



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

August 12, 2009

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman Bachus:

Thank you for soliciting the Federal Deposit Insurance Corporation's input on the proposed Consumer Financial Protection Agency (CFPA). Enclosed are responses to the questions you posed.

We appreciate the opportunity to comment. If we can provide further information, please do not hesitate to contact me at (202) 898-6974 or Eric Spitzer, Director, Office of Legislative Affairs at (202) 898-3837.

Sincerely,

Sheila C. Bair

Enclosure

**Response to Questions from
The Honorable Spencer Bachus**

Q1. What problem would be addressed by the creation of a CFPA that is not or cannot be addressed by the current system of financial institution and product regulation?

A1. The proposal addresses one of the principal limitations of the current regulatory system. It would eliminate the remaining regulatory gaps between insured depository institutions and *non-bank* providers of financial products and services by establishing strong, consistent consumer protection standards. It also would address another gap by giving the CFPA authority to examine non-bank financial service providers that are not currently examined by a federal, or in many cases, state agency. In addition, the Administration's proposal would eliminate the potential for regulatory arbitrage that exists because of federal preemption of certain state laws.

Q2. How would the new consumer protection standards established in H.R. 3126 impact the availability of credit for consumers? Would any particular category of consumers be affected more than others?

A2. Properly defined standards should not impede the availability of credit to any category of consumers. H.R. 3126 does not prohibit the offering of consumer financial products and services. Rather, it seeks to protect consumers against abusive products and practices that strip individual and family wealth. The standards could lower risks to consumers of such financial products by enhancing transparency of terms and features, and facilitating comparison of alternative products or services. The standards also could bring greater protection to consumers of non-bank financial products and services, which are not subject to the examination and supervision for consumer protection and safety and soundness compliance that currently benefits insured institution customers.

Q3. One of the directives given to the proposed agency is to coordinate with a variety of other agencies, both state and federal, to “promote consistent regulatory treatment of consumer and investment products.” However, the legislation would permit individual states to pass laws that will differ from federal law. What would be the impact on consumers and the institutions you regulate if individual states can impose additional and different standards?

A3. To a great extent, the current patchwork regulatory situation is the result of a lack of coordination of national consumer protection laws and regulations. Creating a federal floor for consumer protection will provide standardization for institution and product regulation. While the proposal allows states to apply more protective state consumer laws, a strong federal floor should make additional state standards unnecessary. It should be noted that state-chartered banks operating in multiple jurisdictions currently comply with those jurisdiction's consumer laws with no problems.

Q4. The legislation envisions the separation of safety and soundness regulation from consumer protection regulation. How would this separation impact the safety and soundness of banking institutions? Would it enhance or undermine safety and soundness, in your view?

A4. Separating the examination and supervision of insured depository institution consumer protection compliance from that of safety and soundness could undermine the effectiveness of both. As the banking regulators' experience during the past few years has shown, consumer protection issues and the safety and soundness of insured depository institutions go hand-in-hand. Examination and supervision for safety and soundness and consumer protection must be closely coordinated and reflect a comprehensive understanding of an institution's management, operations, policies, and practices. Consumer protection and risk supervision benefit from the synergies created by this holistic approach and by ready and timely access to expertise and critical information. Separating consumer protection examination and supervision from other supervisory efforts could weaken both and result in weakened financial institutions.

By contrast, if the CFPB has sole rule-writing authority over consumer financial products and services, this will ensure appropriate focus on protecting consumers and a level playing field between insured depository institutions and other types of entities that offer similar financial products. In addition, the FDIC would support providing the CFPB with back up enforcement and examination authority to ensure that the federal regulators are providing effective supervision of these standards. Freeing the CFPB from direct supervision and enforcement of depository institutions would allow this entity to focus its examination and enforcement resources on the non-bank entities that provide financial products and services that have not previously been subject to federal examination or enforcement.

Q5. Does your agency have a separate consumer protection compliance examination force? If not, how could the consumer compliance examination function be transferred to a new agency and what would be the impact of the transfer on your safety and soundness supervision?

A5. The FDIC has a dedicated force of consumer protection compliance examiners. As discussed above, consumer protection and risk supervision benefit from the synergies created by ready and timely access to expertise and critical information in both areas. For example, violations of consumer regulations by an institution frequently signal management problems related to safety and soundness issues as well. Preserving the current regulatory framework, and the ability of the examiners to work together to evaluate institutions, will ensure that financial institutions will be continue to be viewed holistically.

Q6. H.R. 3126 requires coordination and consultation between the CFPB and the Federal banking agencies. However, it does not offer a framework or mechanism in the event that there is not a consensus. Please comment on any practical or legal problems or challenges that would be presented by this proposal.

A6. In our answer to Question 7, we describe the many ways that consumer protection compliance and safety and soundness examination and supervision are intertwined. Separating the functions into two agencies inevitably would create issues. For example, it would constrain the ability of examination staff to develop a comprehensive view of the institutions they supervise. It also would be more difficult to easily coordinate, share information, and bring joint actions on consumer protection and safety and soundness issues. In addition, the flow of information would slow, thus reducing opportunities to quickly identify and resolve problems.

As indicated above, one way to address this issue would be for the banking agencies to retain the authority to examine and supervise insured institutions for consumer protection compliance and safety and soundness. The CFPA should be given the authority to examine and supervise *non-bank* consumer product and service providers and back-up enforcement authority over insured depository institutions. Giving the CFPA authority to write rules for all consumer product and service providers would ensure strong and uniform consumer protection standards for all consumer product and service providers.

Another means of ensuring coordination and consultation would be to have federal financial institution regulators represented on the CFPA Board, which could be the final arbiter of any problems that could not be resolved at the staff level. We believe it is particularly important that the FDIC be represented. As ultimate insurer of over \$6 trillion in deposits, the FDIC has both the responsibility and vital need to ensure that consumer compliance and safety and soundness are appropriately integrated. The FDIC also is the primary federal supervisor for the largest number of banks (including many larger ones) and maintains an active examination staff on-site in the largest major banks as back-up supervisor. The FDIC's direct supervision of the majority of the nation's community banks provides it with a unique "Main Street" perspective that enabled it to be an early proponent of affordable and sustainable mortgage loan modifications, improved economic inclusion, and the prevention of abusive lending practices. Moreover, the FDIC's deposit insurance function involves a significant consumer protection role with regard to consumer deposits that affects all institutions, but is unique to the FDIC.

Q7. H.R. 3126 provides for each of the Federal banking agencies to transfer consumer financial protection functions to the new agency. Such functions are defined to mean "research, rulemaking, issuance of orders or guidance, supervision, examination, and enforcement activities, powers, and duties relating to the provision of consumer financial products or services." Please identify all of the functions within your agency that would be transferred under this new provision? Does it affect underwriting standards for mortgage loans? Insider lending rules? Lending limits? Anti-money laundering compliance? If so, what would be the impact of the transfer on safety and soundness?

A7. Staff in three different FDIC Divisions likely would have to be transferred if the new agency is created as proposed: the Division of Supervision and Consumer Protection (DSC), the Legal Division, and the Division of Insurance and Research (DIR). In particular:

1) DSC: Generally speaking, staff in this Division performs research, rulemaking, guidance, supervision, examination and enforcement functions, and coordinates extensively with the Legal Division and DIR in connection with all of these functions.

- *Examinations*: Consumer protection compliance examiners and examination management and staff in FDIC field offices, regions, and at headquarters in Washington, D.C. examine banks for compliance with consumer protection and CRA regulations and coordinate with legal staff to bring informal and formal enforcement actions when banks fail to comply with laws or regulations. Consumer protection staff also coordinates with DSC's risk management/safety and soundness function on applications and other regulatory requests from institutions that have less than satisfactory consumer compliance or CRA programs.
- *Policy*: Consumer protection compliance policy analysts conduct outreach to industry and consumer groups, monitor legislative and regulatory developments, develop policy and guidance for examiners and institutions, participate in interagency working groups to issue regulations and examination procedures, and develop and provide training for consumer protection compliance examiners.
- *Consumer Protection Outreach*: Consumer affairs staff receives, investigates, and responds to consumer complaints and inquiries involving FDIC-supervised institutions, along with other data requests concerning consumer protection laws and banking practices. In addition to assisting individual consumers, the consumer complaint resolution function provides information used in individual bank compliance examinations and to detect emerging consumer protection issues. As part of its deposit insurance function, FDIC consumer affairs staff provides consumer education and assistance with regard to deposit insurance coverage matters. This function would necessarily remain with the FDIC.
- *Community Affairs*: DSC also has a Community Affairs program that provides technical support to financial institutions to help them identify and respond to the credit and banking needs of the communities they serve. Program staff conducts the FDIC's financial education and consumer protection outreach, except for deposit insurance. Community affairs staff facilitates the Alliance for Economic Inclusion -- the FDIC's national initiative to establish broad-based coalitions of financial institutions, community-based organizations, and other partners to bring unbanked and underserved populations into the financial mainstream. The FDIC developed and distributes the award-winning *Money Smart* financial education program, which is available in several formats and languages. In addition, the Small Dollar Loan pilot project is reviewing affordable and responsible small-dollar loan programs in financial institutions to identify effective and replicable business practices that banks can incorporate into their mainstream services. Community Affairs staff also leads the FDIC's ongoing outreach efforts to mitigate foreclosures and help consumers avoid scam artists.

2) Legal Division: Legal Division attorneys from headquarters and regional offices support the research, supervision, examination, legislative, rulemaking, policymaking and

enforcement functions. Enforcement attorneys work closely with examination staff in bringing formal and informal enforcement actions against institutions.

- 3) DIR: Economists and statisticians support the consumer protection compliance examination and policy programs and Legal Division staff by conducting research and analyzing quantitative and qualitative data. Staff pursues original research exploring consumer financial products, behaviors, and trends.

On balance, transferring consumer protection compliance examination and enforcement to the new consumer protection agency would cause disruption to agency operations during a critical time, complicating safety and soundness functions and enforcement efforts. A number of mission-critical regulatory functions exist in which consumer protection and safety and soundness issues are intertwined. Consumer protection weaknesses may affect the safety and soundness of an institution, or they may reflect an overall weakness, particularly of management. Unsafe or unsound practices, or the resulting financial weakness of an institution, can impact a bank's customers, the community, and even the financial markets.

Significant expertise, lines of communication, and cooperative efforts among safety and soundness and consumer protection compliance staff would be hampered by moving these functions to the new consumer protection agency. Particular areas of supervision, examination, and enforcement that would be impacted include:

- Non-Traditional Mortgage Lending
- Subprime Lending
- Payday Lending
- Credit Card Lending
- Predatory Lending
- Loan Modifications
- Flood Insurance
- Third-Party Risk
- Retail Securities and Insurance Sales and Referrals, under the Gramm-Leach-Bliley Act of 1999 (GLBA) and Regulation R
- New Bank Application Investigations and Community Reinvestment Act (CRA) Analysis
- Bank Branch and Merger Applications, which require consideration of compliance ratings, fair lending and CRA ratings
- Privacy (GLBA)
- Identity Theft Red Flags and the Fair and Accurate Credit Transactions Act of 2003 (FACT Act)
- The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act)

Because the FDIC and other regulators must continue to consider consumer protection issues in evaluating banks – even if a new agency is established – separating these functions will necessarily create a duplication of effort.

The new agency also would impose incremental burden on financial institutions as they would be examined and evaluated by another federal agency. Separating the compliance examination

function from the safety and soundness program also will delay action on applications or other requests requiring federal approval.

Q8. Does the proposed CFPA get at the heart of what caused the mortgage crisis?

A8. If a CFPA-type agency had been in place, it could have taken the long view of both the banking sector and the non-bank financial sector. A strong focus on consumer protection could have called into question the underlying rationale for many of the more abusive mortgage products. Further, rules and guidelines could have been developed that would have slowed or halted the worst practices.

However, the CFPA, as currently proposed, does not get at one of the fundamental causes of the mortgage crisis: the lack of effective supervision and enforcement of non-bank entities that offer mortgages and other financial products. While these entities are subject to many of the same laws and regulations as federally supervised banks and thrifts, they are not subject to the same regular examinations or supervision, or the resulting potential for enforcement actions if they break the law. State and federal enforcement agencies (state consumer protection agencies and the Federal Trade Commission for civil matters, state Attorneys General and the Department of Justice for criminal) have limited resources and must make constant choices about whether situations are egregious enough to warrant bringing an action to stop a particular practice.

To the extent possible, legislation should specifically define the components of an effective enforcement and examination regime focused on non-banks. For example, rather than diluting resources by aiming them at all financial products and entities, the CFPA's primary supervisory resources should be targeted on non-bank entities. The federal bank and thrift supervisors should continue to have examination and enforcement authority over banks; however, they would enforce the consumer protection standards set by the CFPA. Under such a regime, overall consumer protection would be greatly strengthened because the CFPA would have back up authority to enforce all consumer protection laws regarding banks, and there would be several supervisory entities, including the CFPA and the bank regulators, targeting their resources on enforcing consumer protection laws across the country.

Q9. H.R. 3126 provides for the agency to approve "standard" financial products and services. What would be the impact of this proposal on product innovation, especially when you consider the risks, expenses, and compliance requirements (e.g., disclosure and opt-out requirements) associated with the creation or sale of other than standard products?

A9. At this time, it is difficult to determine the impact on product innovation. However, it has become clear from the current economic crisis that when innovative products are not well understood by investors and consumers, product innovation does not always benefit consumers, the economy, or society as a whole. Inappropriate promotion of interest-only and other non-traditional mortgage products contributed to the current economic crisis. Therefore, it could be argued that non-standard products should receive stronger attention from regulators to ensure they are being used appropriately.

Q10. What will be the impact on consumers if banking and some insurance products are subject to regulation by the new agency, but economically similar investment products are subject to a different form of regulation by the SEC?

A10. In creating the CFPA, Congress should provide a clear and effective mechanism for ensuring comparable consumer protections regardless of the entity from which a consumer purchases economically or functionally equivalent products. The CFPA should have the authority to set comparable standards for comparable products and to ensure that there is no loophole in consumer protection for products that are economically similar. Prudential supervisors would enforce the standards established by the CFPA for products and institutions under their jurisdiction. The ability to establish comparable protections will strengthen coordination and cooperation among the banking agencies, the new consumer agency, and federal and state securities and insurance regulators, and should prevent practical and operational gaps in regulations and supervision.