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BEFORE THE COMMITTEE ON FINANCIAL SERVICES OF THE U.S. HOUSE OF REPRESENTATIVES

ON BEHALF OF CONSUMER ACTION, CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, CENTER FOR RESPONSIBLE LENDING, NATIONAL CONSUMER LAW CENTER AND THE U.S. PUBLIC INTEREST RESEARCH GROUP

IMPROVING FEDERAL CONSUMER PROTECTIONS IN FINANCIAL SERVICES

JULY 25, 2007

Chairman Frank, Ranking Member Bachus and Members of the Financial Services Committee, my name is Travis Plunkett and I am the Legislative Director of the Consumer Federation of America (CFA).[1] I appreciate the invitation to testify today on behalf of a number of national consumer organizations with tens of millions of members, including CFA, Consumer Action,[2] Consumers Union,[3] the publisher of Consumer Reports, the Center for Responsible Lending,[4] National Consumer Law Center[5] and the U.S. Public Interest Research Group.[6]

I commend the Committee for its diligence in examining the extremely important question of how well federal regulators are protecting consumers in the fast changing, increasingly complex financial services marketplace. This is the second hearing that the Committee has held on this topic, while many Committee and Subcommittee hearings this year have touched on regulation of important financial services markets, including mortgage lending, credit cards and other bank loans.

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[1] **Consumer Federation of America** (CFA) is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer's interest through advocacy and education.

[2] **Consumer Action** (www.consumer-action.org), founded in 1971, is a San Francisco based nonprofit education and advocacy organization with offices in Los Angeles and Washington, DC. For more than two decades, Consumer Action has conducted a survey of credit card rates and charges to track trends in the industry and assist consumers in comparing cards.

[3] **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of *Consumer Reports*, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

[4] **The Center for Responsible Lending** is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

[5] The **National Consumer Law Center** is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as community groups and organizations, who represent low-income and elderly individuals on consumer issues.

[6] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

I. Summary of Concerns and Recommendations

Any discussion about the quality of federal financial services regulation must begin by mentioning the "elephant in the living room." The Supreme Court's recent decision in Watters vs. Wachovia Bank, N.A. represents the culmination of efforts by the Office of the Comptroller of the Currency (OCC) to cut off the long-standing ability of states to protect the consumers of national banks. OCC's preemptive efforts harm consumers because, while not perfect in many respects, states have traditionally had the experience, the regulatory infrastructure, the willingness to experiment and the desire to protect consumers. Unfortunately, the OCC has serious deficits in all of these categories. In fact, over the years, the OCC appears to have demonstrated a lot more interest and expertise in exercising preemptive authority than in protecting consumers. Our recommendation is for Congress to clarify and limit the OCC's preemptive authority, as Representative Gutierrez has proposed, restoring the ability of the states to assist in protecting consumers who purchase financial services from national banks.

We recommend a number of consumer protection standards that the Committee can use to evaluate the effectiveness of financial services regulation, whether state or federal, and to propose changes to improve federal efforts. One of the most difficult problems that the Committee will face in attempting to improve consumer protection efforts is a culture of coziness with the financial institutions they regulate at most of the agencies and an insensitivity to consumer concerns. For example, most of the regulatory failures we highlight today are in areas, like oversight of high-cost "overdraft" loans, where federal regulators <u>have</u> existing authority to act and have chosen not to do so. Simply increasing the authority of the agencies to write or enforce rules, or to offer a unified complaint hotline, will not change the culture in some agencies that has caused them to ignore festering problems in the credit arena or to reject adequate consumer protection measures.

In order to improve federal consumer protection efforts, serious underlying problems with this regulatory culture must be addressed, including a focus on safety and soundness regulation to the exclusion of consumer protection, the huge conflict-of-interest that some agencies have because they receive significant funding from industry sources, the balkanization of regulatory authority between agencies that often results in either very weak or extraordinarily sluggish regulation (or both) and a regulatory process that lacks transparency and accountability.

The key to addressing these root problems is to make the regulatory process more independent of the financial institutions that are regulated. This means allowing the Federal Trade Commission (FTC) to bring enforcement actions against national banks and thrifts for unfair and deceptive practices and to initiate regulation of these entities. It also means granting consumers the right to privately enforce federal laws. Finally, Congress should act to rein in lending abuses where agencies have shown an unwillingness to act vigorously, such as credit card lending, sub-prime mortgage lending and the use of deceptive and high-cost "overdraft" loans by national banks.

II. Achieving Strong Consumer Protection in the Credit Arena, Whether at the State or Federal Level

The Supreme Court's recent ruling in Watters vs. Wachovia Bank, N.A., upheld a regulation by the Department of Treasury's Office of the Comptroller of the Currency (OCC) that permits operating subsidiaries of national banks to violate state laws with impunity. The court ruled that the bank's operating subsidiary is subject to OCC superintendence – even if there effectively is none – and not the licensing, reporting and visitorial regimes of the states in which the subsidiary operates. This split 5-3 court decision all but guarantees ongoing controversy and will likely mean that federal banking regulators will be encouraged to apply federal preemption to new entities associated with national banks.

The practical effect of the exercise of far-reaching federal preemption authority as now permitted by the courts is that it prevents states from using their historical authority to protect consumers and communities in large parts of the financial services arena and leaves a huge consumer protection gap that federal regulators have not shown an inclination or an ability to fill. The OCC has even sought to prevent state attorneys general and regulators from enforcing state laws that it concedes are not preempted. The recent court ruling encourages national banks and their subsidiaries to ignore even the most reasonable of state consumer laws.

Worse still, it promotes further competition to lower consumer protections. States are already getting pressure to reduce protections in order to retain state-chartered banks, and federal regulators have an incentive to keep standards lax, in order to continue to attract the participation of large state-chartered institutions in the federal banking and thrift system.[7] We have already seen that the expanding scope of federal preemption has intensified efforts by state banks and other state regulated financial entities to ask both federal and state regulators to provide them with parallel exemptions.

The truth is that the states have many advantages when protecting consumers in the credit practices arena. States can experiment with different consumer protection approaches more easily. Americans throughout the country have been the beneficiary of this experimentation many times as effective state laws are modeled and adopted in other states and at the federal level.[8] States have the flexibility to respond to variations in problems with credit practices from region-to-region. Given their smaller districts, state legislators are more likely to be responsive to problems in the credit market that surface in certain areas, before they spread nationally. States have an infrastructure in place to license, bond, and otherwise regulate the wide variety lenders, agents, servicers and brokers that offer credit services. State and local enforcement officials are better known to the public than their federal counterparts and more likely to have the

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[7] Several large national banks have chosen in recent years to convert their state charter to a national charter. Charter switches by JP Morgan Chase, HSBC and Bank of Montreal (Harris Trust) alone in 2004-05 moved over $1 trillion of banking assets from the state to the national banking system, increasing the share of assets held by national banks to 67 percent from 56 percent, and decreasing the state share to 33 percent from 44 percent. Arthur E. Wilmarth, Jr., "The OCC's Preemption Rules Threaten to Undermine the Dual Banking System, Consumer Protection and the Federal Reserve Board's role in Bank Supervision," Proceedings of the 42nd Annual Conference on Bank Structure and Competition (Fed. Res. Bank of Chicago, 2006) at 102, 105-106.

[8] Among the many examples that could be provided are The Truth in Lending Law and provisions of the Fair and Accurate Credit Transactions (FACT) Act.

personnel, experience and infrastructure to properly resolve consumer complaints about lenders and their agents.

Nonetheless, we certainly do not contend that states always provide effective consumer protection. The states have also been the scene of some notable regulatory breakdowns in recent years, such as the failure of some states to properly regulate mortgage brokers and non-bank lenders operating in the sub-prime lending market, and the inability or unwillingness of many states to rein in lenders that offer extraordinarily high-cost, short term loans and trap consumers in an unsustainable cycle of debt, such as payday lenders and auto title loan companies. Conversely, federal lawmakers have had some notable successes in providing a high level of financial services consumer protections in the last decade, such as the Credit Repair Organizations Act and the recently enacted Military Lending Act.[9]

As the Committee moves forward to examine the implications of the Watters decision on consumers and the effectiveness (or lack thereof) of federal consumer protection efforts, we urge you to use the below consumer protection principles to determine where federal consumer protection laws and regulations must be upgraded, as well as where federal efforts should accede to or partner with state regulation. These are the standards that should apply in evaluating the effectiveness of any consumer protection efforts, whether at the state or federal level.

- **Protection from unfair, deceptive and abusive practices**, including those that unjustifiably increase the cost of the credit product or expose consumers to unexpected fees and costs.
- **Protection from unsustainable debt**, as measured by the borrower's ability to re-pay the loan, caused by such factors as usury, rate gouging, or high fees.
- **Effective redress**, through a private right of action, and timely investigation and resolution of complaints by regulatory bodies, and other appropriate redress mechanisms, such as performance bonds. Access to such redress should not be blocked or unnecessarily delayed through such methods as mandatory arbitration requirements, choice-of-law contract terms, required waivers of legal rights, prohibitions on class action litigation, or unjustifiable restrictions on access to bankruptcy.
- **Strong civil enforcement** by federal and state authorities, including Attorneys General and federal consumer protection authorities, e.g. the Federal Trade Commission (FTC).
- **High standards for comparable products applied to all creditors**, whether a product is offered by a bank, a bank affiliate, a third party contracting with a bank, or a non-bank entity. Conflicting standards should always be harmonized upward to protect consumers.
- **Safety and soundness protections,** such as appropriate licensing, bonding, examination, and supervision requirements.
- **Timely, clear and complete disclosure** of all costs, as well as consumer rights and obligations and contract terms.

[9] Military Lending Act, 10 U.S.C. § 987. Credit Repair Organizations Act, 15 U.S.C. § 1679h (giving state Attorneys General and FTC concurrent enforcement authority).

III. Widespread Federal Regulatory Failures beyond the Mortgage Lending Market Have Harmed Consumers

Since the beginning of the year, a major focus of Congressional oversight of the credit market has been the serious regulatory failures at the federal and state level in the sub-prime mortgage lending market. Given the fact that at least 2.2 million homeowners with sub-prime mortgages face the prospect of losing their homes over the next several years (1 in 5 sub-prime loans issued in 2005 and 2006 are projected to default), this focus is understandable.

However, the focus on sub-prime mortgage lending may have obscured the failures of federal financial services regulators to address a number of other significant lending abuses by banks in recent years. If the Committee is to consider measures to improve consumer protection enforcement by federal financial services regulators, it is necessary to be aware of how and why these abuses have been allowed to continue.

A. <u>The Federal Reserve Board and Office of the Comptroller of the Currency Have Done Very Little Beyond Proposing New Disclosures to Address Abusive Practices and Reckless Lending in the Credit Card Market</u>

The Subcommittee on Financial Institutions and Consumer Credit has conducted two very comprehensive hearings on the impact of current credit card issuer practices on consumers. The Committee heard testimony from academics and consumer representatives regarding abusive lending practices that are widespread in the credit card industry, including:

- The unfair application of penalty and "default" interest rates that can rise above 30 percent;
- Applying these interest rate hikes retroactively on existing credit card debt, which can lead to sharp increases in monthly payments and force consumers on tight budgets into credit counseling and bankruptcy;
- High and increasing "penalty" fees for paying late or exceeding the credit limit. Sometimes issuers use tricks or traps to illegitimately bring in fee income, such as requiring that payments be received in the late morning of the due date or approving purchases above the credit limit;
- Aggressive credit card marketing directed at college students and other young people;
- Requiring consumers to waive their right to pursue legal violations in the court system and forcing them to participate in arbitration proceedings if there is a dispute, often before an arbitrator with a conflict of interest; and
- Sharply raising consumers' interest rates because of a supposed problem a consumer is having paying <u>another</u> creditor. Even though few credit card issuers now admit to the discredited practice of "universal default," eight of the ten largest credit card

issuers continue to permit this practice under sections in cardholder agreements that allow issuers to change contract terms at "any time for any reason."[10]

The Subcommittee also heard about the inaction of banking regulators in responding to these problems in the credit card marketplace:

- The Federal Reserve Board (FRB) has proposed new disclosure regulations under Regulation Z of the Truth in Lending Act (TILA). Although these proposed disclosures are positive and many respects and will make it easier to understand credit card terms and conditions, they will not include all of the information necessary to help consumers make informed choices. Most importantly, the disclosures won't stem the most abusive practices in the market.[11]
- The OCC has taken public enforcement action against a major credit card issuer only twice in recent years. The best-known case involved deceptive marketing practices by Providian. However, this occurred only after the San Francisco District Attorney and California Attorney General initiated action against Providian.[12]
- "In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates, including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US Bancorp – for a wide variety of abusive practices over the past decade…"[13]

The OCC and FRB have also been largely silent while credit card issuers expanded efforts to market and extend credit at a much faster speed than the rate at which Americans have taken on credit card debt. This credit expansion has had a disproportionately negative effect on the least sophisticated, highest risk and lowest income households. It has also resulted in both relatively high losses for the industry and record profits. That is because, as mentioned above, the industry has been very aggressive in implementing a number of new – and extremely costly – fees and interest rates.[14] Although the agencies did issue significant guidance in 2003 to require issuers to increase the size of minimum monthly payments that issuers require consumers to pay,[15] neither agency has proposed any actions (or asked for the legal authority to do so) to rein in aggressive lending or unjustifiable fees and interest rates.

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[10] Testimony of Linda Sherry of Consumer Action, House Subcommittee on Financial Institutions and Consumer Credit, April 26, 2007.
[11] Testimony of Kathleen E. Keest, Center for Responsible Lending, U.S. House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit, June 7, 2007.
[12] Testimony of Edmund Mierzwinski, U.S. Public Interest Research Group, Subcommittee on Financial Institutions and Consumer Credit of the Financial Services Committee, June 2, 2007.
[13] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, April 26, 2007.
[14] Testimony of Travis B. Plunkett of the Consumer Federation of America, Senate Banking Committee, January 25, 2007.
[15] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.

B. The Federal Reserve has Allowed Debit Card Cash Advances ("Overdraft Loans") without Consent, Contract, Cost Disclosure or Fair Repayment Terms

The FRB has refused to require banks to comply with the Truth in Lending Act (TILA) when they loan money to customers who are permitted to overdraw their accounts. While the FRB issued a staff commentary clarifying that TILA applied to payday loans, the Board refused to apply the same rules to banks that make nearly identical loans. As a result, American consumers spent $17.5 billion last year on cash advances from their banks without signing up for the credit, getting cost-of-credit disclosures, or a contract that the bank would in fact pay overdrafts. Consumers are induced to withdraw more cash than they have in their account at ATMs and spend more than they have with debit card purchases at point of sale. In both cases, the bank could simply deny the transaction, saving consumers average fees of $34 each time.

The FRB has permitted banks to avoid TILA requirements because bankers claim that systematically charging unsuspecting consumers very high fees for overdraft loans they did not request is the equivalent to occasionally covering the cost of a paper check that would otherwise bounce. Instead of treating short term bank loans in the same manner as all other loans covered under TILA, as consumer organizations recommended, the FRB issued regulations under the Truth in Savings Act, pretending that finance charges for these loans were bank "service fees." Once again, national consumer organizations provided well-researched comments, urging the Federal Reserve to place consumer protection ahead of bank profits, to no avail.

As a result, consumers unknowingly borrow billions of dollars at astronomical interest rates. A $100 overdraft loan with a $34 fee that is repaid in two weeks costs 910 percent APR. The use of debit cards for small purchases often results in consumers paying more in overdraft fees than the amount of credit extended.

Cash advances on debit cards are not protected by the Truth in Lending Act prohibition on banks using set off rights to pay themselves out of deposits into their customers' accounts. If the purchase involved a credit card, on the other hand, it would violate federal law for a bank to pay the balance owed from a checking account at the same bank. Banks routinely pay back debit card cash advances to themselves by taking payment directly out of consumers' checking accounts, even if those accounts contain entirely exempt funds such as Social Security.

C. Despite Advances in Technology, the Federal Reserve has Refused to Speed up Availability of Deposits to Consumers

Despite rapid technological changes in the movement of money electronically, the adoption of Check 21 to speed check processing, and electronic check conversion at the cash register, the Federal Reserve has failed to shorten the amount of time that banks are allowed to hold deposits before they are cleared. Money flies out of bank accounts at warp speed. Deposits crawl in. Even cash that is deposited over the counter to a bank teller can be held for 24 hours before becoming available to cover a transaction. The second business day rule for local checks means that a low-income worker who deposits a pay check on Friday afternoon will not get access to funds until the following Tuesday. If the paycheck is not local, it can be held for five business days. This long time period applies even when the check is written on the same bank where it is deposited. Consumers who deposit more than $5,000 in one day face an added wait of about five to six more business days. Banks refuse to cash checks for consumers who do not have equivalent funds already on deposit. The combination of unjustifiably long deposit holds and banks' refusal to cash account holders' checks pushes low income consumers towards check cashing outlets, where they must pay 2 to 4 percent of the value of the check to get immediate access to cash.

Consumer groups have called on the Federal Reserve to speed up deposit availability and to prohibit banks from imposing overdraft or NSF fees on transactions that would not have overdrawn if deposits had been available. The Federal Reserve vigorously supported Check 21 to speed up withdrawals but has refused to shorten deposit hold periods for consumers.

D. <u>The Federal Reserve has Supported the Position of Payday Lenders and Telemarketing Fraud Artists by Permitting Remotely Created Checks (Demand Drafts) to Subvert Consumer Rights Under the Electronic Funds Transfer Act</u>

In 2005, the National Association of Attorneys General, the National Consumer Law Center, Consumer Federation of America, Consumers Union, the National Association of Consumer Advocates, and U. S. Public Interest Research Group filed comments with the Federal Reserve in Docket No. R-1226, regarding proposed changes to Regulation CC with respect to demand drafts. Demand drafts are unsigned checks created by a third party to withdraw money from consumer bank accounts. State officials told the FRB that demand drafts are frequently used to perpetrate fraud on consumers and that the drafts should be eliminated in favor of electronic funds transfers that serve the same purpose and are covered by protections in the Electronic Funds Transfer Act. Fraudulent telemarketers increasingly rely on bank debits to get money from their victims. The Federal Trade Commission has reported that 25 percent of all fraud complaints received by the agency in 2004 involved a bank debit, an increase of 40 percent in just one year. Since automated clearinghouse transactions are easily traced, fraud artists prefer to use demand drafts.

Remotely created checks are also used by telemarketers and others to remove funds from checking accounts that receive the protections of the Electronic Funds Transfer Act. CFA issued a report on Internet payday lending in 2004 and documented that some high-cost lenders converted debts to demand drafts when consumers exercised their EFTA right to revoke authorization to electronically withdraw money from their bank accounts. CFA brought this to the attention of the Federal Reserve in 2005, 2006 and 2007. No action has been taken to safeguard consumers' bank accounts from unauthorized unsigned checks or conversion of an obligation from an electronic funds transfer to a demand draft to thwart EFTA protections.

E. <u>The Federal Reserve Has Taken No Action to Safeguard Bank Accounts from Internet Payday Lenders</u>

In 2006, consumer groups met with Federal Reserve staff to urge them to take regulatory action to protect consumers whose accounts were being electronically accessed by Internet payday lenders. We joined with other groups in a follow up letter in 2007, urging the Federal Reserve to make the following changes to Regulation E:

- Clarify that remotely created checks are covered by the Electronic Funds Transfer Act.
- Ensure that the debiting of consumers' accounts by internet payday lenders is subject to all the restrictions applicable to preauthorized electronic funds transfers.
- Prohibit multiple attempts to "present" an electronic debit.
- Prohibit the practice of charging consumers a fee to revoke authorization for preauthorized electronic funds transfers.
- Amend the Official Staff Interpretations to clarify that consumers need not be required to inform the payee in order to stop payment on preauthorized electronic transfers.

While FRB staff has been willing to discuss these issues, the FRB has taken no action to safeguard consumers when Internet payday lenders and other questionable creditors evade consumer protections or exploit gaps in the Electronic Funds Transfer Act to mount electronic assaults on consumers' bank accounts.

F. <u>The Banking Agencies Have Failed to Stop Banks From Imposing Unlawful Freezes on Accounts Containing Social Security and Other Funds Exempt from Garnishment</u>

Mr. Chairman, we applaud you for urging federal banking regulators to take action regarding recent reports that national banks are not complying with the Social Security Act's prohibition on the garnishment of Social Security and Veteran's benefits. These federal benefits (as well as state equivalents) are taxpayer dollars targeted to relieve poverty and ensure minimum subsistence income to the nation's workers. Despite the purposes of these benefits, banks routinely freeze bank accounts containing these benefits pursuant to garnishment or attachment orders, and assess expensive fees – especially insufficient fund (NSF) fees – against these accounts.

The number of people who are being harmed by these practices has escalated in recent years, largely due to the increase in the number of recipients whose benefits are electronically deposited into bank accounts. This is the result of the strong federal policy to encourage this in the Electronic Funds Transfer Act. And yet, the banking agencies have failed to issue appropriate guidance to ensure that the millions of federal benefit recipients receive the protections they are entitled to under federal law.

G. <u>The Comptroller of the Currency Permits Banks to Manipulate Payment Order to Extract Maximum Bounced Check and Overdraft Fees, Even When Overdrafts are Permitted</u>

The Comptroller of the Currency permits national banks to rig the order in which debits are processed. This practice increases the number of transactions that trigger an overdrawn account, resulting in higher fee income for banks. When banks began to face challenges in court to the practice of clearing debits according to the size of the debit -- from the largest to the smallest --rather than when the debit occurred or from smallest to largest check, the OCC issued guidelines that allow banks to use this dubious practice.

The OCC issued an Interpretive Letter allowing high-to-low check clearing when banks follow the OCC's considerations in adopting this policy. Those considerations include: the cost incurred by the bank in providing the service; the deterrence of misuse by customers of banking services; the enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and the maintenance of the safety and soundness of the institution.[16] None of the OCC's considerations relate to consumer protection.

The Office of Thrift Supervision (OTS) addressed manipulation of transaction-clearing rules in the Final Guidance on Thrift Overdraft Programs issued in 2005. The OTS, by contrast, advised thrifts that transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees.[17] The Guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies. The Interagency "Best Practices" state: "Clearly explain to consumers that transactions may not be processed in the order in which they occurred, and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumers."[18]

CFA and other national consumer groups wrote to the Comptroller and other federal bank regulators in 2005 regarding the unfair trade practice of banks ordering withdrawals from high-to-low, while at the same time unilaterally permitting overdrafts for a fee. One of the OCC's "considerations" is that the overdraft policy should "deter misuse of bank services." Since banks deliberately program their computers to process withdrawals high-to-low and to permit customers to overdraw at the ATM and Point of Sale, there is no "misuse" to be deterred.

No federal bank regulator took steps to direct banks to change withdrawal order to benefit low-balance consumers or to stop the unfair practice of deliberately causing more transactions to bounce in order to charge high fees.

IV. The OCC's Consumer Assistance Efforts are Weak

A. The Consumer Assistance Group

The OCC's approach to handling consumer complaints against national banks is unfortunately illustrative of the agency's disappointing overall record in consumer protection. The OCC was established to supervise national banks and its primary focus continues to be on maintaining the safe and sound operation of these banks. However, the OCC also has been assigned important consumer protection responsibilities. Most notably, under the Federal Trade Commission Act, the agency is directed to protect consumers from unfair and deceptive practices by national banks. Further, enforcement of other applicable consumer protection, fair lending and community reinvestment laws and regulations is handled through the bank examination process.

Another consumer responsibility is the processing and disposition of consumer complaints against national banks. This function is largely handled through the OCC's Customer Assistance Group (CAG) which operates a single national call center in Houston, Texas. The

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[16] 12 C.F.R. 7.4002(b).
[17] Office of Thrift Supervision, Guidance on Overdraft Protection Programs, February 14, 2005, p. 15.
[18] Dept. of Treasury, Joint Guidance on Overdraft Protection Programs, February 15, 2005, p. 13.

agency's self-described approach to processing consumer complaints is one of a "neutral arbiter." Yet the CAG seems to primarily function as a channel for funneling consumer complaints to national banks. A 2006 U.S. General Accountability Office (GAO) report issued last year found that, as with the other banking regulators, the OCC resolves most of the complaints it receives mostly by providing clarifying information to bank customers.[19] The agency investigates or makes determinations about whether the customer or bank erred less frequently. The GAO report also found that while the OCC receives a greater volume of complaints than other regulators, it lacked a mechanism for gathering consumer feedback on how helpful they were.

CFA and other national consumer groups long have questioned the adequacy of the OCC's complaint system. Our concerns are heightened particularly by the agency's preemption rules that give it exclusive authority for supervising non-bank subsidiaries of national banks. This new authority exponentially increases the number of financial institutions that the OCC's complaint process now has primarily responsibility for handling.

The Houston complaint center historically has been understaffed and, for a time, was only open to the public for limited daily hours four days a week. Criticism from the Chairman and other committee members has prodded the OCC to take some steps aimed at addressing these concerns. For example, several years ago the OCC increased the number of full-time-equivalent CAG staff to fifty, more than doubling its previous staff. However, even this expanded staff still represents less than two percent of the OCC's total workforce of more than 2,800 employees (1,900 of which serve as bank examiners).

The CAG service hours also were increased from 7 to 12 hours a day and we understand that the Houston office now operates a full five-day schedule. (The agency says that the expanded service hours require it to use a third-party vendor to provide initial intake on complaints). Just weeks ago, the OCC finally redesigned the consumer complaint website.

Last year, CFA staff visited the Houston call center. We were impressed with the professionalism of the CAG staff we met that day. Yet we were disappointed to learn that the information collected from consumer complaints are apparently used only at the case-specific level. Agency officials indicated that complaints against specific national banks were sometimes used in developing upcoming compliance exams. However, no concrete examples were provided of instances in which the agency analyzed the overall pattern of complaints against varying institutions and utilized the complaints it received to develop new regulatory guidance or issue new rules for national banks.

In short, the OCC's record is as passive in providing consumer assistance as it is in other areas of consumer enforcement.

B. Consumer Assistance Website

[19] U.S. Accountability Office, "OCC Consumer Assistance: Process is Similar to That of Other Regulators but Could Be Improved by Enhanced Outreach," GAO-06-293 (February 2006).

Just last week, OCC rolled out a new website (http://www.helpwithmybank.gov/) with fanfare, as a tool for consumers with questions or concerns about their bank.[20] Unfortunately, there is less there than meets the eye in both cases. Indeed, a review of the FAQs on the new "Help" site concerning some of the issues that are most problematic for consumers today suggest that it is possible that the site itself may actually discourage consumers from making complaints. For example, on the issue of manipulating payment order of debits to maximize fees, a problem discussed above, here is what the "Help With My Bank" site says:

> **My bank paid my largest check first and then the smaller ones. Doing so created more overdraft fees on my account. Why did the bank pay in this order?**
>
>> You may write your checks in numerical order, but that doesn't mean the bank will post them that way. The same is true with point-of-sale or other electronic transactions: They don't necessarily post in the order in which you made the purchases.
>>
>> When several items come to the bank for clearing, it can choose to debit them from your account in several ways. Many national banks are opting to post the largest dollar items first instead of posting the checks in numerical order. Often the largest check represents payment for rent, mortgage, car payments, or insurance premiums.
>>
>> If your bank adopts this policy throughout its territory, it normally will notify you via your statement.

Another bank practice which increasingly has been attracting attention is the institutions' encouragement of overdrafts to maximize their revenues.[21] Indeed, banks advertise the ability to have overdrafts covered, seducing their customers into taking advantage of that "convenience." Yet here is what the OCC says to the consumer:

> **I wrote a check that was returned because of insufficient funds (NSF) in my account. But the bank never notified me, so other checks bounced and I got hit with several overdraft fees. Shouldn't the bank have sent me a notice?**
>
>> The bank is not required to notify you when a check bounces. You are responsible for keeping a current and accurate check/transaction register. By balancing it with your monthly statement, you will know your account balance and prevent overdrafts.

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[20] " *Comptroller of the Currency Launches Web Site to Help National Bank Customers,*" NR-2007-73 (July 17, 2007), ,http://www.occ.treas.gov/ftp/release/2007-73.htm.

[21] *See, e.g.* Eric Halperin and Peter Smith, *Out of Balance: Consumers Pay $17.5 Billion Per Year in Fees for Abusive Overdraft Loans,"* Center for Responsible Lending (July 11, 2007), http://www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf.

> State laws generally provide that it is illegal to write a check—knowingly or negligently—without having sufficient funds to cover the check *on the day you write it.*

And for consumers who do try to keep their checkbook balanced and up-to-date, in accordance with the OCC's suggestion? Here's the OCC's advice:

> **How can my account be overdrawn when I just made a deposit?**
>
> > Many transactions are processed overnight. These transactions may not be reflected in an available balance.
> >
> > Thus it's important to keep a current and accurate check/transaction register and balance it to your monthly statement. A bank's online, telephone, or ATM balances are for information purposes only—they do *not* replace your check/transaction register.
> >
> > On checking accounts, banks generally post deposits before withdrawals. However, there are no laws requiring national banks to do this. In addition, banks may establish a cutoff time for deposits made at a branch or through an ATM. Deposits made after that time may be treated as having been made on the following business day.
> >
> > For example, a deposit made after the Friday afternoon cutoff time would be treated as if it were made on the following Monday. So any items with next-day availability would then be available the next day (Tuesday).

But can the bank still charge the overdraft fee in that case?

> **Can the bank charge an overdraft fee while there is a deposit pending?**
>
> > Yes. Many transactions are processed overnight. These transactions may not be reflected in an available balance.
> >
> > This is why it's important to keep a current and accurate check/transaction register and balance it to your monthly statement. A bank's online, telephone, or ATM balances are for information purposes only—they do *not* replace your check/transaction register.
> >
> > On checking accounts, banks generally post deposits before withdrawals. However, the law does not require this. In addition, banks may establish a cutoff time for deposits made at a branch or through an ATM. Deposits made after that time may be treated as having been made on the following business day.

> For example, a deposit made after the Friday afternoon cutoff time would be treated as if it were made on the following Monday. So any items with next-day availability would then be available the next day (Tuesday).

A consumer victimized by multiple overdraft fees could be forgiven for taking away this message: "There's no point in complaining, because the bank can do whatever it wants."

Consumers, advocates and state regulators have long noticed that card issuers are either themselves ignorant of, or do not honor, special rights that consumers have when they have a dispute with a merchant over goods or services purchased with a credit card. This right allows consumers to assert the claims and defenses arising out of a credit card purchase of goods or services against the card issuer.[22] The rules for asserting these claims are different than the standard "billing error" rights.[23] We were unable to find any reference at all to this important consumer right in the portion of the "Help With My Bank" section labeled "credit cards dispute."

If, on balance, the overall message of the new website is that there's not much point in filing a complaint, there is also little heart to be taken from the complaint process itself. Apart from the question of whether the resources are adequate, the consumer complaint page on the OCC's website discourages consumers from complaining about situations which, it should be hoped, the OCC would most want to be made aware of: the possibility that a bank was engaging repeatedly in misrepresentations or violations of contractual obligations. Yet the website discourages consumers from do so, instead simply telling them to get a lawyer:[24]

> **When You Need Other Help**
>
> Many complaints stem from factual or contract disputes between the bank and the customer. Only a court of law can resolve those disputes and award damages. If your case involves such a dispute, we will suggest that you consult an attorney for assistance.

Assuming that the consumer does file a complaint, despite all this discouragement, the OCC now explains that it would be illegal for them to tell the consumer if the bank violated the law with respect to the action about which the consumer complained.

> **Can the OCC help me find out if a bank has been cited for a violation of a regulation or law?**
>
> According to Federal law, results of examinations are considered confidential. The OCC cannot release any information relating to any supervisory actions *or regarding whether a violation of law or regulation occurred in connection with your complaint*. [**emphasis added**]

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[22] 15 U.S.C. § 1666i; Reg. Z, § 226.12(c)
[23] 15 U.S.C. § 1666, Reg. Z, § 226.13. For example, there is a 60-day time limit for the consumer to dispute a billing error. There is no flat 60-day time limit for the merchant-related dispute, though there are other restrictions.
[24] http://www.occ.treas.gov/customer.htm#The%20OCC's%20Complaint%20Process.

However, you can look for two kinds of information on our Web site, www.occ.gov:

- whether a bank is in compliance with the Community Reinvestment Act (CRA)
- whether a bank is subject to an enforcement action[25]

It is possible that the OCC's overall discouraging approach to hearing complaints about their banks reflects the poor odds that it would do the consumer any good to make the effort. Results from a GAO study indicate that customer complaints are rarely resolved in the consumer's favor.[26] Overall, the message from the OCC to consumers seems to be, "you're on your own."

V. "Principles-Based" Regulation Leaves Consumers Vulnerable to Lax Enforcement

Some federal regulators have contended that their unwillingness to adopt regulations proscribing specific unfair and deceptive practices that are forbidden in the Federal Trade Commission (FTC) Act and Home Ownership and Equity Protection Act (HOEPA) is actually an advantage for consumers, allowing regulators to nimbly apply broad-based legal requirements on a case-by-case basis. Such case-by-case enforcement based on broad legal principals, they say, makes it more difficult for financial institutions to maintain technical compliance with the letter of the law, while violating its spirit.[27]

In our experience, industry representatives who advocate a principles-based approach to regulation often have weakened consumer protections as their real goal. That certainly appears to be the case in recent calls to adopt a principles-based approach to securities regulation as a way to make our securities markets more competitive internationally. Moreover, in practice, the principles-based approach has been shown to have inherent weaknesses that more than outweigh the purported advantages of streamlined rules and greater regulatory flexibility.

Ideally, under a principles-based approach, regulations clearly define the outcome regulated entities are expected to achieve, and regulators hold them accountable for achieving that outcome. Under such an approach, one could in theory hold a company accountable for filing financial statements that fail to fairly present the company's financial status, or hold a bank accountable for misleading borrowers, for example, without having to prove that any rule was broken. Aggressively implemented, such an approach could in theory provide for effective consumer protection regulation.

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[25] http://www.helpwithmybank.gov/faqs/other_occ_help.html#drop02.

[26] Referring to a 2006 GAO Review of "OCC Consumer Assistance," (GAO-06-293): "What stands out in the 41-page report is that bank regulators rarely stick up for the consumer." Gail Liberman and Alan Lavine, *Regulators RarelyBlame Banks,"* MarketWatch, (April 3, 2006), http://www.marketwatch.com/

[27] "To be effective, rules must have broad enough coverage to encompass a wide variety of circumstances so that they are not easily circumvented. At the same time, rules with broad prohibitions could limit consumers' financing options in legitimate cases that do not meet the required legal standard. That has led the Federal Reserve to focus primarily on addressing potentially unfair or deceptive practices by using its supervisory powers on a case-by-case basis rather than through rulemaking." Statement of Randall S. Kroszner, Member, Board of Governors of the Federal Reserve System before the Committee on Financial Services, U.S. House of Representatives, June 13, 2007.

There are several problems with this approach, however. One is that it relies on regulators to be far more aggressive in holding companies accountable than the banking regulators have shown themselves to be. A second problem is that it moves decisions about what constitutes non-compliant behavior out of the relatively transparent public rulemaking process into backroom negotiations between the regulator and the regulated entity. Observation of the United Kingdom's experiment with principles-based regulation suggests that the likely result of making decisions about the enforcement of regulatory policy behind closed doors will be lax enforcement.

If, on the contrary, regulators were to attempt to adopt a tough approach to enforcement under a principles-based regulatory regime, the lack of clarity in the principles-based approach is likely to result in a large number of disputes between the regulator and regulated entities. In such cases, the task of interpreting regulations may ultimately fall to the courts. That has the disadvantage of being both costly and time-consuming, and of removing decisions about the best approach to regulation from the expert regulators.

The recent forays into principles-based regulation in the securities area suggests another potential problem – the lack of principle in principles-based regulation. Both the recently revised management guidance on Section 404 of the Sarbanes-Oxley Act, and the revised audit standard for internal controls audit, have been touted as adopting a principles-based approach to regulation. However, neither the management guidance nor the proposed audit standard is founded on clearly articulated principles that managers and auditors could be held accountable for achieving. Instead, they spend a great deal of time explaining what managers and auditors will not be held accountable for failing to do. If this is an example of what we can expect of principles-based financial services regulation, our skepticism regarding this approach seems more than justified.

Finally, those who call for principles-based regulation typically ignore both the degree to which our rules-based system is founded on strong underlying principles and the degree to which principles-based systems must rely on "guidance" to provide clarity that the principles alone cannot convey. Ironically, the same parties who have advocated a more principles-based approach to securities regulation have also argued for greater clarity in two areas where a principles-based approach has been adopted – the definitions of materiality and scienter. This further illustrates what we found to be the case – that the support for principles-based regulation tends to be more theoretical than real, and that the last thing most regulated entities want is a regulatory system that defines general consumer protection principles and holds them accountable when they fail to achieve them.

VI. Identifying the Underlying Causes of Federal Regulatory Failures

It would be easy to blame the federal regulatory failures in the credit practices arena solely on the lack of legal or enforcement authority for federal banking agencies, but this would not be true. Although our groups do recommend that Congress enact new consumer protection laws, especially regarding credit card abuses, and that it increase the legal jurisdiction granted to the FTC in the credit arena, underlying problems that have caused poor federal enforcement will not be solved simply by giving new authority to the same banking agencies.

Most of the regulatory failures cited above are in areas where federal regulators have existing authority to act, and have chosen not to do so. Simply increasing the authority of the agencies to write or enforce rules, or to offer a unified complaint hotline, will not change the culture in some agencies that has caused them to ignore festering problems in the credit arena or to reject adequate consumer protection measures. In fact, by raising expectations of reform and then not following through, such changes could actually be harmful by impeding meaningful reform. In order to fashion effective federal remedies consistent with the above consumer protection standards, the underlying problems with the regulatory culture at the federal banking agencies must also be addressed. These problems include:

1. **An overwhelming focus on safety and soundness regulation, often to the exclusion of consumer protection**. All four of the primary banking regulatory agencies examine and supervise banks.[28] A major focus of this supervision is the financial safety and soundness of the institutions. These agencies are also charged with enforcing consumer protection laws that affect the institutions they supervise, but in many cases do not appear to make consumer protection a significant budget or strategic priority.[29] The obvious problem with vesting both safety and soundness and consumer protection with a single agency is that the agency might well view the two goals as in conflict or place too high a priority on safety and soundness enforcement.[30] As illustrated above regarding the FRB's inaction on bounce loans, an agency focused almost exclusively on what is financially beneficial for banks would likely view a restriction on bank loan income as a threat to the bank's financial stability, even if the practice in question is financially harmful to consumers.

2. **Significant funding from industry sources represents a major conflict-of-interest**. None of the banking agencies receive appropriated funds from Congress. The OCC and OTS receive virtually all of their income from direct assessments on the institutions they supervise. The FDIC is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in Treasury securities. The Federal Reserve System receives the greatest portion of its income from interest earned on government securities, but it does receive substantial income from what it calls "priced

[28] The OCC and OTC charter and supervise national banks, and thrifts, respectively. State chartered banks can choose whether to join and be examined and supervised by either the Federal Reserve System or the Federal Deposit Insurance Corporation (FDIC). The FTC is charged with regulating some financial practices in the non-bank sector, such as credit cards offered by department stores and other retailer.

[29] The OTS, for example, cites consumer protection as part of its "mission statement" and "strategic goals and vision." However, in identifying its eight "strategic priorities" for how it will spend its budget in Fiscal Year 2007, only part of one of these priorities appears to be directly related to consumer protection ("data breaches"). On the other hand, OTS identifies both "Regulatory Burden Reduction" and "Promotion of the Thrift Charter" as major strategic budget priorities. Office of Thrift Supervision, "OMB FY2007 Budget and Performance Plan," January 2007.

[30] Safety and soundness concerns at times can lead to consumer protection, as in the eventually successful efforts by federal banking agencies to prohibit "rent-a-charter" payday lending, in which payday loan companies partnered with national or out-of-state banks in an effort to skirt restrictive state laws. However, from a consumer protection point-of-view, this multi-year process took far too long. Moreover, the outcome could have been different if the agencies had concluded that payday lending would be profitable for banks and thus contribute to their soundness.

services to depository institutions," bank examinations, inspections and risk assessments of bank holding companies.[31]

Given that it supervises the largest financial institutions in the country, the OCC's funding situation is the most troublesome. (See Appendix C for more information on the OCC's funding, conflicts-of-interest and regulatory failures.) As highlighted above, the OCC has not initiated a public enforcement order against any of the eight largest national banks for violating consumer credit laws since early 1995. As Professor Arthur Wilmarth said in his testimony before the Financial Institutions and Consumer Credit Subcommittee:

> More than 95% of the OCC's budget is financed by assessments paid by national banks, and the twenty biggest national banks account for nearly three-fifths of those assessments. Large, multi-state banks were among the most outspoken supporters of the OCC's preemption regulations and were widely viewed as the primary beneficiaries of those rules. In addition to its preemption regulations, the OCC has frequently filed amicus briefs in federal court cases to support the efforts of national banks to obtain court decisions preempting state laws. The OCC's effort to attract large, multi-state banks to the national system have already paid handsome dividends to the agency….Thus, the OCC has a powerful financial interest in pleasing its largest regulated constituents, and the OCC therefore faces a clear conflict of interest whenever it considers the possibility of taking an enforcement action against a major national bank.[32]

3. **Regulatory balkanization leads to downward pressure on consumer protections, often resulting in "lowest common denominator" regulation. On the other hand, when agencies do collaborate to raise standards, the process can take so long as to make eventual regulatory action far less helpful for consumers.** The present regulatory system for credit practices is institution-centered, rather than consumer-centered. It is structured according to increasingly irrelevant distinctions between the type of institution that is lending money, rather than the type of product being offered to consumers. Agency charter "shopping" is not a viable option in most cases for national banks, but it can be for thrifts and for state chartered banks, which can and do choose between supervision by the Federal Reserve system and the FDIC[33] and, as explained above, between a state and national charter. Regulators often appear to be more concerned that the requirements they place on the institutions they regulate – even if highly justified for consumer protection purposes – might be viewed by these institutions as a "regulatory burden." All of the banking agencies cite "reducing regulatory burden" as a priority and often appear to compete to do so, even if it means that important protections are reduced.

[31] In 2006, this income was $909 million. "Federal Reserve Release," January 9, 2007. This amount was about one-third of the just under $3 billion in operating costs for the entire Federal Reserve System. Board of Governors of the Federal Reserve System, "Annual Report: Budget Review," April 2007.
[32] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, April 26, 2007.
[33] For example, the First Bank of Delaware dropped its Federal Reserve member bank status and switched to supervision by the FDIC to continue its rent-a-bank payday lending operation.

When agencies do collaborate to apply consumer protections consistently to the institutions they regulate, the process can be staggeringly slow. For example, as credit card debt loads began to increase for Americans in the mid and late 1990s, consumer organizations and credit experts began to issue serious warnings that the lower minimum payment amounts that all credit card issuers were offering their cardholders were contributing to the sharp increase in the number of consumer bankruptcies.34 It wasn't until January 2003 that regulators issued guidance recommending that credit card lenders increase the size of the minimum payment amounts so that consumers would "amortize the current balance over a reasonable period of time," noting that prolonged negative amortization would be subject to bank examiner criticism.35 Issuers were not required to fully phase in the changes until the end of 2006, close to a decade after initial concerns were raised. Another obvious example of a sluggish regulatory process that has harmed consumers is the federal delay in issuing regulations to deal with the serious and well-publicized problems in the sub-prime mortgage lending market.

4. **An undue focus on bank examination instead of enforcement, which lacks transparency and effectiveness.** Bank regulators have said repeatedly to this Committee and others that the process of supervision and examination results in a superior level of consumer protection to taking enforcement action against institutions that violate laws or rules. For example, Comptroller of the Currency John Dugan told this Committee on June 13th that "…ours is not an 'enforcement-only' compliance regime – far better to describe our approach as "'supervision first, enforcement if necessary,' with supervision addressing so many early problems that enforcement is not necessary."[36] Given the widespread consumer abuses in the credit card market documented above and the OCC's ineffectual regulation of national banks like Providian that committed these abuses, this claim is simply not supported by the facts.

   There is another serious problem with relying almost exclusively on the examination process to require national banks to comply with laws and regulations: the process is highly discretionary and not open to public view.

   > Findings made during compliance examinations are strictly confidential and are not made available to the public except at the OCC's discretion. Similarly, the OCC is not required to publish the results of its safety-and-soundness orders….Thus, the OCC's procedures for compliance examinations and safety-and-soundness orders do not appear to provide any public notice or other recourse to consumers who have been injured by violations identified by the OCC.[37]

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[34] Day, Kathleen and Caroline E. Mayer, "Credit Card Penalties, Fees Bury Debtors," *Washington Post*, March 6, 2005.
[35] Joint Press release of Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Office of Thrift Supervision, "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," January 8, 2003, see attached "account Management and Loss Allowance Guidance" at 3.
[36] Testimony of John C. Dugan, Comptroller of the Currency, Before the Committee on Financial Services of the U.S. House of Representatives," June 13, 2007.
[37] Testimony of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School, April 26, 2007.

At best, these factors combine to create a culture of coziness with regulated institutions at many of the agencies. At worst, as in the case of the OCC, they appear to have led to regulatory capture.

VII. Recommendations

All of our recommendations are directed at creating a more independent enforcement and regulatory process that is more focused on consumer protection. Unless the underlying causes of federal regulatory failures are addressed to achieve greater independence from regulated institutions and to grant more power to consumers to enforce the law, protections for consumers will not improve. Greater regulatory independence will also mean that some of the meritorious ideas that the Committee has been considering that are not mentioned below, such as a "one stop shopping" process for consumer complaints, will be implemented in an effective manner.

1. **Restore the Ability of the States to Protect Consumers in the Credit Arena.** As it stands now, OCC rules prevent enforcement of many state consumer protections against national banks and their subsidiaries. Banks even maintain that these stronger state laws are preempted when they are based on Congressional statutes that specifically permit states to provide protections beyond those in the federal law. The OCC rules also preempt the performance of essential functions of state officials to protect state citizens and defy over a century of jurisprudence holding that state officers can enforce a broad set of laws against national banks. Historically, these protective actions have covered both the individual bad acts of national banks, as well as bank policies that are deemed to be unfair or deceptive to consumers.

   This is why national consumer organizations favor the approach taken by "The Preservation of Federalism in Banking Act" (H.R. 1996) introduced earlier this year by Representative Luis Gutierrez. We have previously supported legislation along these lines offered by the by the Chairman and Mr. Gutierrez in the last Congress and believe that this bill is particularly necessary and relevant in light of the Watters decision.

   H.R. 1996 establishes much needed standards governing the relationship between state consumer authority and the operation of national banks and their subsidiaries. The bill also covers federal thrifts, as the Office of Thrift Supervision has from time-to-time sought to broaden the scope of federal preemption to new entities, such as independent third party agents of thrifts.

   H.R. 1996 directs federal regulators to distinguish between preempted state laws affecting the business of banking and the powers of national banks and thrifts, as well as permissible state laws of general applicability protecting consumers. The bill also prevents federal preemption from diminishing the ability of states to protect their consumers from fraudulent, deceptive and predatory banking practices. Frequently, no corresponding federal protections exist when the OCC preempts state laws, and thus consumers are deprived of protections currently available to them. Other key provisions in the bill would clarify the visitorial rights of state officials seeking to enforce applicable federal or state laws and reinstate state authority over non-bank operating subsidiaries.

Finally, the bill makes clear that the National Bank Act is not intended to bar a state's ability to enact stronger laws regulating national banks when those laws are based on clear Congressional intent of other federal laws to serve as a floor and not a ceiling for consumer protections.

We urge the committee to hold hearings on this legislation.

2. **Enact legislation to establish high consumer protection standards for credit card, bank overdraft and mortgage loans.** Take legislative action to protect consumers where bank regulators have failed to do so, such as the FRB's unwillingness to apply TILA protections to overdraft loans. We urge Congress to adopt legislation introduced by Representative Maloney (H.R. 946) that would require that consumers who receive overdraft loans benefit from the same protections under TILA as they would for other loans. (See also the attached credit card reform platform in Appendix A and the principles for enacting mortgage lending reforms in Appendix B.)

3. **Authorize the Federal Trade Commission to bring enforcement actions against national banks and thrifts for unfair and deceptive practices. Give the FTC concurrent and independent rulemaking authority over national banks and thrifts for all matters covered by the FTC Act.** Unlike the banking agencies, the FTC has no responsibility to protect the profitability of financial institutions. Its sole job is, or should be, to protect consumers from the unlawful and deceptive practices prohibited by the FTC Act. And yet, the FTC Act deprives the FTC of the essential authority over regulated institutions. The FTC has extensive experience dealing with unfair and deceptive practices by non-bank entities. In light of the failure of the FRB to use its authority under the FTC Act, the FTC should be given concurrent authority both to bring enforcement actions and to engage in rulemaking. This authority would be consistent with the independent authority that state attorneys general have regarding state chartered banks in some states. This is not to say that giving authority to the FTC will be a perfect solution. The FTC's record in recent years with respect to non-bank entities is less than perfect, and Congress may need to make clear to the FTC that it will gain this authority only if it commits to using it in an appropriate fashion. However, the FTC lacks the inherent conflict of interest that paralyzes some of the banking agencies, and it is appropriate for the agency to have full authority under the FTC Act over all entities that engage in unfair and deceptive practices.

4. **Grant states concurrent enforcement authority against national banks and thrifts under federal lending laws and for unfair and deceptive practices under the FTC Act.** This approach will help put state enforcement officials, including banking regulators, back "on the beat." The model for this approach would be the concurrent enforcement authority granted to states under such federal laws as the Telemarketing Sales Act[38] and the Credit Repair Organizations Act.[39] This approach would lead to more vigorous enforcement, and in particular would foster attention to emerging problems that

[38] 15 U.S.C. § 6103 (giving state Attorneys General concurrent authority with FTC to enforce Telemarketing Sales Rule, 12 C.F.R. § 310).
[39] 15 U.S.C. § 1679h (giving state Attorneys General and FTC concurrent enforcement authority).

have not yet become national in scope.

5. **Provide consumers with a private right-of-action under the FTC Act.** At present, the essential protection in the FTC Act against unfair and deceptive practices is not privately enforceable. Yet, individuals are obviously in the best position to invoke the Act in response to individual violations. Even strong federal agency enforcement against widespread abuses would not help consumers who confront individual abuses. Although most states have parallel protections, in many states consumers cannot bring claims under the state deceptive practices statute against banks or other financial institutions. In some states, the deceptive practices statute explicitly excludes these entities. In other states, courts have interpreted the statute to exclude them (often construing an exemption for "regulated practices" to exclude any activity by a regulated financial institution, not just specific practices authorized by banking regulations). Another weakness of state deceptive practices laws is that many prohibit only deceptive practices, not unfair practices, or define the prohibited practices very narrowly.[40] As a result, in many states consumers have very limited remedies for unfair or deceptive practices by financial institutions. Public enforcement does not fill this gap. Even if state Attorneys General and the FTC were granted enforcement authority, their resources are limited and they have to concentrate on cases with broad impact, rather than on obtaining justice for individual consumers.

6. **Reduce conflicts-of-interest between regulators and regulated institutions. Consider requiring federal banking agencies to pool funds collected for supervision, examination and consumer protection.** We would urge the Committee to consider establishing an independent, inter-agency process that receives input from consumer representatives, to distribute the funds to banking agencies based on need.

7. **Require agencies to conduct periodic reviews of the effectiveness of consumer protection rules and enforcement efforts.** Federal agencies must meet statutory requirements regarding the reduction of regulatory burdens and "paperwork" on regulated industries, but no such requirement exists for consumer protection. We urge the Committee to enact legislation that would require banking regulators to regularly investigate key emerging consumer issues and concerns and to make recommendations to Congress regarding changes in supervision, regulation and law that should be made. The agencies should be required to consult consumer representatives, state regulators, Attorneys General as part of this review.

8. **Evaluate industry proposals for "principles-based" regulation with great Skepticism.** All regulations should be founded on strong underlying principles, but we urge you to skeptically view calls by representatives of the financial services industry for principles-based regulation. There is overwhelming evidence that many consumers have been harmed by unfair and deceptive practices in a number of credit markets. As stated above, the OCC and FRB appear to have taken what is essentially a "principles based"

[40] In addition, federally-regulated financial institutions are increasingly claiming that state deceptive practices statutes are preempted by federal law (although many courts have rejected this argument).

approach in protecting consumers for a number of years. It stretches the bounds of credulity to claim this approach has been effective for financial services consumers.

APPENDIX A

<u>ACORN * Center for Consumer Finances * Consumer Action * Consumers Union</u>
Consumer Federation of America * Demos * National Association of Consumer Advocates *
National Consumer Law Center • U.S. PIRG

Joint Recommendations of Consumer Groups on the Eve of the Jan. 25, 2007 U.S. Senate Banking Committee Oversight Hearing on Unfair Credit Card Practices

<u>Eliminate reckless and abusive lending by credit card companies</u>

No unsound loans. Make issuers offer credit the old fashioned way, using sound underwriting principles based on the ability of consumers to pay and that ensure the cardholder is not overextending financially by taking on more debt.

Restrict lending to youth without conditions. Young people deserve credit, but only if they qualify. Yet right now, young people are the only group that can obtain a credit card without either a positive credit report, a job, or other evidence of ability to pay, or, barring any of these, a co-signer. No other adult can get a credit card without meeting at least one of these conditions. Young people should have the same safeguards.

No abuse of consumers in bankruptcy. Credit card issuers drive consumers into bankruptcy with abusive terms and collection practices. Stop issuers from collecting on these abusive loans in bankruptcy.

<u>End deceptive and unjust terms, interest rates and fees</u>

Ban retroactive rate increases. Stop issuers from changing the rules in the middle of the game by raising interest rates on past purchases.

No unilateral adverse changes in terms for no reason. Credit card company contracts currently claim the right to change terms for any reason, including no reason. Any change in terms during the course of the contract should require knowing affirmative consumer consent and reasonable notice.

Ban universal default in all its forms. Prohibit punitive "universal default" interest rates based on alleged missteps with another issuer but involving no missed payments to the credit card company itself. It is unfair to impose a penalty rate on a consumer who has not made a late payment to that creditor. Stop card companies from using a change in terms clause to impose penalty rates.

Stop late fees for payments mailed on time. Require credit card companies to follow the Internal Revenue Service (IRS) and accept the postmarked date as proof of on-time payments. This will also eliminate the tawdry practice of assessing late payment fees when payment is received on the due date, because it did not arrive by a specific time (such as 11 a.m.).

Relate fees to cost. Ensure that all fees and other charges closely match the true cost borne by the card issuer.

End roll-over or repeat late and over-limit fees. Ban fees that are charged in consecutive months based on a previous late or over the limit transaction, not on a new or additional transaction offense, even if the consumer remains over the previous limit.

No fees for creditor-approved transactions. Don't let the credit card company charge a fee for a transaction it has approved. Ban over-limit fees when the issuer approves the over-limit transaction.

Empower consumers with more detailed information.

Ban deceptive credit card offers. Solicitations and "invitation to apply" solicitations that do not make a truly firm offer of credit are deceptive because they lead consumers to believe that they are pre-approved for or have a good chance of getting certain interest rates. Most consumers instead receive cards at much less favorable interest rates and terms.

Simplify pricing. Reduce the number and types of fees so consumers can compare cards and understand the real cost of using the card.

Real minimum payment warning. Give each consumer a personalized warning on his or her monthly statement calculating the length of time—in months and years—and the total interest costs that will accrue, if the consumer makes only the requested minimum payment.

Ban unfair teasers. Stop issuers from downplaying permanent interest rates in advertisements and solicitations and from trumpeting temporary rates as "fixed rates."

Enhance 'Schumer Box' disclosures. Include a "Schumer box" disclosure table in all cardholder agreements containing personalized information about the terms of the card granted. The box should include the APR, the credit limit, and the amount of all fees, such as late charges, cash advance fees, over limit fees and any other applicable miscellaneous fees.

Give consumers strong protections to deter illegal acts

Ban pre-dispute binding mandatory arbitration. No consumer should be forced to waive his or her right to a court trial as a condition of using a credit card. Prohibit binding mandatory arbitration for consumers' claims *and* for collection actions against consumers.

Toughen Truth In Lending Act (TILA) penalties. TILA penalties have stagnated since 1968.

Give aggrieved consumers a private right of action to enforce the Federal Trade Commission Act to challenge unfair or deceptive practices by businesses, including banks.

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February 6, 2007

APPENDIX B

The Honorable Barney Frank
Chairman
House Financial Services Committee

The Honorable Spencer Bachus
Ranking Member
House Financial Services Committee

The Honorable Chris Dodd
Chairman
Senate Banking Committee

The Honorable Richard Shelby
Ranking Member
Senate Banking Committee

Dear Chairman Dodd, Chairman Frank, Ranking Member Shelby, and Ranking Member Bachus:

Homeownership is the most accessible tool available to help families achieve a secure economic future, but today market failures and abusive lending practices are stripping the benefits of homeownership from millions of families **throughout the mortgage market.** The epidemic of home losses on subprime mortgages—as many as one in five— is a wake-up call, providing strong evidence that the current system of mortgage regulation is seriously flawed. To preserve homeownership for American families, we need real, systemic change embodied in policies that protect the **sustainability of homeownership**. Below, we outline a policy framework that would drive effective solutions to preserve the traditional benefits of owning a home. Our views represent those of many consumer, civil rights, and community groups, as well as a number of responsible mortgage lenders.

As Congress begins a new session, we respectfully ask that any new anti-predatory lending legislation be based on the following principles:

- **Restore sensible underwriting and eliminate unsustainable loans;**
- **Eliminate incentives for lenders to steer borrowers to abusive loans;**
- **Require accurate and accountable loan servicing;**
- **Ensure effective rights and remedies for families caught in predatory loans;**
- **Preserve essential federal and state consumer safeguards; and**
- **Reduce foreclosures through assistance to distressed borrowers.**

S**ustainable loans.** <u>Many lenders have abandoned careful lending standards to make loans that borrowers cannot repay without refinancing or selling their home</u>. As a result of this weak underwriting, an increasing number of homeowners are unable to keep up with their mortgage payments. High-risk adjustable rate mortgages (ARMs), which are underwritten to a low teaser payment instead of to the fully indexed rate, are an example of this problem. Studies show that today's subprime mortgages typically include features that increase the chance of foreclosure *regardless of the borrower's credit.* This has caused many families to default on unnecessarily risky loans and lose their homes. Other families are forced to refinance and pay associated fees or sell their home. *Responsible lending demands a realistic analysis of the borrower's ability to repay the loan based on all its terms*.

Incentives for fair loans. <u>The subprime market now rewards lenders and brokers who charge borrowers excessive points and fees or channel them toward riskier loan products</u>. Unknown to most borrowers, brokers receive payments known as "yield spread premiums" for selling loans at a higher interest rate than the lender requires. Most subprime mortgages also include prepayment penalties, which can cost families thousands of dollars when they refinance or pay off their loans early. Too often the borrower does not receive a lower interest rate in exchange for the prepayment penalty. In the inefficient subprime market, prepayment penalties are simply another method of stripping home equity or trapping borrowers in costly loans. These fees are only appropriate when they are in exchange for a real benefit to the borrower. A law to sustain homeownership must prohibit brokers and lenders from steering borrowers into mortgages with excessive costs.

Accountable loan servicing. <u>Companies that collect payments on mortgages—loan servicers—have tremendous influence on the success of the loan</u>. Servicer errors and unfair practices in recent years have contributed to the recent surge in foreclosures. Problems typically arise when loan servicers impose costly and unnecessary hazard insurance or delay crediting mortgage payments so that they can charge costly late fees to the homeowner. As it stands now, mortgage servicers have incentives to profit from loan defaults. In a healthy and truly competitive market, loan servicers would charge reasonable fees and support homeowners' efforts to avoid foreclosure.

Basic rights and remedies. <u>Victims of abusive lending practices have very little recourse because industry often uses its market power to limit homeowners' access to justice</u>. To be effective, consumer protection laws must: (1) give families a private right of action, the right to pursue class actions, and defenses against collection and foreclosure, which are often the only effective way to deter bad actors; (2) contain strong remedies and penalties for abusive acts; (3) provide effective assignee liability so that borrowers can pursue legitimate claims even when the originator has sold their loan; and (4) prohibit mandatory arbitration clauses that weaken victims' legal rights and deny them access to seeking justice in a court of law. Without these fundamental procedural protections, other consumer protection rules are unenforceable.

Preserve and advance existing protections. Current laws contain certain essential consumer protections designed to address some of the egregious practices in the mortgage industry, and these protections must be preserved. In particular, the majority of states have passed laws that have been highly effective in curbing abusive lending practices without hampering borrowers' access to credit. Any new law must build on these protections, bearing in mind that real estate markets vary significantly in different locations, and that states are in the strongest position to address new lending abuses that evolve over time. Legislative solutions must also preserve protections for families outside the mainstream real estate market—for example, those who use alternative ownership options such as mobile and manufactured housing and seller-driven financing; are credit impaired; have limited or no credit histories; have limited English skills; or are located in high-poverty areas.

Reduce skyrocketing foreclosures. Any new law should preserve the benefits of homeownership by assisting homeowners already in distress. Recent research shows that as many as one out of five subprime mortgages made in recent years will end in foreclosure. In addition to strengthening the market to benefit future borrowers, legislation should address the increasing numbers of existing homeowners who risk losing their home. Federal legislation could build on successful state models to provide affordable homeownership preservation loans to borrowers who are in default due to circumstances beyond their control.

* * * * *

We welcome legislation that, based on the principles outlined above, contains effective solutions to current problems and allows rapid responses to emerging abuses. We look forward to working with you on the critical issue of preserving the benefits of homeownership, and we thank you for your time and consideration.

Sincerely,

AARP
AFL-CIO
American Council on Consumer Awareness
Association of Community Organizations for Reform Now (ACORN)
Center For Responsible Lending
Coalition of Community Development Financial Institutions
Consumer Action
Consumer Federation of America
Consumer Union
International Union, United Auto Workers
Leadership Conference on Civil Rights
NAACP (National Association For The Advancement of Colored People)
NAACP Legal Defense & Educational Fund, Inc.
National Association of Consumer Advocates
National Consumer Law Center (on behalf of its low-income clients)
National Council of La Raza
National Fair Housing Alliance
National Lawyers' Committee for Civil Rights Under Law
National People's Action
National Training and Information Center
Rainbow/ PUSH
U.S. Public Interest Research Group
Affordable Housing Education and Development, Inc. (NH)
Alaska Public Interest Research Group
Alexandria Affordable Housing Corporation (LA)

Allen Neighborhood Center (MI)
American Community Partnerships (DC)
American Friends Service Committee NH Program (NH)
Arizona Consumers Council
Arizona PIRG
Birmingham Business Resource Center (AL)
Border Fair Housing & Economic Justice Center (TX)
Cabrillo Economic Development Corp. (CA)
California Reinvestment Coalition
Cambridge Consumers' Council
CATCH Neighborhood Housing (NH)
Ceiba Housing and Economic Development Corp. (Puerto Rico)
Center for Consumer Affairs (WI)
Center for Social Concerns, University of Notre Dame
Champaign County Health Care Consumers (IL)
Cherokee Nation (OK)
Chicago Consumer Coalition
Cincinnati Change (OH)
Civil Justice, Inc
Coastal Enterprises, Inc. (ME)
Codman Square Neighborhood Development Corp. (MA)
Colorado Rural Housing Development Corporation (CA)
Columbia Consumer Education Council (SC)
Community Development Corporation of Long Island, Inc. (NY)
Community Enterprise Investments, Inc. (FL)
Community Frameworks (WA)
Community Housing Development Corporation of North Richmond
Community Housing Partners Corporation (VA)
Community Law Center
Community Law Center, Inc. (MD)
Community Neighborhood Housing Services, Inc. (MN)
Community Reinvestment Association of North Carolina (NC)
Consumer Federation of California
Consumer Federation of Southeast
Corporation for Enterprise Development (DC)
Cuyahoga County Foreclosure Prevention Program
Dayton Community Reinvestment Coalition (OH)
Delaware Community Reinvestment Action Council, Inc. (DE)
Department of Sociology and Anthropology, IU South Bend
Detroit Alliance for Fair Banking (MI)
Durham Community Land Trustees (NC)
East Akron Neighborhood Development Corporation Inc. (OH)
East Side Organizing Project - Cleveland, OH
Empire Justice Center
Enterprise Corporation of the Delta/HOPE (MS)
Ethical Lending Foundation

Fair Housing Council of the San Fernando Valley Housing Research & Advocacy Center (Cleveland)
Fort Berthold Housing Authority (ND)
Foundation Communities (TX)
Frontier Housing, Inc. (KY)
Greater Rochester Community Reinvestment Coalition (NY)
Hamilton County Community Reinvestment Group (OH)
Hawaiian Community Assets (HI)
HEED (MS)
Hipanic Leadership Coalition of St. Joseph County
Home Management Resources
Homeward, Inc. (IA)
Housing Action Illinois
Housing and Credit Counseling, Inc(KS)
Housing Assistance Program of Essex County, Inc. (NY)
Housing Education Program (CA)
Housing Opportunities Made Equal of Virginia, Inc.
Housing Partnership of Northeast Florida, Inc. (FL)
Indiana Association for Community Economic Development (IN)
Inglewood Neighborhood Housing Services, Inc. (CA)
Interfaith Housing Center of the Northern Suburbs - Chicago, IL
Iowa Citizens for Community Improvement
Jacksonville Area Legal Aid, Inc.
Jewish Community Action (MN)
Joseph Corporation of Illinois, Inc. (IL)
Justine Petersen Housing & Reinvestment Corporation (MO)
Kensington-Bailey Neighborhood Housing Services, Inc. (NY)
Knox Housing Partnership, Inc. (TN)
LaCasa of Goshen, Inc. (IN)
Latino Leadership, Inc. (FL)
Lawyers' Committee For Civil Rights Under Law of the Boston Bar Association (MA)
Lighthouse Community Development - Pontiac, MI
Long Island Housing Services, Inc. (NY)
Louisiana CRA Coalition (LA)
Madison Park Development Corporation (MA)
Manna, Inc. (DC)
Mass Consumers' Coalition
MassPIRG
Metropolitan Housing Coalition (KY)
Metropolitan Milwaukee Fair Housing Council (WI)
Metropolitan St. Louis Equal Housing Opportunity Council (MO)
Miami-Dade Neighborhood Housing Services, Inc. (FL)
Michigan Community Reinvestment Coalition (MI)
Micronesia Self-Help Housing Corporation
Mission Economic Development Agency (MEDA)
Monmouth County Fair Housing Board (NJ)

Montgomery Housing Partnership (MD)
Mountain State Justice, Charleston, WV
National Association of Community Economic Development Associations (MD)
National Community Reinvestment Coalition
National NeighborWorks Association (DC)
Native American Health Coalition (TX)
Navajo Housing Authority (AZ)
Nehemiah Community Reinvestment Fund, Inc. (CA)
Neighborhood Housing Partnership of Greater Springfield, Inc. (OH)
Neighborhood Housing Services of Baltimore, Inc. (MD)
Neighborhood Housing Services of Greater Cleveland, Inc. (OH)
Neighborhood Housing Services of Kansas City, Inc. (MO)
Neighborhood Housing Services of New Haven, Inc. (CT)
Neighborhood Housing Services of Oklahoma City, Inc. (OK)
Neighborhood Housing Services of the Black Hills, Inc. (SD)
Neighborhood Housing Services of the Lehigh Valley, Inc. (PA)
Neighborhood Housing Services, Inc. (PA)
Neighborhood Nonprofit Housing Corporation
Neighborhood Renewal Services of Saginaw, Inc. (MI)
NeighborWorks Columbus (GA)
NeighborWorks Rochester (NY)
New Directions Housing Corporation (KY)
New Jersey Citizen Action (NJ)
NHS of Chicago (IL)
Northeast South Dakota Community Action Program
Northeast South Dakota Economic Corporation
Northwest Indiana Community Reinvestment Alliance (IN)
North West Side Housing Center - Chicago, IL
Norwalk (Connecticut) Fair Housing (CT)
Notre Dame Legal Aid
Nuestra Comunidad Development Corp. (MA)
Opportunity Finance Network
Oregon Consumer League
Piedmont Housing Alliance
Pittsburgh Community Reinvestment Group (PA)
PPEP MicroBusiness and Housing Development Corporation
PPEP Microbusiness and Housing Development Corporation, Inc. (AZ)
Project Change Fair Lending Center (NM)
Reservoir Hill Improvement Council
Resurrection Project - Chicago, IL
Rural Opportunities, Inc. (NY)
Salisbury Neighborhood Housing Services, Inc. (MD)
Sargent Shriver National Center on Poverty Law (IL)
Scott County Housing Council (IA)
Scranton Neighborhood Housing Services, Inc. (PA)
Seedco

Self-Help Enterprises (CA)
Shorebank
Shorebank Enterprise Pacific
Siouxland Economic Development Cooperation
SJF Ventures
South Austin Coalition Community Council - Chicago, IL
South Bend Center for the Homeless
Southeast Community Development Corporation
Southern Good Faith Fund (AR)
Southwest Fair Housing Council (AZ)
St. Joseph Valley Project
St. Lawrence County Housing Council, Inc.
Tlingit-Haida Regional Housing Authority (AK)
Tri-County Housing & Community Development Corporation (CO)
Unidos Para La Gente (TX)
United Keetoowah Band of Cherokee Indians (OK)
United Neighborhood Centers of Northeastern Pennsylvania (PA)
United South Broadway Corporation (NM)
Utica Neighborhood Housing Services, Inc. (NY)
Village Capital Corporation
Virginia Citizens Consumer Council
Virginia Poverty Law Center
West Elmwood Housing Development Corp. (RI)
Westchester Residential Opportunities, Inc. (NY)
Western Massachusetts Enterprise Fund
Wisconsin Consumers League
Working Together for Jobs (NJ)

APPENDIX C

THE OCC'S UNAUTHORIZED PREEMPTION THREATENS CONSUMERS AND FEDERALISM

Issue: For approximately a decade, the Office of the Comptroller of the Currency, a division of the Department of the Treasury, has systematically worked to undermine states' efforts to protect their consumers through measures such as state anti-predatory lending laws. This effort culminated in a cluster of rules issued in 2004 that, in effect, allow the OCC to determine what state law applies to national banks and prohibit state attorneys general or state financial regulators from enforcing any remaining applicable state law.[41] The practical effect of these OCC actions has been to deprive banking customers of basic marketplace protections provided by state law and enforcement actions by state agencies.

The OCC states that its purpose in charting this radical new course is uniformity. In the area of consumer protection, however, Congress has consistently stressed the rights of states to enact greater protections for their citizens. A decision to abolish state consumer protections in the name of banking uniformity should not be made by agency mandate. This is particularly true in the OCC's case because of the inherent conflict between its promotion of federal bank charters (and thus increased OCC funding) and the needs of its banking customers.

A challenge to a 2001 OCC rule that permits operating subsidiaries of national banks to "piggy-back" on the preemption rights of their parents is pending before the Supreme Court in *Watters v. Wachovia Bank, N.A.*, No. 05-1342. While the case may provide judicial guidance on the question of whether the OCC has overreached as to this rule, the remaining rules that preempt state law and states' enforcement rights over national banks are also serious threats to federalism and consumer rights.

Scope of Impact: The OCC supervised banks holding 67% of total assets of all U.S. commercial banks in 2005. These banks have approximately 500 operating subsidiaries that deal directly with consumers and that can claim their parents' preemption under the OCC's rules. Further, the scope of the agency's preemption affects far more than just national banks and their operating subsidiaries, because federal law, and some state laws, gives non-national banks "parity" rights with national banks. These result in a considerable spill-over preemption to other entities not regulated by the OCC.

Concerns:

1) **Charter competition:** Depository institutions get to choose the type of charter under which they operate, and thus get to choose their regulator. They may chose between state and federal charters, and among federal charters. This has led to "charter competition." The

[41] This displacement of state enforcement authority is contained in the OCC's claim of broad exclusive "visitorial powers," in 12 C.F.R. 7.4000. The validity of that rule is pending in the Second Circuit. *See OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal docketed,* No. 05-5996cv (2d Cir. 2005).

OCC has marketed its broad preemption of state consumer protections to attract depositories to its charter.

2) **Funding:** The OCC is not funded by Congressional appropriations, but by asset-based assessments on its regulated entities. In 2005, 97% of its operations were funded by revenue from assessments. The agency uses a size-based assessment scale, which makes it especially dependent on a few large banks. In one recent year, for instance, the equivalent of 10% of the OCC's budget ($40M) came from one bank alone.

3) **Imbalance of customer and regulated entity interests:**

- Rule-making and interpretation: The agency's interpretations have been consistently result-oriented to allow banks maximum relief from existing law. For example, "interest" is broadly defined to include many fees for purposes of exporting the laws of business-friendly states and ignoring the laws of the customers' states, 12 C.F.R. § 7.4001(a), but narrowly defined if a broad definition would hurt a bank in its home state, 12 C.F.R. § 7.4001(c).

- Interfering with litigation between banks and their customers or state enforcers: The OCC has expended considerable resources over the last decade filing amicus briefs in litigation on the side of banks against their customers and state enforcement agencies. The amicus activity by the OCC has been substantially higher than other federal financial regulators. In one case, the OCC attempted to stop a state attorney general from pursuing claims of telemarketing fraud by a bank mortgage subsidiary.[42] The company's own employees had described the challenged practice as "unethical," a "fraud," and a "scam."

- Inadequate enforcement to replace the displaced state enforcement: In its recent efforts to displace state enforcement authority even as to non-preempted state law, the agency realized it "could not replace something with nothing."[43] The OCC therefore found authority that it had never used for 25 years to enforce the FTC's unfair and deceptive practices law. However, the OCC has used this authority very sparingly, and, in some instances, only after state law enforcement action has begun.

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[42] *Minnesota ex rel. Hatch v. Fleet Mortgage Corp.*, 158 F. Supp. 2d 962 & 181 F. Supp. 2d 995 (D. Minn. 2001).
[43] A former Treasury official gave that explanation for the OCC's first use of the FTC UDAP authority at a legal conference in San Francisco in May, 2002. (Practising Law Institute, *Consumer Financial Services Litigation)*