Testimony of Michael Calhoun, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services
"Perspectives on the Consumer Financial Protection Agency"

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Good morning Chairman Frank, Ranking Member Bachus, and members of the Committee. Thank you for inviting me to testify on H.R. 3126, a bill to establish a Consumer Financial Protection Agency to keep the market for financial products and services free of unfairness, deception and abuse.

I. Introduction

I testify today on behalf of the Center for Responsible Lending (CRL), a non-profit, non-partisan research and policy organization, and Self-Help, a non-profit credit union and lender that would be subject to the supervision and enforcement of the proposed Consumer Financial Protection Agency (CFPA). It is unusual for a financial institution to welcome change that strengthens lending oversight, but in this case we believe that the current regulatory structure has worked so poorly, and the need to prevent another crisis in the future is so vital, that we unequivocally support the creation of a strong and independent consumer protection agency that preserves the ability of the states to protect their residents—one that would streamline the current system and eliminate the conflicts of interests that played a key role in the economic crisis we are grappling with today.

I serve as President of CRL, which is dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a non-profit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Self-Help's lending record includes an extensive secondary market program, in which we partner with for-profit lenders to encourage and enable sustainable loans to borrowers with blemished credit.

The financial oversight system we have today is fundamentally broken, hobbled by conflicts of interest and strong incentives to ignore lending abuses. Nowhere is this more starkly evident than in the area of consumer protection. Thirty-five years ago, Congress vested all the federal banking regulators with the responsibility to prevent unfair and deceptive acts and practices by the banks, thrifts and credit unions they regulate. Yet in recent years none of these agencies has pursued this mandate diligently, and, in fact, often denied their authority to do so or refused to take enforcement actions.

To the extent that Americans have received decent, up-to-date protections from unfair and deceptive products, those protections have come primarily from the states. For example, many of our states were years ahead of federal regulators in recognizing and taking action to curb abusive mortgage lending. Yet some of the very same institutions that helped cause this crisis, and their regulators that stood by passively, are fighting hard to keep the locus of their power here in Washington.

We strongly support a robust and independent Consumer Financial Protection Agency, but we would actively oppose such an agency if the price of enacting it would be to overturn existing state consumer protection laws or to restrict the ability of the states to respond to new "innovations" in the marketplace that harm their residents. The most robust system for consumers and for our economy as a whole would be a strong federal agency that establishes minimum standards, allowing states to take stronger action when necessary. We urge Congress to stand up for the states they represent, and to refrain from any action that would undermine our states' ability to protect their residents and their local economies.

In considering all aspects of this proposal, the stakes are high. Unfair and deceptive credit card, overdraft and mortgage products have been allowed to proliferate, injuring millions of individuals and families across the country. The result was that Americans have had less choice in financial products, and every year families lose billions of dollars in unnecessary overcharges and fees.

It is no mystery why lenders would aggressively market high-cost credit cards, load their overdraft loans with staggering fees, or steer people into more expensive loans than they qualify for. These practices yield high fees for lenders who face pressure to keep up with competitors that are doing the same. In fact, responsible financial institutions that refuse to engage in these aggressive anti-consumer practices are put at a competitive disadvantage.

Less obvious are the reasons why the banking regulators permit these abusive practices, but a review of the current regulatory structure is helpful in understanding those reasons. Currently, five different banking agencies are responsible for the safety and soundness of banks, thrifts, bank holding companies and credit unions, and also for protecting consumers against harmful practices by these entities. Each has its own consumer affairs department responsible for receiving and acting upon consumer complaints and enforcing federal law against unfair and deceptive acts and practices, and three of the agencies are responsible for writing regulations to further the purpose of preventing unfair acts and practices. Only one of the agencies has authority to write regulations covering non-depository lenders.

In this testimony, we identify numerous failures by the regulators who have been entrusted and charged with preventing lending abuses, particularly failures by the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Federal Reserve Board (FRB). We also identify several flaws built into the system that produced the banking regulators' worst failures: conflict of interest; competition to attract lending institutions; the ability to pressure the States into weakening their lending rules to match the lowest common denominator; failure to set minimum standards for all relevant market participants, and the absence of a mechanism for enforcing them.

Our current system that relies on five separate agencies—creating inherent conflicts and regulatory sprawl—has proved both wasteful and ineffective. Rather than guarding against lending abuses, the agencies have been distracted by the demands of protecting their turf. The current structure encourages them to focus on competition amongst themselves, to misdirect resources to market themselves to regulated companies; to litigate against States to prevent consumer protection enforcement; and to maintain five separate consumer protection departments that overlap with each other, but still leave large portions of the market uncovered. It would be much better to harness these resources into a single, well-resourced agency that is capable and highly motivated to accomplish its consumer protection mission.

Another key part of this testimony highlights the importance of making the proposed CFPA comprehensive enough to avoid loopholes that could drastically undermine the agency's effectiveness. Meaningful financial reform will benefit legitimate small businesses and financial providers of all sizes, reducing the necessity of competing against market distorting forces of unfair and irresponsible businesses. But meaningful financial reform will only come if the reform is not riddled with exemptions that create loopholes, since it is inevitable that any gaps and exclusions will be exploited for opportunistic abuse. We urge Congress to resist pressure to include unnecessary exemptions.

We also urge absolute clarity about where the systemic vulnerabilities lie, so we can design a better system for the future. Any effective system will include these minimal requirements:

(1) The agency must be separate from the safety and soundness regulators to focus on consumer protection;

(2) It must have rule-making authority over *all* providers of consumer financial services and products to avoid gaps in coverage that create opportunities for abuse and force competitors into a race to the bottom;

(3) Strong enforcement authority is required so that rules are backed by meaningful consequences;

(4) Examination or supervisory authority is required to detect problems before they become widespread; and

(5) Consumer protection regulation and enforcement must honor our federalist system, allowing the States to step in when local conditions require action.

In other areas of economic life, American markets have been distinguished by the standards of safety and fairness that are fundamental to economic stability. The financial services sector is too important to fail to meet these standards. A strong, properly incented, independent Consumer Financial Protection Agency will help restore consumer confidence, reassure secondary market investors, and protect our economy from the consumer financial dislocations that helped produce the global economic collapse of the past year.

We look forward to working with the Committee to create a strong, effective and efficient CFPA.

II. Perverse Incentives and Lack of Consumer Choice

One of the central causes of the current economic crisis was the absence of sustainable choices of financial products for many American families—choices that would have been win-win for working Americans, for financial institutions, for investors, and the economy.

We got on this rocky road because many companies made bigger fees by pushing bad financial products. In its final form, the proposed Consumer Financial Protection Agency must ensure that never again will we have a market that only offers millions of families "options" from the bottom of the barrel.

The box below outlines a few examples of bad practices and products crowding out good ones, reducing both consumer choice and honest competition.[1] The market pushed the products that generated the biggest short-term revenues, depriving people of the ability to make the financial choices that best suited their needs, such as a loan they had a real chance to repay,[2] a checking account that did not hemorrhage their hard-earned money to the banks, or a credit card that did not arbitrarily change the rules on them.

Examples of Bad Practices that Reduced Consumer Choice and Honest Competition

<u>Mortgages</u>

- **In 2003**, nearly $2.5 trillion in <u>prime</u> mortgages were originated. In sharp contrast, less than $500 billion in the riskier nonprime[3] mortgages were originated.
  By 2006, non-prime mortgage originations (jumbo loans, Alt-A, and subprime) of nearly $1.5 trillion had surpassed prime mortgage originations, which had decreased to $990 billion.[4]
- A 2007 Wall Street Journal study found that 61% of subprime borrowers may have qualified for a conventional loan. [5]

<u>Overdraft Fees</u>

- **In 2004**, 80% of institutions simply denied ATM and point-of sale debits that would have overdrawn their customers' accounts.
  Now 80% of institutions fund these debits *with loans that their customers didn't ask for and most don't want,* taking well in excess of $20 billion from their customers' accounts this year alone.[6]

<u>Credit Cards</u>

- Before Congress passed the Credit Card Act this year, it was virtually impossible for credit cardholders to "choose" a card that had honest accounting and that gave them the benefit of low-rate balance transfer deals they were offered.7 Even now, the card companies are devising new ways of scamming customers to make up for lost revenue.

III. Regulatory Failures

A. Congress has repeatedly vested the federal banking agencies with the authority and obligation to prevent unfair and deceptive lending, yet the agencies have repeatedly refused to use this authority.

For more than half a century, the federal banking agencies have had the responsibility for protecting consumers from unfair and deceptive acts in practices by financial institutions within their jurisdiction. Unfair or deceptive acts or practices in commerce have been illegal under federal law since at least the 1930s.[8] In 1966, Congress gave all the federal banking agencies authority to bring enforcement actions and issue "cease and desist" orders against companies that violate laws or regulations, including those involving unfair or deceptive acts or practices. This mandate was further strengthened in 1975 when Congress expressly required each banking agency to establish a separate division of consumer affairs to act upon consumer complaints alleging unfair or deceptive acts or practices.[9]

Also in 1975, Congress gave the Federal Reserve Board rulemaking authority to define with specificity unfair and deceptive acts and to promulgate regulations to prevent them. The same authority was given to the Office of Thrift Supervision ((OTS), then the Home Loan Bank Board) and the National Credit Union Administration, with respect to the institutions they cover.[10] This new rule-making authority supplemented the banking agencies' existing authority to enforce federal prohibitions on unfair or deceptive acts or practices, which Congress had granted to the federal banking agencies in 1966.[11]

Finally, reacting to the rise of abusive mortgage loans, in 1994, Congress passed the Homeowner Equity Protection Act, which gave the FRB further rulemaking authority to prohibit acts or practices in connection with mortgages that the Board determines are unfair, deceptive, or designed to evade HOEPA, or that are made in connection with a refinancing of a mortgage loan that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.[12] Importantly, this authority extends to all financial institutions, both depository institutions (banks, thrifts and credit unions) and non-depositories (such as non-bank mortgage lenders).

Thus, for over fifty years, Congress has repeatedly authorized and required the federal banking agencies to set and enforce consumer protection standards to prevent unfairness and deception in by financial institutions. These delegations do not represent abdication of legislative responsibility; rather, they represent common sense. In enacting the original FTC Act, Congress recognized that "there is no limit to human inventiveness" in creating unfair practices. If Congress reserved the obligation to define such practices itself, "it would undertake an endless task."[13] (To see a few examples of how failures on safety and soundness are linked to failures on consumer protections, see Appendix A.)

B. The federal banking agencies have been unwilling to ban the unfair and deceptive acts and practices that have proliferated in mortgage lending, credit cards, overdraft loans, and other areas.

In recent years, the banking agencies remained remarkably passive in the face of increasingly risky lending practices—practices that were highly visible in the marketplace and the media. Neither the FRB, which has the rule-making authority to ban unfair and deceptive acts and practices across the market, nor the other banking agencies, which have the authority to ban them as to their own institutions through the issuance of "guidance," supervisory activity, and enforcement actions, took any steps to regulate such practices.

1. A long record of inaction.

Through all the years leading up to the 2008 foreclosure crisis and financial collapse, the federal regulators failed to act. The two frontline national banking regulators, the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC), came to view the banks they regulate as their paying customers, and they have been reluctant to take action that could cause their customers to switch their charter to another regulator. As a result, these agencies have defended practices that hurt consumers. Moreover, they have intervened to prevent state authorities from acting to stop harmful lending practices, preempting state laws and blocking state law enforcers from investigating banks that were taking advantage of consumers.[14] Consider these examples:

- The OCC did not exercise its consumer protection authority to address unfair and deceptive practices under the FTC Act for twenty-five years.[15] The OCC's first action using its power to go after a bank's unfair and deceptive practices came only after a decade in which the target bank "had been well known in the … industry as the poster child of abusive consumer practices" and after the OCC was "embarrassed … into taking action" by a California prosecutor.[16]

- From 1987 to the present, the OCC brought only four formal enforcement actions under the Equal Credit Opportunity Act, 15 U.S.C. § 1691c(a)(1)(A), and its implementing regulations, and from 2000 to 2008 the OCC made no referrals under ECOA**{** TA \l "15 U.S.C. §§ 1607(a)(1)(A) (TILA), 1691c(a)(1)(A) (ECOA)." \s "15 U.S.C. §§ 1607(a)(1)(A) (TILA), 1691c(a)(1)(A) (ECOA)." \c 2 **}** to the U.S. Department of Justice of matters involving race or national origin discrimination in mortgage lending.[17]

- Between 2000 and 2008, as the mortgage market grew wildly and abusive practices against homeowners flourished, the OCC took only two public enforcement actions against banks for unfair and deceptive practices in mortgage lending – both against small Texas banks.[18]

- Although the OTS has recently increased the number of ECOA referrals to the Department of Justice (DOJ), from 2000 to 2006 the agency made no referrals for race or national origin discrimination in mortgage lending. Despite the lack of referrals, in 2002 the DOJ filed a complaint alleging that Mid America Bank, an OTS-regulated bank, engaged in a pattern or practice of redlining on the basis of race.

- Another federal bank regulator, the Federal Deposit Insurance Corporation (FDIC), in 2002 gave Centier Bank a satisfactory rating under the Community Reinvestment Act. However, when the Department of Justice reviewed data from 2000-2004 they found that Centier failed to serve the credit needs of minority communities. Centier eventually settled DOJ's redlining suit.[19]

2. Failure to ban abusive mortgage lending practices.

Fourteen years ago, Congress required the Federal Reserve Board (the FRB) to prohibit mortgage lending acts and practices for all originators that are abusive, unfair or deceptive. Although borrowers, state regulators, and advocates repeatedly raised concerns about abuses in the subprime market, and hard evidence demonstrated the destructive results of abusive practices, *the Board took no action until July 2008*.[20] Federal banking regulators could and should have banned the most egregious mortgage lending practices:

- They should have prohibited lenders from making loans where it was clear that the borrower lacked sufficient income to sustain the loan when the interest rate reset two or three years after the loan was originated.
- They should have prohibited lenders from offering mortgage brokers financial incentives to steer their customers into more expensive loans than they qualified for.
- They should have prohibited large prepayment penalties that trapped borrowers into high cost loans or stripped large amounts of home equity with each refinancing.

Regulators were well aware of highly questionable lending practices. For example, a 2005 OCC survey of credit underwriting practices found a "clear trend toward easing of underwriting standards as banks stretch for volume and yield," and the agency commented that "ambitious growth goals in a highly competitive market can create an environment that fosters imprudent credit decisions." In fact, 28% of the banks eased standards, and the 2005 OCC survey was its first survey where examiners "reported net easing of retail underwriting standards."[21]

In late September 2006, several agencies (the FDIC, FRB, National Credit Union Administration, the OCC and the OTS) issued joint guidance on underwriting nontraditional loans, years after the problems they addressed had become apparent and a full nine months after they first solicited comments on proposed guidance on that topic.[22] It is unclear to what degree the nontraditional guidance was enforced as lax underwriting standards continued in the nontraditional market until the market collapse.[23] While the agencies explicitly required lenders to evaluate a borrower's ability to repay a nontraditional loan based on the fully indexed rate and based on a fully amortizing repayment schedule, they did not implement similar explicit rules for subprime loans for another ten months, finally issuing parallel guidance on underwriting subprime loans in July 2007.[24]

Even without the new guidance, the regulators could have used rules already in place at least to mitigate the impact of abusive subprime lending, but they failed to act. The agencies did issue guidance as early as 1999 on subprime lending,[25] with a second guidance in 2001 that explicitly described predatory lending as including: "Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation…"[26] Despite these guidances, there is no evidence of instances where the agencies prevented lenders from devising new products that similarly failed to evaluate the borrowers' ability to repay the loan.

It was not until 2008 that the FRB finally acted by issuing new regulations to address unfair, deceptive and abusive mortgage lending practices that prevailed during the prior eight years—but the regulations came too late to have an impact on the current economic calamity. Indeed, some of the new FRB rules are only taking effect now, on October 1, and some have yet to become effective. Moreover, they apply to subprime loans alone; they do not address the widespread payment option ARMs and Alt-A loans whose worst collapse is still ahead of us.

3. Abuses not confined to finance companies – banks played a role.

The federal banking agencies and the American Bankers Association have claimed that their institutions have not engaged in abusive mortgage lending. If only this were so.
Under the OCC's watch, national banks moved aggressively into risky "Alt-A" low-documentation and no-documentation loans during the housing boom.[27] A 2004 OCC rule prohibiting the origination of unaffordable mortgages "was vague in design and execution, allowing lax lending to proliferate at national banks and their mortgage lending subsidiaries through 2007," as law professor Patricia McCoy has testified.[28]

Big national banks continued rolling up huge volumes of poorly underwritten subprime loans and low- and no-documentation loans. For example, in 2006 more than 62 percent of the first-lien home purchase mortgages made by National City Bank and its OCC-supervised subsidiary, First Franklin Financial, were high-priced subprime loans. As these loans began to go bad in large numbers in 2007 and 2008, National City Corp. reported five straight quarters of net losses. It was saved from receivership only by a "shotgun marriage" to PNC Financial Services Group.[29]

OCC inaction is even more troubling given the evidence of potential discrimination among national banks. Studies show national banks routinely originate a disproportionate number of subprime loans among minority borrowers. For example, one study found that national banks were 4.15 times more likely to make higher-cost refinance loans to African-Americans than they were to make higher-cost loans to white borrowers.[30] In addition, two former Wells Fargo employees have signed declarations that the bank's sales staffers steered minorities into high-cost subprime loans.[31]

OCC Ignores First Union Case

The case of Dorothy Smith, a 67-year-old homeowner is East St. Louis, Illinois, illustrates the OCC's lack of concern for consumers. As described in a 2007 article in the *Wall Street Journal*,* Ms. Smith, who was living on $540 month in government benefits, was taken in by a home repair contractor and a mortgage broker who landed her in a mortgage from First Union National Bank. The loan contract required her to pay two-thirds of her income – $360 a month – for 15 years, followed by a balloon payment of more than $30,000. After receiving Ms. Smith's complaint about First Union, the OCC brushed her off, saying that it couldn't intercede in a "private party situation regarding the interpretation or enforcement of her contract. . . . The OCC can provide no further assistance."

*Greg Ip and& Damian Paletta**,** *Lending Oversight: Regulators Scrutinized In Mortgage Meltdown --- States, Federal Agencies Clashed on Subprimes As Market Ballooned,* Wall Street Journal (March 22, 2007).

4. Failure to ban abusive credit card practices

While destructive lending proliferated in the mortgage market, the credit card companies were also becoming increasingly bold in implementing abusive practices that had an adverse effect on consumers. Here are a few examples of credit card abuses that became commonplace:

- Retroactive changes in interest rates: Credit card companies were routinely raising their customers' interest rates and applying the higher rate to charges that had been made before the rate increase.

- Adverse allocation of credit card payments: Many credit card companies allocated their customers' payments in a manner that made promotional rates disappear quickly and artificially kept high APR balances on the books as long as possible.

- Universal default rates: Credit card customers who paid their credit card bills on time were getting penalty interest rate increases for late charges on completely different accounts or for any credit score decline. For example, customers who had a late charge on a light bill or who had their credit score decline because they closed an inactive account might be hit with steep increases on their credit card rate—even as applied to existing balances—even though the late bill had no connection to the credit card.

- Double cycle billing: Some credit card companies were charging customers interest based on balances from the prior month as well as the current month in a practice known as "double-cycle billing."

Abusive practices have not been exclusive to the largest card issuers; some community banks have engaged in them as well. In just the last three months, cards issued by community banks carried penalty rates approaching 30 percent—often more than double the regular rate; penalty fees as high as the largest issuers; cash advance fees higher than most of the largest issuers; and the same payment allocation policies as the largest issuers. Here are several examples:

Skylands Community Bank Visa Platinum Business Rewards Card (offered through Elan Financial Services), 8/2009

- 28.99% penalty rate (more than double the regular rate)
- $2 minimum finance charge (the highest seen with large banks)
- $2.50 account management per month if you have a closed account with a balance
- Cash advance fee of 4% (higher than most of the top issuers)
- Late fee: $39 for balances $250 and over (as high as the highest among top issuers)
- Other fees and practices are in line with the more aggressive of the top issuers
- Same payment allocation policy as top issuers

New York Community Bank Business Card (offered through B of A), 7/2009

- Penalty rate of up to 29.99%
- Cash advance fee of 4% (higher than most of the top issuers)
- Introductory rate is lost after being late just one day
- Other fees and practices are in line with the more aggressive of the top issuers
- Same payment allocation policy as top issuers

Riverview Community Bank Visa (offered through Elan Financial Services) 6/2009

- 28.99% penalty rate (more than double the regular rate)
- $2 minimum finance charge (the highest seen with large banks)
- $2.50 account management per month if you have a closed account with a balance
- Cash advance fee of 4% (higher than most of the top issuers)
- Late fee: $39 for balances $250 and over (as high as the highest among top issuers)
- Other fees and practices are in line with the more aggressive of the top issuers
- Same payment allocation policy as top issuers

As credit card abuses became widespread, agencies in charge of oversight showed very little interest in credit card problems or other issues that affected consumers. From 1997 to 2007, the Federal Reserve Board reported just nine formal enforcement actions against banks by the OCC under TILA. An academic researcher found that most OCC actions regarding violations of consumer lending laws have targeted small national banks, even though "ten large banks accounted for four-fifths of all complaints" received by the OCC's Customer Assistance Group in 2004. The Customer Assistance Group receives roughly 70,000 complaints and inquiries each year on consumer issues. Despite the hundreds of thousands of complaints and inquiries it fielded between 2000 and 2008, the OCC took just a dozen public enforcement actions during this span for unfair and deceptive practices relating to home mortgages, credit cards and other consumer loans combined.[32]

Finally, in December 2008, the FRB did take action to address some of the practices listed above. By then, credit card holders had paid billions of dollars in unnecessary fees, making millions of families more vulnerable to the negative effects of the economic recession.

5. ***Failure to address abusive overdraft practices***

Today, consumers pay well over $20 billion a year in overdraft fees—more than the financial institutions extend to cover the overdraft loans themselves—and that figure is rapidly rising.[33] From 1997 to 2007, the average overdraft fee charged increased by over 75 percent.[34] The most common triggers of overdraft fees are small debit card transactions that institutions could easily deny for no fee.[35] Institutions pay consultants for specialized proprietary software and implementation strategies designed to increase overdraft fees. And the majority of institutions enroll customers in these programs without their affirmative consent.

The federal banking regulators first recognized overdraft practices as a potential problem at least as early as 2001. In the years since, as regulators have failed to take meaningful action to curb abuses, overdraft practices have grown exponentially worse.

In 2001, the OCC refused to give a bank a program evaluation/comfort letter in connection with an overdraft program that a third party vendor was marketing to depository institutions.[36] Instead, it articulated a number of compliance concerns about the program, while devoting its greatest discussion to FTC UDAP, supervisory and policy concerns. The letter noted "the complete lack of consumer safeguards built into the program," including the lack of limits on the numbers of fees charged per month; the similarities between overdraft fees and other "high interest rate credit;" and the lack of efforts by banks to identify customers incurring numerous overdraft fees and meet their needs in a more economical way. In 2002, the FRB issued a preliminary request for comment on overdraft programs.[37]

Four years later, the regulators issued joint guidance addressing overdraft fees. Rather than conducting a rigorous UDAP analysis, the agencies transformed what the OCC had in 2001 described as policy issues, many created by the "complete lack of consumer protections," into "Best Practices."[38] The guidance recommended several practices CRL has strongly supported, including requiring affirmative consent to overdraft coverage; considering limiting overdraft coverage to checks alone (i.e., excluding debit card and other transaction types); alerting customers before an overdraft is triggered; establishing daily limits on fees; and monitoring excessive usage.

The identification of "Best Practices" in the proposed rule had generated requests from some industry representatives for clarification on whether examiners would treat the best practices as law or rules when examining institutions offering overdraft protections.[39] The agencies clarified: "The best practices, or principles within them, are enforceable to the extent they are required by law."[40]

There is little evidence to suggest that the OCC has instructed its examiners to even evaluate overdraft practices—much less attempted to encourage best practices. A search of the OCC's Compliance Handbook for depository services finds no reference to the guidance. And a search of the OCC's "Other Consumer Protections" Compliance Handbook finds no reference to overdraft protection, or, indeed, to the FTC Act's UDAP provisions at all. Moreover, the OCC's message to its banks' customers has essentially been that the banks can do as they please. For example, the OCC's online consumer reference "HelpWithMyBank" has a FAQ on its overdraft section concerning transaction posting order (generally manipulated by banks to maximize overdraft fees) that simply mirrors the line we so often hear from banks—they can post transactions in whatever order they please.[41]

So it's not surprising that, by and large, these best practices have not been followed. There was never a clear signal from regulators that they needed to be followed. And some best practices have only become *less* common since the regulators identified them as such: As recently as 2004, 80 percent of institutions declined debit card transactions when the account lacked sufficient funds;[42] today, 81 percent of banks surveyed by the FDIC allow debit card and ATM overdrafts, charging a fee for each overdraft transaction.[43]

In 2005, the FRB also chose to exempt overdraft loans from cost of credit disclosures by addressing overdraft programs under the Truth in Savings Act rather than the Truth in Lending

Act,[44] meaning consumers receive no disclosures to aid in comparing fee-based overdraft to far less expensive alternatives.

The latest proposed regulatory action on overdraft is a FRB proposal suggesting two alternatives with respect to debit card purchases and ATM withdrawals.[45] The first alternative requires institutions to give customers the right to opt out of overdraft coverage; the second requires institutions to obtain customers' affirmative consent to coverage before charging the customer an overdraft fee. Even if the stronger opt-in alternative is adopted, the FRB's approach is inadequate. It does not address checks and electronic payments at all; it condones the approval of debit card overdrafts that could easily be denied for no fee; it does nothing to address the dramatic disparity between the amount of the overdraft and the amount of the fee institutions charge for covering it; and it does nothing to address the excessive number of overdraft fees borne by a relatively small portion of consumers who are least able to recover from them.

IV. HR 3126's preemption provisions must not be weakened. Preemption was part of the problem, and more of it cannot be part of a wise solution.

One way to leave the nation vulnerable to a repeat of the financial crisis is to do more of the same and call it "reform." For the last two decades or more, preemption (i.e., overriding state laws) has been touted as a cure-all to make credit delivery efficient, enhance competition, and democratize credit. Just in the past few days, the same record has started playing over again.[46] Amidst the rubble of a collapse only narrowly averted, in part by taxpayer bailouts and cheap government loans, some of the very same institutions that got those bailouts and loans, and their primary regulators, want to go back to the *status quo ante* or even to expand preemption further.

But the facts speak for themselves. Preemption was part of the guidance system that drove us to the precipice. Not all of it, granted, but part of it absolutely. And make no mistake, the last thing taxpayers want to hear is that the institutions want to return to business as usual, and that Washington let it happen.

Let's look at some of those facts, first as to the supposed benefits of preemption.

A. Examining the purported benefits of preemption.

The improved access to credit was facilitated by the abandonment of underwriting. That led to a credit bubble that, in turn, fed the housing bubble. It also created over-leveraged households struggling under mounds of debt, making full recovery from the recession more risky. The debt-to-disposable income ratio for households more than doubled from 60% in 1980 to 133% by 2007.[47]

The "democratization of credit" was vaunted as improving homeownership rates, without any empirical support for that claim. But the data belied that claim even before the foreclosure crisis, and the homeownership rate has now declined to 2002 levels.[48] According to Census data, Black homeownership peaked at 49.7% in 4Q2004 and is at 46.5% as of 2Q2009. It dropped a full percentage point between 3Q2008 and 4Q2008.

The supposed benefits to competition, too, are overstated. The most deregulated segment of the consumer credit market, courtesy of preemption, is the credit card market. Yet just three issuers control nearly 60% of card balances.[49] Nearly half (47%) of America's 708.6 million cards last year were issued by one of these three banks, and an astonishing 82% by just the top 10 issuers.[50] Testimony to a Congressional Antitrust Task Force last year noted that the credit card industry met Department of Justice merger guidelines for a "highly concentrated" industry.[51]

Uniformity can be a benefit or a harm—or neither. Uniformly bad practices, unchecked, as we have seen, create a self-feeding cycle that can spiral out of control. But, sometimes uniformity is simply not an appropriate polestar. There is a national market for the traffic in commercial paper relating to mortgages; but what lies behind that paper is as local as anything comes – a family's home, a neighborhood, a community. Mortgages may be a national market; but real estate is most decidedly local. Sometimes, uniformity is just a red herring.

B. Examining the contributions to problems in the financial services market by beneficiaries of preemption.

The "we didn't do it" claim rings hollow. The banks, and the federal banking regulators that have marketed their charters by touting preemption, have repeatedly argued that they did not create this mess. But they stand by a table of shattered crockery and deny breaking a cup.

We cannot cover all the examples relating to preemption and irresponsible practices made easier by preemption, but here are a few.

*1. **Preemption, federally chartered institutions, and risky mortgages.***

Federally chartered banks and their supervisory regulators repeatedly deny originating the "subprime mortgages" that first melted down. But that is a half truth, at best. The mortgage market that went awry because of irresponsible underwriting and reckless selling was the *non-prime* market, not just the higher-cost "subprime" loans. Because the irresponsible subprime activity started earlier than the equally irresponsible Alt-A market, that wave was the first to crash. But the Alt-A wave began to follow shortly thereafter.

The Alt-A market ballooned from $85 billion in 2003, to $938 billion in just three years. In 2006, that $938 billion Alt-A market was a third higher than the $600 billion subprime market. Together, that $1.5 trillion *non-prime* market dwarfed the $990 billion prime market in 2006.[52] Concentrated in states with higher housing prices, the explosion of these loans contributed to the bubble.

Many of the so-called non-traditional loans—interest-only loans and payment option ARMS (POARMS)—are considered "Alt-A" loans, instead of "subprime loans." These loans are typically layered with risky features—underwriting only to the teaser rates, adjustable rates, prepayment penalties, negative amortization, yet, astonishingly, *only 17%* of payment option ARMS originated between 2004-2007 were fully documented.[53]

Neither federally chartered banks nor their federal supervisory regulators can credibly deny that they did not participate in the *non-prime* mortgage meltdown, when all non-prime lending is considered. Four of the top seven Alt-A originators between 2004-2007 had federal charters, and enjoyed both the benefits of preemption, and light touch regulation.[54] While the federal regulators issued a non-traditional "guidance" in 2006, there is little evidence that it was enforced. Professor Patricia McCoy has detailed in other Congressional testimony, the litany of familiar names of federally chartered banks that were involved in risky non-prime lending – Bank of America, Wachovia, Wells Fargo, among them. In one Alt-A prospectus, Wells admitted "that it had relaxed its underwriting standards in mid-2005 and did not verify whether the mortgage brokers who had originated the weakest loans in that loan pool complied with its underwriting standards before closing." (By mid-2008, nearly a quarter of that loan pool was delinquent or in default.)[55] The three largest failed institutions in 2007 and 2008—IndyMac, WaMu and Downey—were all federally chartered institutions, free from state law restraints.

That list of federally chartered institutions that contributed to the mess also includes National City Bank, and its then-operating subsidiary, First Franklin. National City asked for the OCC's 2003 determination that state anti-predatory lending laws would not apply to national banks or their op subs, subsequently memorialized by sweeping preemption rules in 2004. First Franklin alone had 4.4 % of the subprime market share in 2005.[56] Six years after obtaining the OCC's preemption determination, First Franklin made the OCC's own list of the "Worst Ten in the Worst Ten"—the originators with the largest number of foreclosures in the metropolitan areas with the highest foreclosure rates – a list which includes two other significant subprime lenders under OCC watch.[57]

2. Credit cards and preemption.

The sector of the credit card market that is perhaps the most completely deregulated, thanks to preemption, is the credit card market. The combination of the judicially-created right of exportation under the National Bank Act, augmented by OCC and OTS regulations, mean that federally chartered card issuers are almost completely immune from state regulation. This preemption was expanded to state chartered banks by Riegle-Neal, which permits state banks to do whatever a national bank is free to do when it operates interstate. That, in effect, means that, until 2008, the OCC set the gold standard for what was permissible in terms of credit cards.

Not surprisingly, then, institutions supervised by federal regulators dominate the credit card market. We noted above that three institutions together, hold about 60% of the credit card account balances – Bank of America, Citi, and Chase, all national banks.[58] The majority of the top 10 credit card issuers are federally chartered.

Under this federal preemption regime and the eye of the federal supervisory regulators, the abusive practices grew so widespread and so out of hand that the Fed, the OTS, and NCUA along with Congress, finally stepped in. That hardly qualifies as a success story for preemption.

Overdraft and preemption: By definition, only depository institutions can engage in abuses related to deposit accounts. I earlier detailed the dismal history of federal regulatory failures in this regard. We know that states would like to respond to their citizens about this abuse. New

York, in fact, did limit these fees. But because federally chartered institutions did not have to comply, the race to the bottom kicked in, and the state-chartered institutions got a “level playing field,” allowing them to do what the national banks could do.[59] This is a perfect example of the silent, but potent side effect of deregulatory preemption—it encourages a race to the bottom.

3. *Preemption and payday lending.*

While more and more states have recognized how the debt treadmill of short-term, high-rate loans wreaks havoc on family finances, at least three national banks are offering payday loans of their own – and not the affordable small loan alternatives that the FDIC has suggested.[60]

4. *Preemption by product, not charter.*

The above examples illustrate how the so-called “charter” preemption has undermined consumer protection and allowed bad practices to spread. (Charter preemption is available to federally chartered institutions, and has been aggressively expanded by their supervisory regulators, the OCC and the OTS.). But any discussion of the contributory role that federal preemption played in the mortgage crisis cannot stop with the charter preemption. The 1982 Alternative Mortgage Transaction Parity Act (AMTPA) also cast a long shadow into the debacle of the mid-2000s. AMTPA preempts the right of states to regulate such “creative financing” terms *even for state-chartered non-bank mortgage lenders*

Adjustable rate loans, interest- only loans, and negatively amortizing loans flooded the market, and were made without regard to whether they could reasonably be expected to pay. Uniformity in allowing appreciation-based lending was a bad idea in housing bubble states, but preventing states from acting on such products where appreciation could not even support such loans in the best of circumstances was disastrous. In other words, the very kinds of disastrous non-standard loans that displaced sustainable, fixed mortgages, were *encouraged* by a 27-year old federal preemption law.

These are just a few examples of the myths about preemption, and about the role played by entities that enjoy the benefits of preemption at consumers’ expense. There are three distinct kinds of preemption provisions in H.R. 3126, and all three are important to assuring fair and balanced regulation over the long term:

1) The CFPA’s rules would preempt inconsistent state laws, and would define inconsistency in a manner similar to existing federal consumer protection laws;

2) H.R. 3126 would restore the state of “charter-preemption” (applicable to federally chartered depositories) back to approximately 2003, before the bank supervisory agencies became even more aggressive about pushing the preemption envelope (The OCC is 1 for 1 on these efforts in the Supreme Court, but other key preemption rules have not been examined by the Court; and

3) H.R. 3125 would make long-overdue amendments to the 1982 AMTPA preemption described above.

C. Broadening preemption would pose a high risk of making matters worse.

We understand that the preemption provisions of the bill are controversial, but we believe that they are central to assure that there are fair and balanced rules of the game over the long haul. The notion of state regulation as a drag on credit is utterly belied by experience. State regulation of consumer credit started with small-loan laws in the first two decades of the twentieth century; retail installment sales acts were the underpinning of the growth in the post-war boom. Indeed, the problems in the consumer credit market that ultimately destabilized our financial system tracked the period of the *greatest* federal preemption. Further, some of the most damaging abuses have been in the market segments where that preemption was most prevalent – mortgages and credit cards.

The proposed changes in governance of the CFPA would put the Agency's policy in the hands of one person. While we believe that overall, an Agency with the American family as its "customer" instead of the financial provider, is structurally more likely to be an honest referee, it would be unrealistic to assume that sometimes the Agency's director would not make some bad calls. It is imperative for the states to be able to act as back-up referee.

A perfect example is the payday lending industry. The green light laws that authorized payday started in the states, typically with some ostensible protections. But experience showed that the protections in those green light laws were insufficient, miring customers in a quicksand of loan-shark priced debt. States increasingly looked at that data, looked at the consequences, and started passing yellow and red light laws. We believe that the CFPA will monitor the market for evidence about the impact of developments, and use that evidence to guide its actions. But if it fails to act, or, as has been known to happen, takes a decade to act, states would be helpless to prevent their citizens from the loss of billions of dollars if the CFPA were to be preemptive.

Another example can be taken from the recent history books. HUD has the authority to address the yield-spread premium for mortgage brokers that became such an important distorting fact in flooding the market with risky loans instead of sustainable ones. In fact, it took a step in that direction ten years ago. But it later took a step back again. The rest is history. But, as the pernicious effect of yield-spread premiums became more obvious, several states stepped up. The Massachusetts Attorney General addressed the unfair and deceptive practice of yield spread premiums, promulgating rules (effective January 2008) that prohibited broker compensation when there was a conflict of interest, such as when broker compensation increases based on the terms of the loan. Within a year North Carolina had followed suit, banning YSPs on all subprime loans. These state laws may well be the impetus behind the Federal Reserve's recent proposed rules banning all compensation based on the terms of the loan.[61]

If a less than vigorous referee at the helm of the CFPA were to do something similar to what HUD did, preemption would prevent the states from acting, and problems could metastasize. It also means that when the CFPA does act, it would do so without the benefit of lessons learned from these state law pilot projects. We believe that the federal consumer protection and equal access federal landscape would be greatly improved with the enactment of the CFPA. As long as it does its job well, then states will have no reason to depart from that federal floor. Not all local problems will become national, and Washington should not set itself up as the arbiter of all local solutions. States must also have the flexibility to be first responders, dealing with local problems before they get out of hand**.** And experience has shown that it is from these state solutions that we learn what works, and what doesn't, based on real experience, not arcane models or unfounded fears. Many of the federal consumer protections, among other laws, were adopted and adapted from successful state laws. There is no basis in experience or policy in a federalist system like ours to centralize consumer protection exclusively in Washington.

V. The CFPA should have full jurisdiction over financial activities irrespective of the identity of the provider; if there must be exemptions, they should be narrowly drawn.

Recent proposed changes to HR 3126 offer some exemptions to certain business sectors. As we understand this proposal, it would:

- exempt retailers, regardless of size, from CFPA's organic rule-making, and all of its oversight and enforcement duties, and from assessments. Rule-making authority under existing transferred statutes would apply to the extent that the retailers are covered now by those statutes, but without oversight or enforcement by the Agency;

- exempt auto dealers from rule-making, oversight and enforcement duties, and from assessments as to the part of the transaction involving the sale of the vehicle, but would retain full CFPA jurisdiction when dealers engage in financial activities,

- exempt credit reporting agencies as to their primary functions., and

- limit CFPA jurisdiction over certain other professions to their activity in regard to financing products.

Meaningful financial reform will be beneficial to legitimate small businesses and financial providers of all sizes, reducing the necessity of competing against market distorting forces of unfair and irresponsible businesses. But meaningful financial reform will only come if we take care to assure that it is not riddled with loopholes.

One of the fundamental purposes of consolidating the existing fragmented system is to ensure that the regulation applies to the activity, not to the provider. Exceptions by category of provider run counter to that purpose, which we believe is the preferred approach, and therefore any exceptions should be few, and carefully drawn.

Recommendation: We believe one provision could help ensure against the possibility that exemptions are exploited. The Act should assure that there are periodic reviews of these exemptions to determine whether they are responsible for loopholes that undermine the integrity of the market and the implementation of the goals. Congress should give the Agency authority to close those loopholes, a tool used successfully in the past to close one of the most serious statutory loopholes in the original HOEPA law.[62]

A. The merchant exception should be narrowly crafted to balance the interests of small business with the clear need for sensible regulation of the consumer credit market.

We understand the fears of legitimate small businesses facing strains from the recession and from high health care costs. But this partial exemption covers much more than the butcher's tab or the local independent dress shop's lay-a-way plan.

The exemption would forbid the CFPA from *enforcing* existing federal consumer protection laws that *currently apply* to merchants, retailers and sellers -- including giants such as WalMart and large department stores. (The exception to the exemption allows only for rule-making under enumerated statutes, not investigation or enforcement under them.) The exemption would prevent the CFPA from addressing unfair and deceptive practices in connection with seller financing of goods or services, even though such unfair and deceptive practices are already banned under the FTC Act.

Giving certain industries an exemption also leads to confusing and inconsistent treatment of similar products and tempting loopholes that scammers will work to exploit.

- Some payday lenders have described themselves as "catalogue" sellers or Internet service providers.[63] Does Section 124 create a bizarrely fragmented system whereby payday lenders who admit that's what they are would be subject to CFPA's full panoply of authority, while payday lenders who disguise themselves as merchants would be under the FTC's jurisdiction?[64]

- Would individual merchants or a collection of merchants at a mall offering store or mall gift cards with hidden fees that eat up the value of the card be subject to FTC jurisdiction while branded gift cards issued through a bank are subject to CFPA jurisdiction?

- How will the twin goals of level-playing-field rules governing the activity and consistent enforcement be met if two-party merchant-issued credit cards have a different regulatory scheme from the retail-branded cards that are actually issued by banks?[65]

- What would be the regulatory scheme applicable to a Wal-Mart that issued payment cards and its own two-party credit cards,?

- What of the "feeder merchants" – the retailers who sells goods with "seller-financed" paper but who assign the installment sales agreement to finance companies? These kind of transactions are often associated with abuses, including misleading "no interest for x months' deceptive practices, and with the subsequent "flipping" by the finance companies to whom they feed the account.[66]

Compounding the regulatory disparities, the providers subject to FTC jurisdiction are not subject to routine monitoring (an authority the FTC does not have), while the non-merchant providers of the same services subject to the CFPA authority would be.

We recently heard of a new program which illustrates the danger of categorical exemptions like this one. In a particularly disturbing development, some large, for-profit colleges have begun making a lot of their own private loans directly to high-risk students.[67] For example, in a recent call with investors and analysts, Corinthian Colleges, Inc. said it plans to make $130 million of such loans in the current fiscal year, on top of $120 million last fiscal year. They fully expect a shocking 56 to 58 percent of the borrowers to default. Yet they consider these loans good investments because they will increase enrollment and with it a profitable flow of federal grant and loan dollars that outweighs the planned writeoffs. Corinthian owns more than 80 colleges across the U.S. through its Everest brands.[68] According to the Associated Press, ITT Education Services, Inc. also expects to make $75 million in loans directly to its students this calendar year, and Career Education Corp. expects to reach $50 million.[69]

The proposal to allow the CFPA might to retain rule-making authority under some transferred enumerated statutes is helpful, but not adequate. The absence of its organic authority may leave gaps. For example, the federal Debt Collection Practices Act does not cover creditors collecting their own debts, and the FDCPA explicitly denies any rule-making authority. Consequently, citizens being harassed for general purpose credit card collections by a collection agency have one set of protections; while citizens subjected to the very same conduct by in-house collectors for a large retailer on its own credit cards would have no federal protections. (And, if the preemption provisions are weakened, they might even be deprived of any state protections.)

Recommendation: Any exemption should be limited to ensuring that small merchants are not subjected to significant new burdens, without carving out any new exceptions to current laws. Thus, merchants, retailers and sellers who do not have a substantial credit business should not be subject to examinations or to assessments. But the CFPA should be able to exercise its full authority under the enumerated statutes and to address any unfair and deceptive practices regardless of the identity of the actor.

B. The proposed auto dealer exception may be difficult to implement, and its interaction with the merchant exception must be clarified.

We commend the effort in the proposed auto dealer exception to separate the dealer’s role as seller of goods, and as a provider of financial products. That is fair and necessary recognition of the key role that auto dealers play in the auto finance market. Overall, about 40% of auto buyers finance through their dealer.[70]

In many respects, dealer-assisted auto finance operates in a fashion parallel to third-party mortgage originations. Abuses in that market bear a remarkable similarity, as well, and are equally rampant. In Appendix B to this testimony, we describe such areas of abuse—abuses which are as harmful to honest competitors as they are to consumers: the “yo-yo”, which involves changing the terms of the financing after the sale; dealer mark-ups, which are basically yield-spread premiums on car loans, with the dealer passing on higher interest rates than the consumer qualifies for to earn more fees; and the "buy-here, pay-here subprime market." It is critical that the CFPA be able to bring its full range of authority to bear on these providers of financial services, including rule-making, oversight, and enforcement.

Operational challenges: One concern is that when the prospective buyer does not bring her own funds to the dealership, the sales and negotiations do not fall cleanly and easily into a sale of goods phase and a sale of financing phase. They more often than not become intertwined. "Packing" an auto sale, for example, can be done with a set of bundled add-ons that include both non-financial services and non-financial services, (e.g. both service contract and "gap protection", that insures against a deficiency.) The valuation on the trade-in (ostensibly part of the goods sale part of the transaction) may be inflated so as to disguise from both the buyer and a subsequent assignee of the credit contract that the loan amount actually refinances the balance on the trade-in, as well as the purchase price of the car. (For more examples, see Appendix B.) How overlapping jurisdiction would disentangle these common scenarios is difficult to see.

Lack of clarity about the intersection between the dealer exemption and the general merchant exception. Auto dealers are merchants, and it is quite common for the dealer to be the "creditor" in the sale. When the dealer is involved in the financing, it is common for the retail installment sales contract to be between the dealer as both "seller and creditor." The dealer does not intend to keep that loan, but rather will assign it immediately or within a few days to an indirect lender. The assignee often has approved the loan before the consumer signs the contract, so the assignment can be immediate. (When the deal hasn't been approved by a potential assignee first, the abuse called the "yo-yo" that we describe in the Appendix comes into play.) Additionally, the dealer and the creditor are the same in the "buy-here, pay-here" subprime auto market. Dealers therefore are quite often sellers who would also fall under the merchant exception of proposed new Section 124(a).

The question is what happens when the exception to the auto dealer exemption under proposed new Section 124(g)(2) is applicable. Does it default to the merchant exception? Or does it default to standard CFPA jurisdiction. This must be clarified, and it should be clarified to full CFPA jurisdiction. Otherwise, there will be significant gaps, and consumer protections and fair access would be undermined in this large section of the consumer credit market. Oversight would be missing (because the FTC does not have that authority), and enforcement would be fragmented.

Even the CFPA's rule-making authority under transferred statutes would leave gaping holes. The most critical example is that Truth in Lending's $25,000 threshold has never been updated for inflation, and now the average motor vehicle loan is not even subject to TIL: the average amount financed for a new car loan crossed that $25,000 threshold.[71] (We and others have long urged Congress to make inflation adjustments to the TIL threshold for this reason.) The transferred federal Fair Debt Collection Practices Act would not apply, as it only applies to third party collectors.

Recommendation: At a minimum, it should be absolutely clear that the proposed dealer exception is the sole exception applicable to dealers engaged in financial activities, not the merchant exception.

C. Credit reporting agencies

Credit reports are fundamental to the financial life of American families – not only to what they pay for credit, or whether they get it at all, but to their job prospects, their ability to rent an apartment, and what they pay for insurance. Yet despite the FCRA, the system remains rife with inaccuracies, as documented by multiple studies with some finding serious errors in 25% of credit reports. Furthermore, the dispute system that Congress carefully crafted to enable consumers to correct errors has been turned into a travesty of automation, with the credit reporting agencies (CRAs) spending pennies on each dispute to do less than the bare minimum that we believe is required under the FCRA.

D. Other exemptions

We are pleased to see that the proposed exemptions for tax preparers and attorneys strike a reasonable balance. As you know, tax preparers are the brokers and sales channel for the high cost Refund Anticipation Loans that are often sold deceptively, and even undermine the earned income tax credit program. And attorneys are unfortunately often involved in equity-skimming schemes, foreclosure prevention scams, debt collection abuses and currently in loan modification scams. We understand these exceptions to permit the CFPA to regulate such entities when they participate in such activities to the same extent as it does non-lawyers and accountants engaging in the same conduct.

VI. The agency should have the authority to offer carrots as well as sticks to ensure that consumers have the full range of choices, including the safe ones.

One of the significant proposed changes to H.R. 3126 would assure that the Agency cannot mandate a provider to offer meaningful choice of products to consumers. We are not going to urge you to reconsider that. But we do believe that one of the worst features of the past crisis was that the proliferation of unsound, financially de-stabilizing products and practices actually *deprived* consumers of choice. We have often pointed out here and elsewhere, for example, that the lop-sided rate of prepayment penalties in prime loans (rare) compared the high rate in subprime belied the notion that borrowers "choose" prepayment penalties. Investigations and enforcement actions confirmed that these were just part of the loan package given, partly because they were linked to higher compensation for the originator.

Earlier in my testimony, I cited other examples of the way in which bad practices and products crowded out responsible, sustainable products in relation to credit cards and deposit accounts as well. We can avoid that without mandates. Concrete, certain, and measurable market incentives to encourage responsible practices that are sustainable over the long term is consistent with the consumer choice, and is "win-win" for American families, for providers of financial services, for investors, and the economy.

At the same time, responsible providers can be rewarded for being part of the solution instead of part of the problem. Less regulatory burden, and lower compliance costs reward those providers who make sure that Americans really have a sustainable option as well along with the options that are riskier for them.

The kind of practices and products that overwhelmed fair competition and America's economies cost everyone more when they get out of hand. Those who create greater risks for the economy, hurt genuine competition and deprive consumers of real and honest choices should absorb more of the cost of making sure things don't spin out of control again.

A. The Agency Should Have the Power to Offer Working Market Incentives And Reduce Regulatory Costs

Risky financial products metastasized to dominate the market because, in the short term, the market thought the potential gains outweighed the potential costs, both in operational losses, reputational losses, and litigation or regulatory risks. That is why the head of the first major mortgage lender to suffer an enforcement action for targeting minorities, women, and the elderly predatory loans just turned around and started a second company that targeted customers for predatory loans.[72] The regulatory and litigation risk did not outweigh the potential rewards. We can change that dynamic with "win-win" incentives: enhancing consumer choice and rewarding responsible providers.

Reduced regulatory burden for simple, comprehensible, and sustainable products and practices

- These products and practices would be subject to minimal supervision and reduced reporting. Regulation would be minimal, if any, in any event. This offers relief from both regulatory burden and regulatory risk.

"Risk-based pricing" for assessments to pay for supervision[73]

- We know that too little regulatory attention was paid to risky products and practices, one of the causes of the crisis. And we know that those who engage in those practices ultimately cost the public more than the ones who do not. Just as higher-risk drivers have to pay more for auto insurance, and higher-risk borrowers have to pay more for credit, it is only fair to ask those who put more of the higher risk practices out into the economy should pay more to make sure they do not again lose control and damage us all.

VII. There must be adequate means of holding those who violate the law accountable.

We continue to support the right of the state attorneys general to enforce CFPA rules. This is a vast country with over a hundred million households and about $13 trillion in household credit outstanding. It is unrealistic to suggest that federal enforcement alone is adequate. Consumer protection is a traditional state function, and states have considerably more experience in enforcement than the federal financial regulators. This right should be an essential feature of this reformed system.

We also strongly recommend that consumers have a private right of action to enforce the Agency's rules. Public enforcement, even with state concurrent enforcement, will never have adequate resources. That means that many consumers would never get relief at all, or not when needed. The existing foreclosure crisis is a prime example. Public enforcement officials cannot defend individuals in foreclosures. To deny private enforcement is to deny a homeowner the benefit of these consumer protection and fair lending rules at precisely the time when it is most important.

Conclusion:

Thank you for the opportunity to share my views. I look forward to working with you and the Committee to help make our financial markets work again.

APPENDIX A

Failures on Safety and Soundness Linked to Failures on Consumer Protection

The desire of the OCC and the OTS to protect the institutions they regulate and their reluctance to enforce rules and regulations was not limited to consumer protection. In safety and soundness and other areas, there have been similar lapses. In some instances these lapses also illustrate how a more focused consumer protection agency could have mitigated the scope of the crisis.

- ***It wasn't the market downturn.*** Defenders of the OCC and the OTS have argued that the banks and thrifts under their supervision were largely victims of unforeseeable market downturns. This argument is belied by the superior performances of banking institutions overseen by other regulators. State-chartered thrifts and banks performed significantly better during the crisis in terms of loan quality than OTS-supervised national thrifts and OCC-supervised national banks, FDIC data shows. As of Sept. 30, 2008, the rate of 1-4 family residential loans from national banks that were past due or in "nonaccrual status" was *twice* that of state banks; federal thrifts' rate was *more than four times* that of state thrifts.[74]

- ***Countrywide: A three-part failure.*** The implosion of the nation's largest mortgage lender is instructive, given that three of the main federal regulators – the OCC, the OTS and the Federal Reserve – shared responsibility for overseeing Countrywide Financial and Countrywide Bank. Investigations by CRL and law-enforcement authorities produced compelling evidence that Countrywide targeted borrowers for unfair and unsafe loans that have left many struggling to save their homes.[75] Under the watch of the OCC and, later, the OTS, the company boosted its loan volume by making large numbers of poorly underwritten pay option ARM mortgages and home equity lines of credit—loans that were approved with little scrutiny of borrowers' long-term ability to stay current as monthly payments began to rise.[76] Investigators with the California Attorney General's Office concluded that Countrywide's non-bank subsidiary misled borrowers on a widespread basis; obfuscating, for example, the true terms of its Pay Option ARM loans by misrepresenting the impact of negative amortization and the amount of time the interest rate would be fixed.

- ***Inspector General Reports Criticizing the Agencies.***

  - Reports by the Treasury Department's inspector general have supported the conclusion that the OCC did a poor job of making sure that banks underwrote loans responsibly. ANB Financial failed in 2008 due to risky lending, unsound underwriting and other problems; the inspector general found that the OCC identified most of ANB's problems in 2005, but it "took no forceful action" until 2007, when it was too late to save the bank.[77] The inspector general found a similar pattern in the 2008 failures of FNB Nevada and First Heritage Bank; the OCC knew about problems as early as 2002, and found additional problems in 2005, 2006 and 2007, but failed to take timely and aggressive action to curb the affiliated institutions' risky practices.[78]

- In 2008, the OTS presided over a flurry of unprecedented financial meltdowns. Five thrifts with assets totaling $354 billion collapsed, led by Washington Mutual Savings Bank, the largest banking failure in American history. Seven others holding assets totaling another $350 billion have been sold or were caught up in their parent companies' bankruptcies. The failures of these institutions – and the harm they caused consumers – were the fruits of years of inaction by the OTS.[79] The OTS turned a blind eye as WaMu, IndyMac Bank and other thrifts engaged in a spree of unsafe, abusive lending.[80] A series of inspector general reports have concluded that the OTS failed to rein in reckless lending practices at the institutions it oversaw. The reports cited serious supervisory shortcomings leading up to the failures of Superior Bank[81] in 2001, NetBank[82] in 2007 and IndyMac[83] and Downey Financial[84] in 2008. The reports criticized the OTS for moving too slowly to respond to obvious problems at the thrifts and for failing to quell the institutions' breakneck lending strategies.

- The inspector general also found that the OTS was so pliable in its supervision that it allowed some thrifts to hide the consequences of their imprudent business strategies by falsifying financial reports. The OTS expressly allowed two institutions to backdate capital infusions, and took no action against four others that did so without permission.[85]

- In 2005, a group of senior risk managers crafted a plan requiring that loan officers document that borrowers could afford the full monthly payment on option ARMs. A former bank official told the *Washington Post* that the OTS signed off on the plan, but "never said anything" after top bank executives rejected the plan.[86]

APPENDIX B

Auto Dealers: Lack of Oversight Costs Americans Billions Each Year

- ✓ **The "yo-yo" – bait and switch financing in the dealership**

Car buyers who leave the lot with a vehicle and a signed car loan are often surprised to some days later (or sometimes weeks later) get a call saying the "financing fell through," and they have to either return the car, pay it in full, or come back and sign new car loan papers at more expensive terms.

Dealerships sometimes do this simply so as not to lose a sale. A buyer who wants to "go home and think about it" may decide against it. Waiting to get approval from the lender to which the dealer will subsequently assign the contract may result in a lost sale, so the dealer closes the window by binding the consumer to a one-sided contract – the consumer is bound, but not the dealer. If the dealer can't sell that contract to an assignee at those terms for that buyer, the dealer considers itself not bound.

Returning the vehicle at that point may be difficult for the consumer. At a minimum, he may have become psychologically committed to the transaction, or economically invested, as with purchasing new insurance. But the more egregious situation is where the dealer pulls the string on the yo-yo back *after* it has disposed of the buyer's trade-in, so there is no way to return both parties to *status quo ante.*

CRL's research, unfortunately, gives some weight to the notion that yo-yo sales have a bait and switch taint to them. Sadly, it adversely affects low and low-moderate income buyers, and buyers with lower credit scores. We found that, of those who used dealer financing for their last purchase, 1 in 8 buyers with an income less than $40,000, and 1 in 4 with an income less than $25,000, reported experiencing a yo-yo deal. While at first blush it might be argued that it is simply harder to find financing for lower-income buyers, that seems overly simplistic. Assuming again that the credit professionals at the car dealers are familiar with underwriting standards and consequently with what should be an affordable credit sale, as they should be, then it is difficult to understand why there is such a distorted impact. But more to the point, those who report being "yo-yo'd" pay more than equally positioned buyers who were not, on average, five percentage points more.

- ✓ **Subprime auto market: "Buy-Here, Pay-Here"**

Buy-Here, Pay-Here (BHPH) dealerships are geared toward borrowers with no credit or damaged credit, typically advertising used cars and less stringent underwriting standards. The dealerships finance borrowers in-house, but because of higher risk (or just because the customer wandered onto the lot), borrowers may see rates between 12 and 25 percent. The BHPH industry has had a history with predatory lending and accusations of selling overpriced and faulty cars with this expensive credit.

In this market, the sale of the vehicle is more often secondary to the sale of the credit. According to one expert,

> **"BHPH has always been a finance business, not necessarily a sales business. What we're seeing now with the subprime market having the dent in the housing side and also from the automotive side has actually helped BHPH because it is forcing some of those customers down to our financial level."[87]**

Realizing opportunities to capitalize on subprime borrowers, franchised and independent dealers are creating BHPH branches to have more options.[88]

- ✓ **Yield spread premiums: reverse competition in auto loans**

Auto dealers typically mark-up the interest rate on the car loan over that for which the buyer qualifies. The practice imposes substantial extra costs on consumers, just as the analogous "yield-spread premium" does in the mortgage market. In the mortgage market, we know that perverse market incentives encouraged brokers to steer their clients toward more expensive loans than the borrower would qualify for, because the brokers could increase their own fees by doing so. Because the dealers get to keep all or part of the mark-up, this yield-spread premium (some call it more simply a kickback), this creates a "reverse competition" dynamic, where the intermediary has an incentive to steer the consumer to a higher rate option.

While dealerships argue that these yield spreads are compensation for arranging the financing, that argument does not justify the practice nor the cost. There is simply no legitimate reason for a dealer to receive more compensation for putting a consumer into a 10% loan than for putting her into a 9% loan. The only purpose the yield-spread premium serves is to incent dealers to squeeze extra interest payments out of their unknowing consumers. The abusive nature of the practice is intensified because consumers don't know about it or about how much it costs. Yet it is not a practice that can be cured by disclosure, as testing by the Federal Reserve Board and other agencies has demonstrated with YSPs in the mortgage market. Indeed, the FRB originally proposed to address the issue through disclosure, then withdrew the proposal because testing showed disclosure does not work well.[89] Moreover, the hidden cost is too substantial for that argument to be justified.

CRL research estimates that dealer yield-spread premiums cost consumers an estimated $20.8 billion in 2008.[90] The dealer YSPs add an average $647 to the cost of each vehicle – the rate bumped up an extra .6% for new cars, and 1.8% for used cars. Other data, looking at five major captive auto lenders, reported an average mark up of $989 per vehicle.[91] If evaluated as compensation for a "service", that is a hefty price. Particularly so for a service that, after all, benefits the dealer as much as the consumer: the dealer wants to make the sale, and financing is what lets that happen.

It is not unreasonable for car buyers to assume that the rate they are offered is what they qualify for based on their creditworthiness and the collateral. This is particularly true when the retail installment sales contract actually lists the seller/dealer as the creditor on the deal.[92] Our survey indicated that close to half of buyer-borrowers did not negotiate the *credit* price because they trusted the dealer to give them a good rate.[93] These buyer-borrowers paid a steep price for that trust: it works out to a 2% "trust tax" on the price of credit.

But not all borrowers pay the YSP, so in fact, those consumers who do pay a mark-up pay more than that average. And in yet another parallel to the mortgage market, there is evidence from other studies indicating that minorities were both more likely than whites to be charged a kickback, and that the amount of the kickbacks were larger than the kickbacks whites were charged. Some 54.6% of African American's were charged a kick-back, compared to 30.6% of whites, and the amount of kickbacks charged to African-Americans is about $427 greater.[94] As a result of fair lending litigation over the discriminatory aspect of these mark-ups, some third party lenders capped the amount of the mark-up they permit dealers to around 2-3%.[95] However, that still is a considerable additional cost, and even assuming it eliminates the racially differential impact, it just puts the practice into the category of being an equal opportunity abuse.

DEALER KICKBACK VOLUME BY STATE 2007[96]

Rank	State	New Vehicle Market Share	New Vehicle Kickback Volume	Used Vehicle Market Share	Used Vehicle Kickback Volume	Total Dealer Kickback Volume
26	Alabama	1.26%	$110,476,064	1.65%	$199,560,418	$310,036,482
50	Alaska	0.11%	$9,914,978	0.21%	$26,035,577	$35,950,555
13	Arizona	2.61%	$228,410,644	2.11%	$256,264,673	$484,675,317
35	Arkansas	0.85%	$74,402,532	0.90%	$109,059,142	$183,461,674
1	California	12.11%	$1,057,992,630	11.95%	$1,448,752,786	$2,506,745,416
22	Colorado	1.61%	$140,493,995	1.47%	$178,025,775	$318,519,771
30	Connecticut	1.17%	$102,079,879	1.10%	$132,847,890	$234,927,769
49	DC	0.26%	$22,468,182	0.15%	$18,663,357	$41,131,539
46	Delaware	0.31%	$26,820,950	0.21%	$25,634,228	$52,455,178
4	Florida	5.77%	$504,151,195	5.56%	$674,680,597	$1,178,831,792
8	Georgia	3.70%	$323,065,213	3.36%	$407,671,641	$730,736,855
42	Hawaii	0.33%	$28,538,113	0.30%	$36,936,277	$65,474,390
39	Idaho	0.55%	$48,427,492	0.49%	$58,969,272	$107,396,765
6	Illinois	4.52%	$394,937,006	4.02%	$487,602,027	$882,539,032
16	Indiana	2.18%	$190,226,706	2.02%	$245,349,422	$435,576,129
27	Iowa	1.35%	$118,358,410	1.20%	$145,118,756	$263,477,166
32	Kansas	0.99%	$86,458,502	0.96%	$116,945,478	$203,403,980
20	Kentucky	1.59%	$138,588,600	1.62%	$197,001,967	$335,590,567
25	Louisiana	1.31%	$114,836,696	1.63%	$197,071,081	$311,907,778
41	Maine	0.31%	$27,066,509	0.34%	$41,375,372	$68,441,881
18	Maryland	1.99%	$173,845,933	1.93%	$233,483,543	$407,329,476
17	Massachusetts	2.16%	$189,055,715	1.80%	$218,817,918	$407,873,633
10	Michigan	3.42%	$298,616,832	2.79%	$337,914,435	$636,531,267
24	Minnesota	1.43%	$124,807,602	1.56%	$189,653,997	$314,461,600
33	Mississippi	0.94%	$82,106,608	0.91%	$110,868,246	$192,974,854
19	Missouri	1.67%	$145,547,261	1.88%	$228,497,594	$374,044,855
43	Montana	0.29%	$25,054,850	0.27%	$33,335,045	$58,389,895
38	Nebraska	0.46%	$40,522,425	0.55%	$67,216,943	$107,739,369
31	Nevada	1.12%	$98,264,544	0.91%	$109,960,057	$208,224,601

40	New Hampshire	0.38%	$33,358,404	0.41%	$50,043,793	$83,402,197
11	New Jersey	3.01%	$263,222,301	3.05%	$370,352,203	$633,574,504
36	New Mexico	0.73%	$63,723,788	0.86%	$104,451,505	$168,175,293
3	New York	6.23%	$544,292,611	6.61%	$801,815,017	$1,346,107,627
9	North Carolina	2.97%	$259,900,705	3.34%	$405,176,242	$665,076,947
48	North Dakota	0.20%	$17,265,135	0.21%	$26,004,051	$43,269,186
7	Ohio	3.48%	$303,940,474	3.86%	$467,821,924	$771,762,398
29	Oklahoma	1.09%	$95,642,921	1.20%	$145,106,631	$240,749,552
28	Oregon	1.09%	$94,914,110	1.23%	$149,702,143	$244,616,253
5	Pennsylvania	4.11%	$358,910,664	4.47%	$541,872,721	$900,783,385
45	Rhode Island	0.27%	$23,919,687	0.28%	$33,479,337	$57,399,024
23	South Carolina	1.34%	$117,471,427	1.62%	$197,001,967	$314,473,394
47	South Dakota	0.21%	$18,698,289	0.27%	$32,424,430	$51,122,719
15	Tennessee	2.07%	$180,501,359	2.33%	$282,904,093	$463,405,452
2	Texas	7.85%	$685,630,944	7.90%	$957,842,960	$1,643,473,904
34	Utah	0.87%	$76,438,659	0.88%	$107,201,537	$183,640,196
44	Vermont	0.26%	$22,817,732	0.29%	$34,694,298	$57,512,030
12	Virginia	2.85%	$248,819,979	2.84%	$343,969,840	$592,789,819
14	Washington	2.31%	$202,267,821	2.24%	$271,233,432	$473,501,253
37	West Virginia	0.67%	$58,205,272	0.51%	$62,381,349	$120,586,621
21	Wisconsin	1.52%	$133,240,489	1.57%	$190,286,941	$323,527,431
51	Wyoming	0.11%	$10,024,212	0.13%	$16,281,936	$26,306,148
	Total U.S.	**100.00%**	**$8,738,743,050**	**100.00%**	**$12,125,361,864**	**$20,864,104,914**

[1] See, e.g., testimony of Patricia McCoy before the U.S. Senate Banking Committee, "Consumer Protections in Financial Services: Past Problems, Future Solutions, " available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=11be680d-04db-42cc-89bf-7fe4ffe4d9cd&Witness_ID=b6ba604a-d441-43e3-9951-1fbab4b11e57.

[2] Studies show that the subprime foreclosure crisis was driven more by the kinds of loan terms that came to prevail in too large a segment of the market rather than by the characteristics of the borrowers. *See, e.g.* Lei Ding, Roberta G. Quercia, Wei Li, and Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, Center for Community Capital, Univ. of North Carolina & Center for Responsible Lending (Working Paper, Sept. 13, 2008).

[3] Non-prime includes subprime and "Alt-A", but excludes FHA. Alt-A has vague and inconsistent definitions. It can mean prime-worthy borrowers by FICO scores but with non-standard loan terms, or it can mean FICO scores between prime and subprime.

[4] 2008 Mortgage Market Statistical Annual; Inside B&C Lending.

[5] *The Wall Street Journal, Subprime Debacle Traps Even Very Credit-Worthy, December 2007 at* http://online.wsj.com/article/SB119662974358911035.html?mod=hps_us_whats_news.

[6] Leslie Parrish, *Overdraft Explosion: Bank fees for overdrafts increase 35% in two years*, Center for Responsible Lending, forthcoming October 2009.

[7] See Joshua M. Frank, *What's Draining Your Wallet? The Real Cost of Credit Card Advances*, p. 8, (December 16, 2008).

[8] Federal Trade Commission Act, 15 U.S.C. 45(a)(1).

[9] 15 U.S.C. Sec 57a.

[10] This was the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act of 1975, Pub. L. No. 93-637, 88 Stat. 2183 (1975) (codified as amended in various sections inserted throughout 15 U.S.C.). The provision giving rule-writing authority to the FRB, OTS and NCUA can be found at 15 U.S.C. 15 USC 57a(f).

[11] For an overview of the federal banking agencies' long-standing (but long ignored) authority to enforce the Federal Trade Commission Act's ban on unfair and deceptive acts and practices, from the perspective of a senior official of the OCC, *see* Julie L. Williams & Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Law. 1243 (May, 2003) (hereafter "Williams & Bylsma").

[12] 12 U.S.C. § 1639(l).

[13] H.R. Conf. Rep. No. 1142, 63d Cong., 2d Sess. 19 (1914), *quoted in* American Financial Serv. Ass'n v. FTC, 767 F.2d 957, 966 (D.C. C.A. 1985).

[14] See, e.g., Jess Bravin & Paul Beckett, *Friendly Watchdog: Federal Regulator Often Helps Banks Fighting Consumers*, Wall St. J., Jan. 28, 2002.

[15] See Julie L. Williams & Michael L. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1244, 1246 & n.25, 1253 (2003)**{** TA \l "Julie L. Williams & Michael L. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1244, 1246 & n.25, 1253 (May 2003)" \s "Julie L. Williams & Michael L. Bylsma, On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks, 58 Bus. Law. 1243, 1244, 1246 & n.25, 1253 (May 2003)" \c 3 **}** (conceding that "[a]n obvious question is why it took the federal banking agencies more than twenty-five years to reach consensus on their authority to enforce the FTC Act").

[16] Duncan A. MacDonald (former General Counsel, Citigroup Inc.'s Europe and North American card business), Letter to the Editor, *Comptroller Has Duty to Clean Up Card Pricing Mess*, Am. Banker, Nov. 21, 2003, at 17**{** TA \l "*Comptroller Has Duty to Clean Up Card Pricing Mess*, Am. Banker, Nov. 21, 2003, at 17" \s "Comptroller Has Duty to Clean Up Card Pricing Mess, Am. Banker, Nov. 21, 2003, at 17" \c 3 **}**; *see also* Frontline, *Secret History of the Credit Card*, Transcript at 16-17, http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html.
{ TA \l "Frontline, *Secret History of the Credit Card*, Transcript at 16-17, http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html." \s "Frontline, Secret History of the Credit Card, Transcript at 16-17, http://www.pbs.org/wgbh/pages/frontline/shows/credit/etc/script.html." \c 3 **}**

[17] Information on OCC's enforcement actions is contained in annual reports that the U.S. Attorney General provide to Congress. See U.S. Attorney General, Annual Report to Congress Pursuant to the Equal Credit Opportunity Act, *available at* http://www.usdoj.gov/crt/housing/housing_special. php.

[18] In 2005, the OCC required that Laredo National Bank set aside $14 million to cover refunds to borrowers who'd been harmed by the bank's home loan practices. In 2003, it required Clear Lake National Bank to provide $100,000 in restitution to borrowers who'd received tax-lien mortgage loans and to review a portfolio of mortgage loans to determine if similar violations existed. See *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 18 (2007) (statement of John C. Dugan, Comptroller of the Currency).); cf. *Credit Card Practices: Current Consumer and Regulatory Issues: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 14-15, 18 (2007).

[19] See http://www.bloomberg.com/apps/news?pid=20601068&sid=aVgZgMsNYrzo&refer=economy.

[20] See, e.g. http://www.nytimes.com/2007/12/18/business/18subprime.html.

[21] Office of the Comptroller of the Currency, National Credit Committee, *Survey of Credit Underwriting Practices 2005*; see also Fitch Ratings, 2007 Global Structured Finance Outlook: Economic and Sector-by-Sector Analysis (December 11, 2006).

[22] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, "Interagency Guidance on Nontraditional Mortgage Product Risks," 71 Fed. Reg. 58609 (Oct. 4, 2006) http://www.federalreserve.gov/boarddocs/srletters/2006/SR0615a2.pdf4, 2006), *available at* http://www.federalreserve.gov/boarddocs/srletters/2006/SR0615a2.pdf.

[23] See *In Re Washington Mutual, Inc. Securities Litigation*, No. 2:08-MD-1919 MJP (W.D. Wash) (Former employees allege in the court documents that, well into 2007, WaMu underwrote pay option ARM loans based on the borrowers' ability to afford the low "teaser" payment—and not the full payment that inevitably would cause borrowers' monthly obligations to skyrocket).

[24] Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, "Statement on Subprime Mortgage Lending," 72 Fed. Reg. 37569 (July 10, 2007).

[25] Interagency Guidance on Subprime Lending (Mar. 1, 1999), *available at* http://www.fdic.gov/news/news/financial/1999/FIL9920a.html.

[26] 2001 Interagency Expanded Guidance for Subprime Lending Programs (Feb. 2, 2001), *available at* http://files.ots.treas.gov/25137.pdfhttp://files.ots.treas.gov/25137.pdf.

[27] See *Consumer Protections in Financial Services: Past Problems, Future Solutions: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. (2009) (statement of Patricia A. McCoy, Professor of Law, Univ. of Conn.), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=40666635-bc76-4d59-9c25-76daf0784239.

[28] Id.

[29] Id.

[30] Cal. Reinvestment Coal., *Who Really Gets Higher-Cost Home Loans?* 3, 18 (2005)**{** TA \l "*Who Really Gets Higher-Cost Home Loans?*, at 3, 18, *available at* http://calreinvest.org/pdf/CRC_highcostloans1205.pdf (Dec. 2005)" \s "Who Really Gets Higher-Cost Home Loans?, at 3, 18, available at http://calreinvest.org/pdf/CRC_highcostloans1205.pdf (Dec. 2005)" \c 3 **}**.

[31] Affidavits by Elizabeth M. Jacobson and Tony Paschal in *Mayor and City Council of Baltimore v. Wells Fargo Bank*, No. 1:08-cv -00062-BEL (D. Md.), Documents 74-16 and 74-17.

[32] See **{** TA \l "15 U.S.C. §§ 1613, 1691f" \s "15 U.S.C. §§ 1613, 1691f" \c 2 **}**Board of Governors of the Federal Reserve System, Annual Report, *available at* http://www.federalreserve.gov/ boarddocs/rptcongress/**{** TA \l "Board of Governors of the Federal Reserve System, Annual Report, *available at* http://www.federalreserve.gov/ boarddocs/rptcongress/" \s "Board of Governors of the Federal Reserve System, Annual Report, available at http://www.federalreserve.gov/ boarddocs/rptcongress/" \c 3 **}{** TA \l "Board of Governors of the Federal Reserve System, Annual Report, *available at* http://www.federalreserve.gov/ boarddocs/rptcongress/" \s "Board of Governors of the Federal Reserve System, Annual Report, available at http://www.federalreserve.gov/ boarddocs/rptcongress/" \c 3 **}** (containing information on the OCC's enforcement actions); **{** TA \l "15 U.S.C. §§ 1613, 1691f" \s "15 U.S.C. §§ 1613, 1691f" \c 2 **}**Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 Ann. Rev. Banking & Fin. L. 225, 237-52 (2004) (finding that the OCC's consumer protection enforcement actions targeted small national banks); *Improving Federal Consumer Protection in Financial Services: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 18 (2007) (statement of John C. Dugan, Comptroller of the Currency) (describing number of consumer complaints received by the OCC); OCC, Consumer Protection News: Unfair and Deceptive Practices, http://www.occ.gov/Consumer/Unfair.htm (describing the number of enforcement actions taken by the OCC).

[33] We have reported that consumers paid $17.5 billion in overdraft fees in 2006 in exchange for only $15.8 billion in credit. We are currently updating our estimates based on 2008 data, which will show overdraft fees paid annually have increased to well over $20 billion in just two years.

[34] Statistics indicate that from 1997 to 2007, the average overdraft fee charged increased from $16.50 to $29. The FRB's research indicates that the average was $16.50 in 1997 (*see* Federal Reserve Bulletin, *Retail Fees of Depository Institutions*, *1997-2001*, 405, 409, *available at* http://www.federalreserve.gov/pubs/bulletin/2002/0902lead.pdf) and $21.82 in 2002 (*see* Board of Governors of the Federal Reserve System, *Annual Report to the Congress on Retail Fees and Services of Depository Institutions* at 5 (June 2003), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf). Bankrate's survey on overdrafts found that the average charged was $29 in 2007. Bankrate, *2007 Courtesy Overdraft Study*, *available at* http://www.bankrate.com/brm/news/chk/20071219_overdraft_survey_main_a1.asp.

[35] Eric Halperin, Lisa James, and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, at 25 (Jan. 25, 2007), *available at* http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf.

[36] OCC Interpretive Letter # 914 (August 3, 2001), *available at* http://www.occ.treas.gov/interp/sep01/int914.pdf. The OCC raised compliance issues with respect to TILA, TISA, EFTA, ECOA, and Regulation O (extensions of credit to bank insiders).

[37] 67 Fed. Reg. 72620 (2002).

[38] Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005).

[39] *Id* at 9128.

[40] *Id.*

[41] http://www.helpwithmybank.gov/faqs/banking_overdraft.html#drop08. Additionally, Consumer Federations of America's 2009 survey of overdraft fees at the 16 largest banks finds that their average fee is $35, compared to $27 at FDIC-regulated institutions. CFA Survey: Sixteen Largest Banks Overdraft Fees and Terms (updated July 31, 2009), available at http://www.consumerfed.org/pdfs/overdraft_fee_report_09.pdf; Eleven of the 16 largest banks are OCC-supervised.

[42] Mark Fusaro, *Are "Bounced Check Loans" Really Loans?*, note 4, at 6 (noting 20% of institutions in June 2004 were applying "bounce protection" to debit cards or ATM) (Feb. 2007), *available at* http://personal.ecu.edu/fusarom/fusarobpintentional.pdf.

[43] FDIC Study of Bank Overdraft Programs at iv (Nov. 2008).

[44] 70 Fed. Reg. 29582 (May 2005).

[45] 74 Fed. Reg. 5212 (Jan. 29, 2009).

[46] Comptroller John Dugan released a statement on September 25, urging national preemptive standards.

[47] Dean Baker, Dangerous Trends: The Growth of Debt in the U.S. Economy, at 4, Fig 1 (2004); Stephen Roach, Comment: America's Inflated Asset Prices Must Fall, Financial Times, January 8, 2008.

[48] Sam Roberts, *Census Data Shows Recession Brings Changes*, New York Times, p. A14 (Sept. 21, 2009). For data regarding the net drain on homeownership by subprime lending, see *Subprime Lending: A Net Drain on Homeownership* (Center for Responsible Lending), March 27, 2007 http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/Net-Drain-in-Home-Ownership.pdf.

[49] Michael McKinstry, *Big Trouble*, CardTrak (July 25, 2008), http://cardtrack.com/news/2008/07/25/big_trouble.

[50] Calculated from Nilson Report, *Top Credit Card Issuers*, 1, 9 (Issue 896 February, 2008); Nilson Report, *General Purpose Cards – U.S. 2007*, 1, 9 (Issue 902, May 2008). *See also* Adam J. Levitin, *All But Accurate: A Critique of the American Bankers Association Study of Credit Card Regulation*, p. 20 (2007), (hereafter Levitin (2007) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1029191.

[51] Testimony of Edmund Mierzwinski, *Hearing on Credit Card Interchange Fees* Before the Antitrust Task Force of the House Judiciary Committee, p. 6 (July 19, 2007).

[52] 2008 Mortgage Market Statistical Annual; Inside B&C Lending).

[53] *Option ARMs: It's Later Than It Seems*, Fitch Ratings (September 2, 2008), at 5.

[54] Inside Mortgage Finance (Countrywide, IndyMac, WaMu and Wells.)

[55] Testimony of Prof. Patricia A. McCoy, Hearing on "Consumer Protections in Financial Services; Past Problems, Future Solutions" before the U.S. Senate Committee on Banking, Housing and Urban Affairs, p. 21, *see also* pg. 18-22. (March 3, 2009)

[56] 1 INSIDE MORTGAGE FINANCE, THE 2006 MORTGAGE MARKET STATISTICAL ANNUAL 187 (2006); OCC, NATIONAL BANK OPERATING SUBSIDIARIES DOING BUSINESS WITH CONSUMERS AS OF 12/31/2005 TO BE UPDATED ANNUALLY (2005), http://www.occ.treas.gov/consumer/Report%20-%202006%20for%20Op%20Sub%20pdf.pdf. Because National City Bank sold First Franklin Financial to Merrill Lynch in December 2006, First Franklin Financial is no longer a national bank operating subsidiary. *In Brief: Nat City Sells First Franklin*, AM. BANKER, Jan. 3, 2007, at 20. National City Bank was forced into a "shotgun marriage" with PNC in October, 2008.

[57] Letter from Comptroller of the Currency to Elizabeth Warren , Chair Congressional Oversight Panel, (February 12, 2009).

[58] Michael McKinstry, *Big Trouble*, CardTrak (July 25, 2008), http://cardtrack.com/news/2008/07/25/big_trouble.

[59] 3 N.Y.C.R.R. 6.8.

[60] Wells Fargo's Direct Deposit Advance (*see* https://www.wellsfargo.com/checking/dda/); U.S. Bank's Checking Account Advance (*see* http://www.usbank.com/cgi_w/cfm/personal/products_and_services/checking/caa.cfm); Fifth Third Bank's "Early Access" product (*see* https://www.53.com/wps/portal/pv?New_WCM_Context=/wps/wcm/connect/FifthThirdSite/Personal/Checking+Accounts/Fifth+Third+Early+Access/).

[61] **Massachusetts** (Mass. Gen. Laws ch. 940, § 8.06(17)(Where the financial interest of a mortgage broker conflicts with the interests of the borrower—*e.g.* the broker's compensation will increase directly or indirectly if the borrower obtains a loan with higher interest rates—the broker shall disclose the conflict and shall not proceed with the loan so long as such a conflict exists.); **North Carolina** (N.C. Gen. Stat. § 53-243.11)(No lender shall provide nor shall any broker receive any compensation that changes based on the terms of the loan, other than principal.)

[62] Section 158 of HOEPA mandated periodic hearings on the state of the market and the adequacy of the law. Information from these hearings led the FRB to use its authority under 15 USC 1602(aa) to add abusive single premium credit insurance charges to the HOEPA "trigger fees."

[63] *See, e.g.* Jean Ann Fox and Anna Petrini, *Internet Payday Lending; How High-Priced Lenders Use The Internet to Mire Borrowers in Debt and Evade State Consumer Protections* (Consumer Federation of America, Mov. 30, 2004). Other schemes have involved payday lending disguised as catalogue sales.

[64] Section 124(a)(2) preserves the authority of the FTC or any other agency, (presumably excluding the "Agency" – the CFPA) to act.

[65] Most branded cards are actually issued by banks, to take advantage of federal preemption laws and regulations. Target, for example, has a national bank.

[66] One of the most notorious cases of equity-skimming predatory mortgage lending began with a retail seller-financed "freezer-meat sale" assigned by the seller to Associates. The case was profiled on both the front page of the Wall Street Journal and a network prime-time news program.

[67] Pope, Justin. "For-Profit Colleges' Increased Lending Prompts Concerns." The Associated Press. August 15, 2009. Available online at http://www.usatoday.com/news/education/2009-08-15-profit-college-lending_N.htm. Also see "Corinthian Colleges, Inc. F4Q09 (Qtr End 06/30/09) Earnings Call Transcript" at http://seekingalpha.com/article/158257-corinthian-colleges-inc-f4q09-qtr-end-06-30-09-earnings-call-transcript?source=bnet.

[68] From Corinthian College's website. Available online at http://www.cci.edu/brands/everest.

[69] Pope, Justin. Ibid.

[70] Center for Responsible Lending calculations based on data from CNW Marketing, NCM Associates, and CRL survey data.

[71] *See* Federal Reserve Board Statistical Release G.19 (July, 2009): the average amount financed for 2007 was over $28,000.

[72] Roland Arnall headed the Long Beach Mortgage Company when the Department of Justice brought its first reverse redlining case for discriminatory pricing, ending with a $5 million settlement in 1996. **Cite.** Arnall went on to head Ameriquest. Its practices put it in the sights of a state multi-state investigation resulting in a injunction and a multimillion dollar settlement in 2005.]

[73] The run-up to the recent crisis has provided considerable evidence as to what practices increase risk. The CFPA's mission to engage in reality-based research and evidence-based oversight are key components to preventing yet another market collapse.

[74] See McCoy testimony, *supra*.

[75] See, e.g., *The People of the State of California v. Countrywide Financial Corp.*, Los Angeles Superior Court, June 24, 2008. Available, *available at* http://ag.ca.gov/cms_attachments/press/pdfs/n1588_firstamendedcomplaint.pdf#xml=http://search.doj.ca.gov:8004/AGSearch/isysquery/d9682d50-f6f7-4c18-9b74-dd03bca6cf28/2/hilite/ . Seehttp://ag.ca.gov/cms_attachments/press/pdfs/n1588_firstamendedcomplaint.pdf#xml=http://search.doj.ca.gov:8004/AGSearch/isysquery/d9682d50-f6f7-4c18-9b74-dd03bca6cf28/2/hilite/; see also *Unfair and Unsafe: How Countrywide's irresponsible practices have harmed borrowers and shareholders*, CRL Issue Paper (Feb. 7, 2008). Available at http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-and-unsafe-countrywide-white-paper.pdf .), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-and-unsafe-countrywide-white-paper.pdf .

[76] Countrywide Financial Corporation, Q3 2007 Earnings Call, Oct. 26, 2007. See; see also Gretchen Morgenson, I*nside the Countrywide Spending Spree*, N.YY. Times (August. 26, 2008)); Gretchen Morgenson & Geraldine Fabrikant, *Countrywide's Chief Salesman and Defender*, N.Y. Times (Nov. 11, 2007).

[77] Office of Inspector General, Department of the Treasury, *Material Loss Review of ANB Financial, National Association* (Nov. 25, 2008) OIG-09-013.

[78] Office of Inspector General, Department of the Treasury, *Material Loss Review of First National Bank of Nevada and First Heritage Bank, National Association* (February 27, 2009) OIG-09-033.

[79] In 2004, as warning signs of dangerous practices in the mortgage market grew, then-OTS director James Gilleran made it clear his agency was determined to keep a pliable attitude toward policing the home lenders: "Our goal is to allow thrifts to operate with a wide breadth of freedom from regulatory intrusion." Between 2001 and 2004, the OTS slashed its staff by 25% and changed its examination structure to emphasize having lenders do "self-evaluations" of their compliance with consumer protection laws. By 2005, the OTS had a new director, John Reich, but the message was similar. When concerns were raised about lenders' lack of concern for borrowers' ability to repay their loans, Reich cautioned that regulators should not interfere with thrifts that "have demonstrated that they have the knowhow to manage these products through all kinds of economic cycles." See Binyamin Appelbaum & Ellen Nakashima, *Banking Regulator Played Advocate Over Enforce*r, Wash. Post (Nov. 23, 2008).

[80] For more details on OTS's regulatory failures, see Michael Hudson and Jim Overton, *The Second S&L Scandal: How OTS allowed reckless and unfair lending to fleece homeowners and cripple the nation's savings and loan industry*, Center for Responsible Lending (Jan. 2009). Available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/the-second-s-l-scandal.pdf .), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/the-second-s-l-scandal.pdf.

[81] Office of Inspector General, Department of the Treasury, *Material Loss Review of Superior Bank, FSB* (Feb. 6, 2002); OIG-02-040; and Office of Inspector General, Federal Deposit Insurance Corporation, *Issues Related to the Failure of Superior Bank, FSB, Hinsdale, Illinois* (Feb. 6, 2002) Audit Report No. 02-005.

[82] Office of Inspector General, Department of the Treasury, *Material Loss Review of NetBank, FSB* (Apr. 23, 2008) OIG-08-032.

[83] Office of Inspector General, Department of the Treasury, *Material Loss Review of IndyMac Bank, FSB* (Feb. 26, 2009) OIG-09-032.

[84] Office of Inspector General, Department of the Treasury, *Material Loss Review of Downey Savings and Loan FA* (June 15, 2009) OIG-09-039.

[85] The inspector general discovered, for example, that OTS's western regional director had allowed IndyMac to count money it received from its bank holding company in May 2008 in a quarterly report outlining its financial condition as of March 31, 2008. See Binyamin Appelbaum and Ellen Nakashima, *Regulator Let IndyMac Falsify Report,* Washington Post (December 23, 2008) and Cheyenne Hopkins, *Treasury IG Faults OTS For Allowing Backdating,* American Banker (May 22, 2009).

[86] Appelbaum & Nakashima, *supra* note 77.

[87] Online interview with Brent Carmichael (Moderator, NCM Associates, Inc), *Time is Now for Buy-Here, Pay-Here,* AIN Media (Automotivedigest.com), Aug. 2008 (emphasis added).

[88] Rosland Briggs Gammon, *Buy-here, pay-here plans may attract more dealers; Growing customer base, higher standards may outweigh risks,* Automotive News, Vol. 82, No 6294, Feb 11, 2008.

[89] 73 Fed. Reg. 44522, 44563-65 (July 30, 2008).

[90] See Testimony of Kathleen Keest, *Hearing on H.R. 2309: The Consumer Credit and Debt Protection Act,* before the Subcommittee on Commerce, Trade and Consumer Protection Committee on Energy and Commerce (May 12, 2009).

[91] Mark A. Cohen, Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Vanderbilt University (Dec 2006) [hereinafter Imperfect Competition].

[92] Though the seller-dealer is listed as the creditor on the contract, in fact it typically sends the credit application to one or more potential third- party lenders for approval or disapproval. The outside lender tells the dealer the terms upon which it would approve the deal, including the "par rate" or "buy rate" – that is the rate that the buyer qualifies for based on its credit qualifications and the collateral. The dealer mark-up, or yield spread premium is an upward bump to that "buy rate" from which the dealer receives extra compensation.

[93] This too, is parallel to the mortgage market, where many borrowers believe that lenders are required to give them the best rate they qualify for.

[94] Imperfect Competition. Figures are weighted averages using data from five major auto finance companies compiling 12.6 million records between 1993 and 2004.

[95] For example, the settlement agreement sets limits in this range for GMAC in *Coleman v. GMAC*, Para. 8.3, No. 3-98-0211 (M.D. Tenn, settlement agreement filed Feb. 10, 2004), *available at* http://www.consumerlaw.org/issues/cocounseling/content/GMACSettlementAgrmt.pdf.

[96] Figures derived from kickback data in the 2008 Consumer Bankers Association Automotive Finance Study (2007 full-year data), and 2007 sales data for dealer-financed vehicles from CNW Market Research (excluding leases). State market shares also from 2007 CNW Market Research data.