CHRIS STINEBERT

Thank you, Mr. Chairman, for the opportunity to speak here today.

Founded in 1916, the American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. The association's 350 members includes consumer and commercial finance companies, card issuers, mortgage companies, auto finance and leasing companies, industrial banks and industry suppliers. AFSA member companies provide approximately 30 percent of all consumer credit and offer many types of credit products, including credit cards, vehicle loans and leases, personal installment loans and mortgages.

While banks play a vital role in the economy and the consumer credit market, Federal Reserve Board statistics show that the majority of non-mortgage consumer credit is provided by finance companies and others who raise funds through securitization. Finance companies have a long history of meeting the credit needs of consumers – from buying a car to get to work, to paying college costs for a son or daughter. Most of AFSA's member companies are state chartered and regulated.

Given its significance to our membership, we appreciate the opportunity to discuss the proposal to create a Consumer Financial Protection Agency (CFPA) focused on protecting consumers in the financial services markets. As I just mentioned, our membership includes industrial banks so I'll also comment on a provision within the administration's regulatory relief proposal that calls for the elimination of industrial bank charters.

Let me say at the outset that AFSA fully supports changes that will result in improvements in consumer protection for customers. What's troubling, however, is the notion that improved consumer protection is dependent upon the creation of a new federal agency in charge of determining product choices for consumers.

We believe the country does not need a vast new bureaucracy – and that the goals of the administration and Congress can be achieved through other ways that will be more efficient, less costly and more successful. Before I give our recommendations, let me outline the industry's concerns with the proposed new agency.

Congress is Rushing to Create a New Agency Without Knowing its Potential Impact on the Economy

If signed into law today, the CFPA's earliest action is at least two to three years in the future – well beyond the current financial crisis. During this interim period, the current federal and state regulators would continue their accelerated efforts to improve and strengthen consumer protections.

The availability of credit is an important part of Americans' everyday lives. Why, then, would Congress rush to launch a new agency before evaluating the potential consequences on credit availability and the overall economy? We believe a careful assessment is needed to determine if the benefits will outweigh the risks and the costs.

Consumers Will Pay More for Financial Products and Services

In essence, the proposal would impose a new tax on consumers at a time when they are least able to afford it. A recent Rasmussen Reports survey found that 61% of voters say taxes are a very important issue for them.

Congress should think carefully about setting up a new government agency that would cost taxpayers more money at a time when they are already struggling to stay afloat financially. Given the vast scope of the proposed CFPA's authority, its funding needs could be staggering. The proposal does not suggest moving existing funds from other agencies commensurate with the proposed personnel transfers. The existing agencies will still need funding to step into the CFPA's role at times. Instead, the proposal seeks to fund the CFPA by assessing fees on those it regulates.

Any assessment on financial services providers undoubtedly will be passed on to consumers. The result will be an increase in the cost and availability of credit – a cost that could be avoided by making better use of the existing consumer protection framework.

Splitting the Prudential and Consumer Protection Functions Won't Yield Better Results

AFSA supports, and believes consumers will be better served by, a regulatory structure where prudential and consumer protection oversight is housed within a single regulator. Congress tried to separate these two intertwined functions with the Government Sponsored Enterprises (GSEs). Federal Housing Finance Agency Director James Lockhart recently cited this separation of functions as one of the primary reasons for the failure of Fannie Mae and Freddie Mac. Today, no evidence shows that a separation of prudential and consumer protection regulation will offer better results in the financial services arena – in fact, indications are to the contrary. We urge Congress to support a regulatory structure that does not separate financial products and services from the viability of the companies that offer them.

Indeed, given that the agency would be required only to "consult" with prudential regulators, it is all too likely that the agency would embark on a mission to severely restrict sound business and financial practices it perceives as not "consumer friendly."

The Proposed Agency Could Take Us Backward, Rather than Forward

With its vast, unfettered authority, the proposed regulator has the potential to roll back the clock 30 years, when consumers had only standard, "plain vanilla" borrowing options. From 1977 to 2007, in inflation-adjusted dollars, consumer credit increased from $882 billion to $2.6 trillion, household mortgages from $2 trillion to $10.4 trillion

and revolving credit from $127 billion to $970 billion. For the last 30 years, financial innovation has been the fuel of the economy.

In the auto sector, for example, car sales in the mid-1970s only averaged six to eight million units each year, in large part because securitization didn't exist back then to provide liquidity for additional sales. In 2009, sales are expected to be just under 10 million units, with the 2010 number projected to be somewhere slightly over 11 million. If the economy continues to stabilize and lending regulations do not change, IHS Global Insight estimates that auto sales could be around 15 million in 2012. The uncertainty created by the CFPA, however, is likely to have a dampening effect on the securitization market, perhaps taking us in the direction of the units sold in the mid-1970s.

AFSA is not here to claim that some instances of financial innovation did not contribute to the problems the economy and consumers suffer today. But regress is not progress. Financial services reform should take us forward, not backward.

Creating a New "Watchdog" Doesn't Guarantee Better Consumer Protection

The authority proposed to be vested in a CFPA is astounding in its scope and effect. It would cover many entities and persons who had little or no involvement in activities leading to the current economic crisis, including coffee shops and retailers that offer prepaid cards, as well as small real estate investors and jewelry appraisers. Without any demonstrated need, these and many other unsuspecting persons will be swept into a web of scrutiny and reporting requirements that will yield little in the way of consumer protection and much in the way of increased costs for consumers. Attorneys,

accountants, consumer reporting agencies, auto dealers, title companies, and independent financial literacy educators will find themselves subject to review, potential liability and the CFPA's corresponding costs – with no evidence that they are behaving unfairly.

Strong National Standards are Needed

Most AFSA members are regulated primarily at the state level and subject to a patchwork of varying and sometimes inconsistent requirements. Under the CFPA proposal, lenders and consumers would be faced with 50 different disclosures, forms and requirements. As this ad-hoc approach to regulation is costly and inefficient, AFSA supports strong national consumer protection standards that will allow its members to meet their consumer protection obligations in an efficient and cost-effective manner. These standards must limit the ability of the states to impose additional requirements or apply inconsistent enforcement standards. To do otherwise would only encourage states to exaggerate the federal minimum standard and further limit access and increase the cost of consumer credit.

In addition, strong national consumer protection standards will provide a benefit to citizens and our economy only to the extent they are consistent with sound prudential regulation. Consumer protections that threaten the safety and soundness of financial services will promote conflicts between prudential regulators and the CFPA. The proposed legislation does not address how to resolve agency conflicts arising from the tension between appropriate consumer protection and institutional safety and continuity.

AFSA's View

AFSA does not oppose consumer protections – it embraces them. We support rational consumer protection that is regulated and enforced in a manner that allows financial services providers to plan and price for risk, to operate their businesses efficiently and safely, and promote access to a full range of credit products for Americans.

To that end, we offer the following suggestions:

1. Allow time to evaluate the effects of other government initiatives.

   The Credit Cardholders' Bill of Rights Act was just signed into law less than two months ago. What's more, the administration has undertaken several programs to reduce foreclosures and stabilize the mortgage market. We should give these initiatives time to work before rushing to create a new agency that would do many of the same things.

2. Make current and future consumer protection rules applicable to all financial services providers by implementing national standards.

   Congress should ensure that all federal consumer protection laws and regulations apply with equal force to all providers of financial services with respect to similar classes of products and services. These laws should include strong national standards that preempt state laws and permit all Americans to

enjoy a consistent level of service and access with respect to financial products and services, regardless of their location.

3. Pursue a regulatory structure that does not separate financial products and services from the viability of the companies that offer them.

   All prudential agencies should work together to coordinate on consumer protection regulation for financial products and services with the goal that the regulations be preemptive, consistent and uniform.

4. Leave enforcement of rules with existing regulators and give backstop enforcement authority to the Federal Trade Commission (FTC).

   AFSA supports maintaining and strengthening the current regulatory structure whereby consumer protection regulatory authority is vested with the prudential regulator. This structure will ensure that consumer protection regulation is enforced in a manner consistent with sound prudential management and that it properly balances consumer protection with safety and soundness concerns. The structure also will assure that national consumer protection standards will enhance the efficiency and quality of enforcement and supervisory activities. The FTC should be granted authority to step in if the prudential regulator fails, or is unable to address consumer protection concerns in a timely manner.

5. Step up enforcement of existing consumer protection laws.

The current financial regulators already have many enforcement tools at their disposal. What they may lack is the necessary resources or support to fully use them. Congress should focus its lawmaking efforts toward correcting this situation.

6. Continue efforts to improve financial education.

The President's Advisory Council on Financial Literacy and the U.S. Treasury's Office of Financial Education play important roles in working with the financial services industry and others in the private sector on financial literacy initiatives. Ultimately, an educated consumer is the best defense against fraud and unscrupulous practices.

7. Preserve the industrial bank charter.

The administration's regulatory relief proposal calls for eliminating charters for industrial banks, which provide a safe, sound and appropriate means to deliver financial services to the public and have not been part of the problem. We do not believe that the elimination of the industrial bank charter is warranted or would benefit consumers. To the contrary, it would be the worst possible time to eliminate the charter, as this would lead to further job loss and less financial options in communities across the country.

Industrial banks did not contribute to collapse of the financial system in 2008 and none have failed in 2009. While over 52 community banks have failed already in 2009, industrial banks have been the best capitalized and most profitable banks in the nation. Industrial banks are adequately supervised and regulated by the FDIC and their home state regulators and have steadily provided financial services to a variety of consumers and businesses across America.

As I said at the outset, we fully support the goal of the administration and this committee to improve the quality and effectiveness of consumer protection for all Americans. I appreciate the opportunity to testify here today and am happy to answer any questions Members may have.

July 15, 2009

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

Testimony of Edward L. Yingling
On Behalf of the American Bankers Association
Before the
Committee on Financial Services
United States House of Representatives
July 15, 2009

Chairman Frank, Ranking Member Bachus, and members of the committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

I appreciate the opportunity to present the banking industry's views on the Obama Administration's financial regulatory reform proposals. They constitute a vast reworking and change of the laws governing financial institutions and others involved in the financial system. It is clear that change is needed, and the ABA supports several aspects of the proposal. We are, however, concerned that the proposal is so vast that the most critical parts may not have received the emphasis they deserve. These are incredibly complex issues, with many dimensions and with the real possibility of unintended consequences. We appreciate the full hearings and consideration in this committee, and we hope the Congress will continue its hard focus on needed reforms.

ABA believes there are three areas that should be the primary focus of reform: the creation of a systemic oversight regulator; the creation of a mechanism for resolving troubled systematically important institutions; and filling gaps in the regulation of the shadow banking system. Indeed, legislation focusing on these three areas would constitute the most significant financial reform package since the 1930s and would address the major causes of the crisis and the weaknesses in responding to the crisis that have been identified. Such a major reform is certain to shape our financial system and our economy for decades to come.

The reforms need to be grounded in a real understanding of what caused the crisis. For that reason, our testimony today will discuss the continuing misunderstanding of the place of traditional banking in the crisis, in resolving the crisis, and in the future. ABA appreciates the fact that the bi-partisan leadership of this committee has often commented that the crisis, in large part, developed outside the traditional, regulated banking sector. The Treasury's plan noted that 94 percent of high cost mortgages were made outside the traditional banking system.

While there are issues within the regulated sector that need to be addressed, we are greatly concerned that the public, the media, and some policy-makers do not understand that traditional banking, with the current regulatory structure, did not cause this crisis. Indeed, traditional banking has continued lending during the crisis to a degree that is remarkable when compared to past recessions; and traditional banking, especially as the excesses of the shadow banking system are reigned in, must be the foundation on which we build our future financial system and economy. Unfortunately, we see a number of ideas being put forth which, while often primarily aimed at the shadow banking system, would in fact pile needless additional regulation on already heavily regulated banks, undermining their ability to support economic growth in their communities.

Appendix 1 to our testimony is the current statement of principles of ABA's Future Regulatory Task Force, and it is these principles that will guide us as we work with Congress, the Administration, and regulators on reform. In the rest of our testimony, we will focus on the following key themes:

- Traditional banks did not create the problems and will be at the heart of the economic recovery.
- Creating an agency to oversee systemic risk represents important reform that ABA strongly supports.
- There must be a mechanism for resolving systemically important institutions and that addresses too-big-to-fail.
- Filling gaps in the regulation of the shadow banking system is critical to preventing any recurrence of the current problems.
- The thrift charter should be preserved.
- In spite of its laudable goals, the proposed Consumer Financial Protection Agency and its extraordinary broad powers raise very significant concerns.

I. Traditional Banks are the Solution, Not the Problem

Traditional banks have a very long history of serving their communities. This is not the first recession faced by banks; many are survivors of the Great Depression and all the ups and downs in between. ***In fact, there are 2,556 other banks – 31 percent of the banking industry – that have been in business for more than a century; 62 percent (5,090) of banks have been in existence for more than half a century.*** These numbers tell a dramatic story about the staying power of community banks and their commitment to the communities they serve.

The focus of traditional banks is on developing and maintaining long-term relationships with customers. They cannot be successful without such a philosophy and without treating customers fairly. This is in sharp contrast to the fly-by-night mortgage operations in the shadow banking world that were only interested in short-term gain with no interest, or stake, in the livelihood of their communities. Most of those non-bank originators are out of business – disappearing as quickly as they appeared when housing values were growing.

Not only did the regulated banks not cause the problem, ***they are the primary solution to the economic problem.*** Banks will continue to be the source of financial strength in their communities by meeting the financial needs of businesses and individuals in both good times and bad. Since banks are a reflection of their communities, banks are suffering in many areas of the country right along with the communities they serve. Banks have made every effort to continue to extend new credit and to renew existing loans. In fact, since the recession began (December 2007) consumer lending has increased by over 8 percent and business lending by over 4 percent. This is in sharp contrast to the pattern in most recessions (see the Table at the right).

Bank Lending During Recessions

Percent change in loans outstanding during official recession. Inflation adjusted.

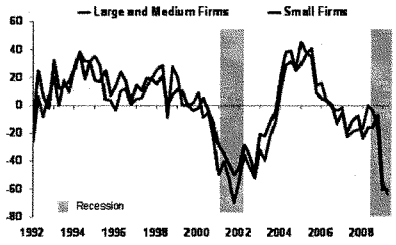
	Business Loans	Consumer Loans
Current Recession (Dec 2007 – May 2009)	4.1%	8.6%
Median of Past 6 Recessions	-2.5%	-3.6%

Source: Federal Reserve

Maintaining loan growth has become increasingly difficult as the economy has continued to struggle and job losses mount. As a consequence, the demand for loans from both businesses and individuals has declined sharply (see the Chart at the right). Loan losses have had an impact too, and regulators continue to press banks to be very conservative in underwriting new loans. Thus, we have seen lending volumes begin to fall in the first half of 2009 and expect that to continue in the coming months.

Business Loan Demand Falls

Net Percentage of Banks Reporting Higher Demand



Source: Federal Reserve

Simply put, thousands of banks across the country did not make a single toxic subprime loan; they are strongly capitalized, and are ready to lend; but they cannot do so if misguided policies increase their regulatory costs and provide disincentives to lend. Thus, it is critical that whatever changes are enacted, they serve to improve the ability of banks to continue to meet the needs of their communities. Now is not the time to hamstring the traditional banks that have served their communities for decades and expect to serve them for decades more to come.

II. Creating an agency to oversee systemic risk represents important reform.

The ABA strongly supports the creation of an agency to oversee systemic risk. There appears to be a strong consensus that an oversight mechanism is needed. The subprime crisis demonstrates clearly that our current system is inadequate. In retrospect, this disaster had been building for several years, and there was ample

evidence that something was very wrong, particularly in the very rapid growth of subprime mortgages. Yet the situation was not addressed in any adequate way until it was too late, due in part to a regulatory structure in which each agency was looking within its piece of the puzzle, while no one was explicitly charged with looking at the overall picture. This needs to be changed.

The ABA has purposely not recommended a specific structure for such an agency. We want to be a constructive part of working with Congress and the Administration in designing and enacting this agency. However, let me provide some thoughts on the role and structure.

First, the role should be one of searching for and identifying potential systemic problems and then putting forth solutions. This process is not about regulating specific institutions, which should be left primarily to the prudential regulators. It is about looking at information and trends on the economy, sectors within the economy, and different types of institutions within each sector. Such problematic trends from the recent past would include: the rapid appreciation of home prices far in excess of income growth, proliferation of "affordability" mortgages that ignored long-term ability to repay; excess leverage in some Wall Street firms; the rapid growth and complexity of mortgage backed securities and how they were being rated; and the rapid growth of the credit default swap market.

This agency should be focused and nimble. In fact, involving it in day-to-day regulation could be a distraction. While much of the early focus was on giving this authority directly to the Federal Reserve Board, now most of the focus is on creating a separate council of some type. This would seem to make sense, but it should not be a committee. The council should have its own dedicated staff. It should not be a large bureaucracy, but rather it should have a small staff dedicated to the functions described above. The council should generally not regulate individual institutions and should primarily use information gathered from institutions through their primary regulators, together with broader economic information. However, the systemic agency should have some carefully calibrated backup authority when systemic issues are not being addressed by the primary regulator.

There is currently a debate about the governance of such an agency or council. A board consisting of the major primary regulators, plus Treasury, would seem logical. As to the chair of the agency, there would seem to be three possible choices – Treasury, the Federal Reserve, or an independent person appointed by the President and confirmed by the Senate.

Related to the creation of a systemic regulator is the need to expand certain authorities for the prudential regulator in regulating systemically important institutions. Increased oversight of capital, liquidity, and risk at institutions that could cause systemic problems is appropriate. These enhanced powers, however, need to be balanced with the need to maintain competitive and innovative markets. Nevertheless, there are clear lessons from this crisis that should be addressed through additional regulatory powers.

As the Federal Reserve is given broader powers over some holding companies, ABA urges Congress to take the logical step of moving the regulation of other bank holding companies to the primary prudential regulator. There is no sound reason for the Federal Reserve to continue to regulate and examine the holding companies of community banks that are not members of the Federal Reserve. This is an unnecessary duplicative regulatory cost to banks and a distraction to the Federal Reserve, particularly given its proposed expanded powers.

A systemic oversight regulator could not possibly do its job if it cannot have oversight authority over accounting rulemaking, since accounting policies increasingly and profoundly influence the degree and pace of economic dislocations and the basic structure of our financial system. A recent hearing before your Capital Markets Subcommittee clearly demonstrated the disastrous pro-cyclical impact of recent accounting policies. Accounting should be a reflection of economic reality, not a driver. Thus, a new system for the oversight of accounting rules – one that considers the real-world effects – needs to be created in recognition of the critical importance of accounting rules to systemic risk and economic activity.

We have testified to this point on several occasions before this committee over the last year. Our voice has been joined by more and more people who are calling for changes. Even the Financial Accounting Standards Board (FASB) acknowledged that "the financial crisis has revealed a number of significant deficiencies and points of stress in current accounting standards."[1] ABA strongly advocates that the Congress follow the general recommendations of the Group of 30 report, chaired by Paul Volcker, the G-20 report, and the Administration's financial regulatory reform proposal relating to accounting policy.[2] The Group of 30, for example, suggests that accounting standards be reviewed:

(1) to develop "more realistic guidelines for dealing with less-liquid instruments and distressed markets";

(2) by "prudential regulators to ensure application in a fashion consistent with safe and sound operation of [financial] institutions"; and

(3) to be more flexible "in regard to the prudential need for regulated institutions to maintain adequate credit-loss reserves."

The Group of Thirty report and the G-20 report, signed by the United States, indicate that there needs to be a role for the financial regulators in the oversight of accounting policy. Otherwise accounting policy can undermine efforts to avoid or remedy systemic meltdowns, as mark-to-market accounting has recently done. Accounting policy-makers were able to largely ignore express concerns of financial regulators about the potential

---

[1] Financial Accounting Foundation 2008 *Annual Report.*

[2] See in particular the U.S. Treasury Department's *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation*, June 200; the G30's *Financial Reform – A Framework for Financial Stability*, January 15, 2009, the G20's *Declaration on Strengthening the Financial System*, London, April 2, 2009, and the Financial Stability Forum's *Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System*, April 2, 2009.

negative impact of policies on reserving and on mark-to-market. The logical way to implement the recommendations of these reports would be to give the new systemic oversight agency an explicit role in the oversight of accounting policy.

The oversight board created by H.R. 1349, introduced by Representatives Perlmutter and Lucas, would be in a position to accomplish the above recommendations. ABA strongly supported this bill in our previous testimony. It would provide, in general, that the FASB report to a group of regulators – including the SEC – rather than solely to the SEC. H.R. 1349 was introduced before the three reports cited above, and those reports clearly align with the overall intent of that bill. H.R. 1349 also predates specific proposals for creating a systemic oversight agency. As the systemic oversight agency is developed, Congress could consider making that agency the appropriate body to which the FASB reports under the approach of H.R. 1349.

III. There must be a mechanism for resolving systemically important institutions and addressing too-big-to-fail.

We have a well-developed and successful mechanism for resolving bank failures, and that system continues to work during these difficult times. Of course, there is no mechanism for the resolution of systemically important non-bank firms. Our regulatory bodies should never again be in the position of making up a solution on the fly to a Bear Stearns or AIG, or of not being able to resolve a Lehman Brothers. The inability to deal with those situations in a predetermined way greatly exacerbated the crisis. It points to the extreme need to create a resolution mechanism for such firms.

The importance of this issue goes well beyond the ability to resolve such firms in the future, however. The lack of clarity about such resolutions creates both uncertainty and presumptions in the marketplace that very much impact the structure and fairness of the financial system today. The structure and protocols for systemic risk resolutions enacted for the future will determine in many respects the structure and fairness of the financial system of the future.

A critical issue in this regard is too-big-to-fail. Whatever is done on the systemic regulator and on a resolution system will set the parameters of too-big-to-fail. In an ideal world, no institution would be too-big-to-fail, and that is ABA's goal; but we all know how difficult that is to accomplish, particularly with the events of the last few months. We agree with Chairman Bernanke's statement: "Improved resolution procedures…would help reduce the too-big-to-fail problem by narrowing the range of circumstances that might be expected to prompt government action…."[3] This too-big-to-fail concept has profound moral hazard implications and competitive effects that are very important to address.

[3] Ben Bernanke, speech to the Council on Foreign Relations, Washington, D.C., March 10, 2009.

We are concerned that the too-big-to-fail concept is not adequately addressed in the Administration's proposal, which seems very sketchy on the resolution issue. The treatment of systemically important institutions in a resolution should be as specific as feasible so that the market knows what to expect to the maximum degree possible. How are shareholders, bank investors, and other stakeholders to be treated?

The goal should be to eliminate as much as possible moral hazard and the unfairness to all the ***non***-systemically important competitors. While it may be necessary to leave some flexibility in the resolution process, the approach should not be as vague as it appears to be in the Administration's plan. In general, when an institution goes into the resolution process because of its systemic importance, its top management, board, and major stakeholders should be subject to clearly set out rules for accountability, change, and financial loss. No one should want to be considered too-big-to-fail.

We also question the approach of naming too-big-to-fail companies in advance. Certainly the size and/or market importance of some companies – as well as the application of certain targeted regulations, e.g., on capital and liquidity – will provide strong evidence of which firms are likely to be considered systemically important; but some "constructive ambiguity" may be called for in this regard.

In addition to being more specific about the rules, the structure of the resolution agency needs to be more concrete. Several months ago, the idea surfaced to basically hand this role to the FDIC, based on the fact that it already exists and has a good track record. ABA strongly objected to this idea and continues to do so.

First and foremost, putting the FDIC in charge of such resolutions would greatly undermine public confidence in the FDIC insurance for bank deposits. This confidence is critical, and it is the reason we have seen no significant runs on banks since the 1930s. The importance of this public confidence should not be underestimated, nor should its existence be taken for granted: witness the lines in front of the British bank Northern Rock at the beginning of this crisis. Yet our own research and polling shows that, while consumers trust FDIC insurance, their understanding of how it works is not all that deep. Headlines saying that "FDIC in charge of failed XYZ non-bank" would greatly undermine that trust. Just imagine if the FDIC were trying to address the AIG situation for the past six months. We urge Congress not to do anything that would confuse consumers or undermine confidence in the FDIC.

Our second concern, frankly, is that the banking industry has supported the FDIC with tens of billions of dollars in premiums. ***In fact, the industry will pay around $17 billion in 2009 alone*** (and perhaps more if another special assessment is needed). During these most difficult of times, the industry is committed to paying for all FDIC insurance costs. Thousands of banks have paid premiums since the FDIC was first created. We are concerned that our premiums will be used to pay for the infrastructure of the resolution mechanism, and furthermore, if our fund is strong and a major non-bank fails, there will be a strong temptation to unfairly raid the bank FDIC fund to pay for it.

Nevertheless, we recognize there can be an important role for the FDIC in this resolution process. In addition, within the bank resolution process itself, the FDIC does appear to be handicapped by the inability to address the holding company of the failed bank, which may be very much linked to the bank. ABA would support a carefully structured approach to permit the FDIC to address holding company issues when a bank fails.

Moreover, the FDIC does have expertise and an existing structure that can be helpful in resolving non-banks. ABA would support tapping that expertise, but only in a manner that protects the public's perception of, and confidence in, the FDIC and that fully walls off the FDIC insurance fund. Merely making the non-bank resolution authority a separate part of, or subsidiary of, the FDIC would not be enough. The resolution agency should be entirely separate from the FDIC and have attributes that make it clear that the "Systemic Resolution Agency" is its own agency, with its own funding, while it does use FDIC expertise.

Additional issues that need to be resolved include how decisions are made and by whom with respect to: which entities are sent to the resolution agency; when they are sent; and how critical decisions during the resolution are made. We also are very concerned about the Administration's proposal to pay for resolutions of non-banks. The proposal targets assessments on total liabilities of all bank holding companies, "other than liabilities that are assessed to fund other federal or state insurance schemes." We would like to see a fuller discussion of just what that means and the rationale for it. We see no reason why a community bank holding company should be tapped to pay for systemic risk resolutions, particularly of non-banks, especially while other financial institutions are not, apparently, to pay anything.

IV. Filling gaps in the regulation of the shadow banking system is critical to preventing any recurrence of the current problems.

A major cause of our current problems is the regulatory gaps that allowed some entities to completely escape effective regulation. It is now apparent to everyone that a critical gap occurred with respect to the lack of regulation of independent mortgage brokers. Questions are also being raised with respect to credit derivatives, hedge funds, and others.

Given the causes of the current crisis, there has been a logical move to begin applying more bank-like regulation to the less-regulated and un-regulated parts of the financial system. For example, when certain securities firms were granted access to the discount window, they were quickly subjected to bank-like leverage and capital requirements. Moreover, as regulatory change points more toward the banking model, so too has the marketplace. The biggest example, of course, is the movement of Goldman Sachs and Morgan Stanley to Federal Reserve holding company regulation.

Consumer confidence in the financial sector as a whole suffers when non-bank actors offer bank-like services while operating under substandard guidelines for safety and soundness. Thus, the fundamental principle for closing the gaps in regulation is that similar activities should be subject to similar regulation and capital requirements. For example, capital requirements should be universally and consistently applied to all institutions offering bank-like products and services. Credit default swaps and other products that could pose potential systemic risk should be subject to supervision and oversight that increase transparency, without unduly limiting innovation and the operation of markets.

As these gaps are being addressed, Congress should be careful not to impose new, unnecessary regulations on the traditional banking sector, which was not the source of the crisis and continues to provide credit. Thousands of banks of all sizes, in communities across the country, are scared to death that their already-crushing regulatory burdens will be increased dramatically by regulations aimed primarily at their less-regulated or unregulated competitors. Even worse is the very real concern that the new regulations will be lightly applied to ***non***-banks while they will be rigorously applied – down to the last comma – to banks. As you contemplate major changes in regulation – and change is needed – ABA would urge you to ask this simple question: how will this change impact those thousands of banks that make the loans needed to get our economy moving again?

V. The thrift charter should be preserved.

ABA strongly supports maintaining the federal thrift charter. We believe there is a very solid case for keeping such thrift charters and their holding companies, which include stock federal savings associations, mutual federal savings associations, savings and loan holding companies and mutual holding companies.[4] Typically, these are smaller banks that have very strong ties to their communities. In fact, the median size of a mutual thrift is $100 million and the median size of a stock thrift is $250 million. These charters reflect a business model that has worked in good times and bad. It is based upon a housing expertise that permits the regulated housing lenders to make safe and sound loans. Thrift institutions have taken the lead in re-establishing economic growth – whether it is the thrifts that are lending to help rebuild New Orleans, or those that are leading community development plans from coast to coast to put Americans back to work.

Mr. Chairman, ABA appreciates your public statements in support of maintaining the thrift charter. There are 800 plus thrift institutions and another 125 mutual holding companies representing 10 percent of the banking industry. They are truly the traditional banks that are lending, that have been lending and will continue to lend. Forcing these institutions to change their charter and business plan is disruptive, costly and wholly

[4] State-chartered savings associations would be affected by any law eliminating the federal thrift charter as the powers and requirements of these state charters are governed under the Home Owners Loan Act. Also, state-chartered savings banks would be affected because a number of savings banks have elected to form thrift holding companies. For instance, about half of all mutual holding companies with state-chartered savings bank subsidiaries are approved and regulated by the Office of Thrift Supervision.

unnecessary. Having these institutions shift their focus deprives our nation of a continuity of lending at a time when we need more credit availability, not less.

Thrift institutions have served our country through many economic cycles. ***In fact, nearly one out of three thrifts have been in existence for over 100 years; one out of two have been in existence over 50 years.*** Federal mutual charters have been a part of the mutual savings bank experience that dates back almost two hundred years. These institutions are survivors of all of our nation's downturns. They made responsible residential mortgage loans through thick and thin and have slowly, steadily, and safely facilitated responsible and growing homeownership in this country – all of which has helped strengthen our economy and the communities served by these institutions.

Eliminating the thrift charter is bad public policy for many reasons:

- ***It hurts legitimate thrift institutions that had nothing to do with the problems.*** "Toxic" subprime mortgages were not and are not the business of traditional thrifts. Most thrifts never made a so-called "toxic" subprime loan; rather, they have maintained solid underwriting standards – particularly because many hold the mortgage loans they make in their own portfolio. They have to write these loans with an eye toward how they will perform over the entire life of the loan.

  Abolishing the thrift charter would exact retribution on institutions that had nothing to do with the crisis we are in. It makes no sense to hurt institutions that made the good loans and are now in a position to help homeowners abused by the shadow banking system. It is inappropriate to continue to use the thrift charter as a symbol of the current housing and financial problems.

- ***It does nothing to address the underlying problem.*** As has been documented time and time again, the problem in subprime lending originated outside the banking industry. As noted above, most of those non-bank originators are out of business. These largely unregulated firms were able to make the toxic subprime loans ***without*** a banking or thrift charter. Simply put, the charter did not create the problems and eliminating it provides no cure.

- ***It targets thrifts in particular, when thrift financial performance is no different from other charters.*** While there have been some high-profile failures of federal thrift institutions over the last 18 months, there have also been high-profile failures of other financial firms. The failures have been a result of bad underwriting and bad business decisions – factors totally unconnected with the charter or business model. In fact, the statistical evidence shows that thrifts are no more likely to be unprofitable and no more likely to be on the FDIC's problem bank list. The financial performance of thrifts in this economic downturn is no different from that of other charters. ***Thus, the problems in housing markets are not a consequence of the charter.*** The real culprits responsible for the vast majority of problems in the housing market were institutions that had ***neither*** a bank or a thrift charter.

It is completely inappropriate to indict the entire thrift industry for the actions of a few players – particularly since most of the abuses arose outside the banking industry. In a competitive marketplace, failures are expected. It makes no sense to punish those firms that made the right decisions, exercised prudent standards, and treated customers well.

- ***It serves only to confuse customers of thrifts and undermine confidence in banking.*** One of the great frustrations of many in the banking industry is that they are being painted with the same brush as those institutions that were at the heart of the problems. If the thrift charter were to be eliminated, the public is likely to infer from it that these institutions are weak or were responsible for the problems – ***none of which is true***. Perpetuating this horrible misperception is not only unfair to these healthy thrifts, but it can potentially be very destabilizing.

- ***It ignores the significant contributions that the thrift industry has made to homeownership.*** Expanding homeownership has long been an important public policy goal in the United States. While the subprime crisis has raised important questions about the appropriate homeownership rate, we should not forget the significant benefits that our country has enjoyed over the decades due to our nation's encouragement of homeownership.

Thrifts are experts in responsible real estate lending. Eliminating the thrift charter, with dedicated expertise that understands the economic benefits to communities, would be backing away from decades of supporting homeowners, builders, developers, and suppliers. It would signal to these institutions that focusing on residential mortgage lending is no longer valued and neither is housing expertise developed over decades. The nation needs stability. That's what the thrift charter offers – continuity of lending at a time when our nation needs more lending, not less.

- ***It creates costs that are unnecessary, taking resources away from potential homebuyers.*** Eliminating the charter will result in very significant costs to these thrift institutions. Inevitably, there will be operational expenses associated with any change in charter. Management time will be diverted in a major way from running the institution to all the complex legal and business issues involved in the change. More troubling is that the clear intent of this provision is to force thrift institutions to focus less on residential housing loans and more on other types of lending – otherwise why would there be any reason to change the charter at all? Thus, former-thrifts would have to change their entire business model, extending loans in areas where they may not have significant experience on staff. Success requires the business model and lending expertise to match. Eliminating the thrift charter would result in less money flowing from prudent housing lenders, and with it, higher costs of any mortgage lending and less credit available.

- ***It will hurt perspective homeowners that benefit from the lending expertise of thrift institutions.*** Supporting homeownership has long been a public policy goal in the United States. The very existence of financial institutions that focus on residential home loans has enabled more and more people to become homeowners. There is no question that imprudent underwriting by some lenders – primarily non-banks – created problems for many individuals. But in spite of these problems, the long history of thrift institutions in facilitating homeownership should not be ignored. Changing the focus and eliminating specialized lenders will likely mean that some deserving individuals will not enjoy the opportunities of being a homeowner.

- ***It forecloses options for mutual savings associations and credit unions that choose a banking charter.*** Mutuals are tax-paying cooperatives that are subject to the full gambit of federal banking laws and one of the few options available to credit unions that wish to remain mutual while seeking new ways to serve their members and communities. Mutuals take the longer view and can invest for good of the community in longer-term projects, which is why more than 40 percent of mutuals institutions have existed for more than a century and more than 95 percent for over 50 years.

  Mutual thrifts' capital is very strong – typically about 30 percent greater than industry averages. However, because of their structure, capital accumulation is typically through retained earnings. The existence of the mutual holding company option, however, provides more tools to raise capital without abandoning the community control represented by mutual ownership. This helps keep the mutual bank local and not the next acquisition target for an out-of-town stock institution.

Eliminating the Office of Thrift Supervision (OTS) does nothing to resolve the problems that occurred either. The recent financial crisis revealed problems associated with all of the regulators, and, most importantly, gaps in the financial regulatory structure. Singling out OTS will not fix the gaps that existed in the shadow banking system. The better solution is to fill the gaps in regulation: bring the non-bank mortgage lenders up to the standards of banks and thrifts.

Moreover, efficiencies that some have suggested would be achieved by eliminating OTS are likely illusory. It is proposed to force charter conversions on thrifts, not eliminate them. As a result, the same number of banking institutions would remain operating, albeit some with charters not of their choice or liking. As a result, the regulatory system would need to commit at least the same level for supervisory resources, and perhaps an even greater amount as the former thrifts adjust to charters not well suited to their businesses.

VI. The proposed Consumer Financial Protection Agency and its extraordinary broad powers raise very significant concerns.

Since the ABA testified before this committee about its deep concerns with the proposed CFPA on June 24, we will not repeat all our concerns in this testimony. However, in general, ABA opposes the proposal on two grounds. First, on the basic structure, ABA does not believe the regulation of a company and its products can be separated without causing severe problems and conflicts. Second, the unprecedented broad powers given to the new agency raise a number of important questions Congress should consider.

Since our June testimony, legislative language on the CFPA has been submitted by Treasury. That language confirms our deep concerns. Based on that language, we want to emphasize two points that were discussed briefly during the June hearing. One point is how the agency is to be funded. The proposed language is very vague, but basically says it will be funded by fees on financial accounts and products. Given the broad mandate of this agency, it will need a significant budget. If it does not have a large budget, it will confirm our concern that it will not effectively enforce its rules on non-banks, which will be grossly unfair to banks. If it does have a large budget, these fees on financial institutions will be considerable. Also, it is very unclear how those fees are to be collected from the wide assortment of entities subject to CFPA jurisdiction – from banks, to credit unions, to mortgage brokers, to appraisers, and to many, many more.

A second point raised at the earlier hearing is the very broad powers of the agency. All current financial consumer protection laws, carefully crafted by Congress, are rendered largely moot—mere floors. The CFPA can do almost anything it wants to go beyond those laws, as well as into new areas, to regulate the terms of products, the way in which they are offered, and even the compensation for offering them. It is one thing to identify holes in existing regulation and close them; it is another, in effect, to take out the entire body of laws, developed over decades, on which consumer finance is based and, in effect, replace it with a broad general regulatory authority – an authority that will create great uncertainty for years to come, reduce consumer choices, and undermine the availability of credit.

ABA appreciates the fact that the Chairman removed the direct transfer of CRA authority to the new agency when he introduced his bill last week. As we noted in our previous testimony, CRA lending has not led to material safety and soundness concerns, and bank CRA lending has been prudent and safe for consumers. However, there is often a debate between a bank and its regulator about individual CRA programs and loans as to the right balance between outreach and sound lending. That debate is now resolved in a discussion with one regulator. If CRA was moved to the consumer regulator, there would be a constant conflict between the two regulators, with banks caught in the middle, as to whether certain loans and their terms were appropriate, and CRA lending would be more subject to second guessing.

Conclusion

The Obama Administration's financial regulatory reform proposals constitutes a vast reworking and change of the laws governing financial institutions and others involved in the financial system – so vast that the most critical parts may not have received the emphasis they deserve. These are incredibly complex issues, with many dimensions and with the real possibility of unintended consequences. The ABA believes that reforms need to be grounded in a real understanding of what caused the crisis. It is critical to understand that traditional banks, operating under the current regulatory structure, did not cause this crisis. Indeed, traditional banks have continued to lend and will be at the heart of the economic recovery.

ABA believes there are three areas that should be the primary focus of reform: the creation of a systemic oversight regulator; the creation of a mechanism for resolving troubled systematically important institutions; and filling gaps in the regulation of the non-bank or what some have called the shadow banking system. Such legislation would address the major causes of the crisis and the weaknesses in dealing with the crisis once it had begun. Focusing on these three key areas would constitute major reform which is almost certain to shape our financial system and our economy for decades to come.

We appreciate the full hearings and consideration in this committee, and we stand ready to work with you to enact workable reform legislation.

Appendix

Principles for Future Regulatory Reform

ABA Future Regulatory Reform Task Force

Preamble

Banks have been and continue to be the primary institutions for saving, lending, and financing economic growth in our nation's communities. Banks are also the leading players in the payments system and the only institutions that can be found participating in every stage of the payments system. Held to high standards of financial strength and integrity of operations, banks are well-poised to be engines of economic recovery and continued economic growth and development thereafter.

Our customers include people and families from all walks of life and involve businesses of all sizes. The innovation and the diversity of the banking industry enable us to meet changing customer needs and interests. Through these efforts in recent decades more people have gained access to a wider array of banking products—and at lower costs—than ever before, and better than anywhere else in the world.

We support a regulatory program that fosters a climate in which we can build on these accomplishments and continue our progress in providing more and better services to more people and businesses at lower costs.

1) Reforms should focus on solving the problem.

a) The central objective of reform efforts should be facilitating the ability of all financial institutions to meet the needs of their customers. This is best done by focusing on the following:

   i) Health of financial institutions, including safety and soundness;

   ii) Consumer protection coupled with consumer education and consumer choices;

   iii) Full and fair competition; and

   iv) Flexibility to innovate and respond to customer interests, needs and changes to the marketplace, including technology changes.

b) A business model combining activities that are financial in nature has served as a solution to, not a part of, the problem. The stability of our nation's financial services is enhanced by a diversified revenue mix, access to a stable base of insured deposits, access to the payment system, availability of a broad range of financial products, and a recognition that the market for most financial products and services is national in scope and connected to global financial markets.

c) Congress should be careful not to impose new regulations on the banking sector, which did not cause the crisis and continues to provide credit; rather it should remove unnecessary regulations that impede sound lending and efficient operations.

d) FDIC-insured financial institutions are not the problem. The regulatory supervision process has been demonstrated to be the most effective approach in minimizing systemic and individual institution safety and soundness risk. Congress should focus on the inadequately and ineffectively regulated sectors of the financial services industry that caused the crisis.

e) Reforms of the payments system must recognize that merchants have been the source of the largest number of abuses and lost customer information. All parts of the payments system must be responsible for its integrity.

2) **The current system of bank regulators has many advantages. These advantages should be preserved as the system is enhanced to address systemic risk and non-bank resolutions.**

a) Regulatory restructuring should incorporate systemic checks and balances among equals and a federalist system that respects the **jurisdictions** of state and federal powers. These are essential elements of American law and governance.

b) We support the roles of the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Federal Reserve, the Office of Thrift Supervision (OTS) and the state banking commissioners with regard to their diverse responsibilities and charters within the U.S. banking system.

c) Bank regulators should focus on bank supervision. They should not be in the business of running banks or managing bank assets and liabilities.

d) An independent central bank is essential.

i) The Federal Reserve's primary focus should be the conduct of monetary policy.

ii) An important part of the conduct of monetary policy is the integrity of the payments system, including the efficiency, security, and reliability of the payments system. The Federal Reserve should have the duty to set the standards for the integrity of the payments system.

e) The FDIC should remain focused on its primary mission of assuring the safety of insured deposits.

i) The FDIC plays a crucial role in maintaining the stability and public confidence in the nation's financial system by insuring deposits, and in conducting activities directly related to that mission, including examination and supervision of financial institutions as well as managing receiverships and assets of failed banking institutions so as to minimize the costs to FDIC resources.

f) There is a need for a regulator with explicit systemic risk responsibility.

i) Systemic risk oversight should utilize existing regulatory structures to the maximum extent possible and involve a limited number of large market participants, both bank and non-bank.

ii) The primary responsibility of the systemic risk regulator should be to protect the economy from major shocks. The systemic risk regulator should pursue this objective by gathering information, monitoring exposures throughout the system and taking action in coordination with other domestic and international supervisors to reduce the risk of shocks to the economy.

iii) The systemic risk regulator should work with supervisors to avoid pro-cyclical reactions and directives in the supervisory process.

g) There should not be a new consumer regulator for financial institutions. Safety and soundness implications, financial risk, consumer protection, and other relevant issues need to be considered together by the regulator of each institution.

h) A system for handling the resolution of non-bank financial firms should be developed to replace the current ad hoc approach, such as was used with Bear Stems and Lehman Brothers.

i) To coordinate anti-money laundering oversight and compliance, a Bank Secrecy Act "gatekeeper," independent from law enforcement and with a nexus to the payments system, should be incorporated into the financial regulatory structure.

3) **The dual banking system is essential to promote an efficient and competitive banking sector.**

   a. The role of the dual banking system as incubator for advancements in products and services, such as NOW and checking accounts, is vital to the continued evolution of the U.S. banking sector.

   b. Close coordination between federal bank regulators and state banking commissioners within Federal Financial Institutions Examination Council (FFIEC) as well as during joint bank examinations is an essential and dynamic element of the dual banking system.

4) **Charter choice and choice of ownership structure are essential to a dynamic, innovative banking sector that responds to changing consumer needs, customer preferences, and economic conditions.**

   a) Choice of charter and form of ownership should be fully protected.

   b) ABA strongly opposes charter consolidation. Unlike the flexibility and business options available under charter choice, a consolidated universal charter would be unlikely to serve evolving customer needs or encourage market innovation.

   c) Diversity of ownership, including S corporations, limited liability corporations, mutual ownership, and other forms of privately held and publicly traded banks, should be strengthened.

   d) Diversity of business models is a distinctive feature of American banking that should be fostered.

      i) Full and fair competition within a robust banking sector requires a diversity of participants of all sizes and business models with comparable banking powers and appropriate oversight.

      ii) Community banks, development banks, and niche-focused financial institutions are vital components of the financial services sector.

      iii) A housing-focused banking system based on time-tested underwriting practices and disciplined borrower qualification is essential to sustained homeownership and community development.

   e) An optional federal insurance charter should be created.

5) **Similar activities should be subject to similar regulation and capital requirements. These regulations and requirements should minimize pro-cyclical effects.**

   a) Consumer confidence in the financial sector as a whole suffers when non-bank actors offer bank-like services while operating under substandard guidelines for safety and soundness.

   b) Credit unions that act like banks should be required to convert to a bank charter.

   c) Capital requirements should be universally and consistently applied to all institutions offering bank-like products and services.

   d) Credit default swaps and other products that pose potential systemic risk should be subject to supervision and oversight that increase transparency, without unduly limiting innovation and the operation of markets.

   e) Where possible, regulations should avoid adding burdens during times of stress. Thus, for instance, deposit insurance premium rates need to reflect a balance between the need to strengthen the fund and the need of banks to have funds available to meet the credit needs of their communities in the midst of an economic downturn.

6) **A new system for the establishment of accounting rules—that makes standard setters accountable and considers the real-world effects of accounting rules—needs to be created in recognition of the critical importance of accounting rules to systemic risk and economic activity.**

   a) The setting of accounting standards needs to be strengthened and expanded to include oversight from the regulators responsible for systemic risk.

   b) Accounting should be a reflection of economic reality, not a driver.

   c) Accounting rules, such as loan-loss reserves and fair value accounting, should minimize pro-cyclical effects that reinforce booms and busts.

   d) Clearer guidance is urgently needed on the use of judgment and alternative methods, such as estimating discounted cash flows when determining fair value in cases where asset markets are not functioning.

7) **Recent government actions have clearly demonstrated a tendency to treat certain financial institutions as if they were too big or too complex to fail. Such a policy can have serious competitive consequences for the banking industry as a whole. Without accepting the inevitability of such a policy, clear policy actions must be taken to address and ameliorate negative consequences of such a policy, including efforts to strengthen the competitive position of all banks.**

   a) Financial regulators should develop a program to watch for, monitor, and respond effectively to market developments relating to perceptions of institutions being too big or too complex to fail—particularly in times of financial stress.

   b) Specific authorities and programs must be developed that allow for the orderly transition of the operations of any systemically significant financial institution.

Statement of

Steven I. Zeisel

On Behalf of the

Consumer Bankers Association

Before the

House of Representatives
Committee on Financial Services

regarding

"Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals"

July 15, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, my name is Steve Zeisel, and I am the Vice President and Senior Counsel at the Consumer Bankers Association ("CBA"). CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets. It is my pleasure to appear before you today to discuss our perspectives on the proposed creation of the Consumer Financial Protection Agency ("CFPA") and the Consumer Financial Protection Agency Act ("Act").

Summary

We commend the Committee for gathering information to determine whether the financial services regulatory framework in the United States needs revision. It is entirely appropriate to undertake this review in light of the recent significant problems for consumers, retail banks, and the economy generally. Only after Congress understands where there are weaknesses inherent in the system can any remedial action be taken.

Retail banks support several of the goals outlined in the CFPA Act, including the need to provide consumers with clear and understandable information to make informed financial decisions, and the need for retail banks to provide products to meet consumers' banking needs. In short, CBA agrees with the goals of transparency, simplicity, fairness, accountability, and access for consumers. However, we believe these objectives can best be achieved by addressing these issues within the existing regulatory framework. We believe the creation of a new federal agency is not necessary.

It is increasingly clear traditional safety and soundness issues, such as inadequate underwriting, played a significant role in the financial crisis that ensued; just as it is clear failures of consumer protection were a factor in the mortgage meltdown. The two are intimately connected and cannot be separated. Therefore, we believe the best approach to improving consumer protection should be done in the context of the existing regulatory system. We also believe there needs to be enhanced supervision of non-bank lenders, so they receive a consistent and comparable level of oversight and enforcement as experienced by banks.

Numerous questions arise. For example, how will consumers be affected by the "plain vanilla" product requirements? And how will consumers be affected once retail banks have to develop product offerings compliant with the laws of up to 50 different jurisdictions? What will happen when consumer protection is separated from safety and soundness? CBA's members continue to ask these and many other questions and are concerned about their consequences. .

Retail banks have served consumers' needs for hundreds of years, providing a safe repository for their funds, and developing credit products and services that have helped to stimulate economic growth in a country that remains the envy of the world. We do not wish to

see changes made which, despite best intentions, may stifle innovation, raise costs to consumers and result in more confusion rather than less.

CBA will continue to work with this Committee and other interested parties to achieve the objectives of transparency, simplicity, fairness, accountability, and access.

Achieving the Objectives of Consumer Protection

CBA shares the Committee's desire to ensure retail banking products are transparent, appropriately simple, and fair. We also believe banks should be accountable and provide consumers with ample access to banks' products. CBA believes there are significant questions, however, as to whether the Act would further these objectives, or be counterproductive to them. In this regard, there are many questions that need to be answered before this Committee approves a complete restructuring of our consumer protection model.

State Law

The Act would subject retail banks to the consumer laws of the fifty states. We ask the Committee to consider the practical impact of such a policy. As drafted, for example, the Act would allow the states to regulate the terms of credit. A state could set minimum payment floors or maximum limits, impose price controls on at least some fees, impose limits on a bank's ability to obtain or use consumer report information, or limit a bank's activities in virtually any other manner in the name of consumer protection. This will significantly affect the products that are offered to consumers.

If the Act were adopted, it is reasonable to assume many states will rush to enact laws pertaining to banks' activities.[1] This could result in dozens of differing requirements pertaining to minimum payments, fee limits, underwriting prescriptions and the like. It is not easy to develop a nationwide lending program if there are up to 50 state law variables for every term in the agreement. Not only will this stifle product innovation, but some banks may have to make the unwelcome decision not do business in states they otherwise would, due to the complexity and cost associated with the compliance burdens. That could mean fewer and more expensive choices for consumers as a result of the decrease in competition. CBA strongly believes the more appropriate approach is to establish a uniform national standard as it relates to retail banking, an inherently interstate activity deserving of a federal standard.

Longer, Not Better, Disclosures

CBA has long supported efforts to simplify and improve disclosures provided to consumers. Nobody benefits when consumers are provided a mountain of information. Consumers do not need more disclosures; they need better disclosures. Ironically, however, the Act could actually increase the disclosure burden on consumers and retail banks, since it does not

[1] States have generally shown some restraint in this area as a result of the well-known preemptions in effect today.

eliminate a single disclosure requirement under any federal law.[2] It is not clear how more disclosures—not better, more concise disclosures—will benefit consumers.

Furthermore, due to the elimination of uniform consumer laws for federally chartered institutions, even a simple, uniform disclosure would have to be supplemented by the state disclosure requirements in every state in which the bank does business. The best intentions of the bank or the CFPA to provide simple disclosures would be frustrated, as a uniform loan agreement would become a voluminous document, cluttered with state-specific information. Thus, the stated goal of "simplicity" would be undermined by eliminating uniformity.

Plain Vanilla: Government as Product Developer

The Act would allow the CFPA to require retail banks to offer certain products designed entirely by the federal government. It is important for the Committee to consider the likely repercussions of the CFPA designing and mandating vanilla products for all retail banks. For example, assuming the CFPA uses its authority, the base product offered by every retail bank in the country—including its features, terms, and conditions—will be set by the federal government. The apparent justification for this mandated uniformity is both that consumers have become confused by the choices in the marketplace today and that non-vanilla products entail excessive risk to the consumer. It is true that some financial products can be complex and often hard to understand. But consumers have benefited from these choices, and have "plain vanilla" options today. A consumer can walk into a local bank branch and get a basic checking account. It may not have bells and whistles, but it is available and well subscribed. The same is true with debit cards, savings accounts, credit cards, and mortgages. There is no shortage of basic banking products available to consumers, and no shortage of consumers who use them. And as for risk, while some risk may be a necessary component of any vibrant financial services sector, many products once considered innovative when they were first rolled out have developed into relatively low-risk staples in a dynamic market place. These include ATMs, debit cards, and on-line banking.

The "plain vanilla" requirement will remove product development from banks and transfer it to the new agency. Banks will offer vanilla products, but it is less clear whether banks will be able to offer the variety of products they offer today—or may develop tomorrow. For example, a retail bank with limited resources may not be able to support a different product that some consumers find valuable. Furthermore, the Act strongly discourages the offering of innovative products consumers find useful by creating regulatory uncertainty regarding how the non-vanilla product must be described, how it can be advertised, and the disclosures that must accompany it. For example, it is not clear to CBA what it means to describe the risks of a product, or how such a description might need to change if a feature on the product changes, or how to present the product so the consumer understands the long-term risks of a product. These uncertainties may lead to requests for the CFPA to preapprove new product features, marketing campaigns, and product promotions, as suggested in the Obama Administration's white paper describing the CFPA. However, this would be practically impossible, since there are thousands of financial institutions (not just banks) in the U.S., each with a slightly different product mix

[2] It does mandate simplification of certain mortgage disclosures by coordinating RESPA and TILA. This is a disclosure reform that CBA has long advocated—but it could be done today without the CFPA.

and marketing plan. As a result, many financial institutions, especially smaller ones, may determine that they are comfortable offering *only* the government-designed plain vanilla product and products sufficiently similar to it to avoid liability under federal and state law. Fewer products being offered and banks offering them in the marketplace mean fewer choices for consumers and increased cost due to reduced competition. We do not believe this will increase consumer access to financial services.

The plain vanilla product requirement raises other questions as well. For example, it is unclear whether an institution would be required to make available the same plain vanilla product features to everyone, regardless of whether they qualify. Depending on the terms, a bank may not be able to safely approve the CFPA's plain vanilla product for anyone but the most creditworthy, if at all. The Act does not prevent the CFPA from imposing requirements that make the offering of the vanilla product an unsafe, unsound or unprofitable activity, such as by placing restrictions on pricing that do not allow for the bank to manage credit risk properly. At the same time, it is hard to see the value of marketing the plain vanilla product to all consumers in every solicitation—as would be mandated by the Act—when only a small percentage of consumers receiving the solicitation may have a legitimate chance of being approved. This is one more example of why consumer protection should not be separated from safety and soundness regulation.

In short, we believe retail banks are in a better position than government to know which products best serve their clients' needs.

Conclusion

CBA strongly supports improving consumer protection. However, we have significant questions regarding these protections under the Act. As we describe in only a few examples of those significant questions, we believe the Act will actually reduce access to financial products, reduce their transparency, and reduce bank accountability.

Thank you again for the opportunity to appear before you today. I would be happy to answer any questions you may have.

TESTIMONY OF
PROFESSOR TODD J. ZYWICKI
GEORGE MASON UNIVERSITY
FOUNDATION PROFESSOR OF LAW
MERCATUS CENTER SENIOR SCHOLAR
GEORGE MASON UNIVERSITY
SCHOOL OF LAW

3301 Fairfax Dr.
Arlington, VA 22201
Phone: 703-993-9484
Fax: 703-993-8088

Before the
United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Banking Industry Perspectives on the Obama Administration's
Financial Regulatory Reform Proposals

Wednesday, July 15, 2009

10:00 a.m.

2128 Rayburn House Office Building

TODD J. ZYWICKI is George Mason University Foundation Professor of Law at George Mason University School of Law and Senior Scholar of the Mercatus Center at George Mason. He is also Co-Editor of the *Supreme Court Economic Review*. From 2003-2004, Professor Zywicki served as the Director of the Office of Policy Planning at the Federal Trade Commission. He has also taught at Vanderbilt University Law School, Georgetown University Law Center, Boston College Law School, and Mississippi College School of Law.

Professor Zywicki clerked for Judge Jerry E. Smith of the U.S. Court of Appeals for the Fifth Circuit and worked as an associate at Alston & Bird in Atlanta, Georgia, where he practiced bankruptcy and commercial law. He received his J.D. from the University of Virginia, where he was executive editor of the Virginia Tax Review and John M. Olin Scholar in Law and Economics. Professor Zywicki also received an M.A. in Economics from Clemson University and an A.B. cum Laude with high honors in his major from Dartmouth College.

Professor Zywicki is also Senior Fellow of the James Buchanan Center, Program on Politics, Philosophy, and Economics, at George Mason University, a Senior Fellow of the Goldwater Institute, and a Fellow of the International Centre for Economic Research in Turin, Italy. During the Fall 2008 Semester Professor Zywicki was the Searle Fellow of the George Mason University School of Law and was a 2008-09 W. Glenn Campbell and Rita Ricardo-Campbell National Fellow and the Arch W. Shaw National Fellow at the Hoover Institution on War, Revolution and Peace. He has lectured and consulted with government officials around the world, including Iceland, Italy, Japan, and Guatemala. In 2006 Professor Zywicki served as a Member of the United States Department of Justice Study Group on "Identifying Fraud, Abuse and Errors in the United States Bankruptcy System."

Professor Zywicki is the author of more than 60 articles in leading law reviews and peer-reviewed economics journals. He has testified several times before Congress on issues of consumer bankruptcy law and consumer credit and is a frequent commentator on legal issues in the print and broadcast media. Professor Zywicki is a member of the Governing Board and the Advisory Council for the Financial Services Research Program at George Washington University School of Business, the Executive Committee for the Federalist Society's Financial Institutions and E-Commerce Practice Group, the Advisory Council of the Competitive Enterprise Institute, and the Program Advisory Board of the Foundation for Research on Economics and the Environment. He is currently the Chair of the Academic Advisory Council for the following organizations: The Bill of Rights Institute, the film "We the People in IMAX," and the McCormick-Tribune Foundation "Freedom Museum" in Chicago, Illinois. He serves on the Board of Directors of the Bill of Rights Institute. From 2005-2009 he served as an elected Alumni Trustee of the Dartmouth College Board of Trustees.

It is my pleasure to testify today on the subject of "Banking Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals." Let me stress at the outset that despite the title of this hearing and my participation in it, I appear in my individual capacity and I am presenting my own perspective on the Obama Administration's financial regulatory reform proposals. I have no affiliation with the "banking industry" except as a customer.

I have studied consumer credit issues for most of my academic career. I have written dozen of articles and opinion pieces on topics related to consumer credit and consumer bankruptcy. In addition to teaching and writing in the area, from 2003-2004 I was the Director of the Office of Policy Planning at the Federal Trade Commission where I participated in the Commission's policy analysis and research on issues of competition and consumer protection.

Today I will focus my remarks primarily on the Obama Administration's proposal to create a new Consumer Financial Protection Agency (CFPA) which would have the authority to issue and enforce new regulations related to consumer lending products.

The creation of a new CFPA is a very bad idea and should be rejected. Nor can the proposal be made tolerable with a few minor tweaks—it is not salvageable and it cannot be improved in substance or in form to be any less of a menace to American consumers and the American economy. It is premised on a fundamental misunderstanding of the causes of the financial crisis: indeed, the Obama Administration's *Financial Regulatory Reform* White Paper offers no evidence—none—to support any of its claims that a meaningful cause of the financial crisis were the result of consumers' inability to understand innovative financial products or that the existence

of the CFPA would have or could have averted the financial crisis. Let me repeat that to make clear—there is *no* evidence that consumer ignorance was a substantial cause of the crisis or that the existence of a CFPA could have prevented the problems that occurred. More importantly, as will be discussed below, no such evidence *could* be produced because no such evidence exists.

Certainly there were incidents of fraud and abuse by lenders during the housing boom that led to subsequent problems and consumers who misunderstood their lending products. And certainly there also were incidents of fraud and abuse by borrowers who defrauded lenders. But there is no evidence that the financial crisis was spawned by a systematic lack of understanding by consumers of the loans into which they were entering. The consumer side of the financial crisis, by which I refer to problems of high levels of default (on mortgages and credit cards) and foreclosure (on mortgages), was caused not by consumer ignorance but misaligned incentives and rational consumer response to them.

It is true that lenders made a huge number of loans that were foolish in retrospect and perhaps should have been recognized as foolish at the time. And these unwise loans presented, and continue to present, major problems for the safety and soundness of the American banking sector. But these loans were foolish *not* because consumers did not understand them. They were foolish because lenders failed to appreciate the incentives that rational, fully-informed consumers would have to default on these loans if circumstances changed.

Consider an extreme, but not unrealistic scenario: a California borrower took a nothing-down, interest-only, adjustable-rate mortgage to buy a new home in the far-flung

exurbs of Northern California, planning to live in the house for a few years and then resell it for a profit. Assume further that the borrower could continue to make his mortgage payment if he chose to do so. Instead, the house plunged in value so that it is worth much less than the outstanding mortgage and with widespread oversupply of housing there is no reasonable likelihood that it will come back above water in the near future. Under California's defaulter-friendly anti-deficiency laws the lender is limited to foreclosing on the house and cannot sue the borrower for the difference between the value of the house and the amount owed on the mortgage. As a result of all of this, the homeowner crunches the number, consults his lawyer, and decides to walk away from the house and allow foreclosure.

This scenario raises substantial concerns about the safety and soundness of such loans. One can ask whether banks should be permitted to make loans that provide such strong incentives for a borrower to default when the loan falls in value. In fact, empirical evidence suggests that many of the terms that have drawn much criticism (such as low-documentation loans) proved to be problematic only when combined with other provisions that reduced borrower equity, such as nothing-down.[1] But while this scenario presents major concerns about the safety and soundness of such a loan, it does *not* present a consumer protection issue. The end result of foreclosure results from the set of incentives confronting the borrower and the borrower's rational response to them—empirical research indicates that loans with no downpayment or which otherwise cause borrowers to have low or no equity in their homes (including interest-only, home equity loans, and cash-out refinances) have proven to be especially prone to foreclosure in the

[1] KRISTOPHER GERARDI, ANDREAS LEHNERT, SHANE SHERLUND, & PAUL WILLEN, MAKING SENSE OF THE SUBPRIME CRISIS, BROOKINGS PAPERS ON ECONOMIC ACTIVITY (Douglas W. Elmendorf, N. Gregory Mankiw, and Lawrence Summers eds., Fall 2008).

recent crisis as stripping equity out of ones' house makes it more likely that a price drop will push the house into negative equity territory thereby providing incentives to default on the loan.

Rather than recognizing the financial crisis as the product of misaligned incentives that has created major safety and soundness issues, the Obama Administration's proposal for a CFPA rests on the assumption that the financial crisis was produced by hapless consumer victims being exploited and defrauded by unscrupulous lenders. This misdiagnosis of the problem to be addressed has produced a proposal that is fraught with a risk of negative unintended consequences for consumers and which could actually exacerbate the structural incentives that produced the current crisis, thereby making such problems more likely rather than less likely in the future.

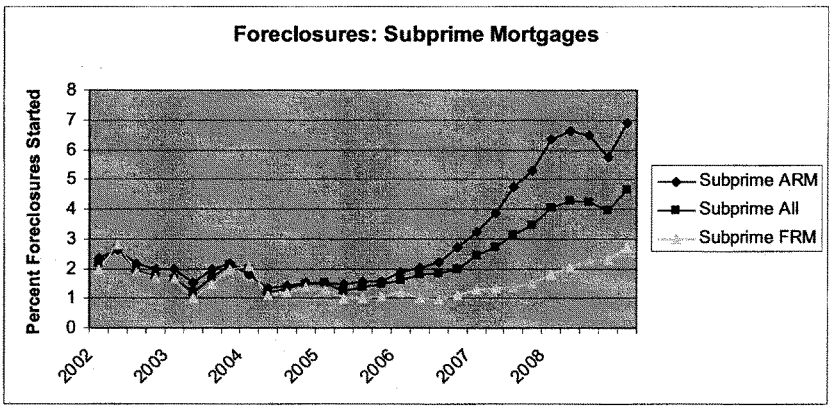
The proposal for a new CFPA is misguided for three reasons. First, it rests on misguided paternalism, and in so doing would likely prove counterproductive to consumer welfare overall. Second, by failing to recognize that the financial crisis primarily resulted from rational consumer responses to misaligned incentives (rather than failures of consumer protection) it offers solutions that could have the unintended consequence of exacerbating the very problems it purports to address, such as the issue of rising foreclosures. Third, by creating a new bureaucracy with defined scope, expertise, and mission, separate from other consumer protection agencies and safety and soundness regulators, it will promote the very bureaucratic balkanization and inconsistency that it aspires to address.

Misplaced Paternalism

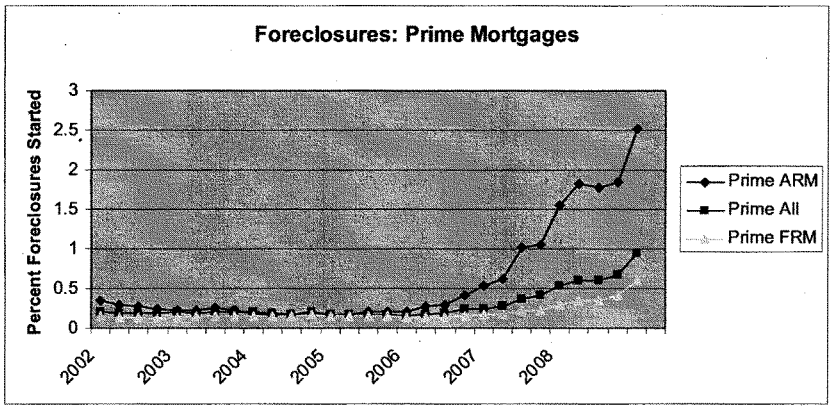
The first problem with the CFPA is its basis in misplaced paternalism about consumers. As noted above, while there was undoubtedly fraud during the housing boom (both by borrowers and lenders) the problems that have been seen in the mortgage market are the result of rational consumer responses to incentives, not a problem of fraud or consumer confusion. The housing crisis—referring specifically to the problem of foreclosures—has little to do with the issues identified by the White Paper and thus an entity such as the CFPA would make little difference in averting a similar problem in the future.

The Mortgage Crisis

The initial wave of foreclosures was triggered by interest-rate resets on adjustable-rate mortgages (ARMs). Consider the following charts, drawn from my forthcoming book, *Bankruptcy and Personal Responsibility: Bankruptcy Law and Policy in the Twenty-First Century* (Yale U. Press, 2010). As is evident, the initial wave of foreclosures was triggered by interest rate resets on adjustable-rate mortgages. First consider subprime mortgages (all data from the Mortgage Bankers Association):

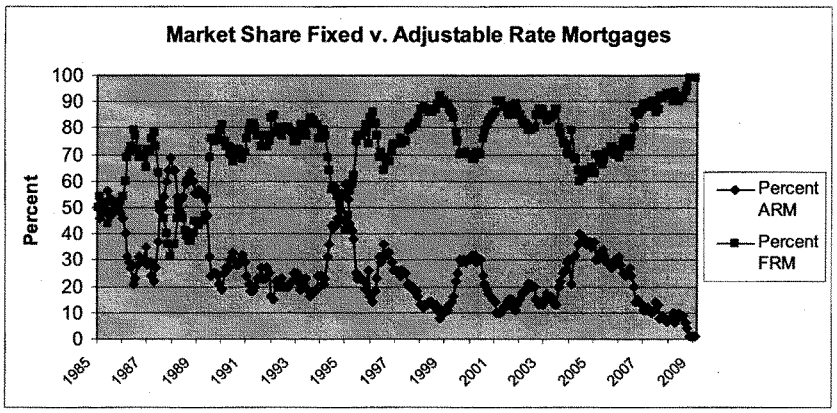


Next compare Prime Mortgages:

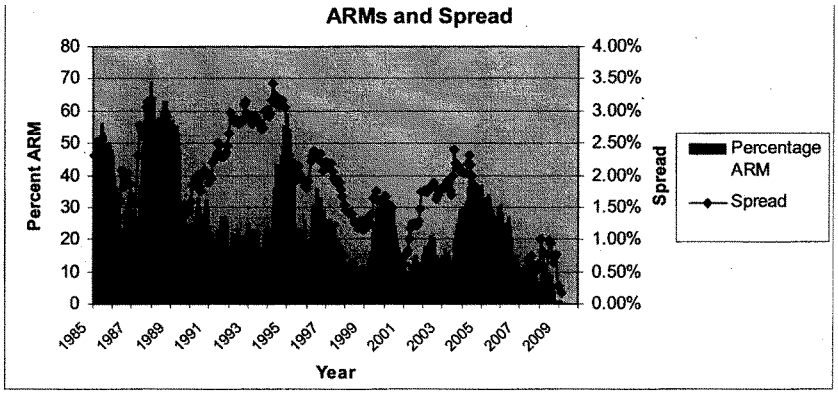


As can readily be seen, the initial surge in foreclosures for *both* prime and subprime mortgages were a manifestation of ARMs, not of subprime lending. In fact, foreclosure rates on fixed-rate subprime loans remained at relatively low levels. By contrast, in percentage terms, foreclosure rates on prime ARMs actually rose faster than for subprime ARMs (starting from a much lower base, of course).

Does this suggest that ARMs are unreasonably dangerous products? Of course not—in fact, even the White Paper does not go so far as to suggest this. In fact, ARMs have been a part of American consumer lending scene for decades. At times in recent decades ARMs have constituted 50 percent, 60 percent, or even more of the market for new mortgages:



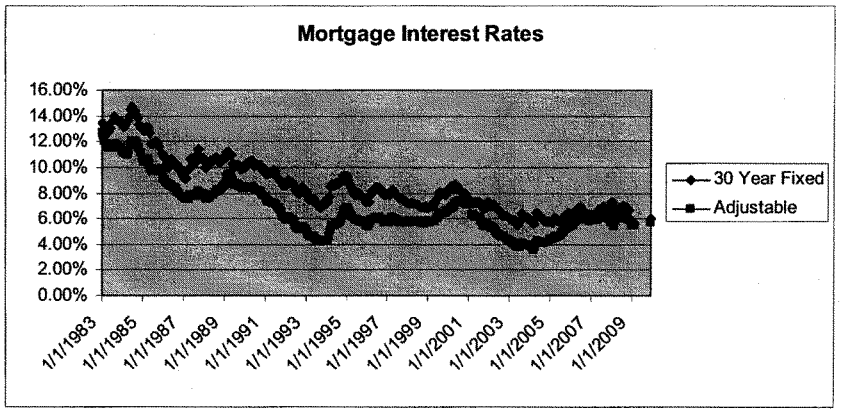
What explains the varying percentage of ARMs versus FRMs over time? It turns out that the determining factor is the spread between the prevailing interest rates on ARM versus FRM. On average, consumers pay a premium of about 100 to 150 basis points o get a fixed-rate mortgage, that premium being what is necessary to compensate the bank for holding the risk of interest rate fluctuations. This spread, however, is not constant over time. When the spread gets larger consumers substitute from FRMs to ARMs and when the spread narrows consumers switch to FRMs:



At the height of the housing boom in 2004, the spread between FRM and FRM was about two percentage points and about forty percent of the mortgages that were written were ARMs.

As can be readily seen, however, the percentage of ARMs was even higher at times in the past, yet this did not lead to a financial calamity. This strongly suggests that ARMs are not inherently dangerous. Further evidence is provided by the fact that virtually all mortgages in Europe are ARMs.

A final ingredient was necessary to make ARMs into a major problem in the United States in recent years: erratic Federal Reserve monetary policy. In the period from 2001-2004, the Federal Reserve drove down short-term interest rates to extremely low levels while FRM interest rates remained essentially constant. This created the observed spread between ARMs and FRMs that encouraged consumers to shift from FRM to ARM, whether for new purchases or to refinance. Then, the Federal Reserve rapidly raised short-term interest rates, creating the interest-rate reset problem described above. Consider the following chart of ARM and FRM interest rates over the past three decades:



The problem, as can readily be seen, was the Federal Reserve's erratic monetary policy, not ARMs per se. In fact, consumers who held ARMs during the 2001-2004 period experienced a major boon as their mortgage payments dropped dramatically without the cost and hassle of refinancing. Consumers simply responded to the incentives presented by the Federal Reserve's monetary policy—as they have regularly in the past. This time, however, the Federal Reserve temporarily pushed short-term rates to an unsustainably low level then whipsawed consumers when it raised rates. I am not aware of any provision in the White Paper that would ensure that the Federal Reserve will not make such catastrophic monetary policy blunders in the future. Nor is it reasonable to think that even the most well-informed consumers about the terms of their mortgages could have understood and anticipated market responses to the Federal Reserve's unprecedented monetary policy decisions when the Federal Reserve itself did not realize what it is doing.

It should be stressed in this context that economic research has overwhelmingly concluded that one factor that was *not* important were so-called "teaser rates" on

subprime mortgages. A "hybrid" mortgage is one with an initial fixed interest rate at the beginning of the loan (usually for two or three years), often termed a "teaser" rate, followed by an adjustable rate for the duration of the loan with the rate set at some spread above an easily-established market rate (such as LIBOR). Critics have claimed that these hybrid mortgages were "exploding" mortgages in that the initial teaser rate was set excessively low and that there would be a dramatic upward shot in interest rates after the interest rate reset that would surprise borrowers with high interest rates and that this has helped to generate rising foreclosure rates. Although often-cited, this theory appears to lack any empirical foundation.

One estimate of subprime loans facing foreclosure in the early wave of foreclosures found that 36% were for hybrid loans, fixed-rate loans account for 31%, and adjustable-rate loans for 26%.[2] Of hybrid loans in foreclosure, the overwhelming majority entered foreclosure *before* there was an upward reset of the interest rate.[3] Most defaults on subprime hybrid loans occurred within the first 12 months of the loan, well before any interest adjustment.[4] For those borrowers who actually underwent an interest-rate reset, the new rate is higher, but not dramatically so when compared to the original

---

[2] James R. Barth et al., *Mortgage Market Turmoil: The Role of Interest-Rate Resets*, *in* SUBPRIME MORTGAGE DATA SERIES (Milken Inst.) (2007); C.L. Foote, K. Gerardi, L. Goette, & P.S. Willen, *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What we Don't*, FED. RES. BANK BOSTON PUBLICLY POLICY DISCUSSION PAPER 08-02 (2007); C. Mayer, K. Pence, & S.M. Sherlund, *The Rise in Mortgage Defaults: Facts and Myths*, J. ECON. PERSPECTIVES (Forthcoming 2008).

[3] Barth, *supra* note. Of those subprime loans in foreclosure at the time of his study, 57 percent of 2/28 hybrids and 83 percent of 3/27 hybrids "had not yet undergone any upward reset of the interest rate."

[4] Mayer, Pence, & Sherlund, *The Rise in Mortgage Defaults* at 11; Shane Sherlund, *The Past, Present, and Future of Subprime Mortgages*, Federal Reserve Board (Sept. 2008); Kristopher Gerardi, Adam Hale Shapiro, & Paul S. Willen, *Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures*, Federal Reserve Bank of Boston Working Paper No. 07-15. Mayer, Pence, and Sherlund find a dramatic rise in "early payment defaults" well before any interest rate adjustment takes place.

rate.[5] On average, the rate for subprime borrowers from the period 2003-2007 adjusted from an initial rate of about 8 percent to about 11 percent a substantial adjustment, but not one that can fairly be characterized as "exploding." Moreover, mortgage interest rates generally were increasing during this period (the spread between the initial and reset rates generally narrowed during this period), so the higher rate on reset also might have reflected a general rise in ARM interest rates, not the hybrid nature of the loan. Economists Anthony Pennington-Cross and Giang Ho find that the transition in a hybrid loan from an initial fixed period to the adjustable rate period results in heightened rates of prepayment but *not* default.[6] They also find that the termination rate for subprime hybrid loans (whether by prepayment or default) was comparable to that for prime hybrid loans. Other studies documented a dramatic rise in early payment defaults, an absence of rising defaults at the time of interest-rate adjustments, a tendency toward prepayment rather than default around the time of reset, and a lack of evidence of "exploding" interest rates. In light of these facts, economists have almost universally concluded that hybrid mortgages (at least alone) cannot explain the rise in foreclosures. After examining the evidence, several economists from the Boston Federal Reserve flatly stated last year, "Interest-rate resets are not the main problem in the subprime market."[7] I am aware of no evidence that contradicts that conclusion.

---

[5] *See* C.L. Foote, K. Gerardi, L. Goette, & P.S. Willen, *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What we Don't*, FED. RES. BANK BOSTON PUBLICLY POLICY DISCUSSION PAPER 08-02 (2007).

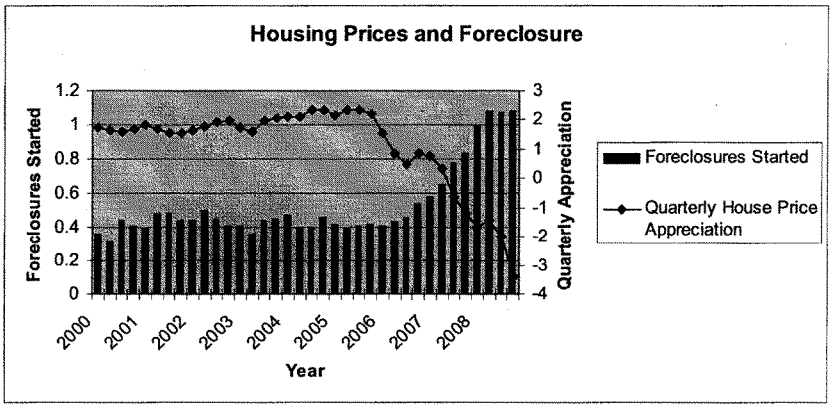
[6] *See* Anthony Pennington-Cross & Giang Ho, *The Termination of Subprime Hybrid and Fixed Rate Mortgages* 18 (Fed. Reserve Bank of St. Louis, Working Paper No. 2006-042A, 2006).

[7] Christopher L. Foote, Kristopher Gerardi, Lorenz Goette, and Paul S. Willen, *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What We Don't*, FED. RES. BANK OF BOSTON PUBLIC POLICY DISCUSSION PAPERS 2 (May 30, 2008).

Whatever the cause of the mortgage crisis, there is no foundation for the belief that "exploding" interest-rate resets on subprime mortgages is a substantial part of the problem nor that consumers would be benefited by eliminating this mortgage option.

More generally, as one might expect, those borrowers who initiate hybrid loans tend to have borrower characteristics that place them in an intermediate position between borrowers who initiate fixed-rate mortgages and those who initiate adjustable-rate mortgages in a variety of characteristics, including income, FICO score, and likelihood of moving within the near future.[8]

Foreclosures in the second phase of the housing crisis have been driven by declining home values and the incentives of consumers to walk away from houses that are underwater. As can plainly be seen, there is a clear inverse relationship between declining home prices and rising foreclosures:



Again, consumers are rationally responding to the incentives provided by declining home prices. Not coincidentally, foreclosures have been most severe where

[8] Gregory Elliehausen, Min Hwang, & Jeehon Park, *Hybrid Interest Rate Choice in the Subprime Mortgage Market: An Analysis of Borrower Decisions* (working paper May 2008).

home-price declines have been most dramatic, such as Las Vegas, Miami, Phoenix, and the Inland Empire region of California. The rational decision of consumers to walk away from underwater mortgages does not present any sort of consumer protection issue—although as noted above, it does present severe safety and soundness issues.

Moreover, some apparently risky attributes of loans are also only potentially problematic when combined with other features of the mortgage regulatory regime. Perhaps most important is the presence in several states of so-called antideficiency or "non-recourse" lending laws that limit the remedies available to lenders upon a borrower's default to foreclosure on the home without the right to sue the borrower personally for any remaining deficiency.

Empirical evidence indicates that foreclosure default and foreclosure rates are higher where law limits lender recourse through antideficiency laws. In a study of the neighboring provinces of Alberta and British Columbia in Canada, Lawrence Jones found that "in a period of sizable house-price declines, the prohibition of deficiency judgments can increase the incidence of default by two or three times over a period of several years."[9] Similarly-situated borrowers with negative home equity (that is, where they owe more than the value of the house) "will be observed defaulting in antideficiency jurisdictions but not where deficiencies are truly collectible."[10] Other researchers have also found that prohibitions on deficiency judgments tend to produce higher delinquency[11] and default rates.[12] The higher risk associated with the presence of

[9] Lawrence D. Jones, *Deficiency Judgments and the Exercise of the Default Option in Home Mortgage Loans*, 36 J. L. & ECON. 115, 135 (1993).
[10] *Id.*
[11] Brent W. Ambrose & Richard J. Buttimer, Jr., *Embedded Options in the Mortgage Contract*, 21 J. REAL ESTATE FIN. AND ECON. 95, 105 (2000).
[12] Brent W. Ambrose, Charles A. Capone, Jr. & Yongheng Deng, *Optimal Put Exercise: An Empirical Examination of Conditions for Mortgage Foreclosure*, 23 J. REAL EST. FIN. & ECON. 213, 220(2001).

antideficiency laws is also reflected in higher interest rates, thus increasing the risk of default for some marginal consumers as well.[13]

A recent study also found that antideficiency law produce increased foreclosures when home prices fall and that the effect is concentrated among wealthier homeowners with more expensive homes.[14] This differential impact is to be expected—wealthier homeowners would be expected to gain a greater benefit from a non-recourse law because they have more assets and income to seize in a lawsuit. Poorer homeowners, by contrast, are likely to have little wealth beyond the home itself. Thus, they gain little benefit from the protection of an antideficiency law.

This also suggests that in many situations the cause of foreclosure is the *interaction* of certain mortgage innovations (such as no-downpayment loans) with preexisting aspects of the legal environment (such as the presence of an antideficiency law). In such situations, loan terms that might prove to be inappropriate in a state with extreme pro-debtor laws (such as an antideficiency law) may be perfectly appropriate in states with more moderate laws that do not provide debtors with such strong incentives to default when their house falls in value. Because these laws governing foreclosure and creditors' rights differ across the country it is difficult to generalize as to whether certain

---

[13] *See* Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mort-gage Credit*, 88 REV. ECON. & STAT. 177 (2006) (finding that average loan size is smaller in states with defaulter-friendly foreclosure laws); Jones, *supra* note 137 (higher downpayments in states with antideficiency laws); Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (estimating 13.87 basis point increase in interest rates as a result of antideficiency laws); Brent W. Ambrose & Anthony B. Sanders, *Legal Restrictions in Personal Loan Markets*, 30 J. REAL ESTATE FIN. & ECON. 133, 147–48 (2005) (higher interest rate spreads in states that prohibit deficiency judgments and require judicial foreclosure procedures); SUSAN E. WOODWARD, U.S. DEP'T OF HOUS. & URBAN DEV., A STUDY OF CLOSING COSTS FOR FHA MORTGAGES 50 (2008), *available at* http://www.huduser .org/Publications/pdf/FHA_closing_cost.pdf (finding that presence of antideficiency laws raises costs of loan). *But see* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 512 (1991) (finding mixed results for impact of antideficiency laws on foreclosure rates depending on specification of regression).

[14] Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from US States* (working paper, June 3, 2009).

loan terms are inherently dangerous—as opposed to certain idiosyncratic state laws that render lending more risky in some states than others. Moreover, when foreclosure results because consumers rationally respond to the incentives created by an antideficiency law and allow foreclosure it is impossible to see how this can be considered a consumer protection issue. The White Paper, of course, makes no acknowledgement of the moral hazard problem created by antideficiency laws that spur foreclosures.

Note also, that there are dramatic regional differences in foreclosure rates. While foreclosures have risen nationwide, there are only a handful of areas that face a true foreclosure crisis, such as Phoenix, Las Vegas, Miami, and regions of California, where foreclosure rates are five or ten times the national average. Are we to believe that borrowers in those areas are five to ten times dumber than borrowers elsewhere or five to ten times more likely to have been misled? Of course not. These markets have turned catastrophic because of conscious speculation by short-term investors who knew precisely what risks they were taking, not because hapless consumers were victimized by overly-complex mortgage products.

Finally, foreclosures have continued today, as this foreclosure impetus from underwater mortgages has been combined with the factor that traditionally drove changes in the foreclosure rate, rising unemployment. Again, to the extent that foreclosures remain high because of rising unemployment, this is a macroeconomic problem, not a consumer protection issue.

Despite the lack of *any* evidence that the financial crisis was caused by overly-complicated consumer financial products, the White Paper nonetheless recommends a radical revamp the entire market for consumer lending products. In particular, the White

Paper contemplates that the CFPA would bless a category of "plain-vanilla" mortgages, credit cards, and other consumer credit products that would be provided with an elevated status. How the CFPA would make this determination is unclear from the White Paper as is the criteria that would need to be met to qualify.

In Europe, for instance, the standard mortgage product in many countries is a 10 or 15-year ARM with a balloon payment and no right to prepay.[15] By contrast, in the United States, the plain vanilla mortgage apparently would be a 30-year self-amortizing FRM with an unlimited right to prepay. Add to this the fact that consumers in the United States pay a hidden premium for FRM of about 100-150 basis points and about another 20-50 basis point premium for the right to prepay the mortgage. On average, these two factors combined add almost two percentage points to the interest rate of American mortgages as compared to mortgages without those features, thus making mortgages more expensive and more financially burdensome to households. Moreover, even though many areas in Europe have suffered home price declines comparable the largest drops here in the United States, foreclosure rates remain well-below the highest foreclosure rates in the United States. If anything, this suggests that the apparently "more complicated" European standard mortgage is a much safer product than the American mortgage.

The CFPA, however, provides no criteria for deciding what the "right" premium a borrower should be forced to pay for a fixed-rate or a right to prepay. Traditionally—and correctly—the American regulatory system has not tried to make this choice for consumers, but instead to encourage disclosure to consumers so that they can make the

[15] Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. ECON. PERSP., Fall 2005, at 93, 107–08 (2005).

best tradeoff of price and other contract terms that is suitable for their situation, budget, and level of risk tolerance. By elevating certain cookie-cutter "plain vanilla" loan products above others, the White Paper would instead seek to substitute its own biased assessment of the "appropriate" terms for a consumer, notwithstanding the fact that in doing so, the regulator would also be dramatically impacting the price that the borrower will have to pay for the loan as well. In so doing, the CFPA could very well force borrowers into more expensive loans that could turn out to be financially unsustainable or deny them the opportunity of home ownership, whereas a different loan with a different package of terms could have been more affordable and better-tailored to the borrowers' personal needs.

The premise that certain lending products can be classified as "risky" to borrowers is implicitly premised on the idea that the traditional American mortgage is not risky. That, of course, is simply incorrect. Principal is paid more slowly than for a shorter mortgage and equity accumulates more slowly. The mortgage interest rate includes a variety of risk premia in it, such as the risk of expected inflation rates, the risk that the borrower will prepay, and the risk of the change in the underlying value of the home as opposed to other investments. Thus, if inflation or market interest rates are lower than expected, then the borrower will have overpaid for the mortgage. If alternative investments (such as investing in the stock market) would have generated a greater return for the money spent on mortgage payments, then the risk of a fixed-rate mortgage is the foregone return on that money. These various risks associated with the traditional American mortgage may explain in part why efforts to introduce the traditional American mortgage have failed in other countries.

Credit Cards

With respect to credit cards, singled out for special criticism in the Obama Administration's White Paper (the "White Paper"), there is scant evidence that borrowers are unable to meaningfully understand their credit cards or shop effectively for credit cards. According to a survey by former Federal Reserve economist Thomas Durkin, 90% of consumers report that they are "Very" or "Somewhat Satisfied" with their credit cards.[16] Durkin also found that two-thirds of credit card owners find it "very easy" or "somewhat easy" to find out information about their credit card terms, and only six percent believed that obtaining this information was "very difficult." Two-thirds of respondents also reported that credit card companies usually provide enough information to enable them to use credit cards wisely. In an ideal world, these figures might be even higher, but the White Paper does a great disservice to American consumers when it implies that consumers are unable comprehend their credit cards or to acquire the information that then need to make reasonable choices.

More importantly, consumers pay attention to and understand the credit card terms that matter most *to them* personally. Consumers who revolve credit card balances are extremely likely to be aware of the interest rate on their credit cards and to comparison shop among cards on that basis, and those who carry larger balances are even more likely to be aware of and comparison shop on this term than those who revolve smaller balances.[17] By contrast, those who do not revolve balances tend to focus on other

---

[16] Thomas Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, FEDERAL RESERVE BULLETIN (April 2002).

[17] *See* Thomas A. Durkin, *Credit Card Disclosures, Solicitations, and Privacy Notices: Survey Results of Consumer Knowledge and Behavior*, FEDERAL RESERVE BULLETIN p. A 109 (2006).

aspects of credit card contracts, such as whether there is an annual fee, the grace period for payment, or benefits such as frequent flier miles. In fact, consistent with the observation of more aggressive interest rate shopping by revolvers, those who revolve balances are charged *lower* interest rates on average than those who do not.[18] American consumers are not passive sheep timidly waiting to be shorn, as implied by the White Paper.

Elevating certain "plain vanilla" loans for exalted status also poses a risk of chilling vigorous competition and innovation in lending products. Consider the dramatic innovations and improvements in credit cards over the past several decades.[19] Thirty years ago credit cards were an immensely simple product—a high annual fee, a high fixed interest-rate, and no benefits such as cash-back, frequent-flyer miles, purchase-price protection, etc. Bank cards were available only to a lucky few. The remainder of middle-class consumers who needed credit were forced to rely on credit from local department stores or appliance stores, thereby obliging them to shop at those stores. These cards were simple—but lousy. The simplicity and uniformity of pricing stifled innovation and, some have alleged, made it easier for credit card issuers to collude to fix prices and stifle competition.

The effective deregulation of the credit card market by the Supreme Court's decision in *Marquette National Bank* set off a process of competition and innovation that continues to this day. Annual fees have disappeared on all "plain vanilla" credit cards, remaining only for those cards that provide frequent flyer miles and the like. Virtually all

---

[18] Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHICAGO L. REV. 63 (2006).

[19] For a discussion of this history see Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79 (2000).

credit cards have variable interest rates. And there is a much greater reliance on behavior-based fees, such as over-the-limit fees, late fees, and the like. The combination of these innovations has resulted in more accurate risk-based pricing for cards and less cross-subsidization by low-risk users of higher-risk users of credit cards. True, credit card pricing has become more complicated—but that is largely because consumer use of credit cards is so much more complicated and varied than in the past.

More fundamentally, the deregulation of credit card terms eliminated arbitrary barriers to competition. Annual fees had been imposed by credit card issuers as a mechanism to evade state ceilings on interest rates. The elimination of those legislative price caps enabled interest rates to meet their market rates—but importantly, also led to the rapid elimination of annual fees. The presence of annual fees was very harmful to consumers because an annual fee acted a "tax" on consumers holding more than one credit card. Once a consumer paid his $40 annual fee, he was unlikely to switch to another card (and pay another annual fee) or to carry another card. This dramatically dampened competition. The elimination of annual fees enabled consumers to hold multiple credit cards, essentially forcing credit card issuers to compete every time the cardholder opens his wallet. Moreover, these cards compete on a number of different margins, permitting consumers to choose the best deal available to him at any given time.

It would be extremely unwise for a hypothetical CFPA to try elevate simplicity above all else without considering the impact of its actions on competition, innovation, and consumer choice. The parable of credit card innovation provides a warning lesson about a narrow fixation on simplicity.

Unintended Consequences

A second major problem with the concept of the CFPA is the high likelihood of unintended consequences that will result from its actions. Consider just two areas identified by the White House as possible areas of action by the CFPA: a proposal to ban (or strongly discourage) prepayment penalties and banning "yield spread premiums" in mortgage products. Both of these actions would likely prove counterproductive and harmful to consumers.

Prepayment penalties are a common term in many subprime mortgages, although they remain uncommon in most prime mortgages in the United States. Prepayment penalties are also included in most commercial loans and are present in virtually all European mortgages. Yet the White Paper contemplates banning prepayment penalties in mortgages. This reasoning is based on faulty economic logic and fails to recognize the overwhelming economic evidence supporting the efficiency of prepayment penalties.

The traditional American right to prepay and refinance a mortgage is relatively unique in the world. Available empirical evidence indicates that American consumers pay a substantial premium for this unlimited prepayment right. Borrowers pay a premium for the unlimited right to prepay of approximately 20 to 50 basis points (.2 to .5 percentage points) with subprime borrowers generally paying a higher premium for the right to prepay than prime borrowers because of the increased risk of subprime borrower prepayment.[20] Borrowers pay this premium to compensate lenders for the risk of having

[20] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 18-20 (2009) (summarizing studies); Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages*, 60 J. ECON. & BUS. 33, 34 (2008) (reviewing studies); Chris Mayer, Tomasz Piskorski & Alexei Tchistyi, The Inefficiency of Refinancing: Why Prepayment Penalties Are Good for Risky Borrowers (Apr. 28, 2008). Term sheets offered to mortgage brokers similarly quoted interest-rate increases of approximately 50 basis points in those states that prohibited prepayment penalties.

to reinvest funds at lower market interest rates when interest rate falls. Where prepayment penalties are banned lenders also take other precautions to guard against the risk of prepayment, such as charging increased points or upfront fees at the time of the loan, which raise the initial cost of the loan.

Nor is there any evidence that prepayment penalties are excessively risky for consumers. Empirical evidence indicates that prepayment penalties do not increase the risk of borrower default. In fact, subprime loans that contain prepayment penalty clauses are less likely to default than those without such clauses, perhaps because of the lower interest rate on loans with prepayment penalties or perhaps because the acceptance of a prepayment penalty provides a valuable and accurate signal of the borrower's intentions.[21] Acceptance by a borrower of a prepayment penalty may also provide a credible signal by the borrower of his intent not to prepay the loan, thus overcoming an adverse selection in the marketplace and permitting a reduction in interest rates. Borrowers obviously have greater knowledge than lenders about the relative likelihood that the borrower will prepay the mortgage, especially in the subprime market where prepayment tends to be highly idiosyncratic and borrower-specific.[22]

The White Paper's approach to prepayment penalties is also internally illogical, stating that prepayment penalties "should be banned for certain types of products, such as subprime or nontraditional mortgages, or for all products, because the penalties make loans too complex for the least sophisticated consumers to shop effectively."[23] This

---

[21] Christopher Mayer, Tomasz Piskorski, and Alexei Tchistyi, *The Inefficiency of Refinancing: Why Prepayment Penalties are Good for Risky Borrowers*, Working Paper (Apr. 28, 2008); Sherlund also finds that the presence of prepayment penalties does not raise the propensity for default. Sherlund, *The Past, Present, and Future.*

[22] *See* Zywicki & Adamson, *supra.*

[23] White Paper at 68.

statement is confused in two respects. First, it conflates two different concepts—the complexity of prepayment terms on one hand and the ability of consumers shop effectively on the other. If the concern is the ability to shop effectively, such as being able to compare competing offers, then the White Paper's concern could be met equally well by *mandating* prepayment penalties in every mortgage, thereby standardizing this term. In which case, it would no longer be a term on which consumers would need to compare across mortgages thereby rendering moot the question of the complexity of the term. Second, the statement refers to the inability of the "least sophisticated consumers" to be able to shop effectively. According to research by the Federal Trade Commission, however, those who have subprime mortgages are just as capable of understanding their mortgage terms as prime borrowers (or more accurately, neither groups understands their loan terms very well).[24] In still other cases the White Paper fails to consider the sophistication of the covered group at all. For instance, it identifies negative amortization loans as being especially complex and subject to particular scrutiny.[25] Mayer et al., find that negative amortization and interest only loans were present in a significant minority of alt-A mortgages, but virtually nonexistent in subprime mortgages.[26] Yet although alt-A and subprime loans are often lumped together, there is reason to believe that many alt-A borrowers were highly-sophisticated borrowers who fully understood the risks of those products and alt-A mortgages were often used precisely to purchase larger and more

---

[24] JAMES M. LACKO & JANIS K. PAPPALARDO, FED. TRADE COMM'N, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007), http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf.

[25] White Paper at 66.

[26] Chris Mayer, Karen Pence, and Shane M. Sherlund, *The Rise in Mortgage Defaults* (working paper). Mayer, et al., find that 40 percent of Alt-A mortgages had interest-only features, compared to 10 percent of subprime; 30 percent of Alt-A mortgages permitted negative amortization, subprime loans did not have these features.

expensive houses. More generally, negative amortization features do not appear to have been common in loans to ordinary borrowers or to subprime borrowers, but were limited to a particular subset of borrowers who often were highly-sophisticated and fully understood the risk of the loan and consciously chose to speculate that the home price would increase. I am aware of no evidence that those who held negative amortization loans failed to recognize or understand this term or the risks it entailed. Nor does the White Paper present any such evidence.

Finally, the ability of American consumers to freely prepay and refinance their mortgages may have exacerbated the current mortgage crisis—and banning prepayment penalties might thus exacerbate a similar situation in the future. When home prices were rising, many consumers refinanced their mortgages to withdraw equity from their homes. These "cash-out" refinancings became increasingly common during the duration of the housing boom—from 2003 to 2006 the percentage of refinances that involved cash-out rose doubled from under 40 percent to over 80 percent[27] and among subprime refinanced loans in the 2006-2007 period around 90 percent involved some cash out[28]. In fact, even though there was a documented rise in LTV ratios between 2003-2007, even that may underestimate the true increase in the LTV ratio if appraisals for refinance purposes were inflated (either intentionally or unintentionally), as appraisals are a less-accurate measure of value than actual sales.[29] The ability to freely prepay and refinance one's mortgage may help to explain the higher propensity for American consumers to default than in

[27] Luci Ellis, *The Housing Meltdown: Why Did it Happen in the United States*, BANK FOR INTERNATIONAL SETTLEMENTS BIS WORKING PAPER 259 at 22 and Fig. 9 (Sept. 2008), *available in* http://www.bis.org/publ/work259.pdf.
[28] C J Mayer & Karen Pence, *Subprime Mortgages: What, Where, and To Whom*, NBER Working Paper no. 14083.
[29] Ellis, *The Housing Meltdown*, at 22; Chris Mayer, Karen Pence, and Shane M. Sherlund, *The Rise in Mortgage Defaults* at 6.

comparably-situated countries where prepayment is more difficult and thus cash-out refinancings are not as common.

This suggests that a ban or limitation on contractual agreements for prepayment penalties would encourage even more refinancing activity and further equity depletion that would otherwise be the case—thereby having the unintended consequence of *increasing* the number of foreclosures.

New restrictions on mortgage brokers would also likely be counterproductive for consumers. First, it should be noted that the fixation on the "yield-spread premium" for mortgage brokers is obviously misplaced: this is nothing more than the difference between the wholesale and retail cost of funds. Every loan from a depository lender also has an implicit yield-spread premium embedded in it.

More fundamentally, the White Paper's apparent hostility to mortgage brokers fundamentally misunderstands the nature of competition and consumer choice in this market. New regulations that might result in a reduction in the number of mortgage brokers, and thus an attenuation of competition, will likely result in harm to consumers. Both economic theory and empirical evidence in this area strongly suggest that greater competition among mortgage brokers results in better loan terms for consumers.

Mortgage brokers are confronted with two distinct incentives. First, mortgage brokers have an incentive to maximize the "spread" between the rate at which they can acquire funds to lend to consumers (essentially the wholesale rate) and the rate at which they can lend to borrowers (the retail price). But second, mortgage brokers face competition from other brokers trying to get a borrower to borrow from them. The net

result of these two factors—one pushing toward higher rates and one pushing toward lower rates—is ambiguous as an *a priori* matter.

Early studies have found various different results, some finding that brokers offer better terms on average than depository lenders and others finding that brokers charge higher prices on at least some elements of the transaction.[30] The explanation for these differing results appears to result from differences in the number of mortgage brokers competing in a given market.[31] Where mortgage brokers are numerous and thus competition and consumer choice is greater, consumers generally receive lower interest rates from brokers (the competition effect predominates); but where there are a smaller number of brokers and less competition, consumers typically pay higher interest rates (the broker interest effect predominates). Empirical studies indicate that overly-restrictive broker regulations may also lead to a higher number of foreclosures overall.[32] The lesson seems to be clear—regulators should be wary of adopting overly-stringent regulations that will substantially reduce the number of mortgage brokers in a given market. Similar findings characterize many industries where overly-stringent regulations result in higher prices and other welfare losses for consumers.

Finally, any regulations imposed by the CFPA are likely to be a very blunt instrument for addressing the suitability of various lending products for consumers. "Low

---

[30] *Compare* Amany El Anshasy, Gregory Elliehausen & Yoshiaki Shimazaki, The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders (July 2005) (working paper, *available at* http://www.chicagofed.org/cedric/files/2005).
conf_paper_session1_elliehausen.pdf); *see also* Gregory Elliehausen, The Pricing of Subprime Mortgages at Mortgage Brokers and Lenders (Feb. 2008) (working paper) (updated results confirming the initial findings) *with*.WOODWARD, *supra* note 143, at ix (concluding that loans made by mortgage brokers have higher costs of $300 to $425).

[31] M. Cary Colins & Keith D. Harvey, *Mortgage Brokers and Mortgage Rate Spreads: Their Pricing Influence Depends on Neighborhood Type*, J. REAL ESTATE FIN. & ECON. (Forthcoming 2009).

[32] Morris M. Kleiner & Richard M. Todd, *Mortgage Broker Regulations That Matter: Analyzing Earnings, Employment, and Outcomes for Consumers* (working paper Nov. 2008).

documentation" or "no documentation" mortgages (sometimes called "liar's loans") have also come in for criticism. As noted above, the performance of these mortgages has depended to some degree on whether they are refinance or purchase-money loans. Other researchers have found that low-documentation mortgages perform as well as other loans except when the loans combine other risk-increasing terms, such as no downpayment (a practice known as "risk-layering").

More generally, low-documentation loans appear to be extremely reasonable in some circumstances if not others. Low-documentation mortgages are safe and appropriate for many refinancing transactions, such as a borrower with a high credit score, a long track-record of timely payment and equity in his home. For such a borrower, a low-documentation loan may provide an opportunity to refinance at a lower interest rate without the substantial cost, delay, and inconvenience of a full-blown refinancing process that would add little valuable information. By contrast, a low-documentation loan makes little sense for a purchase-money loan to a new borrower with no equity in the home. Prohibiting low-documentation loans in the former situation because of fear that it will be misused in the latter will raise the cost of refinancing for many borrowers and thereby make it more difficult for them to take advantage of lower interest rates. Even more importantly, questions regarding the proper role of low-documentation loans—whether refinance or purchase money—again raise safety and soundness issues, not consumer protection questions.

But this distinction between the appropriateness of low documentation loans in different contexts simply highlights a more fundamental problem: the CFPA's inability to engage in the sort of fine-grained regulatory analysis that is necessary to try to implement

its charge. For instance, empirical studies have found dramatic differences in the performance of subprime loans with different terms depending on whether they are purchase-money or refinance. Economist Morgan Rose found, for instance, that while a three-year prepayment penalty is associated with a higher probability of foreclosure for purchase-money fixed-rate mortgages and refinance adjustable-rate mortgages, that same provision has no impact on increased foreclosures for refinance fixed-rate mortgages.[33] Danis and Pennington-Cross found that low documentation loans increase the probability of delinquency and the intensity of delinquency, but they decrease the probability of default and prepayment.[34] If this is true, which is the proper measure of the suitability of such a mortgage—the higher delinquency rate or the lower default rate?

More importantly, what matters is the suitability of the entire terms of a given loan *as a whole*, not the complexity or "riskiness" of particular terms standing alone. It is frankly absurd for regulators to try to single out particular terms standing alone as being inherently dangerous or inappropriately complex, noting that whether a particular term leads to a higher risk that a given loan will default depends very little on the presence of any given loan term but depends greatly on the type of loan—refinance versus purchase-money, adjustable-rate versus fixed—and the presence of other non-traditional loan terms. Rose summarizes his findings, "In most instances, a given combination of loan features is associated with a greater increase in the predicted probability of foreclosure than the sum of the relevant individual loan feature impacts. For purchase FRMs with reduced documentation combined with either a long prepayment penalty period or a

[33] Morgan J. Rose, *Predatory Lending Practices and Subprime Foreclosures: Distinguishing Impacts by Loan Category*, 60 J. ECON. & BUS. 13 (2008).
[34] Michelle A. Danis & Anthony Pennington-Cross, *A Dynamic Look at Sub-prime Loan Performance* 12 (Fed. Res. Bank of St. Louis, Working Paper 2005-029A, May 2005), *available at* http://research.stlouisfed.org/wp/2005/2005-029.pdf.

balloon payment (but not both), the reverse holds—those combinations are associated with substantial falls in the predicted probability of foreclosure beyond the sum of the relevant individual loan feature impacts."

As Rose concludes:

> With regard to the implications of these results for potential federal predatory lending regulation, the overall pattern of results is of greater import than the individual estimates. That pattern illustrates that the magnitude, and even the direction, of the impact of a long prepayment penalty period, a balloon payment, or low- or no-documentation on the probability of foreclosure depends significantly on (a) the category of the loan under consideration, and (b) the presence or absence of the other two loan features. This suggests that relationships among predatory loan features and fore-closures are much more complex than previous analyses portray, casting doubt on regulators' and legislators' current ability to confidently discern abusive versus non-abusive lending. In particular, broad federal prohibitions or restrictions of these loan features that do not distinguish among loan categories, especially between refinances and purchases, and that do not recognize that loans with multiple loan features may require different treatment than loans with only one, are likely to be quite prone to causing unintended and undesired consequences.

Thus, even if we assume that these issues can be considered consumer protection issues rather than safety and soundness, it is absurd to think that a government bureaucracy can make the sorts of fine-grained distinctions to distinguish appropriate from inappropriate loans. To make data-based decisions a bureaucrat would have to know not only the identity and financial sophistication of the borrower, but also whether the loan is refinance or purchase-money and whether the *combination* of terms in the loan make the loan a likely candidate for default, because there is no sound evidence that particular terms standing alone can be thought of as inherently dangerous. This is not a serious proposition. And it illustrates precisely why the government has eschewed central planning of credit terms in the past—and should continue to do so.

Bureaucratic Inconsistency

A final problem with the CFPA is that it creates a new bureaucracy with a defined scope, expertise, and mission, separate from other consumer protection agencies and safety and soundness regulators. In so doing, it will promote the very bureaucratic balkanization and inconsistency that it aspires to address.

Of primary concern is the distinguishing of the CFPA's consumer protection mission from the Federal Reserve's safety and soundness regulatory authority. Under the White Paper's proposal, the CFPA would have authority to enforce regulations and impose substantial financial penalties. Inevitably, this power to impose financial penalties will threaten the financial condition of banks, thereby bringing the CFPA into conflict with the safety and soundness regulatory authority of the Federal Reserve.

The standard that the CFPA seeks to achieve is also unrealistic and suggests a virtually unlimited scope of authority for its action. The White Paper proposes that CFPA "should be authorized to use a variety of measures to help ensure alternative mortgages were obtained only by consumers who understood the risks and could manage them."[35] This statement fails to recognize, however, that according to a study by James Lacko and Janis Pappalardo of the Federal Trade Commission, very few homeowners understand all of the risks associated with their mortgages—whether traditional or alternative.[36] In this fact, of course, consumer credit products are not unique: consumers routinely purchase complex products and services for which they do not understand all of the nuances and wrinkles of the product, whether automobiles, computers, medical services, legal

[35] White Paper at 66.

[36] JAMES M. LACKO & JANIS K. PAPPALARDO, FED. TRADE COMM'N, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007), http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf.

services, and the like. Citizens routinely vote for politicians without understanding all of the "risks" of voting for one candidate rather than another. To establish such an unrealistic and implausible standard is to open up a capaciousness of regulatory discretion and authority that is simply stunning. This standard of perfect understanding has probably never been met in practice, even for the most simple mortgage and most sophisticated borrower. Yet most mortgages work well for most borrowers without mishap.

Moreover, this standard fails to consider the question of *which* risks are relevant to be understood. For example, must those who enter into a fixed-rate mortgage understand that in doing so they are bearing the risk that market interest rates will fall, thereby forcing them to make higher payments than they would have with an ARM or to undergo a costly and inconvenient refinance process? For instance, during the low interest rate period of 2001-2004, those with fixed rate mortgages could have saved tens of thousands of dollars in lower interest rates if they had an ARM instead.[37] Must lenders insure that borrowers understand this "overpayment" risk? Must lenders make sure that borrowers understand that they pay a premium at the outset of a mortgage in order to have the right to prepay and refinance the mortgage later? What if the buyer only intends to own a given house for a few years?

Life, and credit, is full of risk: instead of acknowledging this, the CFPA apparently assumes away the existence of some sorts of risk, such as the risk of overpaying on a fixed-rate mortgage, and simply assumes that it is not actually a risk that

[37] Alan Greenspan, Chairman, Fed. Reserve Bd., Remarks at the Credit Un-ion National Association Governmental Affairs Conference: Understanding Household Debt Obligations (Feb. 23, 2004), *available at* http://www.federal reserve.gov/boardDocs/speeches/2004/20040223/default.htm.

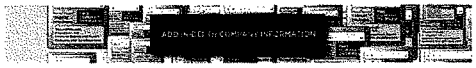
matters to consumers. The CFPA substitutes vague and empty aspirational statements for serious analysis of the challenges of trying to establish coherent and rule-bound standards for assessing the propriety of different loan products. These empty generalities provide a recipe for overzealous, incoherent, and contradictory regulatory action. Although consumers will occasionally err in making this evaluation, who is in a better position to evaluate this panoply of risks—consumers with the knowledge of their particular situations and needs or governmental bureaucrats seeking to lay down blunt rules for what sorts of risks are acceptable for different buyers.

The CFPA would attempt to carve off the regulation of consumer financial products from all other consumer protection agencies. Scholars and policy-makers have long recognized that governmental bureaucracies are prone to "tunnel vision," especially those bureaucracies defined by the substantive sector that they regulate rather than by their function. Such agencies are prone to interest-group capture that undermines their effectiveness.

Finally, the CFPA's limited substantive scope and responsibility is likely to cause it to undervalue the importance of competition and innovation in financial services. As noted above, the White Paper's emphasis on the value of simplicity in "plain vanilla" financial products fails to appreciate the value of innovation and competition in financial services.

Instead of creating a new bureaucracy, Congress instead should consider expanding the jurisdiction of the Federal Trade Commission and strengthen the Federal Reserve to meet the discrete categories of true consumer protection issues that arise under current law. Alternatively, this Committee should consider the Republican proposal to

streamline regulatory authority into a new consolidated agency that might perform the Federal Reserve's traditional oversight function more effectively. The FTC has longstanding expertise in consumer financial protection issues as well as related areas of consumer information, labeling, and advertising. In particular, this Committee should review the FTC's study of consumer disclosure regulations which provides numerous useful recommendations for improving consumer disclosures in a more user-friendly (and less lawyer-friendly) manner.



THE WALL STREET JOURNAL.
WSJ.com

REVIEW & OUTLOOK | JULY 15, 2009

A Tale of Two Bailouts

Goldman's profits, CIT's trouble, and 'too big to fail.'

Yesterday saw one TARP recipient, Goldman Sachs, report $3.44 billion in profits even as another, CIT, teeters on the edge of either bankruptcy or another taxpayer bailout. Which way CIT will tip remained unclear as we went to press, but its very plight shows how the government's approach to systemic risk has created groups of financial "haves" and "have nots."

What the Goldmans of the world have in addition to profits is the widespread belief that they are too big to fail. Both Goldman and CIT converted into bank holding companies at the height of the financial panic last fall, which made them eligible for TARP injections. Goldman also benefited at a crucial moment from the Federal Reserve takeover of AIG, and it received the additional filip of FDIC-guaranteed debt issuance through the Temporary Liquidity Guarantee Program. CIT was excluded from the latter program on grounds that it didn't pose a systemic risk, even as larger competitors like General Electric were allowed in.

CIT's asset quality has since fallen further, and it now faces $2.7 billion in maturing debt this year that investors fear it will not be able to roll over. So it is seeking another taxpayer rescue, and officials at Treasury and Fed are sympathetic.

But if CIT -- a company one-tenth the size of Lehman Brothers -- can be bailed out long after the panic has passed, the word "systemic" has lost all meaning. CIT has long been a lender to subprime corporate borrowers, and this decade it took on even greater risks at precisely the wrong time. It has lost money for eight straight quarters. Its lending supports less than 1% of the total U.S. retail and manufacturing, and plenty of competitors could pick up its market share.

There's also a question of why the FDIC -- which is supposed to protect bank depositors -- should be the rescue agent. CIT's bank is only a small part of the company and is so far walled off from trouble. CIT executives want permission to stuff some of the company's assets into the bank so they can finance them with brokered deposits. But that would put the FDIC's deposit fund at greater risk just when it is stretched from other bank failures. The FDIC should also be winding down its debt guarantee program, not extending it to new and riskier companies. Taxpayers shouldn't be put at risk for further losses via the FDIC merely because Treasury and the Fed don't want to admit losses on their TARP investment.

Of course, if the feds do let CIT fail, this will only confirm that the only certain survivors in the current market are banks big enough that the government figures it must bail them out. Just ask the many small banks that have been rolled up by the FDIC at a rate of two a week since the beginning of the year, with eight so far in July alone. That can only strengthen the likes of Goldman, which apparently needs no help printing money anyway.

Goldman's traders profited in the second quarter from taking advantage of spreads left wide by the disappearance of some competitors (Lehman, Bear Stearns) and the risk aversion of others (Morgan Stanley). Meantime, Goldman's own credit spreads over Treasurys have narrowed as the market has priced in the likelihood that the government stands behind the risks it is taking in its proprietary trading books.

Goldman will surely deny that its risk-taking is subsidized by the taxpayer -- but then so did Fannie Mae and Freddie Mac, right up to the bitter end. An implicit government guarantee is only free until it's not, and when the bill comes due it tends to be huge. So for the moment, Goldman Sachs -- or should we say Goldie Mac? -- enjoys the best of both worlds: outsize profits for its traders and shareholders and a taxpayer backstop should anything go wrong.

We like profits as much as the next capitalist. But when those profits are supported by government guarantees or insured deposits, taxpayers have a special interest in how the companies conduct their business. Ideally we would shed those implicit guarantees altogether, along with the very notion of too big to fail. But that is all but impossible now and for the foreseeable future. Even if the Obama Administration and Fed were to declare with one voice that banks such as Goldman were on their own, no one would believe it.

If there is a lesson in this week's tale of two banks, it's that it won't be enough to give the Federal Reserve a mandate to "monitor" systemic risk. Last fall's bailouts are reverberating through the financial system in a way that is already distorting the competition for capital and financial market share. Banks that want to be successful will also want to be more like Goldman Sachs, creating an incentive for both larger size and more risk-taking on the taxpayer's dime.

One policy response to the incentives created by last fall's bailout is simply to restrict the proprietary trading done by the subsidiaries of bank holding companies that enjoy both FDIC deposit insurance and an implicit government subsidy on their cost of capital. This is what Paul Volcker proposed, only to be overruled by Tim Geithner and Larry Summers. Another answer would be an FDIC-style bailout tax, perhaps tied to leverage ratios, for those in the too-big-to-fail camp. Developing a template to facilitate the seizure and orderly winding down of failing financial giants is also an essential element of whatever reform Congress cooks up.

* * *

No one welcomes the pain and dislocation if CIT files for bankruptcy. But U.S. policy toward financial companies cannot avoid all hardship, or the result will be a de facto cartelization of finance, with a resulting loss of competition and dynamism that have long been an American strength. The divergent fortunes of CIT and Goldman Sachs show how much we changed when we stepped in to save certain banks in the name of saving the system.