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THE CONSUMER FINANCIAL PROTECTION AGENCY: KEY TO SAFETY AND SOUNDNESS AND CONSUMER PROTECTION

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The **Kirwan Institute for the Study of Race and Ethnicity** is a university-wide interdisciplinary research institute. We generate and support innovative analyses that improve understanding of the dynamics that underlie racial marginality and undermine full and fair democratic practices throughout Ohio, the United States, and the global community. Responsive to real-world needs, our work informs policies and practices that produce equitable changes in those dynamics.

The Consumer Financial Protection Agency:
Key to Safety and Soundness and Consumer Protection

Gregory D. Squires

Of the many factors that have made the United States the world's premier capital marketplace for 80 years, our robust regime of consumer and investor protections is among the most important. The United States cannot have a world-class financial marketplace unless consumers and investors have full confidence in the safety and soundness of financial institutions, the integrity of the markets, the quality and suitability of financial products, and the basic fairness of the broader financial system.

Robert S. Nichols (2009: 6)
President and Chief Operating Officer
The Financial Services Forum

As part of its financial regulatory reform proposal the Obama Administration has called for the creation of a Consumer Financial Protection Agency (CFPA) that would consolidate enforcement of most consumer financial services requirements under one roof (U.S. Department of the Treasury 2009). A truly independent agency, with appropriate staff and financial resources, is critical to the realization of the goal of fair access to credit and to assure the safety and soundness of the nation's financial service providers. The industry opposes the creation of this agency. According to Barney Frank (D-Mass.), Chair of the House Financial Services Committee, the industry's "highest priority is killing the agency" (Dennis 2009). But the success of efforts to restore stability to the nation's financial markets and continue what has been progress toward the goal of fair access to financial services may depend on the fate of this agency.

What the Consumer Financial Protection Agency Would Do

The CFPB would be “dedicated to protecting consumers in the financial products and services markets” (U.S. Treasury 2009: 55). It would have authority to write regulations, supervise compliance, and enforce the law when violations occur. According to the initial Administration proposal, among the statutes that would be covered are the Truth in Lending Act (TILA), Home Ownership and Equity Protection Act (HOEPA), Real Estate Settlement and Procedures Act (RESPA), Community Reinvestment Act (CRA), Equal Credit Opportunity Act (ECOA), Home Mortgage Disclosure Act (HMDA), and Fair Debt Collection Act (FDCPA). The agency would also have jurisdiction over non depository institutions (e.g. independent mortgage bankers, brokers) that are not currently supervised by any federal authority. These are the lenders that were primarily responsible for the problematic subprime and predatory lending of recent years (Immergluck 2009, Kroszner 2008).

One objective of the agency would be to create clearer, simpler products and disclosure forms to better educate consumers and bring far more transparency to financial services markets. As part of that effort the CFPB would establish minimum standards for all lenders to follow but it would not pre-empt those states or local communities that chose to take stronger actions or respond to localized problems.

If a truly independent consumer protection agency is created, it would build on a number of steps that have been taken in recent decades to make credit available on more equitable terms. That progress has been challenged by the rise in predatory lending, the foreclosure crises that followed stripping equity and wealth particularly from minority and low-income homeowners, and the ensuing economic crises that now reach well beyond financial institutions (Immergluck 2009, Katz 2009). But since the Federal Fair Housing Act was passed in 1968 (interestingly, this

is not one of the laws the new agency would enforce), a fair lending and community reinvestment infrastructure has emerged that has changed the way many financial institutions do business. Groups like ACORN, National Community Reinvestment Coalition, Center for Community Change, National Fair Housing Alliance, and others have developed a wide range of skills (including organizing, litigation, and social science research) to exploit federal laws like HMDA and CRA in order to increase access to credit in neighborhoods that have traditionally been underserved. According to the National Community Reinvestment Coalition the CRA led to \$4.7 billion dollars in loans to such neighborhoods in the first 20 years of passage of the law in 1977 (National Community Reinvestment Coalition 2007). (Some pundits have argued that the CRA and related fair lending rules were major contributors to the rise in subprime lending and the economic fallout but research by the Federal Reserve Board and others demonstrated that CRA-covered lenders made a tiny fraction of the problematic loans, that it was unregulated lenders not covered by the Act who made the overwhelming share of these loans and that CRA-related lending has been profitable (Kroszner 2008, Squires 2008)). The Consumer Financial Protection Agency would provide an additional tool that the growing fair lending and community reinvestment infrastructure could utilize (Squires and Chadwick forthcoming).

Industry Response, and a Reply

While asserting its commitment to consumer protection, the financial services industry has argued against creation of such an agency. A typical response is that offered by the Executive Vice President of the Securities Industry and Financial Markets Association, “we are concerned that creating a new agency for these purposes might lead to wasteful and duplicative regulation while failing to deliver the hoped-for benefits due to the separation of consumer

protection and prudential regulation” (Snook 2009: 17-18). And in the words of the President and CEO of the Investment Company Institute, “A separate regulatory regime...could well mean...conflicting regulatory philosophies and potential regulatory overlap” (Stevens 2009: 8).

Specifically in the area of home finance the charge is often made that separating safety and soundness regulation from consumer protection could compromise the stability of financial institutions while undermining innovation and limiting choice all to the detriment of consumers. And it is not just the industry that takes this position. As Sheila Bair, Chair of the Federal Deposit Insurance Corporation (FDIC) observed “Consumer protection and risk supervision both benefit from the synergies created by this holistic approach and the ready and timely access to expertise and critical information. Separating consumer protection examination and supervision from those other supervisory efforts could undermine the effectiveness of both, with the unintended consequences of weakening bank oversight” (Bair 2009: 13). Federal Reserve Chair Ben S. Bernanke offered a similar sentiment when he said, “consumer protection rules and their enforcement are complementary to prudential supervision” (Bernanke 2009: 16). John C. Dugan expressly rejected this separation observing that “the Proposal’s attempt to completely divorce consumer protection from safety and soundness raises real potential problems” (Dugan 2009: 12). And the ultimate consumer protection, it is argued, is maintaining the solvency of financial institutions which could be threatened by this approach (Tyler 2009). In fact, legislation (H.R. 3126, the Consumer Financial Protection Agency Act of 2009) was subsequently introduced by Barney Frank to retain CRA jurisdiction within the current prudential bank regulatory agencies.

But as Elizabeth Warren, Harvard Law Professor and Chair of the Congressional Oversight Panel that oversees the Troubled Asset Relief Program (TARP) who has long called for such an agency, observed, the current regulatory system has delivered neither safety and

soundness nor consumer protection (Warren 2009). As several consumer advocates have noted, had the Federal financial regulatory agencies, and particularly the Federal Reserve Board, enforced the laws on the books, subprime and predatory lending would not have taken off and the foreclosure crisis and related economic problems would not have occurred to anywhere near the same extent (Plunkett 2009, Mierzwinski 2009). The primary problem remains the absence of a strong, independent consumer advocate.

Two factors compromise consumer protection under the current regime. First, the financial regulatory agencies that currently have authority to enforce fair lending and related consumer credit laws have other primary motivations. The Federal Reserve is primarily concerned with monetary policy while the Office of the Comptroller of the Currency, Office of Thrift Supervision, and other regulators focus on capital adequacy, often for the short run. Consumer protection is, at best, a secondary consideration (Warren 2009). As Treasury Secretary Timothy F. Geithner said, "...the banking agencies responsible for implementing and enforcing consumer protection have higher priorities. The agencies' primary focus is the safety and soundness of the institutions they oversee. As a matter of mission and internal organization, they are focused on the effect of a bank's products and practices on the bank itself, rather than the effect on consumers" (Geithner 2009: 3,4). The President of one Midwestern mortgage lender advised me, off the record, that he did not know of any career professional in any regulatory agency who was promoted because of his or her interest in, knowledge of, or advocacy for consumer protection, but he knew several who were promoted at least in part because they did not push for strong enforcement of consumer protection laws.

A second problem is regulatory arbitrage. Regulatory agencies are funded by the fees paid by the institutions they oversee. If lenders perceive their regulator is too aggressive, they

can and do change their charter and seek out a more “sympathetic” regulator (Warren 2009, Geithner 2009). Such “shopping” clearly serves as a disincentive to enforce consumer protection laws and leads to a race to the regulatory bottom.

An independent agency whose primary task is to enforce such rules would operate differently. There would be no conflict. The culture would encourage rather than discourage strong enforcement. As Secretary Geithner (2009) observed, the transparency that would be provided by the CFPB coupled with its market-wide jurisdiction, would reduce regulatory shopping, encourage innovation in the creation of better products for more informed consumers, and strengthen safety and soundness while better protecting consumers. The key, again, is independence. While such an agency needs adequate support, in terms of the number and skills of the staff and of course funding, to assure its independence its funding should not come from fees paid by lenders. Congress would have to provide the necessary level of support. Otherwise, the agency would eventually become captured by the entities it is supposed to regulate.

There are shortcomings in the Administration’s proposal. A primary example is the limited attention to traditional forms of discrimination. As the Leadership Conference on Civil Rights has argued, “the CFPB must explicitly be tasked with protecting the civil rights of consumers” (Zirkin 2009: 5).

The fact that the Fair Housing Act is not addressed in the proposal constitutes one critical deficiency. Even if all authority to enforce the Act were not moved from HUD and Justice, the newly created agency should have the eradication of discrimination in housing, housing finance, and other consumer credit markets as part of its mandate. This objective could be pursued in collaboration with HUD, Justice, and other civil rights agencies, perhaps in a Civil Rights/Fair Lending Compliance and Enforcement Office within the agency (Zirkin 2009: 5).

A related issue that HUD is currently examining is the extent to which the obligation to affirmatively further fair housing is carried out by recipients of Community Development Block Grants and other recipients of federal funds as required by law. Such a requirement should be established for all recipients of federal funds including lenders receiving TARP and other bailout funds, those who benefit from the Federal Reserve's discount window, and financial service providers who receive any other form of financial assistance from the federal government. All should be required to use those funds and operate their businesses generally to affirmatively further fair housing. Enforcement of this obligation should be explicitly included as one of the responsibilities of CFPA.

Does the Consumer Financial Protection Agency Have a Future?

Whether an effective CFPA is ever created remains to be seen. Already, as noted, a bill has been introduced that would limit the authority provided in the Administration's initial proposal. No doubt other changes will occur before any agency is up and running, if that should occur. Some would strengthen the agency, others would weaken it. Once again, the devil is in the details.

A strong, independent consumer agency can help change the way financial service providers do business. But, as Chairman Frank observed, the industry is out to kill the agency. Perhaps this is just one more indication why such an agency is necessary.

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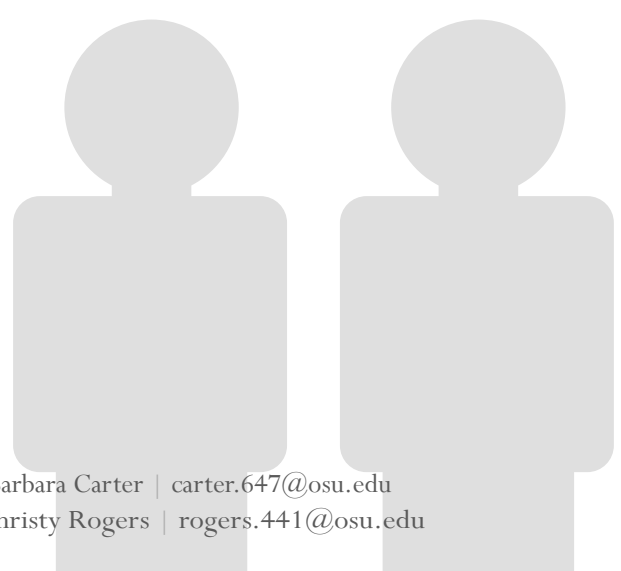
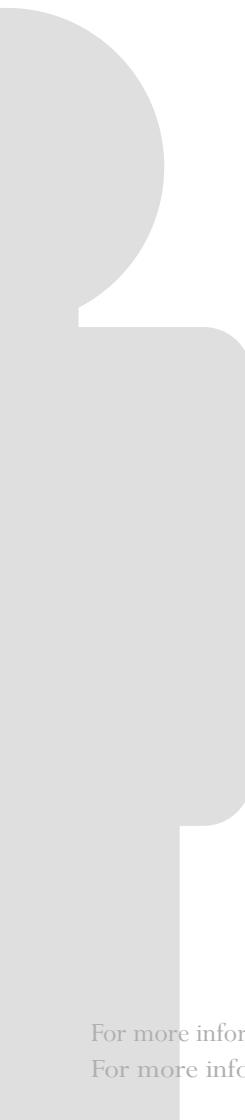
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