



## The Future of Consumer Financial Protection

By Charlie Curnow

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"It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house," Harvard law professor Elizabeth Warren wrote in the summer of 2007, shortly after the onset of the subprime mortgage crisis. "But it is possible to refinance an existing home with a mortgage that has the same one-in-five chance of putting the family out on the street."

Buyers of toasters are protected, Warren wrote, because the Consumer Product Safety Commission prevents defective goods from ever going to market. Similarly, a Financial Product Safety Commission, she argued, "could eliminate some of the most egregious tricks and traps in the credit industry."

Warren may soon get her wish. Last month, Senate Banking Committee chairman Chris Dodd introduced a 1,336-page financial reform bill that, if approved, would reshape the country's financial regulatory system and attempt to fix many of the problems that sparked the recent financial crisis. Among the items that headline the proposal is a new Consumer Financial Protection Agency (CFPA) that would consolidate regulatory responsibilities for consumer financial products, currently handled by four separate agencies, in one central office. President Obama supports the idea of a CFPA, and a measure to establish the CFPA passed the House of Representatives in December. This makes the passage of a Senate bill the last major obstacle to the new agency's creation.

The primary goal of the CFPA would be to protect consumers from misleading and unfair lending practices. Its main targets would likely be the subprime and adjustable-rate mortgages that figured so prominently in the recent economic crisis, as well as other low-quality consumer financial products like high-interest credit cards and payday loans. If approved, it would have the authority to write consumer protection rules across bank and nonbank firms; inspect and supervise most non-bank lending institutions for compliance; enforce regulations through orders, penalties and fines; and set standards that serve as a floor for state laws.

The agency could require mortgage lenders, for example, to present borrowers with a simple, uniform mortgage disclosure. It could ban or restrict the fees some institutions charge if a borrower pays off a loan entirely, which critics say lock borrowers into bad loans. It could also require loan originators who securitize mortgage debt to retain at least 5 percent of the loans' credit risk, or make mortgage lenders provide customers with the best possible prices under prevailing market conditions.

The agency could also change rules for mortgage brokers. It could ban the side payments some lenders make to encourage brokers to push consumers into higher-interest loans, or



it could require mortgage brokers to receive contingent payments based on continued loan performance, rather than a lump sum on closing.

American Business Leaders for Financial Reform, a group of business executives, academics and commercial organizations, says the CFPA would help restore public trust and confidence in the financial services sector. We recently spoke with the group's national chairman, Tim Duncan, who is also president and founder of Story Street Partners, an investment management firm in Cambridge, Massachusetts.

Duncan compares the current financial market to the early aviation industry. Before the federal government created the Federal Aviation Administration to set uniform nationwide safety standards for commercial airlines, flying was a dangerous proposition, and fatal accidents were common. Rather than constraining the aviation industry, he says, the FAA helped it grow by establishing consistent safety standards, building public trust, and preventing airlines that invested less in safety and accident prevention from gaining a competitive advantage over those that made safe flying a priority. Similarly, Duncan says, the subprime mortgage crisis, rising credit card interest rates, and other developments have eroded the public's trust in the financial services industry over the past several years. A new federal administration with the power to ensure the safety of consumer financial products could help consumers and creditors alike by making people feel safe borrowing again and by forcing bad actors out of the industry.

One critic of the consumer protection agency is Edward Yingling, president and chief executive of the American Bankers Association. New consumer protection rules would almost certainly raise compliance costs for lenders, and may threaten revenues from certain restricted products. Because federal regulators currently hold banks to standards of "safety and soundness," or profitability, to assess their eligibility for government support, Yingling argues, holding banks accountable to a second agency that cares only about consumer protection could leave them in an intractable position between two conflicting sets of expectations.

Another sticking point in the CFPA debate is the question of whether to establish it as independent agency or house it an existing federal bureau. Under the House bill passed in December, the CFPA would be a stand-alone agency with its own budget and staff, and its decisions would be final. In an apparent move toward compromise with Republican critics, however, Dodd's bill would locate the CFPA within the Federal Reserve, though it would grant the agency its own funding stream and presidentially appointed head. Richard Shelby, the Senate Banking Committee's top Republican, has signaled that he wants to go even further to limit the power of the CFPA by subjecting any decisions it makes to veto by bank safety and soundness regulators.

Ultimately, the question of veto power will likely prove more contentious than where the CFPA is housed. Duncan, for example, said he would prefer the agency to be independent of any existing bureau, but he also said this may not matter much, as long as the agency is



able to make final decisions without the threat of veto and to independently enforce its rules. Indeed, if the head of the new agency is a direct presidential appointee, he (and by extension the president) may be able to shape the culture of the new agency, regardless of whether the agency is technically part of an existing government department. And if the CFPB is granted its own revenue stream, it will have considerable freedom of action. Subjecting any CFPB decision that may interfere with bank profitability to veto by outside regulators, however, could render the new agency impotent from the start, given the high compliance costs and reductions in bank revenues that tighter consumer protection regulations could produce. Such an agency might be worse than useless, because it would cost valuable resources and may produce only limited results.

In any event, the end of this year may be a hard deadline for passage of the CFPB, or for any major financial reforms. The Democrats could suffer heavy losses in this November's midterm elections, and, as Duncan notes, many Republicans seem wary of the CFPB, as well as other aspects of the Democratic financial reform agenda. Duncan and other observers place the deadline as early as August, because sitting representatives will need to return to their districts to campaign before the fall. In the meantime, the fate of the new agency will depend on the ability of Senate Republicans to stall – and the willingness of Senate Democrats to compromise.

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