REMAPPING DEBATE
Asking "Why" and "Why Not"

Causing a furor before it exists

Original Reporting | By James Lardner | Banking, Regulation

May 12, 2011 — With the passage of last year's Dodd-Frank reform law, the 111th Congress called for the creation of a Consumer Financial Protection Bureau. Now, two months before its scheduled launch date, the ascendant Republicans of the 112th Congress are trying to limit the bureau's power by making basic changes to its authority and architecture.

> "It's not like the history of bank regulation or consumer product regulation in the United States suggests that the overwhelming problem is that the public voice is heard too loudly and special interests are silenced," Lisa Donner said.

The House Committee on Financial Services moved last week toward approval of legislation that would put the new CFPB under a bipartisan commission rather than a single director, while enhancing the ability of a panel of traditional bank regulators to veto consumer-protection rulings that, in their view, jeopardize financial "safety and soundness." Meanwhile, 44 senators (all the Republicans, except Scott Brown of Massachusetts and Lisa Murkowski of Alaska) signed a letter to President Obama declaring that until the White House agrees to similar limits on the bureau's power, they will refuse to vote for a nominee — any nominee — to run it.

At first glance, it was hard to understand the urgent need to reorganize an agency that hasn't had a chance to do anything yet. Outside observers might also have been startled by what a number of congressional Republicans identified as their underlying concern: the danger of having a financial regulatory body that simply cares too much about consumers, and too little about banks.

Hand in hand

One pending proposal — put forward by Rep. Sean Duffy (R-WI) — would allow a council of financial regulators to overrule, by majority vote instead of the two-thirds requirement set by Dodd-Frank, any CFPB action it sees as a safety-and-soundness threat. Duffy's bill would also allow for consideration of the impact on "financial institutions" rather than just to the system as a whole (see box).

Critics of the CFPB in its present form argue that consumer protection and safety-and-soundness go "hand in hand," as Rep. Shelley Moore Capito (R-WV) said recently, because many bank practices (loan underwriting, for example) have consequences for both.

The Bureau's supporters make two basic counter-arguments. What Duffy, Capito, and others are seeking, according to Rep. Brad Miller (D-NC), is a restoration of the old model of regulation — one in which, Miller told Remapping Debate in a phone interview, "all of the prudential regulators that had supposed consumer-protection responsibility put [that] protection way to the bottom of their list of responsibilities."

It was because of that history, Miller said, that Congress decided to establish a stand-alone financial protection agency. The record of recent experience suggests that a financial system that pays more attention to consumer protection will also be a more stable system, Miller added. "If you trap consumers in debt that they cannot pay, it's bad for the consumers immediately," he said. "It was very bad for consumers in the early and middle part of the last decade, and eventually it caught up with the lenders as well."

Drafted to protect safety-and-soundness...or something else? (part 1)

In its single-minded focus on consumer protection, critics say, the Consumer Financial Protection Bureau could take steps that ignore the competing interests of financial safety-and-soundness.

Such concerns were aired in the debate over the bureau's creation, leading to a number of provisions that already limit its authority. Under the Dodd-Frank law that set up the CFPB, a body known as the Financial Stability Oversight Council, which includes representatives of the Federal Reserve, the Office of Comptroller of the Currency and the Federal Deposit Insurance Corporation (as well as the CFPB itself), can veto any rule that seven of its ten members judge to "put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk."

That language set the bar too high, bank lobbyists and congressional Republicans now argue. Under their revised formula, only five votes would be required (a majority of the council, with the CFPB director excluded). Moreover, the council could veto any rule viewed as "inconsistent with the safe and sound operations of United States financial institutions."

The idea, according to its author, Rep. Sean Duffy (R-WI), was to guard against a threat to the safety-and-soundness of one part of the industry, such as credit unions or community banks. But defenders of the CFPB protest that the new wording would permit a veto on far slighter grounds. The Duffy bill, Rep. Brad Miller (D-NC) told Remapping Debate, could make it hard for the CFPB to issue a rule that causes financial harm to a few banks, even if the profits threatened by the rule came from "taking advantage of consumers."

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The CFPB is needed, said Lisa Donner, who oversees a consumer-labor coalition known as Americans for Financial Reform, “both in order to make sure that people aren’t gouged and treated unfairly day to day, and because if they’re allowed to be treated unfairly and gouged in the consumer market, that can be, and just was, profoundly risky for the system as a whole.”

Remapping Debate asked a number of elected officials and bankers for illustrations of consumer-protection policies that would be bad for safety-and-soundness. Few responded (see box). One who did, Joe Witt, president of the Minnesota Bankers Association, offered the example of a rule ensuring quick customer access to deposited funds, before banks could properly determine “if there are funds in the underlying account to cover [a deposited] check.”

Ed Mierzwinski, a Washington-based consumer advocate, pointed out that Dodd-Frank assigns such questions to the shared jurisdiction of the CFPB and the Federal Reserve, thus putting some check on the new agency’s power. Mierzwinski added that modern electronic-clearance practices allow banks to tap most funds overnight, while account-holders typically have to wait two or more days. Despite a 1988 law that gives consumers the right to withdraw $100 immediately (a figure raised to $200 by Dodd-Frank), Mierzwinski argued that banks still get the better of the situation. “Banks have gotten rapid access to our money,” he said, “but they still haven’t given us [the same] rapid access.”

“It’s not like the history of bank regulation or consumer product regulation in the United States suggests that the overwhelming problem is that the public voice is heard too loudly and special interests are silenced,” Lisa Donner said. “The truth is, the resources at the disposal of industry to influence the regulatory process are, and continue to be, overwhelming as compared to the resources of the public.”

Drafted to protect safety-and-soundness...or something else? (part 2)

The language of Duffy’s proposal seemed to raise questions. Why wasn’t it limited to rules affecting a sector or defined segment of the banking industry? Couldn’t a consumer-protection requirement be consistent with the safe and sound operations of a vast majority of banks — or actively promote safety-and-soundness for those banks — even while making it harder for other banks to thrive? Could the failure of certain institutions, under such circumstances, even be considered a positive result (that is, one that clears the marketplace of less reputable operators)?

Remapping Debate was anxious to put these questions to Congressman Duffy in light of the fact that two banking lobbyists we interviewed had seemed to interpret his legislation as covering a rule that put the “safety and soundness” of even a single institution at risk. But, as noted elsewhere, the congressman and his staff did not respond to our repeated requests for an interview.

A charm offensive?

Elizabeth Warren, the Harvard law professor who conceived the idea for the CFPB and has been tapped by President Obama to oversee its implementation, has sought to calm bankers' fears. In an interview with National Journal last week, Camden Fine, president of the Independent Community Bankers of America, suggested that Warren was making headway in that department: the small banks he represents might do well to consider supporting Warren as the bureau's permanent director, Fine said; better Warren, he explained, than "some fang-tooth zealot who is going to lump us into the same box as Wall Street and just say 'I don't give a rat's ass how big you are; I am going to hammer your butt!'"

Fine seemed to be expressing a minority viewpoint, however. Joe Witt, of the Minnesota Bank Association, acknowledged that Warren has been saying "all the right things." Nevertheless, he said many in the industry were unconvinced by what they viewed as essentially a "charm offensive."

Talk to us about safety and soundness (part 1)

Congressional Republicans are pushing several proposals to change the governance structure of the new Consumer Finance Protection Bureau. The aim, the backers all insist, is not to undermine the bureau, but to make sure that in its efforts to protect consumers, it does not do anything to compromise the "safety and soundness" of financial institutions.

Seeking examples of such missteps, Remapping Debate contacted the offices of half a dozen House members who have raised the issue. Repeated emails and phone messages failed to elicit a response from five of the six legislators. They were:

Sean Duffy (R-WI), who, interviewed on Fox TV last week, said that the CFPB was on the way to becoming "so powerful that one of our concerns is that consumer protection can actually trump safety-and-soundness in the banking industry."

Shelley Moore Capito (R-WV), who, in a recent press release, said that "consumer protection and safety and soundness go hand in hand." Congress, Capito went on to say, has "a responsibility to ensure that [consumers'] personal financial decisions are left up to them and not unduly influenced by unelected bureaucrats who seek to limit consumer choice."

Blaine Luetkemeyer (R-MO), who, during a March hearing, pressed Elizabeth Warren to say exactly how much money the CFPB would be willing to have banks spend meeting any particular regulation. When Warren declined to give a dollar amount, Luetkemeyer chastised her for what he said was indifference to cost-benefit analysis.

Edward Royce (R-CA), who unsuccessfully sought to impose a safety-and-soundness mandate on the CFPB as part of the original Dodd-Frank law.

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As part of that effort, CFPB officials met with Witt's group last week. They pointed out that — thanks to the bureau's creation — check cashers, mortgage brokers, and other "nonbank" entities will now have to observe some of the same financial rules that govern banks. In theory, this could be a step forward, Witt told Remapping Debate. But he said he had challenged the CFPB representatives about their ability to monitor between 70,000 and 100,000 nonbanks with anything like the same vigilance given to the regulation of the nation's 7,000 banks.

"They said no, realistically, we can't do it," Witt recalled. We can't come up with enough examiners to really do the job to the extent that it's done in the banking industry. So I said, 'Then you don't have a level playing field… Until there is equal enforcement, it is not a level playing field.'"

Code language

What accounts for the intensity of the distrust? Why all the talk about consumer protection overriding safety-and-soundness? The issue is a legitimate one in some situations, said Travis Plunkett, legislative director of the Consumer Federation of America. "Regulators around the world have struggled" to find the right balance, Plunkett told Remapping Debate. "But what we're hearing in Congress now is not an intellectually serious argument," he added. Instead, safety-and-soundness is being used as "code for fears that the consumer bureau will be too vigorous in restricting abusive, deceptive, or unfair practices."

Talk to us about safety and soundness (part 2)

Spencer Bachus (R-AL), chairman of the Financial Services Committee, who, in a February speech, described the creation of the CFPB as "problematic," citing, among other concerns, reservations about the decision to separate consumer protection from safety-and-soundness.

The only substantive response came from the office of Rep. Scott Garrett (R-NJ), who had quizzed Warren on this issue in March: "Your agency doesn't have a safety and soundness mission to it, does it?" Garrett asked her at the time. Last week, Garrett's press secretary, Ben Veghte, emailed Remapping Debate with an example of something the CFPB might do that would jeopardize safety-and-soundness: require mortgage modifications entailing principal writedowns as well as interest reductions. "This could cause some banks to go belly up in order to 'protect consumers,'" Veghte said.

Consumer groups have long advocated for writedowns of mortgage principal, arguing that foreclosure often turns out to be a more costly alternative for banks. But the CFPB is not in a position to decide this question, according to Travis Plunkett of the Consumer Federation of America. "They have to follow the law," he said, "and there's no federal law that would allow them or require them to mandate a principal write-down."

Talk of safety-and-soundness allows elected officials to avoid coming across as tools of an unpopular, but politically generous, industry, according to Plunkett. For bankers, he said, it's preferable to expressing their concern that the CFPB represents the beginning of something new: independent oversight.

"Banks and other financial firms were exceedingly comfortable with the status quo where they had enormous influence with an alphabet soup of regulators," Plunkett said. Under the old arrangement, he added, banks had often been able to fend off consumer-protection rules. Plunkett recalled that the former head of the Office of Comptroller of the Currency, John Dugan, had challenged an effort to bar OCC banks from raising interest rates on existing credit-card balances because of a change in a customer's "risk profile" (typically triggered by a late payment to another creditor). Dugan defended this practice, known as "repricing," as vital to safety-and-soundness. (Dugan turned out to be mistaken on that score, according to Plunkett. The banks wound up losing money as a result of an unprecedented wave of credit-card defaults.)

> "Since the CFPB cannot require any financial institution to offer any particular product," what its critics are really saying is "that financial institutions, banks, and other lenders need to be able to cheat consumers to stay in business," Rep. Brad Miller said.

Brad Miller, the North Carolina congressman, recalled that safety-and-soundness had also been the OCC's justification when it "specifically approved banks jiggling the order that they put customer charges through," so as to "kick people over into [paying additional] overdraft fees. Let's say you got to the end of the month," Miller explained, "and you had $100 bucks in your account, and you wrote a $20 check and then went to the ATM machine with your debit card a couple of more times for $20, and made a $15 purchase on your debit card, and then finally wrote a $105 check. Well, the OCC specifically allowed the banks to put the $105 check through first so that every one of those other transactions would trigger an overdraft fee. It's hard to square that with any concern for consumers at all."

With the advent of the CFPB, an important piece of bank regulation has moved to an agency that won't necessarily see things the banks' way, Plunkett said. The bureau might decide, for example, that some products or product features are so inherently tricky or dangerous that they need to be restricted or banned. That concept, according to Plunkett, is anathema to many bankers.

Indeed, Joe Witt of the Minnesota Bankers Association expressed concern that the CFPB might impose severe limits on mortgage prepayment penalties. "Consumer types," he said, "always argue against prepayment penalties." But when banks go into the secondary market to obtain loan funds, they can face pre-payment penalties themselves. In any case, Witt added, it's wrong to "demonize" certain types of loans or loan features "when what you're really talking about is probably a series of ten steps that were bad or maybe even fraudulent…" The loan term isn't the bad thing, it's the bad actor; let's go after the bad actors instead of making judgments about particular loan terms."

In last week's House markup session, Rep. Miller and others argued that the Republican proposals could effectively define any threat to bank profits as a safety-and-soundness problem. "Since the CFPB cannot require any financial institution to offer any particular product," what its critics are really saying is "that financial institutions, banks, and other lenders need to be able to cheat consumers to stay in business… [I]f that is true of a financial institution," he said, "maybe that one should be out of business."

The efforts to rein in the CFPB are based on farfetched notions of its power and intent, Donner said. The bureau, she noted, is required by law to put its rules out for comment, to listen to what bankers say, and to specifically consider the impact of its decisions on regulatory compliance costs and the availability and affordability of credit, among other factors.

For many bankers, these requirements are small comfort. Steve Zeisel, general counsel of the Consumer Bankers Association, acknowledged that the bureau has an obligation to listen to bankers; but it doesn't necessarily have to be swayed by what it hears. "The statute does talk about them consulting with the other agencies… They obviously have to put rules out for comment — that's standard administrative procedure; anybody would have to do that." The bottom line of Zeisel's concern? Having a consultation requirement, he said, "doesn't dictate what they decide."

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