

Consumer Protection Debate Pits Theory Against Record

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By Emily Flitter

WASHINGTON — The drive to create a new consumer protection agency — a key component of the Obama administration's regulatory restructuring plan — will get its first test in a House hearing this week and has already sparked fierce debate.

The banking industry and its federal regulators oppose the plan, which would strip current agencies of their power to write and enforce rules related to consumer protection. They argue that safety and soundness and consumer protection are closely related and that separating them would be needlessly burdensome and expensive and could even threaten the industry's health.

"It'd be a disaster" to create a new consumer protection agency, said Nicholas J. Ketcha Jr., a managing director at FinPro and a former director of supervision for the Federal Deposit Insurance Corp. "When they separated the consumer compliance division from the bank supervision division, it just set up a dichotomy of examiners working against the interests of what's being done on either side."

But consumer advocates claim regulators have failed to adequately enforce consumer laws because compliance too often takes a back seat to safety and soundness concerns.

Even some former examiners agreed that safety and soundness and consumer protection could be handled by different people at different agencies.

"They are different skill sets," said Carmina Hughes, a former special counsel for enforcement and special investigations at the Federal Reserve Board and now an executive director of Daylight Forensic and Advisory LLC in Washington. "Consumer protection issues are much more bound by regulations; they're very specific programs. Whereas safety and soundness is a very broad concept."

Though the witness list was not public on Monday, the House Financial Services Committee is expected to collect testimony from both sides on Wednesday. None of the banking agencies would answer questions about the Obama proposal on the record for this story.

Emphasis on consumer compliance has waxed and waned depending on which political party was in charge of Congress and the White House, and how the banking industry was performing.

At the beginning of this decade, all four banking agencies had consumer protection and supervision divisions.

But shortly after President Bush took office, the FDIC and Office of Thrift Supervision combined those departments and began conducting joint examinations. The two agencies also adopted a "risk-based model" of supervision for compliance examinations. Previously, the agencies had randomly pulled loan files and tested them for compliance violations. Under the new system, the agencies interviewed senior bank officials to determine an institution's overall consumer protection strategy.

The move was popular with banks and was soon adopted by the Office of the Comptroller of the Currency. Only the Federal Reserve Board continued to keep supervision separate from consumer protection. Ironically, it is the Fed that has been the focus of criticism because it chose not to exercise its authority over unregulated mortgage players.

Some former regulators said the jobs should be separate but equal parts of the exam process.

"I favor carving consumer compliance out as a separate discipline but working hand-in-glove with the prudential examiners under the same supervisor," said Wayne Rushton, former chief national bank examiner at the OCC and now working at Promontory Financial Group.

Rushton said it would be a mistake, however, to create a new agency, calling it "a massive duplication of effort.

"I have seen it tried both ways, and when it is done right, it is always best to integrate it," he said.

Ellen Seidman, OTS director during the Clinton administration and now the director of the Financial Services and Education Project at the New America Foundation, argued for a compromise approach. She favored the creation of a separate consumer protection agency to set the rules and enforce them against nonbank lenders and mortgage brokers while leaving enforcement at financial institutions to the banking regulators.

Lawmakers could also require the banking agencies to pay more attention to consumer protection, she said, rather than just giving enforcement powers to the new agency.

She also advocates a safety-valve — giving a consumer protection agency the power to step in at a bank if it feels the agencies are not adequately policing the issues.

"If this new regulator doesn't think the problem is dealt with by the other supervisor, then it can take action," said Seidman, who said she is scheduled to testify Wednesday.

If Obama prevails, and consumer protection and safety and soundness supervision are split up, questions remain about how conflicts between the banking agencies and a consumer regulator would be resolved.

Bert Ely, an independent analyst in Alexandria, Va., argued that such a situation could arise if the consumer protection agency is the primary enforcer of the Community Reinvestment Act, which many conservatives argue contributed to the financial crisis by encouraging lenders to make poor loans (a theory most regulators dispute).

"My concern is that serious conflicts could develop between the consumer protection agency and the safety and soundness regulators between the conflicting objectives of expanding credit availability on one hand and preserving safe banking practices on the other," said Ely. "You worry about the consumer protection regulator taking some sort of enforcement action against a bank even though the safety and soundness regulator would be opposed to the enforcement action."

Seidman agreed CRA enforcement should be left with the banking agencies.

"The CRA says the service must be consistent with safe and sound operations — that's a reason to keep the CRA exam authority with the same entity that examines for safety and soundness," she said.

John Bley, a lawyer at Foster Pepper in Seattle and a former Washington state banking commissioner, said existing regulators remain better positioned to detect problems at banks. "Financial regulators with a safety and soundness background have an intimate knowledge of the operations of those organizations they regulate and the impact that over-aggressive regulation could have on that organization," he said.

Consumer advocates, however, argue that the financial crisis has demonstrated the need to be a separate agency with sufficient enforcement authority.

Safety and soundness examiners "are captured and that contributes to bad enforcement," said Ed Mierzwinski, the director of the Public Interest Research Group. "By taking away the consumer job that they have not done, we're going to put it in an agency that will do it better."